Hale and Dorr LLP

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antitrust and trade regulation bulletin

Sun Sues Microsoft

For almost two years, rumors suggested that Sun Microsystems was about to bring a private antitrust action against Microsoft. On March 8, 2002 Sun finally filed suit in federal court in San Jose, California. Unlike many private suits, which follow federal prosecutions almost to the letter, Sun seeks not merely to recover for what the government already has established in its antitrust case, but asserts many more claims than the government ever contemplated.

Sun's expanded charges include both claims that the Justice Department brought, but failed to prove (such as tying), and completely new claims which have not yet been litigated (such as server operating system issues). Sun's twelve-count complaint includes claims for: illegal maintenance of monopoly; attempted monopolization of the browser market; tying of Internet Explorer to Windows; tying Windows to Microsoft server software; tying web server software to server operating systems; tying Microsoft's .Net framework to the Windows desktop and server operating systems; monopolization of the office productivity software market; violation of the Cartwright Act, California's statute analogous to federal antitrust law; unfair competition; and copyright infringement. The California law claims may be particularly important as California law is regarded as somewhat more "plaintiff friendly" than federal law.

This is not the first time Sun has sued Microsoft. Back in 1997, Sun brought breach of license agreement claims against Microsoft over Microsoft's misuse of Sun's Java program. The companies settled that action, but Sun reserved its right to bring an antitrust suit. Because some of the issues in Sun's new antitrust case involve issues similar to those previously settled, the scope of the prior settlement will almost certainly be a subject of dispute.

Sun's new complaint seeks damages as well as injunctive relief. Damages could amount to over $1 billion before trebling. Sun seeks to enjoin Microsoft from distributing its Java Virtual Machine through separate downloads which would require Microsoft to embed the program in Windows. In addition, Sun asks the court to require Microsoft to include Sun's current Java plug-in as part of Windows XP and Internet Explorer.

This litigation hits Microsoft at a time when its legal efforts already are somewhat fragmented. Microsoft

Lawsuit will require Sun to prove many new antitrust allegations.

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continues to battle on two different fronts with various government entities. First, it is embroiled in proceedings to convince the court that the proposed settlement with the Department of Justice and nine states is fair and reasonable. Second, it now has begun the remedy phase of a trial with the nine other states that have refused to join the settlement. In addition, Netscape and Be, Inc. have sued Microsoft, bringing claims that track the Justice Department litigation, and numerous private suits by classes of direct and indirect purchasers remain in various stages of activity.

Co-Conspirator Who Has No Direct Liability to Plaintiffs May Nonetheless Face Damages Claims for Joint and Several Liability

The complicated interplay of competing legal doctrines creates conspirator liability.

In a class action litigation brought in district court by purchasers of thermal fax paper, Nippon successfully invoked the *Illinois Brick* doctrine that only direct purchasers could recover for price-fix overcharges. Unfortunately for Nippon, the Seventh Circuit considered a different longstanding doctrine, and reversed.

Nippon was one of five thermal paper manufacturers sued by a group of paper resellers for horizontal price-fixing. Unlike the others, however, Nippon did not sell to any of the plaintiff firms. Instead, it sold exclusively to two resellers who were not involved in the suit. For this reason, Nippon sought dismissal under *Illinois Brick*, which the district court granted.

The Seventh Circuit agreed with the district court that "*Hanover Shoe* and *Illinois Brick* allocate to [Nippon's direct purchasing resellers] any right to collect overcharges attributable to Nippon Paper's sales." *Paper Systems, Inc. v. Nippon Paper Indus. Co.,* 2002-1 Trade Cas. (CCH) ¶ 73,568 (7th Cir. Feb. 6, 2002). However, the Seventh Circuit went further and concluded that the absence of the Nippon resellers as plaintiffs did not necessarily mean that Nippon escaped liability for damages. It is a long-held tenet that conspirators are jointly and severally liable for all damages caused by a conspiracy. Therefore, the Seventh Circuit held, even if the *Illinois Brick* principle means that the plaintiffs cannot collect damages for price-fixing overcharges associated with Nippon's sales, Nippon, as a member of the conspiracy, remained jointly and severally liable for the damages associated with overcharges on the sales of the other alleged conspirators. Unfortunately for Nippon, the remaining four defendants already had settled, leaving it to return to the district court to face trial alone.

FTC Conditions Nestlé Acquisition of Ralston Purina; Remedy Includes Sale to Financial Buyer

Nestlé Holdings, Inc., owner of the popular Friskies and Alpo pet food brands, acquired Ralston Purina, the largest pet food company in the world for over $10 billion. The parties announced the transaction in January, 2001, but FTC scrutiny delayed its closing for nearly a year. Because both Nestlé and Ralston have significant shares of the United States dry cat food market, the FTC conditioned approval on Nestlé's agreement to sell Ralston's Meow Mix and Alley Cat brands to J.W. Childs Equity Partners II, L.P.

Divestiture is a commonplace method for resolving antitrust concerns associated with overlapping businesses within a larger transaction. Often, the agency agrees to a divestiture and allows the merging firms several months to locate a buyer and complete the sale of the divested business. The FTC normally insists upon approval rights to ensure that the proposed purchaser will vigorously continue the divested business and thereby retain existing competition. Generally, the FTC prefers buyers already established in the business, as they are thought to be the most likely to maintain competition. Over time, the FTC has come to prefer divestitures of entire business units as opposed to single products or product lines.

The Nestlé order diverged from common divestiture practice in several noteworthy respects. First, the order contemplated a specific buyer. More interestingly, it contemplated a financial buyer rather than an existing competitor. Childs already owned a line of Hartz pet supplies, so it was not a complete newcomer to the pet business. However, it was unquestionably more a financial buyer than an existing competitor. Also unique, the divestiture included only two brands of cat food rather than a free-standing line of cat food business.

These differences from standard practice generated some other interesting new provisions in the order. The order required Childs to hold the assets for five

years and banned completely the sale of the acquired assets without advance approval from the FTC. In addition, because Childs had no manufacturing facilities and was buying only brands and recipes, Nestlé was required to manufacture and pack the cat food for up to two years and provide technical assistance to enable Childs to begin manufacturing.

Although the commissioners voted unanimously for the order, several of them wrote separately to express some hesitation with the arrangement and, most specifically, the acceptance of a financial buyer. The success or failure of the divestiture to Childs may profoundly influence the FTC's willingness to accept any future divestiture to a financial buyer.

Joint Defense Privilege Held Not To Apply Unless Litigation Is Imminent

Recently, the Fifth Circuit affirmed a district court ruling that required the production of numerous attorney-client documents because the court found that sharing the documents with third parties waived the attorney-client privilege, without qualifying for the common legal interest exception to the waiver rule. *In re Santa Fe Int'l Corp.,* 272 F.3d 705 (5th Cir. 2001). The decision provides a strong warning to firms interested in sharing legal advice or information with competitors facing similar issues.

In August, 2000, a group of offshore oil drillers sued their employers (a total of twenty-two competing offshore drilling corporations) alleging that for the past ten years the defendants had met together to set, stabilize or limit the wages and benefits paid to their drilling employees. As the case proceeded through discovery, it became apparent that in1991 the general counsel of a number of the defendants had written memoranda analyzing the antitrust implications of the meetings and salary surveys that the various competitors were considering coordinating. Counsel for the defendants withheld all of these documents as privileged, even though at least some had been shared with other firms in the group. The defendants argued that the common legal interest doctrine prevented this disclosure from waiving the privilege, because it was precisely these surveys and meetings that were the subject of the memoranda that generated the present litigation. The court disagreed, however, and found no common legal interest existed in 1991 when the memoranda were shared.

The common legal interest doctrine is most often used in co-defendant situations where attorneys for the defendants work together to share analysis and information to facilitate their mutual interest in defending against the plaintiffs' claims. The exception, however, generally does not require the existence of actual filed litigation, but can expand to cover firms potentially defending against common claims. Determining when two parties become "potential co-defendants" is a difficult undertaking and was the issue on which the Santa Fe case turned.

The *Santa Fe* majority concluded that "there must be a palpable threat of litigation at the time of the communication rather than a mere awareness that one's questionable conduct might some day result in litigation" before parties can consider themselves potential co-defendants and take advantage of the common legal interest exception. *Id.* Santa Fe described the reasons for circulating the memoranda as follows: "ensuring compliance with the antitrust laws and minimizing any potential risk associated with the exchange of wage and benefit information." Santa Fe conceded, however, that in 1991 it did not "perceive a threat of antitrust litigation." Distinguishing between seeking to "avoid conduct that might lead to litigation" and "preparing for future litigation," the court rejected Santa Fe's claim. *Id.*

The Fifth Circuit concluded that "there must be a palpable threat of litigation at the time of the communication" before joint defense privilege attaches.

The lengthy interval between circulation of the memoranda and the initiation of litigation worked against Santa Fe, even though the memoranda were circulated around the time the claimed antitrust violations began. Parties considering sharing privileged material with other than current co-defendants must do so carefully. Only where there is a clear and immediate threat of litigation can one be confident that the joint defense privilege will be upheld. The *Santa Fe* decision notes that the burden of proof rests on the party asserting the common legal interest, and suggests that close calls will be resolved in favor of the party seeking production.

Federal Trade Commission and Department of Justice Struggle To Divide Merger Review Responsibilities

On January 17, 2002, the FTC and DOJ announced a joint press conference to be held that afternoon. The agency heads, Tim Muris for the FTC and

Charles James for the DOJ, were expected to announce an end to the years of uncertainty, and more than occasional controversy, over which agency would review mergers in which industries. After the reporters had assembled and on the verge of its beginning, the press conference was abruptly cancelled; it appeared that the dispute was not over after all.

In the days that followed, the cause for the cancellation surfaced. It turned out that Congress had not been informed of the plan and took exception to its exclusion from the discussion. Sen. Hollings (D-S.C.) demanded that the agreement be tabled; Attorney General Ashcroft acceded to this demand and the DOJ refused to sign. Hollings' committee oversees the FTC, meaning that Hollings would lose oversight of the industries the proposed agreement ceded to the DOJ. His chief concern was the media industry, which was to be reviewed by the DOJ under the agreement.

Hollings was not the only one who felt slighted. FTC Commissioners Sheila Anthony and Mozelle Thompson issued statements complaining that Muris had proceeded with this agreement without consulting them and that the proposed agreement gave too much to the DOJ in the areas of media, entertainment, computer software and the Internet.

On March 5, 2002, the two agencies succeeded in reaching an agreement. Its proponents hope it will make merger reviews quicker and more efficient; time that used to be wasted bickering over which agency would conduct the review can be spent addressing the substance of the transaction. Under the old system, disputes created when both the FTC and DOJ sought to review a transaction required up to three weeks to resolve—a terribly ineffective use of the first thirty-day waiting period.

The new agreement allocates to the FTC: airframes; autos and trucks; building materials; chemicals; computer hardware; energy; grocery manufacturing; the operation of grocery stores; healthcare; industrial gases; munitions; pharmaceuticals and biotechnology; professional services; the operation of retail stores; satellite manufacturing and launch vehicles; and textiles.

The agreement allocates to the DOJ: aeronautics; agriculture and associated biotechnology; avionics; beer; computer software; cosmetics and hair care; defense electronics; financial services, insurance, and stock, option, bond and commodity markets; flat glass; health insurance; industrial equipment; media and entertainment; metals, mining and minerals; missiles, tanks and armored vehicles; naval defense products; photography and film; pulp, paper, lumber and timber; telecommunications services and equipment; travel and transportation; and waste.

Although the agreement has been signed, dissent lingers. Mozelle Thompson issued another statement expressing his "profound disappointment" with the agreement. While Commissioner Thompson takes issue with many elements of the agreement, his primary concern focused on the media industry. Thompson recited the FTC experience in the area and his concerns about lodging it in the executive branch instead of with the politically more independent FTC. Thompson's proposal would not give the FTC authority over all media, but would, instead, further sub-divide that category giving the FTC a substantial portion. Senator Hollings recently threatened to cut FTC funding and salaries if the agency implements the March agreement.

Antitrust agencies issue a joint press release giving each agency specific merger review responsibility.

Disgorgement and Divestiture Required To Resolve FTC Claim of Illegal Merger

In the last edition of this bulletin (December 2001), we reported that the Hearst Corporation had agreed to pay the single largest HSR fine in history to resolve claims that it had withheld important documents in the HSR pre-merger filing associated with its acquisition of Medi-Span. Shortly thereafter, Hearst reached an agreement to resolve the underlying FTC case that charged that the merger created an illegal monopoly. This settlement, too, is unique, as it is the first time the FTC sought disgorgement of profits in a federal lawsuit arising out of a consummated merger. See *FTC Press Release*, December 14, 2001.

Hearst agreed to sell the Medi-Span business to a specific purchaser to restore competition in the market for integrated drug-information databases. To further enhance competition, the settlement required Hearst to permit its customers to cancel their existing contracts with Hearst and to choose another supplier. Finally, the settlement required Hearst to disgorge $19 million in profits it allegedly earned from the illegal monopoly from consummation of the Medi-Span acquisition in 1998 to the present. The disgorged funds will be paid to customers as part of the settlement of private class action litigation brought by customers shortly after the

FTC sued Hearst. The total private settlement is $26 million, so the $19 million in disgorgement will be contributed towards that settlement with Hearst, to which Hearst will add an additional $7 million to complete the class action settlement.

While the Commission voted unanimously in favor of the settlement, several commissioners wrote separately. Commissioners Anthony and Thompson took note of the exceptional nature of a disgorgement remedy, but approved its use in this case because of what they called "exceptional circumstances" and "egregious" conduct. Commissioners Swindle and Leary, however, disagreed with disgorgement and suggested that civil penalties might have been more effective in the situation because civil penalties would have to be paid in addition to the $26 million private litigation settlement and not as an offset against it. Disgorgement, while still controversial, is taking an increasingly prominent place in the arsenal of remedies from which antitrust enforcement authorities can choose.

The FTC also filed a brief with the court overseeing settlement of the private litigation, opposing the fees that the plaintiffs' attorneys sought to collect. According to the FTC, the government was largely responsible for the recovery and, therefore, the plaintiffs' lawyers should not collect their usual substantial portion of the recovery.

Airline Baggage Dispute Sent Back to the District Court

As previously reported, Continental Airlines convinced a district court that United Airlines and a Dulles Airport association unreasonably restrained competition when they voted to install baggage templates at security check points to restrict the size of carry-on luggage. *Continental Airlines, Inc. v. United Air Lines, et al.*, 136 F. Supp. 2d 542 (E.D. Va. 2001). The Fourth Circuit has ruled, however, that the district court improperly rushed to judgment by using a "quick look" analysis on summary judgment and sent the case back for a full factual hearing. *Continental Airlines, Inc. v. United Air Lines, et al.*, 277 F.3d 499 (4th Cir. 2002).

The "quick look" approach to antitrust analysis is more rigorous than the "per se" standard, but less thorough than a "rule of reason" inquiry. A "quick look" requires some probing of the proffered pro-competitive benefits of the activity for the purpose of determining whether they mitigate the anti-competitive effects. The district court employed the "quick look" on summary judgment and found that while there was a factual dispute about the proffered pro-competitive benefits, it was not material. Noting that there is no Supreme Court case sanctioning the use of "quick look" without a full factual record, the Fourth Circuit pointed to a variety of factors not sufficiently considered below.

First, Dulles is unique and requires more collaboration among competitors than other airports. Dulles has only two security screening areas, and passengers for all airlines pass through both areas. The operation of these areas, therefore, demands collaboration which, the Fourth Circuit suggested, necessarily renders the collaboration less anti-competitive. On the pro-competitive side of the analysis, the appellate opinion rejected the notion that the "plausibility" of pro-competitive benefits could be analyzed with a quick look on summary judgment. Instead, the court implied that this assessment can only be undertaken on a full record.

Finally, the appellate opinion questioned whether or not the templates, in fact, had an anti-competitive effect. Continental hired personnel to assist their customers in bypassing the templates, which formed the basis of its damage claim. There can be no question that Continental experienced higher costs, but unless those costs increased because of a decrease in output or increased prices to consumers, there is no basis under the antitrust laws to consider these increased costs as antitrust damages. If all of the Continental customers who sought to bring oversized bags had circumvented the templates, the templates did not restrain any output. The law does not require Continental to pursue all conceivable alternatives, but it does recognize that a practice is unreasonable only when an alternative is not realistically available. Ironically, Continental's success in avoiding the restriction may serve to validate it.

Conspiracy Claims Arising from Agreement Blocking Supplies to Competitor Must Proceed to Trial

In 1995, Eli Lilly sued American Cyanamid Co. and others, alleging that the defendants infringed certain patents related to the production of the antibiotic cefaclor (sold by Lilly as "Ceclor"), and the litigation continues after years of decisions and discovery. *Eli Lilly v. American Cyanamid Co.*, 2002-1 Trade Cas. (CCH) ¶ 73,531 (S.D. Ind. Nov. 9, 2001).

Illegal exclusive agreement can be used as evidence of conspiracy after its termination.

American Cyanamid asserted antitrust counterclaims alleging that Lilly had illegally restrained trade by conspiring with suppliers to prevent generic competitors, such as American Cyanamid, from obtaining necessary inputs to produce a generic version of Ceclor. Both Lilly and American Cyanamid moved for summary judgment, but the court determined that the antitrust claims must go to trial.

American Cyanamid's best evidence of a conspiracy was a 1990 agreement between Lilly and a supplier that categorically prevented the supplier from selling the input to anyone other than Lilly. The court had no difficulty concluding that that contract was direct evidence of a conspiracy to restrain trade. The problem for American Cyanamid was that the contract stayed in force for only four months. A replacement agreement was more narrowly tailored and allowed the supplier to sell to others so long as it did not use any Lilly know-how and did not violate any Lilly patents. The supplier could, therefore, produce for a different company so long as they used other methods.

American Cyanamid's evidence of conspiracy after the initial agreement was thin, but the court allowed American Cyanamid's claims to go forward because the four-month long agreement constituted circumstantial evidence of a conspiracy that lasted beyond the agreement itself. This, combined with other circumstantial evidence, prevented summary judgment in favor of Lilly. The court concluded that a jury will have to determine how long any conspiracy continued.

Drop in HSR Pre-Merger Filings Reflects Change in the Law and Mirrors Overall Economic Softness

Fiscal year 2001 broke the trend of ever-increasing HSR pre-merger filings due to the combination of two different events. Effective February, 2001, the HSR thresholds increased so that mergers valued at less than $50 million no longer needed to be filed. The substantial increase from the prior $15 million threshold was expected to substantially reduce the number of filings. The soft economy and firms' reluctance to make acquisitions further contributed to a reduction in filings.

The FTC expected that the change in thresholds would not impact its filing fee revenue because the fees for larger transactions were raised in an attempt to offset any reduction in the number of filings. In fact, however, the agency collected just over half of the expected amount. There were a total of 2,232 filings in fiscal 2001. This was less than half of the 4,926 transactions reported in 2000. Interestingly, more than half of the 2001 filings were made before the February change in thresholds. After February, 340 smaller deals paid $45,000 to file; 404 medium-sized deals paid the new $125,000 fee; and 171 large transactions paid the highest fee of $280,000.

The merger wave required the agencies to allocate substantial manpower to analyzing and investigating mergers. Now that the wave has abated somewhat, experts expect the agencies to devote more resources to more traditional non-merger enforcement cases. In particular, increased enforcement is expected in healthcare, pharmaceuticals, professional organizations and standard setting.

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For more information, contact Hale and Dorr's Antitrust and Trade Regulation Group.

James C. Burling
Co-Chair, Boston office
617.526.6416
<james.burling@haledorr.com>

John C. Christie
Co-Chair, Washington office
202.942.8403
<john.christie@haledorr.com>

Michelle D. Miller
Vice-Chair, Boston office
617.526.6116
<michelle.miller@haledorr.com>

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