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antitrust and trade regulation bulletin

Department of Justice Unravels Distribution Agreement Among Competitors

Wind River Systems Inc. (Wind River) and The MathWorks, Inc. (MathWorks) are competitors in the development and sale of dynamic control system design software tools. These tools enable engineers to develop computerized control systems for sophisticated devices, such as anti-lock brake systems for automobiles, guidance and navigation control systems for unmanned spacecraft, and flight control systems for aircraft. By automating the steps of modeling, analyzing, simulating, testing and generating software code for these types of control systems, engineers can develop them in a shorter time and at a much lower cost. MathWorks' dynamic control system software is called Simulink, and Wind River's competing product is called MATRIXx. The two product lines are reported to have competed for over 10 years.

On February 16, 2001, MathWorks and Wind River entered into a series of agreements, including a distribution agreement that gave MathWorks a 30-month exclusive right to price and sell Wind River's MATRIXx products (with a follow-on option to buy) and required Wind River to cease developing and marketing its own products. MathWorks paid $11.5 million to Wind River, and it effectively obtained control over the prices, marketing, support and future development of the Wind River dynamic control system design tools. Shortly after the agreement, MathWorks announced its intention not to undertake any further development of the MATRIXx products—thereby eliminating those products as a competitive force going forward.

On June 21, 2002 the Department of Justice filed a civil antitrust lawsuit against MathWorks and Wind River and simultaneously filed a proposed consent decree that settled the lawsuit against Wind River alone. The lawsuit alleged that the distribution agreement was a *per se* violation of Section 1 of the Sherman Act because it illegally fixed prices and allocated and eliminated competition in the dynamic control system design software market. The Department alleged that the competition between MathWorks and Wind River, which had existed prior to the distribution agreement, had resulted in significant

DOJ finds that distribution agreement in which one competitor ceased production was a *per se* violation of Section 1 of the Sherman Act.

in this issue

technological improvements and price reduction for consumers. The complaint further alleged that in two markets, simulation software and automatic code generation software, MathWorks and Wind River had combined market shares of 84% to 95%.

The consent decree that settled the lawsuit against Wind River required Wind River to cooperate with any discovery in the case and also to cooperate with any future divestiture of the MATRIXx products from MathWorks. Wind River remained a party to the lawsuit, but the Department agreed to refrain from seeking civil penalties or other damages.

On August 15, 2002, the Department filed a proposed consent decree that settled the lawsuit against MathWorks. MathWorks agreed to sell the MATRIXx business assets and to provide the buyer with relevant patent licenses. Wind River, as required by its earlier consent decree, agreed to divest its remaining interest in the MATRIXx assets. The Department retains the right to approve the prospective purchaser and the terms of the sale.

The MathWorks/Wind River transaction was not subject to the reporting requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 because filing with respect to exclusive distribution agreements is not required under the Act. Additionally, the consideration for the agreement was well below the Act's $50 million minimum threshold. Notwithstanding the form of the transaction, the Department proceeded to challenge the distribution agreement as if it were a consummated merger.

FTC determines that sale of acquired software–now obsolete–would constitute meaningless relief, and requires acquiror to license new generation product to competitors.

Dispute over Two Consummated Acquisitions Settled by Software Licensing Agreement

After a lengthy investigation and the initiation of litigation, the Federal Trade Commission and MSC.Software Corp. finally settled their dispute over MSC's 1999 acquisition of two competitors—Universal Analytics Inc. (UAI) and Computerized Structural Analysis and Research Corp. (CSAR). MSC, UAI and CSAR all manufactured advanced Nastran software. Nastran is a computer language that allows structural analysis of automotive and aerospace designs during the design of products. In 1999, MSC acquired both UAI and CSAR. Both transactions fell below the HSR filing threshold and, therefore, there was no requirement that the transactions await government review before closing. MSC closed the transactions and began integrating UAI and CSAR technology into its new Nastran product. Both existing UAI and CSAR products were essentially shelved in favor of the newly developed product.

In October, 2001, the FTC sued MSC to undo these two acquisitions. On the verge of trial, the case settled and MSC agreed to license its new Nastran product to up to two new competitors. The FTC maintained that the shelving of the competitors' old products would have rendered the sale of those assets meaningless relief because they had not been developed or maintained, and a company buying them was unlikely to put any competitive pressure on MSC and its new generation product. Under the settlement, MSC can select a company to license its intellectual property and, depending upon the Commission's view of the competitive viability of that firm, may be required to license to another. MSC also must allow the new competitor to hire away MSC employees without any interference.

This arrangement may create much more formidable competition than existed in 1999. Both UAI and CSAR were weak companies in 1999 and accounted for only single digit market shares. MSC was by far the dominant manufacturer. The proposed relief is likely to create one—if not two—competitors stronger than UAI or CSAR.

Charles James Speaks on Merger Statistics and New Directions

At the ABA Annual Meeting in August, Charles A. James, assistant attorney general for the Antitrust Division of the Department of Justice, spoke to attendees about the Division's accomplishments and future directions.

James began with some stunning statistics about the declining level of merger activity nationwide. At the same time last year, the FTC and the DOJ had received 2,075 pre-merger notifications. That number plummeted to just 1,020 this year. James blamed the economic downturn, particularly in the telecommunications and technology sectors, for this dramatic reduction.

James reviewed some of the Division's more significant merger challenges, including General Dynamics' failed attempt to acquire Newport News, and United Airlines' unsuccessful bid for USAirways. The Division deemed a total of 19 transactions anticompetitive and succeeded in its challenges to all but one of them—the Sungard/Comdisco merger.

James suggested a few areas that will be receiving increased attention now that mergers are no longer dominating the Division's workload. These include joint venture arrangements that James believes are often alternatives to actual mergers.

Note: Since the writing of this article, Charles James unexpectedly resigned his position with the Antitrust Division of the Department of Justice. He will be replaced in the coming months.

FTC and GlaxoSmithKline Battle over Privileged Documents

In connection with the FTC's investigation of GlaxoSmithKline's (GSK) actions related to generic competitors of its popular drug Paxil, GSK claimed attorney-client privilege for 91 documents. The FTC challenged that designation, arguing that the documents were distributed widely within the company and that GSK failed to prove that all of the recipients had job responsibilities that required them to know the information. The FTC also claimed GSK failed to demonstrate that each document contained confidential information necessary for obtaining or providing legal advice.

The district court agreed with the FTC and ordered that all 91 documents be produced. The court found that GSK had not demonstrated that all of the recipients of all of the documents had a need to know the contents, nor that each and every document contained confidential information directly related to giving or receiving legal advice.

On appeal, GSK argued that the district court improperly second-guessed its corporate decision that distribution to the entire group was necessary. The appeals court agreed with GSK and reversed. The court obviously wanted to avoid reviewing and evaluating corporate decisions to share information with particular employees. The court reasoned that it is sufficient for distribution to be limited to employees whose corporate duties generally relate to the contents of the documents. This standard grants companies broad protection. The FTC has not yet decided whether or not to seek Supreme Court review of the decision.

Despite early victory, appeals court denies FTC access to documents for which, the latter argued, GlaxoSmithKline could not claim attorney-client privilege.

FTC Vote to Enjoin Ends Medical Testing Merger

Following the Federal Trade Commission's announcement authorizing its staff to seek a preliminary injunction to block Cytyc Corporation's (Cytyc) proposed $420 million acquisition of Digene Corporation (Digene), the parties announced the termination of the agreement. Cytyc first announced its intention to acquire Digene on February 19, 2002. Following a lengthy Hart-Scott-Rodino Act process that included a reset waiting period and a request for additional information, the Commission voted unanimously on June 24, 2002 to authorize seeking a preliminary injunction.

Cytyc develops, manufactures and markets products for medical diagnostic applications primarily focused on women's health. Its core products involve a system for liquid-based Pap tests for primary screening of cervical cancer. Digene develops, manufactures and markets proprietary gene-based testing systems for the screening, monitoring and diagnosis of human

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diseases with primary focus on women's cancers and infectious diseases. Its core product (the only one of its kind) includes a DNA-based test for human papillomavirus (HPV), a virus believed to cause nearly all cervical cancer cases. Digene's HPV test is a more targeted test for cervical cancer, used when Cytec's Pap test results are ambiguous or borderline. The HPV test is most effectively performed by using residue from the original Pap test, but such reuse requires the liquid-based test manufacturer to obtain FDA approval for its samples to be later used with the Digene test. Obtaining such approval requires the two firms to cooperate. Prior to the merger, Digene was cooperating with Cytec and Cytec's only competitor.

FTC's challenge to merger refutes predictions that current administration would be unlikely to challenge predominantly vertical mergers.

According to the FTC, Digene is the only U.S. source for DNA-based HPV tests, and the Commission alleged that entry by other firms was a remote possibility. Cytyc is one of two U.S. sources for liquid-based Pap tests and accounts for 93% of the market. Three other companies have yet to begin clinical trials for their products. The FTC alleged that Cytec's acquisition of Digene would result in Cytec being the only company with FDA approval for sample reuse with Digene's test. If this were true, Cytec's competition would be substantially disadvantaged and likely driven from the market.

Digene has also tested its HPV test as a primary screen for cervical cancer, both in conjunction with Pap tests and as a stand-alone test, and is seeking FDA approval for such uses. If approved, the HPV test would become a direct competitor of Cytyc's Pap tests. Therefore, the Commission concluded that the merger would eliminate the possibility of any future competition between the products.

This challenge is notable because conventional wisdom predicted that the present administration would not likely be challenging mergers that were predominantly vertical in nature.

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