Antitrust and Trade Regulation Bulletin

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EXECUTIVE SUMMARY

- Unreasonable trade practices and collusion among distributors found in a cooperative advertising program.
- Microsoft appeal will not be direct to the Supreme Court.
- A class of California consumers may sue Microsoft for price fixing.
- Seventh Circuit agrees that Toys "R" Us orchestrated an illegal boycott.
- Competition issues resolved for door hardware business.
- FTC Chairman Robert Pitofsky discusses issues of high technology, patents, and antitrust law.
- A patent holder's obligation to license at all is discussed in connection with dismissal of claims.
- Indirect purchasers challenge DuPont's attempt to prevent the sale of a competing generic drug.
- Claim of fixing minimum prices may proceed without proof of harm to competition.

FTC Prohibits CD Distributors' Minimum Advertised Price Programs

The FTC recently concluded its three-year investigation of the five largest distributors of music compact discs to retailers, obtaining consent orders against their minimum advertised price (MAP) programs. In re Sony Music Distribution, et al., FTC Docket No. 9710070 (May 10, 2000). The five firms control an estimated 85 percent of CD sales in the United States. The FTC's complaint alleges that prices for CD's had begun to drop due to a new entrant into the market who was slashing prices and putting pressure on all CD prices. The FTC claims that, in response, these five firms each developed a MAP program that prevented retailers from advertising or displaying prices lower than the distributor-set MAP. This restriction applied not only to advertising paid for in whole or in part by the distributors, but also to advertising and signage funded and supplied entirely by the retailer. The distributors terminated all advertising funded to any retailer who failed to comply with the program, according to the complaint. These severe penalties, combined with the breadth of the restrictions, distinguish these MAP programs from other MAP cooperative advertising programs.

The FTC contended that the programs effectively maintained higher CD prices and cost consumers as much as $500 million. The FTC found no plausible efficiency justification offsetting this harm and, therefore, concluded that the actions were unreasonable vertical restraints of trade that should terminate. In addition, the FTC determined that the program facilitated horizontal collusion among distributors. The settlement agreement prohibits the distributors from conditioning advertising funds on the prices retailers charge for CDs for seven years and eliminates, for five years, the distributors' rights to terminate dealers who fail to comply with minimum prices.

FTC Chairman Robert Pitofsky, joined by the other commissioners, issued a statement concurrently with the settlement announcing that, "(i)n the future, the Commission will view, with great skepticism, cooperative advertising programs that effectively eliminate the ability of dealers to sell product at a discount." Pitofsky also reiterated the FTC's intent to challenge "any arrangement between a manufacturer and its dealers that includes an explicit or implied agreement on minimum price or price levels" and "any cooperative advertising program that is part of a resale price maintenance scheme."

Microsoft Battle Moves to Appellate Level

On September 26, the Supreme Court declined to accept direct review of Judge Thomas Penfield Jackson's decision in the Microsoft case. Judge Jackson had certified the case for immediate review by the Court (without intermediate review by the Court of Appeals for the District of Columbia) under a rarely applied statute that allows a district court judge effectively to "nominate" a case for direct appeal to the Supreme Court. The Supreme Court acted on an 8-1 vote, with Justice Stephen Breyer dissenting. Justice Breyer expressed the view that the Court should hear the case directly because speed in reaching a final decision "may help create legal certainty."

Microsoft had urged the Court to decline direct review in order to permit the court of appeals to review the record and "clear out the procedural and factual underbrush first." Presumably, Microsoft also sought this result because of the court of appeals' reversal, on prior occasions, of Judge Jackson's decisions relating to Microsoft. The government had urged the Supreme Court to take the case for the reason articulated by Justice Breyer in his dissent, the inevitable delay of a long appeals process, and its possible adverse effect on competition.

Class of California Consumers Can Pursue Microsoft for Overcharging

A state court judge in California recently certified two classes of consumers, clearing the path for them to seek monetary relief from Microsoft for overcharges they claim resulted from a Microsoft monopoly both in the markets for operating systems and certain office application software. In re Coordination Proceedings Special Title (Rule 1150(b)) Microsoft I-V Cases, No. J.C.C.P. 4106 (Cal. Super. August 29, 2000). California is in the minority of states that permits indirect purchasers, such as consumers, to sue for price fixing under a state statute known colloquially as an Illinois Brick repealer. Contrary to federal law (as construed in the Illinois Brick case), the California statute expressly permits indirect purchasers to sue the manufacturer of the product they purchased, even if the consumers purchased the product from a retailer or other third party many levels removed in the distribution chain. The judge ruled that the plaintiffs made the necessary threshold showing that they could demonstrate both liability and damages on a class-wide basis.

Certification of these two classes - one for purchasers of Windows or MS-DOS and one for purchasers of Word and Excel - allows the suit to proceed on the merits. The plaintiff classes rely on Judge Jackson's findings in the U.S. v. Microsoft case to demonstrate that Microsoft violated the law and in so doing, injured consumers. The federal class action suits filed against Microsoft following Judge Jackson's decision have been consolidated in a federal multi-district litigation (MDL) proceeding, but this California case, along with a number of other state court cases, will proceed independently.

Seventh Circuit Upholds Ruling Against Toys "R" Us

Nearly two years after the FTC ruled against Toys "R" Us (TRU) for pressuring manufacturers not to sell popular toys to competing retailers (especially wholesale clubs), the Seventh Circuit has affirmed the commission's conclusion that the activity constituted a per se illegal boycott. Toys "R" Us, Inc. v. FTC, No. 98-4107 (7th Cir., August 1, 2000). The discussion of the FTC decision appeared in an earlier Antitrust and Trade Regulation Bulletin and can be viewed by clicking here.

The FTC found that TRU's orchestration of the boycott, which included as many as 10 toy manufacturers, was not simply a series of separate vertical agreements between TRU and the manufacturers, but instead a horizontal conspiracy, orchestrated by TRU, which created a per se illegality, and held that the FTC was not required to conduct a detailed economic inquiry or analyze market share. The Seventh Circuit decision rested largely on the conclusion that the manufacturers had acted against their economic interests in agreeing not to sell the toys to the clubs.

TRU argued that its policy was a legitimate response to "free riding" by competitors in connection with the "extra services" it provided the manufacturers. The Seventh Circuit summarily rejected this argument, finding that the manufacturers had determined their profits would be maximized by selling through as many channels as possible, thus confirming that the "extra services" were not necessary.

Hale and Dorr Helps Williams plc Sell Door Hardware Businesses

Williams plc, a British-based company, recently received FTC clearance to sell the substantial majority of its Intruder Security Division to Assa Abloy, a Swedish-based company. Both Williams and Assa Abloy sell locks and other door hardware in the United States and around the world. In the United States, the Williams companies include Yale and Corbin Russwin, and the Assa Abloy companies include Sargent and Arrow. We represented Williams in connection with the FTC's review of the transaction, which continued for a number of months following the filing of HSR forms.

Ultimately, the FTC concluded that there were no competitive issues that needed to be addressed with respect to the door hardware business. However, certain of the production facilities that produced door hardware products also produced products for an electronic access control company, which was being retained by Williams and which competed with an electronic access control company owned by Assa Abloy. The transaction was restructured to exclude those facilities, thereby resolving the FTC concerns.

FTC Chairman Gives Views on High Technology and Patent and Antitrust Law

FTC Chairman Robert Pitofsky delivered a speech, "Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property, " at the recent American Antitrust Institute Conference. Pitofsky used the speech to respond to the increasingly popular contention that 19th century antitrust law and 21st century technology are incompatible. Pitofsky defended antitrust enforcement in the technology arena, arguing that the time-tested principles of antitrust remain valid and can be applied even in new industries characterized primarily by innovation.

A fundamental antitrust principle is that the government should prevent the acquisition and continuation of monopoly by inappropriate means, and it is on this basis that the government blocks mergers that would produce monopoly power in certain markets. The presence of monopoly or market power also increases the likelihood that the government will challenge boycotts or other predatory or exclusionary conduct. This core principle, Pitofsky believes, can and should be applied to protect consumers in all industries, including emerging technology industries.

Pitofsky responded to the three most common arguments used by those who would exempt technology industries from antitrust constraints. First, while admitting that the technology sector is fast-moving and dynamic, Pitofsky argued that significant barriers to entry may exist that can allow firms to dominate industries for significant periods. These days, such barriers often arise from network effects and lock-ins, rather than more traditional barriers such as large capital costs. Nevertheless, their impact on competition can be much the same as more traditional barriers, and Pitofsky believes the antitrust laws, therefore, should continue to apply.

Second, in response to critics who argue that the antitrust laws are anathema to innovation, Pitofsky cited examples of the FTC's protection of innovation. Research and development joint ventures can be viewed as decreasing short-term competition, but the FTC often allows them because of their long-term positive impact on innovation and consumer welfare. Patent cross-licenses, even when they contain price provisions, are often found acceptable to circumvent blocking patent issues, even when the firms involved dominate their industry. While Pitofsky admits there may have been instances where the FTC was not appropriately solicitous of innovation, today he believes that the two goals of fair competition and innovation can, and do, coexist

Finally, Pitofsky challenged the notion that high technology industries cannot be properly analyzed using traditional static price analysis, but instead require new economic models that the FTC is not applying. While admitting that there may be some rare occasions when traditional competition is not necessary to yield lower prices and product choice, Pitofsky argued that innovation thrives in a competitive environment, and the FTC will continue to maintain a competitive environment in all markets.

Pitofsky criticized the recent federal circuit decision in the Xerox antitrust litigation a he turned to a discussion of intellectual property and its role in antitrust analysis. The Xerox decision was reported in the June 2000 Antitrust and Trade Regulation Bulletin and can be viewed by clicking here. The federal circuit in Xerox allowed the company to discontinue supplying parts to independent service organizations seeking to provide after-market service to Xerox machines. The court held that where patents are involved, the holder is free to deny others patented products so long as the patent is valid. Pitofsky fears that this places patent rights too far above competitive concerns. He concluded, "I have no quarrel with the fundamental rule that a patent holder has no obligation to license or sell in the first instance, A patent holder is not under any general obligation to create competition against itself within the scope of its patent. But what will the rules be when the patent holder conditions the availability of its patented products or inventions on terms that affect the competition?" Clearly, the last word on this subject has yet to be spoken, and patent holders should be cautious of placing too much reliance on Xerox, particularly in dealings with the FTC.

Patents, Standards and Licenses

A district court in California recently dismissed a series of antitrust counterclaims brought by an alleged infringer in a patent suit. Townshend v. Rockwell Int'l Corp., 2000 Trade Cas. CCH 72,890 (N.D. Cal. March 28, 2000). Townshend invented 56K modem technology, which he licensed to 3Com. That technology was incorporated into an industry standard by the International Telecommunications Union (ITU). Townshend alleged the defendants (collectively referred to as Conexant) infringed his patent by using the now industry-standard 56K modem technology. Conexant counterclaimed alleging that Townshend and 3Com violated the antitrust laws and competed unfairly by offering to license the industry-standard technology to Conexant only on unreasonable terms.

The court relied heavily on the recent federal circuit decision in Xerox and concluded that because a patent holder could choose not to license at all, the antitrust counterclaims must be dismissed. ITU policy required patent holders whose technology was incorporated in an industry standard to license relevant patents on reasonable terms and conditions. Because 3Com had disclosed their proposed license terms to the ITU before the latter adopted the standard, the court found 3Com and Townshend could not have violated the ITU rule so long as they were willing to license on those terms. The court refused to assess the reasonableness of the terms independently or to assess their affect on competition.

Indirect Purchaser Class Can Seek Injunctive Relief

The Third Circuit allowed a class of indirect drug purchasers to seek injunctive relief against DuPont based upon its alleged attempts to prevent a generic alternative to its blood-thinning drug Coumadin from entering the market. In re Warfarin Sodium Antitrust Litigation, 214 F.3d 395 (3d Cir. May 30,2000). The court distinguished suits seeking injunctive relief from those seeking monetary damages that fail under the Illinois Brick doctrine, and held that the dangers that would result from indirect purchasers seeking monetary compensation were not present in an injunction context.

Indirect purchasers may seek injunctions, however, only when the injury they allege is sufficiently linked to the behavior they challenge. The district court had held that the existence of a variety of intermediaries, including managed care firms and insurance companies, attenuated the antitrust injury to the consumer and barred their claim. The Third Circuit disagreed and found that the consumers were foreseeable victims - paying high prices for Coumadin was precisely the type of injury one would expect to result from the violations alleged.

Victim of Per Se Antitrust Violation Need Not Demonstrate Competitive Harm, But Only Injury to

His Business

The Third Circuit recently allowed a dealer terminated for failure to comply with an alleged vertical minimum pricing scheme to maintain an action for damages simply by alleging harm to its business, without the need to allege competitive harm to the market. Pace Electronics, Inc. v. Canon Computer Systems, Inc. et al., 213 F. 3d 118 (3d Cir. May 22, 2000). Vertical minimum price-fixing is per se illegal; it does not require proof of injury to competition. To require a private plaintiff to show injury to the market as a whole threatens the per se distinction. Instead, a plaintiff must show only that it suffered an injury and that the injury is of a type that the law seeks to prevent by condemning that conduct.

The Third Circuit observed that fixing minimum prices harms competition, in part, by preventing entrepreneurs from engaging in a price competition that may be the only means they have of distinguishing themselves and gaining customers. Accordingly, harm to Pace, as a dealer, is harm of the type sought t be prevented by condemning minimum price fixing.

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