

WASHINGTON WEEKLY

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When Only One Vote Matters

The elections consumed plenty of attention and money during the past four quarters. President Bush's "capital expenditure" program, which includes legislative and judicial objectives, has occupied much of the global mass media and market interest for the past two weeks. Our last report, "Reign-Maker Revisited," focused on what we perceived were outsized expectations for quick delivery on the President's broad and not well-defined legislative agenda. This week, and a few times more before year-end, we plan to delve into policy issues important to the markets that we overlooked during the heat of elections.

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Executive branch discretion is some of the capital that the President has earned; this form of policymaking asset is also more attractive as it is self-replenishing. Only imagination and the Constitution limit a president's ability to make changes in areas the law reserves to his or her choosing. Only in extreme cases does either of the other branches encroach on these decisions. In effect, only the president's vote usually matters.

The Department of Justice's Antitrust Division last month issued an internal guidebook for merger remedies.¹ The primary reason for the document, as best we can tell, is to help Division economists and lawyers utilize consistent methodologies when considering or suggesting remedies to preserve postcombination competition. Of course, none of us is an antitrust lawyer, so we highly recommend that you consult a member of the relevant bar for a specific interpretation. We did, and our tutor found that on whole the document is "useful," more so for business people than antitrust practitioners, as "there is not anything new in there." Major themes of the paper include the following:

- Remedies will not be accepted unless there is a sound basis for believing a violation will occur.
- Careful application of established legal and economic principles pertinent to the case under review must guide any remedies.

Also in This Issue**Health Care: The D.C. Pulse**

The FDA's drug approval process will receive pointed attention at an upcoming Finance Committee hearing.

Geopolitical Risks

The post-Arafat era begins with respectful mourning and cautious hope.

¹ *Antitrust Division Policy Guide to Merger Remedies*, U.S. Department of Justice, Antitrust Division, October 2004 (www.usdoj.gov/atr/public/guidelines/205108.htm).

**PLEASE REFER TO THE BACK COVER FOR ANALYST CERTIFICATION
AND IMPORTANT DISCLOSURES.**

- Restoring competition is the key objective in an antitrust remedy.
- Remedies should promote competition, not competitors.
- Any remedy must be enforceable, and the Antitrust Division will commit the time and effort required to ensure compliance.

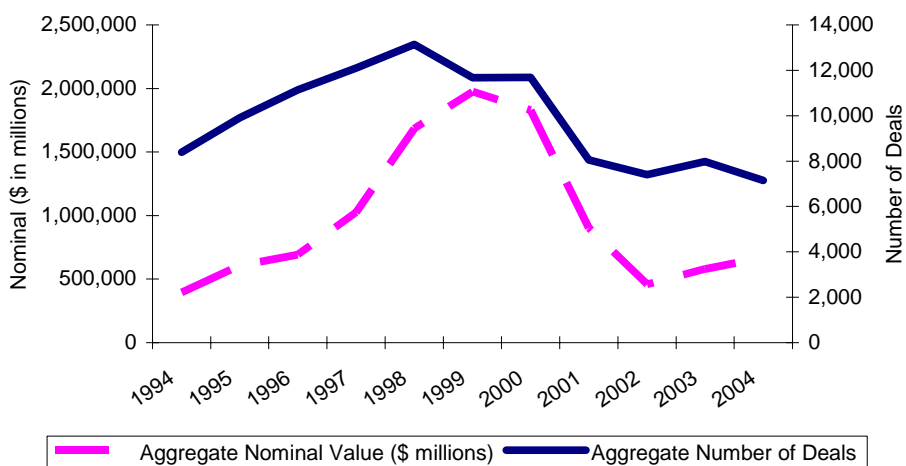
A growing economy usually yields good equity markets, which, in turn, provide both capital and reason for combinations.

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Looking at the accompanying chart, the Division's guidance would seem to come at an opportune time. Without surprise, merger and acquisition activity neatly correlates with macroeconomic performance; a growing economy usually yields good equity markets, which, in turn, provide both capital and reason for combinations. Although the number of deals completed in the past two years has been flat, the nominal value of those deals has increased. People are finding reason to pay for deals. The real question for markets is whether the value trajectory in 2002–04 is a precursor of more deals and a better economy, as was hinted by a similar trajectory just before the growth surge in the 1990s.

Markets responded nicely to Bush's reelection in part due to vanishing risks of Executive reregulation. Even if the new antitrust guidelines are not new, our read of them makes it very clear that the Antitrust Division is strongly telling its career professionals that the standards for imposing government restrictions on deals are high. Anticompetitive proposals will not find proponents in this administration, but it would seem to us that gray areas in DOJ antitrust reviews have been better defined. While this may not be news to lawyers, we believe that it will be reassuring to business people and markets.

U.S. M&A Activity, 1994 to November 9, 2004



Source: Thompson Financial

Health Care: The D.C. Pulse

Sector	Recent Developments
Brand-Pharma Generics Biotech Med-Tech	<ul style="list-style-type: none"> • Who Will Head the FDA? Speculation has increasingly turned to who could head the Food and Drug Administration in the new Bush administration. Reports indicate that the White House may have contacted some candidates, and acting Deputy Commissioner Janet Woodcock has generated some interest, but acting Commissioner Lester Crawford appears to be the likely choice to continue in his caretaker role at the FDA. The risks to this view remain ongoing headlines and negative attention on the agency from its handling of drug reimportation, antidepressants, and the Vioxx withdrawal. Investigations into each incident, particularly the one related to Vioxx, carry significant policy risk if the FDA is found to have intentionally withheld information about the drug or withdrawal. • Does Vioxx Show "Systemic" FDA Problems? Charging that the FDA must address what appears to be "systemic problems when it comes to putting public health and safety first and public relations second," Senate Finance Committee Chairman Charles Grassley (R-IA) announced a November 18 hearing, "FDA, Merck, and Vioxx: Putting Patient Safety First?" Witnesses are expected to include Lester Crawford; Raymond Gilmartin, Merck's CEO (although Merck reportedly has not decided whether he will testify); and Dr. David Graham of the FDA's Center for Drug Evaluation and Research, whom Grassley alleges was pressured to tone down his research showing Vioxx posed safety risks. We certainly expected increased headlines from the hearing, particularly (as Grassley points out) because this will be the first time that the FDA and Merck will testify together on Vioxx. The broader risk from Vioxx is not only for other COX-2s but also for the FDA as a whole on the drug safety front. Serious concerns have been raised on Capitol Hill by aides with whom we have spoken, as Senate HELP Committee staff indicated that drug safety would have been a primary concern if Senator HELP Chairman Judd Gregg (R-NH), who resigned to chair the Budget Committee, had remained as chairman in 2005. The FDA recently announced a five-point plan to increase its drug safety role, including finally naming a Director of the Office of Drug Safety (vacant since October 2003) and conducting an Institute of Medicine study to evaluate the U.S. medication safety system. • Reimportation and Canada Canada's Health Minister Ujjal Dosanj warned that his government could take action to halt exportation of drugs into the United States if Canada's supply is threatened. The Canadian government had largely stayed away from commenting on exportation into the United States, particularly as the estimated \$600 million in shipments have created a significant number of jobs in Canada. "It is a matter of common sense that Canada cannot be the drug store of the United States. Neither American consumers nor Canadian suppliers should have any illusions otherwise," said Dosanj. • Reimportation and the New Senate <ul style="list-style-type: none"> ▶ The resignation of Chairman Gregg from HELP has consequences for the drug reimportation debate. Incoming Chairman Mike Enzi (R-WY) was one of only two GOP senators to cosponsor Gregg's reimportation bill, suggesting continuity on that front. ▶ The HHS Task Force on Drug Reimportation must produce its report by year-end, suggesting a near-term catalyst for the issue ahead of the 2005 legislative cycle. ▶ Of the seven newly elected GOP senators in 2005, five support drug reimportation. ▶ The Canadian pharmacies servicing the Wisconsin state program indicate that they have filled only 2,300 prescriptions and that the rates have been declining. • Flu Politics <ul style="list-style-type: none"> ▶ On November 18, the House Energy and Commerce Subcommittee on Oversight and Investigations will hold a hearing to examine the flu vaccine shortage. ▶ New York City and New Mexico have now followed Illinois in seeking to procure flu vaccine from Europe. Illinois Governor Rod Blagojevich (D) has located nearly 650,000 doses in Europe, primarily through a licensed British wholesaler, Ecosse.
Facilities Managed Care PBMs	<ul style="list-style-type: none"> • Seniors Push for PBM Leverage? The Pharmaceutical Care Management Association (which represents PBMs) conducted a postelection seniors' survey on Medicare drug benefits. Above all, the findings underscore seniors' desire for a benefit that provides more choices of drug plans and lower prices. In addition, they are concerned about manufacturers' role in determining the drugs for which Medicare should reimburse them. <ul style="list-style-type: none"> ▶ 82% of seniors believe that Medicare should make drug manufacturers compete to provide discounts on drugs, rather than accept their suggestions on which drugs should be covered; and ▶ 69% of seniors believe that involving manufacturers in coverage decisions is a bad idea. • Tough Negotiations for TennCare Tennessee Governor Phil Bredesen (D) escalated a high-stakes negotiating battle between his office and the Tennessee Justice Center (a nonprofit law firm) over the future of TennCare, the state's health program for low-income individuals. Bredesen presented a tough reform plan for the program, looking to sharply cut back benefits offered to participants. However, consent decrees (issued in <i>Grier, John B. and Rosen</i>) reached over previous lawsuits prevent Bredesen from implementing the proposed cuts. In response, Bredesen filed a waiver request with CMS Administrator Mark McClellan for changes to TennCare, despite the potential conflicts that such a waiver would have with the consent decrees. To our knowledge, McClellan has yet to respond. As an alternative, Bredesen last week argued that the Justice Center's intransigence would force him to dissolve TennCare and move the state to a more traditional Medicaid program, cutting eligibility for the 400,000 people TennCare covers. November 16 remains the (self-imposed) deadline Bredesen has set with the Justice Center. In our view, the Justice Center is likely to back down, rather than take the blame for preventing a solution that could have saved the program.

Source: Lehman Brothers

GPR Weekly

Issue	The Week Just Past	Our Call
<p>Iraq</p> <p>The Americans came thousands of kilometers to invade Iraq and kill people, and they should now be punished. Who gave them the right to kill us? We have an illegal interim government, so we have to have our revenge by our hands.</p> <p>— An Iraqi preacher at a mosque outside Fallujah</p>	<ul style="list-style-type: none"> • Fallujah: Coalition and Iraqi forces have begun to retake Fallujah from insurgents, who have controlled the city for more than six months; conventional tactics such as large-scale air and ground strikes, coupled with unconventional tactics such as trucks blasting heavy metal music, have yielded significant progress; security forces estimate that they reclaimed as much as 70% of the city last week • Kirkuk: Small-scale suicide bombings and mounting ethnic tensions have plagued Kirkuk; as coalition forces increasingly occupy major southern cities throughout Iraq, this impoverished but oil-rich northern city has become more vulnerable to insurgents seeking economically impactful hard targets, in our view • Attacks: U.S. and Iraqi forces are clearly making strides in Iraq, mainly through significant progress in the militant stronghold of Fallujah; however, many jihadists fled Fallujah prior to U.S. engagement and instability remains in the central regions of Baghdad and Samarra and in more remote locations throughout the desert, portending a long and bumpy road ahead, 	<p>Short-Term Catalysts</p> <ul style="list-style-type: none"> • Offensive attacks in Fallujah drive insurgents to border cities <p>Long-Term Call</p> <ul style="list-style-type: none"> • More desperate rebels increasingly seek out economically impactful and symbolic hard targets leading to January 31 scheduled elections
<p>Terrorism/Iran</p> <p>By these fatwas all terrorists have died, or will die, fully convinced that they will immediately enter Paradise.</p> <p>— Excerpt from the <i>Arab Liberals Manifesto</i>, on the need for prosecution of religious clerics who incite terrorism</p>	<ul style="list-style-type: none"> • Iran: Some reports from Iran suggested that uranium enrichment talks with the EU were successful, with the Iranian government on the verge of ceasing internal enrichment activity in exchange for a nuclear energy incentive package; as we see it, past action and rhetoric from Iranian authorities make it clear that Iran is not looking to engage in diplomatic efforts on nuclear nonproliferation • Fatwas: Arab liberals began a petition on two liberal Arab Web sites in an effort to establish an International Tribunal for the prosecution of terrorists, as well as people and institutions (especially religious clerics issuing fatwas) that incite terrorism; this is a positive development in the battle of ideas in the Arab World, regardless of the outcome of the petition 	<p>Short-Term Catalysts</p> <ul style="list-style-type: none"> • November 25 UN transparency deadline for Iran <p>Long-Term Call</p> <ul style="list-style-type: none"> • Continued threats and mixed rhetoric to the EU and a disregard for the IAEA shift focus to Iran at the center of escalating regional politics
<p>Oil</p> <p>[Nigerian workers] shall not embark on any strike from 16th of November 2004 or any day thereafter.</p> <p>— Justice Tanko Mohammed Yusuf, in an order to the main Nigeria Labor Congress</p>	<ul style="list-style-type: none"> • Crude Talk: Light sweet crude oil prices on the NYMEX settled just below \$49.00 per barrel (down 10% from a record nominal high of \$55.67 per barrel) following a mixed geopolitical news cycle that included a Nigerian high court ruling banning an oil workers' strike and two pipeline bombings near Kirkuk that caused a supply stoppage to the Ceyhan terminal in Turkey and forced the distribution of up to 3.3 million barrels of reserves 	<p>Short-Term Catalysts</p> <ul style="list-style-type: none"> • OPEC calls for release of U.S. SPR oil, rather than produce more oil itself <p>Long-Term Call</p> <ul style="list-style-type: none"> • Bad news surrounding negotiations in Nigeria and Iraq could be impetus for secular price increases
<p>Other Developments</p> <p>I think Hamas is a mature political movement.</p> <p>— Atef Odwan, professor of political science at the Islamic University of Gaza</p>	<ul style="list-style-type: none"> • Palestine: Palestinian leader Yasser Arafat passed away at a Paris military hospital at the age of 75; the timing of Arafat's death could enable more pragmatic progress in the region, particularly as it closely follows Israeli Prime Minister Ariel Sharon's concessions in Gaza and a new term for the Bush administration; reformer Mahmoud Abbas, as new head of the PLO, could also facilitate change, in our view • Russia: Kremlin adviser Andrey Illarionov effused harsh criticism for Vladimir Putin's recent restriction of personal rights and stubborn economic policies; citing the case against Yukos, Illarionov noted that "the authorities do whatever they want with whoever they want"; he further suggests that Russia believes that it can do without domestic and economic reforms because authorities believe "it is enough to slightly tighten the tax screw to fill state coffers with money" 	<p>Short-Term Catalysts</p> <ul style="list-style-type: none"> • Arafat's death opens a window for a more pragmatic, multilateral approach <p>Long-Term Call</p> <ul style="list-style-type: none"> • Palestinian acceptance of new PLO leadership, or lack thereof, dictates the nature of the peace process

Source: Lehman Brothers

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