Antitrust and Trade Regulation Bulletin

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HSR Reform

As one of its final acts, the 106th Congress enacted legislation modifying the premerger notification requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. President Clinton signed the legislation on December 21, 2000. Effective February 1, 2001, some smaller transactions that were required to file premerger notifications under the old law will be able to be consummated without filing. On the other hand, some larger transactions that were previously exempt from filing because one of the parties was considered too small will require filing. The filing fee structure has been altered so that some parties will pay as much as $280,000 instead of the current $45,000.

Generally speaking, under the new rules acquisitions of stock and/or assets valued in the aggregate at less than $50 million will not be subject to the premerger filing and waiting period rules. This is a dramatic increase over the current $15 million threshold. Transactions valued between $50 million and $200 million will be reportable only if one of the parties has revenue or assets in excess of $100 million, and the other party has assets or revenues in excess of $10 million. All transactions valued at over $200 million will require filing regardless of the size of the parties, unless otherwise exempted.

The filing fees will also be changed. For transactions up to $100 million in value, the current $45,000 filing fee will be required. Transactions valued in excess of $100 million but less than $500 million will pay $125,000. Transactions that exceed $500 million will pay a $280,000 filing fee.

This legislation contains a few other miscellaneous changes to the existing law. The dollar thresholds recited above will be automatically adjusted annually after September 30, 2004 by reference to an economic index, so that they will change in accordance with other economic factors. All HSR dates falling on weekends or holidays will move to the next following business day, rather than the previous business day. The government will have thirty (rather than twenty) days after substantial compliance with a Request for Additional Information (commonly called a "Second Request") to decide whether to challenge the merger. Both the FTC and the Department of Justice will be required to appoint someone without direct responsibility for enforcement recommendations to resolve disputes arising over the scope of or compliance with a Second Request.

As was true of the old law, determining whether or not a particular transaction is subject to HSR filing requirements can be complex. Hale and Dorr has lawyers who answer these questions on a regular basis, available to advise on any particular transaction.

New European Antitrust Regulation Retroactively Affects Existing Distribution and Reseller Agreements

A recent European Union antitrust regulation (which can be viewed at by clicking here) will deliver an unwelcome New Year's present next year on January 1, 2002 to Internet and other technology companies distributing goods or services through third parties. The changes in the law are retroactive and will apply to agreements entered into on or before May 31, 2000, the effective date of the regulation. In light of the fundamental changes resulting from the new regulation, any company marketing its goods and services in the European Economic Area ("EEA") through distributors, resellers, systems integrators, strategic allies or other third parties should review its existing distribution, purchase, OEM, franchise and service agreements to determine whether any of those agreements extending beyond December 31, 2001 need to be adjusted.

The new regulation applies to all vertical agreements with a party in the EEA or relating to the distribution of goods or services in EEA countries. The EEA currently consists of the following 18 countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden and the United Kingdom.

The new regulation is what Europe calls a "block exemption," which offers a safe harbor against antitrust challenges under Article 81 of the Treaty of Rome, which generally prohibits all agreements and practices that may prevent, restrict or distort competition within the EEA. Exclusivity provisions, non-competition covenants and territorial restrictions may run afoul of Article 81, unless covered by a block exemption. The new regulation replaces several earlier block exemptions, including two 1983 regulations that provided safe harbors for exclusive distribution agreements and exclusive purchase agreements.

Under the new regulation, for the first time, the market share of the parties is relevant in determining whether the safe harbor is available. The safe harbor is not available if the supplier's market share exceeds 30% or, in exclusive supply arrangements, the buyer's market share exceeds 30%. For companies that offer goods and services that are often promoted as having no competitive alternatives, it may sometimes be difficult to prove that relevant market shares are less than 30%.

Several contractual restrictions explicitly fall outside the new regulation's safe harbor, meaning that they will remain subject to antitrust challenge under Article 81. These include restrictions on the buyer's ability to determine the resale price or to resell goods or services in a defined territory or to specified customers, as well as prohibitions on members of a selective distribution system from selling products of particular competing suppliers. Some exceptions to this general rule are still available. For example, the supplier may still restrict active sales into an exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another reseller.

Agreements that were in force on or prior to May 31, 2000 and satisfied the prior block exemptions for exclusive distribution agreements, exclusive purchase agreements and franchise agreements, will continue to benefit from those safe harbors, but only until December 31, 2001. After that date, to remain shielded from Article 81 antitrust challenges, pre-May 31, 2000 vertical agreements may need to be amended to comply with the new regulation. However, if the supplier's market share exceeds 30% under a distribution agreement or if the buyer's market share exceeds 30% under an exclusive supply arrangement, the new regulation's safe harbor will not be available, and the parties will need to choose between (1) removing exclusivity, non-competition and other restrictive provisions from their agreement, or (2) seeking protection through either an individual exemption or an informal ruling from the European Commission.

For further information on this important subject, please contact Ken Slade in Boston, Pierre-André Dubois or Peter Kremer in Munich.

FTC Seeks to Halt Baby Food Merger

On February 28, 2000, H.J. Heinz and Milnot Holding Corporation, the parent of Beech-Nut Corporation, agreed to merge their baby food operations. Two months after filing premerger notification, the FTC issued a Second Request. On July 7, 2000 three of the five members of the FTC approved a court action seeking a preliminary injunction to stop the merger.

Judge James Robertson of the U.S. District Court for the District of Columbia held five days of hearings in August and September and issued an opinion in October, denying the injunction. The opinion is notable for its reliance on evidence about efficiencies and innovation that the court found would offset any anti-competitive harm resulting from the merger of the nation's second and third largest baby food manufacturers. *Federal Trade Comm'n v. H.J. Heinz, Co., et al.,* 116 F. Supp. 2d 190 (D.D.C. 2000).

Having concluded that the relevant market was jarred baby food sold in the United States, the district court calculated the Herfindahl-Hirschman Index ("HHI") to assess concentration. The data demonstrated that the market was highly concentrated before the proposed merger and that the merger would substantially increase the concentration. Under the merger guidelines, the post-merger HHI of 5285 with an increase of 510 points created a presumption that the merger would harm competition.

Concluding that there was no realistic probability that a new firm would enter the jarred baby food market, the district court considered the nature of the competition between the two merging firms. Gerber is the dominant market brand in the United States, and because most supermarkets carry Gerber and only one other brand, Heinz and Beech-Nut "are virtually never found in the same supermarket." The court also found that the two firms do not price against each other and do not even monitor each other's prices. Econometric evidence supported the conclusion that the two firms do not constrain each other's retail prices.

Nevertheless, there could be important competition between the two firms to be chosen as the second brand on the shelf with Gerber. The district court concluded, however, that the FTC's economic evidence failed to demonstrate that this competition yielded any real benefit to consumers. Further, the FTC failed to demonstrate that the merger would meaningfully affect the amounts manufacturers pay grocers for coupons, loyalty card programs, etc.

The heart of the defense to the commission's case was the contention that merging was the only way these companies could compete effectively against Gerber and bring actual competition to the market. Expert testimony was offered to demonstrate that the merger would cause substantial efficiencies and opportunities for product innovation. The underutilized capacity at Heinz's automated plant would cut the cost of producing the Beech-Nut food almost in half and broader, nationwide distribution would inspire new products. Ultimately, the district court found "it more probable than not that the consummation of the merger . . . will actually increase competition in jarred baby food in the United States."

The Federal Trade Commission voted to approve an appeal from the district court ruling by a 3-1 vote (Commissioner Anthony abstaining and Commissioner Swindle dissenting). The U.S. Court of Appeals for the District of Columbia entered an order enjoining the merger pending the appeal which will be heard on an expedited basis. In doing so, the Court of Appeals determined that the commission demonstrated "a substantial probability of success," characterizing the merging parties' efficiencies assertions as "a novel defense." *Federal Trade Comm'n v. H.J. Heinz, Co., et al.,* Action No. 00-5362 (D.C. Cir. Nov. 8 , 2000).

District Court Enjoins Tobacco Merger

After noting the irony of the FTC's efforts to protect consumers of chewing tobacco, Judge Thomas Hogan of the U.S. District Court for the District of Columbia granted an FTC motion for a preliminary injunction to block a tobacco merger. *F.T.C. v. Swedish Match, et al.*, Civ. No. 00-1501 (D.D.C. Dec. 14, 2000). The injunction bars Swedish Match's acquisition of loose leaf tobacco brands and assets from National Tobacco Company, L.P. pending a full hearing on the issue at the FTC. Swedish Match is reportedly reviewing the decision and determining what action to take as a result of the opinion.

The principal issue to the court was properly defining the relevant product market to use in evaluating the potential impact of the merger. The FTC advocated a "loose leaf tobacco" market while the merging parties argued for a broader "smokeless tobacco" market that would include moist snuff as well as chewing tobacco. Although the court found some functional interchangeability among the two products – based largely on data showing a significant number of consumers who use both products – it refused to include loose leaf tobacco and moist snuff in the same product market.

The court primarily rested its decision on the price responsiveness of the two products. Both sides offered testimony from economist experts who had performed econometric calculations and reached opposite conclusions. Finding flaws in the methodology of both experts, the court instead focused on internal company documents and testimony from executives in the industry which both suggested that changing the price of loose leaf tobacco does little to its demand. Loose leaf tobacco consumers are brand loyal and relatively price insensitive. Whatever dual usage may exist was not sufficiently strong to constrain price increases. Perhaps most persuasive to the court were company documents demonstrating that when they set prices and tracked prices they looked only at loose leaf tobacco brands.

Having accepted the commission’s narrower market arguments, the court rather easily determined that there would be a substantial lessening of competition after the merger. Swedish Match is the largest loose leaf tobacco seller and National is the third largest. After the merger they would have sixty percent of the market which was highly concentrated even before the merger. The substantial increase in concentration was well above the merger guideline thresholds.

The merging parties asserted that, despite the market Concentration, competition would remain vigorous. Even though the court accepted the fact that demand for loose leaf tobacco is and will continue declining, it rejected the suggestion that the decline would necessarily cause decreases in pricing. In fact, it looked at the historical pricing of loose leaf tobacco and found that companies sustained price increases even in the face of falling demand.

The parties also asserted that the efficiencies arising out of the merger would offset any competitive harm. Citing the Court of Appeals’ stay order in the baby food litigation (see above), the district court questioned whether it was even appropriate to consider efficiencies in light of the substantial concentration the merger would cause. Moreover, even were such consideration appropriate, the court found the savings that would be passed on to consumers in the form of lower prices in this case were "at best" speculative. "Without significantly more evidence to substantiate the savings purported in this case, and without greater clarity on the state of the antitrust law [concerning efficiencies] in this circuit," Judge Hogan rejected the defense.

Business-to-Business Ventures Receive Abundant FTC Commentary and Scrutiny

Within the last several months, the FTC has held a public meeting about business-to-business (B2B) exchanges, released a report about them, given speeches on them and cleared the first one through the HSR premerger notification process. The FTC defines B2Bs as, "electronic market-places that use the Internet to electronically connect businesses to each other." The subject will be of continuing interest and companies preparing to participate in B2B exchanges should be aware of the FTC’s current interest in these new electronic business arrangements.

FTC Meeting and Report Address B2Bs

In June, the FTC held a two-day workshop to discuss the antitrust issues associated with B2B exchanges. In October, the FTC staff synthesized the information it garnered from the workshop and issued a lengthy and detailed report entitled, "Entering the 21stCentury: Competition Policy in the World of B2B Electronic Marketplaces." A full copy of the report is available by clicking here.

In general, the FTC believes that traditional antitrust analysis can be adapted to analyze a B2B exchange. Attention to the traditional antitrust issues arising out of agreements among competitors should allow B2Bs to craft operating rules to minimize agency concern. Areas of some sensitivity that could arise in a B2B context include: exchange of sensitive information; joint purchasing threatening to create monopoly power; and exclusionary practices which threaten competition or potential entry.

Recognizing that each B2B exchange is unique – in the industry it serves, the products it supplies, the market power of the participants and the operating rules by which it is governed – the FTC advocates a fact-intensive analysis that treats each specific case on its own merits. The report identifies several levels of potential competitive concern with B2B exchanges – in the markets for the goods and services traded on the exchanges at both the buyer as well as the seller level and in the market for the B2B marketplaces themselves. According to this report, competitive concerns are more likely to be significant the greater the combined market share of the owner/participants, the greater the constraints on participants outside the B2B and the lesser the interoperability with other B2Bs.

FTC Clears First B2B to File for Pre-Formation Clearance

The FTC has closed its review of its first B2B, but because the project was in such an early stage, the decision not to challenge the exchange provides very little precedential value. In June, five automotive firms – General Motors, Ford, DaimlerChrysler, Renault and Nissan – together with two information technology firms – Commerce One and Oracle – announced their intention to form Covisint. Covisint intends to offer services for firms in the automotive industry supply chain. These services include assistance with product design, supply chain management and procurement functions by auto manufacturers, as well as their direct and indirect suppliers. Following the initial HSR filing, the FTC issued a Second Request and the parties completed their response to it.

Although the FTC ultimately determined not to challenge the venture, the decision was coupled with caution that the actual implementation of the B2B might become the subject of a later challenge if it caused competitive harm. Covisint had not adopted bylaws, operating rules or access rules that left the FTC with few specifics to examine. The FTC made reference to the large market shares of the participants as an important factor in the analysis of the ultimate competitive effect of the venture.

New Leadership at the Antitrust Agencies

Now that George W. Bush has become president, Washington is brimming with speculation about who will serve in his government for the next four years. In the antitrust world, that focus, of course, is on the FTC and the Antitrust Division of the United States Department of Justice.

Bush will appoint a new chairman of the FTC by choosing among the sitting FTC commissioners. Both Thomas B. Leary and Orson Swindle are Republicans and are the two logical choices for Bush. Commissioner Leary has a distinguished background as an antitrust lawyer, while Commission Swindle is a war hero with strong ties to Senator John McCain (R-Az).

It is thought to be unlikely that the current chairman, Robert Pitofsky, will continue as a commissioner after losing the chairmanship. Were he to resign, the FTC would have only four commissioners which could create deadlocks on critical cases until a fifth member could be nominated and confirmed.

On the Department of Justice front, John Ashcroft is the proposed new attorney general and would name the assistant attorney general in charge of the Antitrust Division. One name frequently mentioned is that of Tim Muris, foundation professor at George Mason University Law School. Muris was once the director of the Bureau of Competition of the FTC and, more recently, is thought to have acted as an antitrust advisor to the Bush campaign.

Mylan Laboratories Disgorges $100 Million to Settle FTC Charges

Nearly two years after filing a complaint against Mylan Laboratories, the FTC agreed to settle the charges. As reported in our February 1999 Antitrust and Trade Regulation Bulletin, the FTC went to federal court to determine the legality of a disgorgement remedy in an antitrust context and won that argument.

The FTC alleged that Mylan attempted to monopolize and conspired to monopolize the markets for two anti-anxiety drugs, lorazepam and clorazepate. The FTC objected to Mylan’s supply agreements related to certain active ingredients needed to make the two drugs because the terms of those agreements prevented the manufacturers from selling the active ingredients to others.

Mylan will pay a total of $100 million into two escrow funds that will be used to satisfy consumer claims from various states. The settlement permanently bans Mylan from making any agreement related to any active ingredient that prohibits the supplier from supplying the same ingredient to another firm, or that exclusively licenses an active ingredient.

Commissioner Leary dissented, in part, from the FTC approval of the settlement because he believed that the financial payments threatened to create a dangerous precedent. Citing the Supreme Court decision in *Illinois Brick* which determined that indirect purchasers did not have standing to assert antitrust claims, Leary expressed concern that disgorgement into a fund for indirect purchasers amounted to an end run around current law.

The Federal Trade Commission and Patent Settlements

In September, the Federal Trade Commission intervened in a private patent dispute and asked a federal district court in California to delay accepting a settlement proposal between American BioScience, Inc. ("ABI") and Bristol-Myers Squibb for two reasons. First, the FTC expressed concern that the terms of the settlement would harm competition and impede the marketing of a generic equivalent of the cancer drug Taxol. Second, the FTC opened its own investigation of ABI and Bristol-Myers Squibb to assess the legality of their conduct. As a counterpart to the investigation, the FTC issued subpoenas to ABI seeking, among other things, documents related to the negotiation of the settlement and documents related to the patents in issue. ABI has moved to quash or modify the subpoena and that motion is pending at the FTC.

Department of Justice Scrutinizes Licensing Practices of Largest Semiconductor Supplier

Applied Materials, Inc. has confirmed that the Department of Justice has begun to investigate its licensing of intellectual property. Applied Materials is the world’s largest supplier to the semiconductor industry. Although there is no acknowledged connection, Applied Materials recently settled a private antitrust action by Varian Semiconductor Equipment Associates, Inc. which related to technology patents.

Regardless of the outcome of the DOJ inquiry, its mere existence suggests that government interest in the licensing and use of patents and their interplay with antitrust laws continues unabated.

Ninth Circuit Rules in Favor of Dental Association on Remand

As reported in our March 2000 Antitrust and Trade Regulation Bulletin, the United States Supreme Court ruled last year that the Ninth Circuit looked too quickly at the advertising practices of the California Dental Association ("CDA") before condemning them as illegal under the antitrust laws. On remand, the Ninth Circuit examined the advertising practices more closely using a rule of reason analysis, and dismissed the case. *California Dental Assoc. v. Federal Trade Comm'n*, 224 F.3d 942 (9th Cir. 2000).

The CDA regulations at issue restrict advertising for dental services that contain prices or references to quality, but they do not ban that kind of advertising entirely. Because the Ninth Circuit found no competent evidence of intent to restrict competition, it looked only at the actual economic consequences of the restrictions. The Ninth Circuit faulted the FTC for its failure to produce empirical evidence related to the dental services market showing the impact of advertising restrictions similar to those at issue. Instead, the FTC offered by analogy an analysis of the legal services market, despite the fact that the authors of that analysis had cautioned against cross-profession comparisons. By contrast, the CDA presented evidence that showed that the advertising restrictions corrected informational gaps between doctors and patients, allowed better price comparisons and decreased misleading advertising on both price and quality issues.

Although the FTC sought a remand in order to allow the consideration of additional testimony, the court chose to dismiss the case, concluding that the FTC had made a tactical decision in deciding not to call an additional economic expert, knowing that the case might be evaluated under the rule of reason. In effect, the court refused to give the FTC a second bite at the apple.

Microsoft Deadlines

The lawyers for Microsoft filed their appellate briefs on November 27, 2000. Although they sought 200 pages to make their arguments, the court limited them to 150 pages which they used completely. Microsoft is appealing both the findings that it violated the Sherman Act as well as the structural remedy adopted by the district court. Included in the brief is a request that, if any part of the case is remanded, the remand be to another district court judge. Microsoft claims that Judge Thomas Penfield Jackson made various public comments that revealed a bias against the company.

The federal and state prosecutors filed their opposition briefs on January 12, 2001. Oral argument has been scheduled for January 26 and 27, 2001 and a decision is anticipated in the spring.

Retroactive Challenge to Merger Requires Divestiture

In 1996, Manheim Auctions filed an HSR premerger notification related to its intended acquisition of a controlling interest in its only Phoenix competitor from JM Family Enterprises, Inc. The required waiting period elapsed and Manheim consummated the transaction. Now, almost four years later, the FTC filed a complaint alleging the acquisition gave Manheim an illegal monopoly in the Phoenix market for auto auction services that required a divestiture to resolve. The Phoenix issue came to the FTC's attention in the context of its investigation of Manheim's most recent merger with ADT Automotive Holdings, Inc. The ADT merger required eight divestitures in six different geographic markets to a buyer identified and approved in advance. In addition, Manheim will have to notify the FTC of any acquisition in any of those areas for the next ten years.

Flawed Market Definition Thwarts Pepsi's Fountain Drinks Claims Against Coke

PepsiCo, Inc. sued the Coca-Cola Company in federal court in New York City alleging that Coke had monopolized the market for "fountain-dispensed soft drinks distributed through independent foodservice distributors." *PepsiCo, Inc. v. The Coca-Cola Co.*, 114 F. Supp. 2d 243 (S.D.N.Y. 2000). Although purchasing the fountain syrup through the independent foodservice distributors allowed restaurants and movie theaters to obtain all of their supplies from one dealer, the district court concluded that that fact did not necessarily mean that the market should not also include fountain syrup available for purchase from other sources, such as bottlers. Customer preference for a particular form of delivery did not, standing alone, create a separate market.

PepsiCo failed to persuade the court that the differences in distribution were recognized by the market, or that the characteristics or prices of the products were different based on their method of distribution. The court concluded that PepsiCo picked the particular "market" because of the high market shares. According to the court, markets define themselves and the job of selecting the appropriate product market requires observing participants' behavior, not just market shares.

Auction Houses Create Antitrust News

On October 5, 2000, the Department of Justice filed one-count felony charges against both Sotheby's and its former president, Diana D. Brooks, for price fixing. The company agreed to plead guilty and pay a $45 million criminal fine and Brooks agreed to plead guilty and to cooperate with the Department in its ongoing antitrust investigation. The court will subsequently determine her sentence. The information causing the investigation leading to the charges came from a rival auction house – Christie's – which had allegedly engaged in the price fixing, but decided to take advantage of the Antitrust Division's corporate leniency program by bringing information concerning the practices to the Department.

As often happens, a variety of lawyers filed class actions on behalf of the customers of these companies seeking monetary recovery of overcharges alleged to have been caused by the price fixing. *In re Auction Houses Antitrust Litigation*, 197 F.R.D. 71 (S.D.N.Y. 2000). Confronted with a large number of consolidated cases and numerous attorneys clamoring to be lead counsel (the one who gets the largest fee), the district court determined to resolve the contest by – guess what? – an auction. In doing so, the court required each bidder to bid independently, to describe its qualifications and to choose a class recovery amount which it would agree would go to the class before collecting any attorney's fee. Amounts in excess of that would be shared among the class and counsel. The auction winner was Boies, Schiller and Flexner, the law firm of David Boies. The class actions have reportedly settled for $512 million, but the terms of the settlement have not been filed with or approved by the court.

This publication is not intended as legal advice.Readers should not act upon information contained in this publication without professional legal counseling. For more information, contact Hale and Dorr's Antitrust and Trade Regulation Group.

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