HALE AND DORR LLP

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Antitrust and Trade Regulation Bulletin

Failure to Raise Antitrust Claims in Patent Litigation Results in a Waiver

The United States Court of Appeals for the Second Circuit rejected monopolization and attempted monopolization claims brought by Critical-Vac ("C-Vac") against Minuteman International ("Minuteman") because the claims should have been raised as defenses in previous patent infringement litigation that Minuteman brought against C-Vac. *Critical-Vac Filtration Corp. v. Minuteman Int'l, Inc.*, 233 F.3d 697 (2nd Cir. 2000).

C-Vac prevailed in the patent litigation, but raised no counterclaims. But because it failed to bring what were deemed compulsory counterclaims, the Second Circuit Court of Appeals has held that C-Vac waived its right to prosecute those claims. C-Vac argued that antitrust counterclaims in patent infringement suits were exempted from the general rules pertaining to compulsory counterclaims. The Second Circuit disagreed, holding that some antitrust counterclaims must be raised in patent infringement litigation.

C-Vac's monopolization theories rested on allegations that Minuteman improperly obtained a reissue patent, frivolously asserted that patent's validity in prior litigation and unlawfully sought to extend its patent beyond its scope. The Second Circuit found that C-Vac was aware of all of the essential facts at the time of the prior litigation. In addition, the antitrust claims arose out of the same facts

Some antitrust claims based on patent invalidity must be asserted as counterclaims in patent infringement litigation.

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as those litigated in the patent suit. Accordingly, the court found a logical relationship between the prior claims and the current claims, holding that the claims were compulsory counterclaims that C-Vac waived by failing to assert them in the prior patent suit.

Relying on a 1944 Supreme Court case, C-Vac argued that an exception to the general rule had been crafted for antitrust counterclaims to patent infringement suits. The Second Circuit acknowledged that the Supreme Court had held, in 1944, that antitrust counterclaims were permissive and could be brought in a later suit. *Mercoid v. Mid-Continent Investment Corp.*, 320 U.S. 661 (1944). According to the Second Circuit, that ruling created a narrow exception for antitrust claims based on misuse of a valid patent, which it refused to extend to antitrust claims based on patent invalidity. The court reasoned that while misuse claims relating to valid patents involve a completely different set of facts than those in an infringement suit, invalidity issues are more closely related and must be brought in the first action. C-Vac has petitioned the Supreme Court, seeking to overturn this decision. The Supreme Court has not yet announced whether or not it will hear the case.

Conflict between the Ninth Circuit and the Federal Circuit over implications of licensing patented technology will continue.

Supreme Court Refuses to Weigh in on Interplay of Antitrust and Patent Laws

Earlier this year, the U.S. Department of Justice (through the Solicitor General) petitioned the U.S. Supreme Court to deny *certiorari* in the *CSU v. Xerox* case, which would let stand a Court of Appeals for the Federal Circuit decision that, in what the chairman of the FTC has called "sweeping language," exalted patent rights over antitrust laws. (This opinion was previously reported in the June, 2000 edition of this newsletter and can be seen at www.haledorr.com/publications/archive_pub.asp.) CSU urged the Supreme Court to review the appellate decision, citing a conflict between the Ninth Circuit and the Federal Circuit. The Department of Justice, writing as a friend of the Court, suggested that "these difficult issues" needed additional time to "percolate further in the courts of appeals" before the Supreme Court resolved the dispute. The Federal Trade Commission did not join the brief and has not commented on its omission. The Supreme Court agreed with the government and Xerox and will not hear the case, and the conflict between the courts of appeals remains for now.

The central issue of these cases is the extent to which a patent holder can choose not to license its technology. Xerox had refused to license spare parts and diagnostic software to CSU which wanted the parts and software in order to compete with Xerox in the after-market service of Xerox machines. The Federal Circuit held that the decision to license or not was an integral part of the patent right, which should be respected except in narrow circumstances. The court specified three such situations: a patent holder's illegal tying, sham petitioning or fraud. This opinion conflicts with a 1997 decision from the Ninth Circuit, which found that refusals to license could be illegal exclusionary conduct and required an examination of the patent holder's subjective motives for its refusal to license.

Hale and Dorr Helps Thermo Electron Sell Subsidiary

In September, Thermo Electron Corporation agreed to sell its subsidiary, Thermo Cardiosystems, Inc. ("Thermo Cardio"), to Thoratec Corporation ("Thoratec"). Both Thermo Cardio and Thoratec sell FDA-approved medical devices which help patients suffering from end-stage heart failure survive long enough to receive a heart transplant. Although there is presently only one other company marketing an FDA-approved product for this indication, Hale and Dorr provided extensive information to the FTC staff about the nature of the devices, and the staff subsequently agreed to close its HSR review. Following the receipt of materials prepared by Hale and Dorr and third-party interviews, the Commission staff became convinced that there are important differences between the products produced by the merging parties, which limited their actual competition with each other. The parties closed the sale in February, 2001.

Bush Names New FTC Chairman

On March 22, 2001, President Bush named Timothy J. Muris to be the new chairman of the Federal Trade Commission. Muris was most recently a professor of law at George Mason University and an advisor to the Bush campaign.

Muris is no stranger to the FTC, having worked there in the 1970s and again during the Reagan administration, when he served as the head of both FTC enforcement arms – the Bureau of Consumer Protection and the Bureau of Competition. Muris was somewhat controversial in the Reagan era, when he slashed through what he believed were overly-burdensome regulations issued during the Carter years. Many of the changes Muris then made continue to be standard operating procedure, so it is unlikely that such radical changes will be made as he takes office now.

While there can be no question that Muris is more conservative than Robert Pitofsky, the current FTC chairman, Washington insiders are predicting moderate rather than radical changes in FTC enforcement policy. Muris' appointment suggests that some mergers which might have been challenged under Pitofsky will clear the FTC now. Muris opposed the FTC decision to challenge the merger between Heinz and Beechnut but agreed with the FTC's opposition to the WorldCom-Sprint merger. In addition, some non-merger cases which might have been initiated are likely not to be brought. For example, Muris was a vocal opponent of the FTC's suit against Intel.

Tim Muris will return to the FTC and is expected to bring moderate change.

Microsoft Avoids Many Consumer Class Actions Alleging Violations of Federal Antitrust Laws

Sixty-four different antitrust cases have been filed against Microsoft in the wake of the Department of Justice's prosecution. These cases were transferred by the Judicial Panel on Multidistrict Litigation to Baltimore, Maryland, where they have been consolidated. Microsoft has moved to dismiss three different types of claims: 1) claims filed by consumers who did not purchase products directly from Microsoft; 2) claims by foreign plaintiffs; and 3) various claims under state law. The court ruled that indirect purchasers could not bring damages claims, that foreign plaintiffs cannot seek recovery and that guidance from the state courts was necessary to resolve the appropriate treatment of the state law claims. *In re Microsoft Corp. Antitrust Litigation*, 127 F. Supp. 2d 702 (D. Md. 2001).

The vast majority of personal computers are sold with operating software and other programs installed on the product delivered by the original equipment manufacturer ("OEM"). The hardware manufacturer paid to license the products, incorporated them into the computer, and then sold the computer to the consumer. These consumers purchased Microsoft products, but they did not buy them directly from Microsoft. Longstanding antitrust principles, articulated by the Supreme Court in *Illinois Brick v. Illinois*, bar indirect purchasers from bringing claims for damages against the manufacturer. The plaintiffs sought to avoid the traditional prohibition of such claims by arguing that each consumer had entered into a mandatory end-user agreement with Microsoft at Microsoft's insistence. This agreement, argued the plaintiffs, created a direct relationship allowing the consumers to avoid the indirect purchaser rule.

Consumers who purchase hardware with software already installed do not have a "direct purchaser" relationship with the software manufacturer.

The court acknowledged that the end-user agreement created a relationship between Microsoft and the consumer, but found that it was not a "direct purchaser" relationship as the law uses that term. The court also rejected arguments that Microsoft controlled the OEMs so that a consumer purchase from an OEM was equivalent to a purchase from Microsoft. Finding no unity of economic interest, the court ruled that Microsoft and the various OEMs were clearly distinct economic entities.

Foreign purchasers also asserted claims, arguing that Microsoft's United States' actions affected purchasers regardless of their geographic location. These plaintiffs were direct purchasers, so they were entitled to sue unless their status as foreign nationals presented separate issues. While the court confirmed that in some cases foreign nationals could bring suits under the Sherman Act, it held that they cannot do so when they did not participate in any way in the domestic market for the goods. Here, the plaintiffs bought the goods in a foreign market and suffered their injury in a foreign place. That connection was held to be too tenuous to grant them standing to sue in the United States.

Recognizing the importance of the issues involved, the judge certified his opinion for an immediate interlocutory appeal. The appellate court will decide whether to hear the appeal.

Conspiracy to Restrict Luggage Size Violates Antitrust Law

Frustrated with airline customers arriving at the gate with "super-sized" carry-on luggage, United Airlines persuaded the Dulles Airport Airline Management Council ("AMC") to configure the conveyors at two security check points so that only small items could be x-rayed and approved for carriage to airport gates. Continental Airlines, itself an AMC member, opposed the baggage-size restrictions and sued United and AMC for illegally and unreasonably restricting non-price competition by airlines at Dulles Airport. *Continental Airlines, Inc. v. United Air Lines, et al.*, 126 F. Supp. 2d 962 (E.D. Va. 2001).

The carry-on baggage controversy began in the early 1990s, as airline travel increased at the same time that the number of people seeking to avoid checking their bags increased. Airlines tried a variety of approaches to deal with the problem, including placing strict limits on the size and number of bags passengers could carry. Continental and United both found that strict size limits annoyed customers and threatened to send customers to airlines with more lenient carry-on rules. Continental decided to retrofit many of its airplanes to create more space for carry-on luggage. In addition, it created a flexible policy that let gate agents determine the luggage restrictions for a particular flight based on the number of people traveling on that flight. To support the increasing number of bags checked at the gate, Continental installed additional equipment at its gates to handle the luggage. Continental was widely recognized as the airline most receptive to carry-on baggage and marketed itself as such.

United, on the other hand, continued to insist on strict restrictions and, at least at Dulles, worked to have those restrictions applied to all airport passengers at the security screening area, not just to its own passengers. United, through the AMC, persuaded most of the carriers at Dulles to vote to install size templates (so-called "cow catchers") over both security checkpoints at Dulles. Continental and four other carriers (out of a total of twenty-six) voted against the measure. The AMC recognized that these templates would annoy some passengers, so it issued each airline a small number of "medallions" which would allow customers to avoid the size restriction. These were distributed in proportion to the number of first-class and business-class seats each airline operated from Dulles.

Continental, which quickly exhausted its supply of medallions, eventually hired a contractor (for $10,000 a month) to remove the template for Continental customers.

Court finds carry-on baggage policy to be an important element of airline competition.

The court easily determined that the agreement by United and the AMC and its members was a horizontal agreement among competitors. Furthermore, because carry-on luggage policies are one of the many elements upon which airlines compete, it held that eliminating that competition reduced the quality of airline travel for Dulles customers. Continental argued that these two findings proved that the restriction was *per se* illegal, with no need for analysis of possible justifications. The court declined such a conclusion because it recognized that, as competitors sharing facilities, there could be valid, pro-competitive agreements among the airlines at Dulles. Therefore, the court concluded, a quick-look, rule-of-reason analysis was appropriate, and it considered the pro-competitive benefits the defendants proffered.

United claimed that its size restrictions aided on-time departures, increased safety for passengers and airline personnel and facilitated passenger comfort and convenience by leaving luggage space on planes for the last passengers boarding. The court determined that if the size restriction served any or all of these goals, it was only because the planes had inadequate luggage storage space that caused these problems. There was, therefore, nothing pro-competitive about any of the three proffered justifications. The defendants failed to show that their restrictions corrected a problem the market could not address itself. Instead, the court said, "defendants' agreement does not promote competition itself, but rather only helps individual carriers in competition with other carriers by relieving them of the competitive pressure to offer better products and services with respect to carry-on baggage." *Id.*

The court concluded that Continental suffered economic injury of the type compensable in an antitrust suit, but saved for a later date the determination of the amount of those damages.

Change in stock ownership thresholds will terminate many HSR filing exemptions after February, 2002.

Competitors Settle FTC Charges of Market Allocation

The FTC has entered into consent decrees with FMC Corporation and Asahi Chemical Industry to settle charges that the two firms illegally conspired to divide the world market for a key ingredient in pharmaceutical tablets. According to the FTC complaint, FMC, a U.S. corporation, agreed with Asahi, a Japanese corporation, that FMC would not sell outside North America and Europe without Asahi's consent and Asahi would not sell outside Japan and East Asia without FMC's consent. At the time, FMC and Asahi were the two largest sellers of these products in the world.

As new competitors emerged, FMC allegedly tried to include them in the conspiracy in order to protect its monopoly in the North American and European markets. These emerging competitors refused to join. Hale and Dorr represented one of the emerging competitors as a witness in the FTC investigation.

It is important to note that the FTC prosecuted and obtained a consent decree from not only the U.S. company but also the Japanese firm that had allegedly agreed not to make sales in the U.S.

New HSR Regulations Cut Short Pre-Existing Acquisition Windows

Under the old Hart-Scott-Rodino pre-merger notification rules, after a firm filed to acquire 15%, 25% or 50% of the stock of another firm, it could acquire stock up to the next percentage threshold within a five-year period without refiling.

Under the new rules, the filing thresholds will be based on the value of the securities acquired rather than percentage of ownership. In order to transition from the old system to the new one, the FTC has issued regulations reducing the five-year window period for many firms which have made filings in the past several years. Under the new regulations, firms have until February, 2002 (or five years from the date of their prior clearance, whichever is earlier) to acquire stock up to one of the older percentage thresholds. After February, 2002, firms with old safe harbors will not be able to use them and will have to refile if their acquisitions meet the new monetary thresholds.

The new minimum threshold is $50 million, with additional thresholds at $100 million,

$500 million, 25% of outstanding voting securities when the total securities are valued in excess of $1 billion, and 50% of outstanding voting securities.

Firms may want to accelerate securities acquisitions to take advantage of their current exemptions from filing until February, 2002. The new increased filing fees (up to $280,000 in some cases) may be avoided with careful planning.

Two Courts Dismiss Claims Under U.S. Antitrust Laws for Injury Suffered Outside U.S.

Class Action by Purchasers at Auctions Held Abroad Rejected

As described in our last newsletter, Christie's Auction House's admission that it conspired to fix prices with Sotheby's has created a significant amount of class action litigation. (See http://www.haledorr.com/publications/archive_pub.asp.) Just as the cases brought by United States consumers were reaching a settlement, a class of participants in auctions held outside the United States filed suit. *Kruman v. Christie's Int'l PLC*, 2001-1 Trade Cas. (CCH) ¶ 73,149 (S.D.N.Y. Jan. 29, 2001).

Plaintiffs sued under both the Sherman Act and "customary international law," but neither was sufficient to create jurisdiction in the United States according to the district court judge who dismissed the case. According to the plaintiffs, jurisdiction was proper because the foreign auctions were affected by the price fixing conspiracy that, at least in part, took place in the United States. The court rejected this theory of jurisdiction, finding clear congressional intent to exclude from the Sherman Act conduct which lacks a "direct, substantial and reasonably foreseeable effect" domestically. The court reasoned that the conduct that injured the plaintiffs was the charging of an inflated price in a foreign auction, which had no impact on domestic United States commerce. The court also concluded that because there is no internationally recognized prohibition against price fixing, the case could not be maintained under international law.

Norwegian Oil Company Conspiracy Claim Dismissed

A month later, the Fifth Circuit Court of Appeals cited the *Kruman* decision (above) in its dismissal of claims by a Norwegian oil company, which alleged a conspiracy to rig bids for the sale of a heavy-lift derrick barge and related marine construction services in the North Sea. *Den Norske Stats Oljeselskap As v. Heeremac VOF, et al.*, 2001-1 Trade Cas. (CCH) ¶ 73,160 (5th Cir. Feb. 5, 2001). The plaintiff, which operates only in the North Sea, claimed that it had paid inflated prices for equipment and services as a result of the conspiracy. The Court of Appeals held that, while the plaintiff's allegation that it passed on higher prices to United States customers as a result of the conspiracy satisfied the requirement of pleading conduct that has a "direct, substantial, and reasonably foreseeable effect on United States domestic commerce," the further requirement under the Foreign Trade Antitrust Improvements Act that "such effect gives rise to the antitrust claim" was not satisfied because the plaintiff's injury did not arise from higher oil prices in the U.S., but rather from higher prices for equipment and services in the North Sea.

Only conduct with a "direct, substantial and reasonably foreseeable effect" on domestic commerce can give rise to an antitrust claim in the U.S.

Antitrust Enforcers Release 2000 Statistics

Mergers continued to occupy significant antitrust resources in 2000.

The merger wave continued in 2000 with a record number of pre-merger filings: 4,926. With the new changes in the Hart-Scott-Rodino rules and the slowing economy, this year should see a substantial drop in these figures. The Department of Justice investigated 137 of these filed transactions, and decided to challenge 48. In more than half of the challenged transactions (27), the parties either modified or abandoned the transactions before the Department filed a complaint. The FTC issued second requests in 43 transactions. As a result of these second requests, nine deals were modified or abandoned, 17 were resolved through consent decrees and in five cases the FTC sought a preliminary injunction.

Outside the merger context, both agencies remained active. The Department of Justice initiated 82 restraint of trade cases, eight monopolization cases and 10 additional cases. To assist its investigations, the Department issued nearly 1,000 civil investigative demands, seeking documents, testimony or both. The FTC concluded its high profile prosecution of Toys R Us and settled its investigation of Mylan.

For the first time since reporting began, the FTC reported no penalties imposed for filing violations under the Hart-Scott-Rodino Act.

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