Antitrust and Trade Regulation Bulletin

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Department of Justice Sues to Block Small Merger Falling Under Reporting

Thresholds

Just a few months after Congress raised the thresholds for mandatory pre-merger filings under the Hart-Scott-Rodino Act to $50 million, the Department of Justice sued to block a merger valued at only $45 million. This action demonstrates that the antitrust enforcement agencies do track announced mergers, whether or not they are subject to formal HSR filing requirements, and that they will investigate and prevent any merger they deem to be anticompetitive.

On April 2, 2001, 3D Systems Corporation announced its intention to acquire DTM Corporation. The firms indicated their intent to complete the transaction on June 8, 2001. On June 6, 2001, however, the Department sued to enjoin the merger on the basis of its conclusion that there were only three firms engaged in the manufacture and sale of industrial rapid prototyping systems and that the proposed merger would give the merged entity an eighty percent market share.

Although it is no surprise to antitrust practitioners that the antitrust enforcement agencies engage in just this sort of independent research, the filed case reinforces the message that transactions under $50 million, or otherwise not subject to filing, cannot avoid antitrust scrutiny. Companies contemplating a merger are wise to be prepared to address any competitive issues even if their proposed transaction falls below the filing thresholds.

Baby Food Decision Reversed – Efficiencies Fail to Save Merger

As reported in the January 2001 issue of this bulletin, the FTC recently opposed the merger of the baby food divisions of Heinz and Beech Nut, but a district court refused to enjoin the transaction. The FTC appealed, and the U.S. Court of Appeals for the District of Columbia Circuit reversed the lower court ruling and enjoined the merger pending a full trial on the merits at the FTC. *Federal Trade Commission v. H.J. Heinz, et al.*, 246 F.3d 208 (D.C. Cir. 2001).

The factual details of the transaction are somewhat unique. Gerber is the leading baby food manufacturer with a substantial market share. Grocery stores typically carry only two brands of baby food and inevitably choose between Heinz and Beech Nut when selecting a second brand. Therefore, Heinz and Beech Nut rarely compete for a consumer’s loyalty within the same store, but they both battle Gerber on a regular basis at the retail level. The parties argued that the merger would allow them to combine their resources and use the best of each product line to compete better against Gerber. In addition, they emphasized that a new Heinz plant, which was operating well under its capacity, could absorb all of the Beech Nut production, making the combined firm much more efficient. While the lower court was persuaded by these arguments, the D.C. Circuit disagreed.

The D.C. Circuit was highly critical of the district court opinion. The merger from three competitors to two is, according to the appellate court, a very strong *prima facie* case for the government which can be overcome at the injunction stage only by even more compelling evidence that there will be no anticompetitive effects from the transaction. While retail competition between Heinz and Beech Nut may not have been vigorous, competition did exist at the wholesale level. Although the efficiencies at issue were not trivial, they were not the "extraordinary efficiencies" necessary to rebut the government’s strong showing. In addition, the D.C. Circuit found that the district court failed to rigorously test the efficiency claims to ensure that they were more than mere promises of post-merger behavior. While the district court decision appeared to breathe life into the efficiencies defense, the appellate opinion returned the defense to its relatively weak status.

Perhaps most troubling to would-be merging firms was the court’s discussion of what the consequences of an injunction and a full trial would have on the merging firms. The parties had indicated that they would abandon the transaction if an injunction issued and that the court should consider this when deciding the equities of an injunction. The court refused to accept the parties’ representations that the injunction would kill the merger and ruled that the equities weighed in favor of the government. However, true to their words, the parties did abandon the merger almost immediately upon receiving the adverse ruling.

After Appeals Court Ruling, Microsoft Procedural Sparring Continues

On June 28, 2001, the U.S. Court of Appeals for the District of Columbia Circuit issued its long-awaited decision on Microsoft’s appeal of the decision that it violated the antitrust laws and that it should be broken into two companies. *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001). In summary, the court upheld the finding that Microsoft violated the antitrust laws by abusing its PC operating systems monopoly. On the other hand, it reversed the remedy and the finding of attempted monopolization of the Internet browser market.

Since the decision, both sides have filed motions with the court of appeals. The Department of Justice filed a motion seeking expedited remand of the case in order to allow a new district court judge to immediately begin considering appropriate remedies. Ordinarily, a court of appeals keeps a case for about forty-five days in the event that either side wants to seek a rehearing. The Department argued that it was not seeking a rehearing and that, if Microsoft decided to seek one, it was unlikely to succeed. Given "the strong public interest in prompt entry of a decree providing an effective remedy," the motion urges that the case be sent back to the lower court without delay.

Within a week, Microsoft moved for a rehearing. Microsoft's rehearing request is based on its belief that the appeals court misunderstood the portion of the record concerning "commingling" of software code specific to web browsing with software code used for other purposes (which formed one basis for the appeals court's decision that Microsoft had abused its operating systems monopoly). The Department's response to that motion asserts that Microsoft's repetition of its early arguments offers no reason for the court to re-weigh evidence it has already considered in connection with its original opinion.

On August 2, 2001 the court denied both motions. In a one-page opinion, the court denied the requested rehearing and also refused to return the case to the district court promptly. Less than a week after that decision, Microsoft sought Supreme Court review arguing that the entire district court ruling should be overturned because of the judge's bias. The Supreme Court is not expected to decide whether or not to take the case until this fall. Microsoft requested that the case not proceed while it awaited the Supreme Court decision, but the court denied that request and the case has been returned to the district court.

In a separate development, the State of New Mexico settled with Microsoft and will no longer be involved in the case. The New Mexico Attorney General took office after New Mexico had joined the litigation and withdrew, stating that she was concerned about the expenses New Mexico would incur in continuing to seek to break up Microsoft. Under the terms of the settlement, Microsoft agreed to pay New Mexico's litigation expenses and to let citizens of the state share in any future remedies imposed in the case.

Court Enjoins Baggage Policy and Awards Damages

Having held that an agreement between United Airlines and others to restrict the size of carry-on baggage violated Section 1 of the Sherman Act, the U.S. District Court for the Eastern District of Virginia has held that the complaining carrier, Continental, can recover costs incurred in attempting to circumvent the baggage restriction. *Continental Airlines, Inc. v. United Air Lines, et al.,* 136 F. Supp. 2d 542 (E.D. Va. 2001). (The liability phase of the court's ruling was previously reported in the May 2001 edition of this bulletin.) These damages were trebled for a total award of about $250,000. In addition, the court entered permanent injunctive relief barring the defendants from using or agreeing to use any luggage-restricting template at the security checkpoints at Washington-Dulles International Airport. The defendants' proposed remedy was to allow Continental passengers to avoid the templates, but require others to comply with them. The court held that the remedy was too narrow and instead more broadly banned the templates.

FTC Prevails in Claim that Notes of In-House Attorney Directed to Company's Advertising Agency Not Subject to Joint Defense Privilege

In the Federal Trade Commission's (FTC) investigation of Rexall Sundown (Rexall) advertising claims about a cellulitis treatment, the FTC requested that Avrett Free & Ginsberg (Avrett), Rexall's advertising agency, produce documents related to the cellulitis product. Avrett agreed to produce most of their documents, but withheld fifteen documents claiming attorney-client privilege. Each of the fifteen documents was an advertising draft containing handwritten commentary by Rexall's assistant general counsel. The U.S. District Court for the Southern District of New York rejected the claim of privilege and required production of the documents and the notes.

In most situations, sharing legal advice with someone other than the lawyer's client waives the privilege and renders the documents discoverable. There is a limited exception, however, when the disclosure is to a party with a common legal interest with the client. Co-defendants in litigation commonly use this exception to allow their attorneys to work together and to share privileged information with the common aim of defeating the opposing party's claims. Avrett sought to take advantage of this exception and claimed that it shared a common interest with Rexall in obtaining legal advice about Rexall's advertising. Construing the exception narrowly, the court disagreed.

Legal interests, held the court, must be carefully distinguished from commercial interests, and simply because parties share a commercial interest in abiding by the law generally and avoiding litigation does not mean a common legal interest exists. Instead, the parties must demonstrate that they are working cooperatively to further a specific and common legal goal. This narrow holding raises important issues about the validity of the common interest exception outside traditional co-defendant situations and serves as a strong caution to assess any potential claim of joint defense privilege.

Summary Judgment Inappropriate in Alleged Vertical Conspiracy

Spectators' Communication Network, Inc. (Spectators) wanted to offer radio broadcasts to attendees at golf tournaments and to profit from those broadcasts by selling advertising. The Professional Golf Association (PGA) opposed Spectators' activities and Spectators sued the PGA. *Spectators' Comm. Network, Inc. v. Colonial Country Club, et al.,* 253 F.3d 215 (5th Cir. 2001). Spectators claimed that, while the suit was pending, the PGA conspired, and coerced others to conspire, to undercut Spectators' business. In particular, Spectators alleged that Anheuser-Busch participated in the conspiracy and refused to allow Spectators to broadcast at golf events it sponsored. In return for this refusal, Spectators alleged that the PGA relaxed its restrictions on advertising alcohol products in association with PGA events and allowed Michelob (an Anheuser-Busch product) to become the official beer of the PGA.

In its defense, Anheuser-Busch argued that it was a purchaser of advertising at golf events. Therefore, any alleged conspiracy to restrict advertising at those events made no economic sense because it would reduce the supply and raise the price of advertising. Accordingly, Anheuser-Busch urged, and the district court held that, without direct evidence of the claimed conspiracy, summary judgment was warranted under *Matsushita.* The Fifth Circuit reversed, holding that the district court had ignored that the PGA allegedly gave Anheuser-Busch something of value in return for entering the conspiracy. Gaining "official beer" status for one of its products may well have been worth more to Anheuser-Busch than the cost of any reduction in the supply of advertising.

The Fifth Circuit concluded, however, that the alleged conspiracy was not a *per se* violation of the antitrust laws because the PGA and Anheuser-Busch were not competitors and Spectators did not demonstrate any other horizontal agreement. As a vertical conspiracy, the alleged conspiracy must be analyzed under the rule of reason which takes a variety of factors into account in assessing whether the conspiracy unreasonably injured competition. The case has been remanded to the district court for further proceedings.

Federal Trade Commission Gathering Substantial Information About Generic Drugs

The FTC intends to continue its focus on generic drugs. Recently, it issued approximately seventy-five subpoenas to both branded and generic drug makers. The FTC first proposed this idea months ago, but the need for specific funding approval, as well as a necessary industry comment period, slowed the issuance of the subpoenas. The FTC is requesting information about a variety of practices (such as citizen’s petitions and litigation settlements) that it has come to regard as potentially anticompetitive.

The purpose of gathering this information is to determine whether or not the portions of the Hatch-Waxman Act designed to aid the introduction of generic drugs have succeeded in that mission. The FTC’s interest in this subject has resulted from recent investigations of various particular firms and practices.

The FTC study is expected to continue for at least several more months. In the meantime, the Senate has been hearing testimony on these same subjects, and some legislative proposals may be developed before the FTC finishes its analysis.

Exclusive Dealing Arrangement Must Go to Trial

The United States Department of Justice (and two private parties not relevant to this discussion) sued Dentsply International Inc. (Dentsply), the country’s dominant manufacturer of artificial teeth, on January 5, 1999 alleging that Dentsply’s exclusive agreements with some distributors harmed competition. The Department of Justice alleged that these agreements significantly foreclosed the opportunities for rivals to enter or to remain in the market as artificial teeth manufacturers.

More than two years later, the U.S. District Court for the District of Delaware has held that the case must go to trial because Dentsply failed to demonstrate it was entitled to summary judgment. *U.S. v. Dentsply*, 2001-1 Trade Cases (CCH) ¶ 73,247 (D. Del. March 30, 2001). Dentsply’s "Dealer Criteria" prevent dental products dealers who sell Dentsply’s artificial teeth from carrying any other brand of artificial teeth. There was evidence in the record from several dental products dealers that Dentsply terminated (or threatened to terminate) them as dealers when they began to offer other brands of teeth.

Dentsply asserted a variety of defenses which it argued required the court to conclude, as a matter of law, that its exclusive dealing contract had not significantly foreclosed competition. Dentsply sells its teeth to dental laboratories through dental products dealers; the dealers, in turn, sell the artificial teeth to the dental laboratories that fashion them into false teeth for use by consumers. Dentsply argued that its competitors could forgo dental products dealers and instead sell teeth directly to the laboratories that use them. While accepting that this might negate liability, the court found that it could not conclude, as a matter of law, that such direct sales were viable options for competitors. Dentsply alternatively argued that it did not sell to all of the dental products dealers in the country and that its competitors could just use other dealers. The actual number of potential independent distributors was vigorously disputed and, therefore, in the opinion of the court, must also be resolved at trial before the amount of foreclosed competition could be determined.

Failure to Prove Damages Resulting from Antitrust Violation Leads to Summary Judgment for the Defendants

Microbix Biosystems, Inc. (Microbix) wanted to develop a generic urokinase product to compete with Abbott Laboratories, the only firm with such a product on the market in the mid-1990s. Urokinase is a protein commonly used to dissolve blood clots. In order to manufacture urokinase, Microbix needed human neonatal kidney (HNK) cells which, at the time, were only available from BioWhittaker, Inc. Microbix obtained some sample cells from BioWhittaker, but could not demonstrate that it had a contract for their continued production. Instead, BioWhittaker entered into an exclusive agreement with Abbott that required BioWhittaker to sell HNK cells only to Abbott. Microbix tried to buy cells from BioWhittaker, but BioWhittaker refused. Microbix sued and was granted a preliminary injunction which required BioWhittaker to sell the necessary cells to Microbix.

After the initiation of the lawsuit and the injunction, Microbix and BioWhittaker experienced other difficulties. Microbix failed to secure a manufacturing facility and, ultimately, lost its development partner. BioWhittaker failed an FDA inspection and, ultimately, the FDA banned the importation of HNK cells.

A Maryland federal court granted summary judgment for the defendants, and the United States Court of Appeals for the Fourth Circuit recently affirmed that decision. *Microbix Biosystems, Inc. v. BioWhittaker, Inc. et al.*, 2001-1 Trade Cases (CCH) ¶ 73,299 (4 th Cir. June 4, 2001). The court had little trouble concluding that the exclusive agreement between BioWhittaker and Abbott could be found to be unreasonably restrictive of trade. The court took only a "quick look" at the effects of the agreement and concluded that, at least for purposes of summary judgment, it could conclude that the agreement unreasonably restrained trade. Abbott and BioWhittaker argued that the agreement served legitimate business interests such as securing supply and protecting an investment Abbott had made in BioWhittaker. Relying largely on documents, the court gave that argument little credence. Abbott’s internal documents suggested that the purpose of the agreement was to "assure that other groups could not utilize the cells for production" of competing urokinase.

Having accepted that Microbix met its burden with respect to liability, the court then examined whether or not the presumptively illegal exclusive contract caused Microbix antitrust injury. Microbix alleged that the exclusive contract caused two types of injury: first, it caused Microbix’s development partner to quit, depriving Microbix of income under that agreement; and second, it prevented Microbix from earning profits from the sale of its generic urokinase. Finding that there were many reasons which contributed to the end of the agreement with the development partner, the court ruled that no reasonable jury could find the necessary causal link between the exclusive contract and Microbix’s loss of its development partner. As to the lost profits, the court found they were too speculative. The intervening FDA actions could well have prevented Microbix from ever reaching the market with its product and, therefore, any estimate of lost profits could only be guesswork. Therefore, while Microbix's case of liability appeared very strong, the court dismissed the case because Microbix could not demonstrate that it could prove compensable damages at trial.

American Airlines Successfully Defends Charge of Predatory Pricing

From 1995 through 1997, various low-priced airlines began operating in and out of Dallas-Fort Worth (DFW) Airport. In response, American Airlines, which operates one of its hubs from DFW, expanded its service and lowered its prices. Eventually the new entrants either went out of business or stopped operating from DFW. After that, American's fares rose again. To the Department of Justice this looked like a classic case of predatory pricing. To the U.S. District Court for the District of Kansas this was "bare, but not brass, knuckle competition," causing the court to dismiss the government's case on summary judgment. *United States v. AMR Corp., et al.*, 140 F. Supp. 2d 1141 (D. Kan. 2001).

Whatever the pattern of price decreases and price increases may suggest to the casual observer, the court held fast to the strict requirements for proving attempted monopolization by predatory pricing. In so doing, the court insisted that the government demonstrate that American was pricing below costs. In the opinion of the district court, the government did not meet this burden. Moreover, even were the government to have made such a showing, there was no proof that there existed a dangerous probability that American could recoup its losses from below-cost pricing by charging supra-competitive prices later. The court found that the existence of other competitors and the ease of entry suggested that the market structure was not susceptible to supra-competitive pricing.

The government attempted to demonstrate that American was able to recoup profits from markets other than those DFW routes at issue in the case by having developed a reputation for predation. This reputation allegedly allowed American to earn supra-competitive profits in other markets by keeping potential entrants from entering markets where American operated. The court found two problems with the argument. First, the theory rests on proof of predatory pricing in those other markets that the government had failed to prove. Second, the judge noted that a reputation theory had never formed the basis of a claim under Section 2 of the Sherman Act. The court believed that firms with reputations for being tough competitors may find new entrants avoiding their markets, but tough competition should be encouraged. Any "reputation" rule would inevitably confuse a reputation for vigorous fair competition with one for unfair competition and, perhaps, cause more harm than good. The government has recently announced its intention to appeal the decision.

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