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ANTITRUST UPDATE

As we begin a new year, this issue of *Antitrust Update* gives us an opportunity to reflect upon developments during the latter part of 2001. September 11 brought disruption to all of our lives. While we will be affected forever in important ways, there has been some semblance of a return to normalcy. With that return a number of significant developments in antitrust deserve attention.

Senior Bush Administration Antitrust officials have now been in place for six months and are beginning to make their mark. Both Timothy Muris at the Federal Trade Commission and Charles James at the Antitrust Division of the Department of Justice took office in June 2001. During the last six months they have demonstrated an intention to continue to enforce the antitrust laws, with changes only at the margin.

The most significant developments on the merger front have arguably been enforcement actions that emphasize the importance of following procedural rules. Our first article addresses allegations that Computer Associates International Inc. violated the Hart-Scott-Rodino Act and the Sherman Act through preacquisition coordination. Our second article discusses disgorgement and civil penalty actions against The Hearst Trust for failing to include documents with an HSR filing and for increasing prices post-acquisition. We also discuss FTC challenges to other small, non-reportable and consummated transactions, significant merger enforcement actions in the food industry, and a failed DOJ effort to block a computer industry merger.

Outside the merger area, the FTC and DOJ have announced a series of hearings on intellectual prop-

erty issues, which are previewed below. The states have made their presence known in the pharmaceutical industry by filing an antitrust action against Bristol-Myers Squibb for improperly listing a patent with the Food and Drug Administration, which arguably delayed generic entry. The Southern District of New York issued a long-awaited decision resolving DOJ's challenge to Visa and MasterCard's rules with important implications for joint ventures, innovation theories and network industries. DOJ resolved another long pending matter, challenging Federation of Physicians and Dentists practices in negotiating insurance reimbursement in Delaware, through a consent decree that reinforces limitations on the "messenger model" of contract negotiation. DOJ and Microsoft have also reached a consent agreement to resolve their high profile litigation, though it appears that at least nine states, which have been plaintiffs in the case since the beginning, intend to pursue the matter. We offer insights into each of these developments.

We also discuss important decisions in the realm of private antitrust litigation, including a First Circuit decision upholding the use of slotting fees and a Third Circuit decision to review certification of a class action.

We are also pleased to announce that Drinker Biddle now has offices in Los Angeles and San Francisco, California, through our combination with Preuss Shanagher Zvoleff & Zimmer and attorneys formerly with Haight, Brown & Bonesteel. These lawyers expand our already formidable national complex litigation and class action defense capabilities. We are excited to be working with our new colleagues and their clients and to be better able to serve our existing clients through this West Coast presence.

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Merger and Acquisition News

ACQUISITION AGREEMENT TERMS LEAD TO PRICE FIXING AND HSR CHALLENGE

Most companies are now well aware that they must file under the Hart-Scott-Rodino Act (the “HSR Act”) before consummating mergers and acquisitions that exceed statutory thresholds. But many are unaware that preacquisition coordination between firms proposing to merge may also violate the law. Even those who are aware that preacquisition coordination, sometimes called “gun jumping,” may be illegal, have generally paid little attention to covenants in acquisition agreements restricting conduct of the firm to be acquired.

A recent enforcement action by the U.S. Department of Justice, charging violations of the Hart-Scott-Rodino Act and price fixing for terms included in an acquisition agreement, should teach counselors that such terms deserve antitrust review.

The Justice Department sued Computer Associates International Inc. (“CA”) in federal court in D.C. this past fall over a 1999 merger agreement with Platinum Technology International, Inc. (“Platinum”). DOJ alleges violations of both the Hart-Scott-Rodino Act for gun jumping and the Sherman Act for price fixing based upon covenants in the merger agreement and conduct by CA and Platinum between the date of the agreement and closing.

The HSR Act prohibits businesses from acquiring voting securities or assets of other businesses that meet the statute’s jurisdictional thresholds until both file notification to the DOJ and Federal Trade Commission and observe a statutory waiting period. The government interprets the Act to prevent firms not only from consummating transactions, but also from taking action to give one “beneficial ownership” over another through the exercise of “unlawful control.”

The Sherman Act, meanwhile, prohibits price fixing and other agreements in restraint of trade. It has been found in the past to apply to parties proposing to merge, up until the merger is consummated.

CA and Platinum executed a merger agreement in March 1999, filed their respective HSR forms the same month, and consummated the merger in May 1999 after DOJ required divestiture of a handful of products. DOJ now alleges the CA-Platinum merger agreement “prevented Platinum from undertaking certain competitive activities during the HSR waiting period without CA’s approval, including determining the prices and terms it would offer to its customers.”

The Sherman Act price fixing count is based specifically on the allegation that CA and Platinum agreed that Platinum would not offer its customers discounts greater than 20% off list price unless CA agreed in writing to a larger discount. The central focus of DOJ’s complaint is “conduct of business” provisions that DOJ maintains are not normally found in merger agreements and severely restricted Platinum’s ability to engage in business as a competitive entity independent of CA’s control. In particular, DOJ objects to merger agreement provisions that prohibited discounts, limited customer contracts to an agreed-upon “standard” contract, prohibited certain long-term service contracts, and barred Platinum from offering certain specific services. DOJ alleges that Platinum modified its ordinary discounting and contracting practices and CA installed one of its vice presidents at Platinum’s headquarters to review and approve customer contracts. DOJ also alleges that CA made day-to-day management decisions for Platinum, including how the company recognized revenue, and “reviewed competitively sensitive information about Platinum’s customers and business strategy.”

The HSR gun jumping count, based on some of the same conduct, alleges that CA “exercised unlawful control” over Platinum by:

- Installing CA employees at Platinum headquarters to review and approve contracts;
- Restricting Platinum’s rights to set discounts without approval;
- Limiting Platinum’s rights to negotiate contract terms without approval;
- Limiting Platinum’s rights to enter into fixed price contracts;
- Limiting rights to offer certain services without approval;
- Collecting and disseminating competitively sensitive information; and
- Making day-to-day management decisions, including decisions relating to recognition of revenue and participation at industry trade shows.

CA issued a press release in response to the DOJ complaint, arguing its actions were consistent with the law and were essential in order to protect the assets of Platinum. It is, of course, possible that CA will prevail in litigation (if the case is not settled), but businesses and their counsel should at least be cautioned by the filing of the lawsuit that the government considers the challenged conduct to be unlawful.

In light of this enforcement action, businesses should be advised that antitrust counsel ought to review covenants in merger and acquisition agreements restricting conduct pending closing if those covenants go beyond normal general restrictions limiting the acquired firm to “business in the ordinary course.” The safest course of action may be to turn such covenants into conditions precedent to closing that give a buyer the right to “walk” rather than consummate the transaction, but which do not restrict the conduct of the business pending closing. In addition, merging businesses should be advised as to

appropriate “do’s and don’ts” with respect to pre-closing integration and coordination between the parties, particularly where there may be some competition between them. Finally, businesses should be reminded that the HSR Act and its rules apply even when there is no substantive antitrust concern raised by a transaction (where the HSR jurisdictional test is met).

FAILURE TO INCLUDE DOCUMENTS WITH HSR FILING AND POST-ACQUISITION PRICE INCREASES RESULT IN DISGORGEMENT AND CIVIL PENALTIES AS WELL AS DIVESTITURE

Failure to produce documents required under the Hart-Scott-Rodino Antitrust Improvements Act to the FTC and DOJ in connection with a required premerger notification and post-merger price increases can get a company in trouble. The Hearst Corporation recently settled government enforcement action by paying \$4 million in civil penalties and \$19 million in “disgorgement” and divesting the acquired business, to resolve charges relating to a January 1998 \$38 million acquisition.

In April of last year (as reported in our *May Antitrust Update*), the Federal Trade Commission filed suit against The Hearst Trust and subsidiaries in connection with Hearst Corporation’s 1998 acquisition of the Medi-Span integratable drug information database business. The FTC alleged that Hearst and Medi-Span were the principal competitors in the development and sale of electronic drug databases used by pharmacists and other health care professionals as well as hospitals and health plans to evaluate drug delivery options and pricing information.

The FTC alleged that Hearst failed to produce documents during the HSR Act merger review process and failed to list other documents withheld on the basis of privilege in its HSR filing. The FTC alleged that the documents that Hearst failed to provide included:

- A letter from the company’s CEO to its board of directors;
- A proposal to the board describing the industry, the company’s business, and the proposed acquisition;
- A letter with attachments from the attorney for the selling company to a company officer;
- Handwritten notes by a company officer for oral presentation to the board; and
- A proposal to acquire Medi-Span that describes Medi-Span, the markets, and competition between the companies, prepared three years earlier.

The FTC alleged further that the acquisition violated Section 7 of the Clayton Act, which prohibits mergers and acquisitions that may substantially lessen competition or tend to create a monopoly, and Section 5 of the FTC Act, which prohibits unfair methods of competition. According to the FTC, Hearst “drastically increased prices” to customers, in some instances more than doubling and tripling the fees previously paid. In its April complaint, the FTC sought disgorgement of “unlawful monopoly gains” as well as creation and divestiture of a business entity to restore competition.

In a separate lawsuit, the Justice Department sued Hearst at the request of the FTC in October for civil penalties under the HSR Act. That complaint alleged that Hearst failed to submit documents that went to Hearst’s board in 1997 and failed to list privileged documents, but did not mention the earlier document. Maximum civil penalties for that alleged violation, from January 15, 1998 when the transaction was consummated, until November 22, 2000, 30 days after Hearst filed a corrected HSR notification, during the course of the FTC investigation, could have been in excess of \$11 million. Hearst agreed to pay a \$4 million civil penalty, the largest amount ever by a single company for a violation of the HSR Act.

In mid-December, the FTC accepted Hearst's proposal to settle the FTC suit by divesting a re-created Medi-Span database to Facts and Comparisons, a business unit owned by the Dutch concern Wolters Kluwer N.V. Hearst customers will be permitted to terminate their contracts with Medi-Span and enter into arrangements with Facts and Comparisons or other providers of drug information services.

Hearst also agreed with the FTC to pay \$19 million to injured customers, which funds will be distributed as part of the settlement of a private class action suit alleging unlawful overcharges by Hearst.

While the FTC vote to accept this settlement was unanimous, the commissioners continue to disagree about the appropriateness of the disgorgement remedy. Commissioners Sheila Anthony and Mozelle Thompson wrote in support of disgorgement, maintaining that the defendants' behavior was "sufficiently egregious" and that "absent disgorgement, the divestiture of the Medi-Span assets alone might have allowed Hearst to profit from its unlawful behavior."

In contrast, Commissioners Thomas Leary and Orson Swindle, while acknowledging that disgorgement might be appropriate in some rare instances, expressed a strong preference for administrative, rather than judicial, remedies. They suggest that much more onerous civil penalties than the \$4 million imposed, together with treble damage awards in private suits, would have provided a more effective disincentive to the sanctioned behavior.

Notably, the FTC suit was originally brought by the Democrat-controlled Pitofsky Commission over dissents by Commissioners Leary and Swindle. Republican Chairman Timothy Muris supported the final remedy without comment. We suspect he did not want to appear to be a weak enforcer by dropping the disgorgement aspect of the case, whether or not he would have supported it originally.

How the Commission will act in future cases remains in doubt. In a separate December 20 announcement, the FTC requested public comments on the factors

the Commission should consider in applying the disgorgement remedy and how it should be calculated. The Commission made it clear it is not re-examining its statutory authority to seek disgorgement or other monetary equitable relief in competition cases, only the exercise of its prosecutorial discretion.

Business executives and advisers should note that Hearst and the acquired party *did* file notification and report forms under the HSR Act, and delivered some of the documents required by item 4(c) of the form. The defendants' fault lay in failing to deliver *all* 4(c) documents (or, in the case of documents to which an attorney/client privilege would attach, listing and identifying the privileged documents and the source of the privilege). Increasing prices to customers shortly after consummating the acquisition compounded Hearst's problem by upsetting customers and bringing the acquisition to the government's attention.

We remind our readers that a thorough and documented search by both parties must be conducted whenever the HSR form is being prepared, and that the advice of counsel may prevent costly mistakes and omissions.

FTC CHALLENGES OTHER SMALL AND CONSUMMATED TRANSACTIONS

In a flurry of activity this fall, the Federal Trade Commission filed lawsuits against three consummated acquisitions. One settled while the other two are being challenged in ongoing administrative litigation. Two of the three had been reported under the HSR Act while the third was too small to be reportable.

We suspect that these actions reflect in part the fall-off in new HSR filings, which has given the staff more time to follow up on complaints regarding consummated transactions. They also no doubt reflect a determination on the part of the Bush Administration antitrust officials to demonstrate their seriousness in enforcing the antitrust laws. FTC Chairman Timothy Muris announced at an ABA

Antitrust Section meeting in August that the agency would not hesitate to attack small, non-reportable and consummated mergers.

Corporations must be aware of the serious risks of consummating transactions that raise competitive issues, including protracted litigation expenses and possible divestiture of assets, even after integration has taken place. Divestiture after consummation, colorfully characterized as “unscrambling the eggs” can be difficult and expensive.

It is striking, however, that the complaints in these actions, while challenging acquisitions consummated as early as January 2000, do not allege post-closing price increases or other concrete adverse effects on competition.

MSC. On October 10, 2001, the FTC issued an administrative complaint against MSC Software Corporation (MSC) alleging its 1999 acquisitions of two small software firms were illegal. The FTC alleges that MSC was the “dominant” supplier of a type of advanced computer-aided engineering software used for complex simulation analysis in the aerospace and automotive industries. According to the FTC, MSC had a 90 percent share of a \$60 to \$70 million worldwide market before the acquisitions. Small competitors were acquired for \$8 and \$10 million in two transactions below Hart-Scott-Rodino reporting thresholds. Nonetheless, the FTC is seeking an order requiring that MSC provide two new entrants up-to-date versions of the MSC source code in order to restore competition.

Chicago Bridge. On October 25, 2001, the FTC issued an administrative complaint against Chicago Bridge & Iron Company N.V. (Chicago Bridge) for its \$84 million acquisition of a division of Pitt-Des Moines (PDM) that produced industrial and water storage tanks. That acquisition had been reported under the HSR Act, and the HSR waiting period expired before the acquisition was consummated in February 2001.

According to the FTC, before the challenged acquisition, Chicago Bridge and PDM competed against each other as the two leading U.S. producers of large, field-erected industrial and water storage tanks. The FTC’s complaint alleges that the acquisition reduced competition in four separate U.S. markets involving the design and construction of various types of field-erected specialty industrial storage tanks: for holding liquefied natural gas (LNG); liquefied petroleum gas; liquid oxygen, liquid nitrogen, and liquid argon; and thermal vacuum chambers that simulate the environment of outer space used for testing satellites and other aerospace and defense equipment.

In addition, the FTC alleges that the acquisition likely will have vertical anticompetitive effects in the related markets for LNG liquefaction units and import terminals. Despite some predictions that the Muris FTC would not bring cases based on vertical anticompetitive theories, the FTC alleges that the acquisition may eliminate one or more competitors of Chicago Bridge as suppliers of LNG peak shaving plants used to liquefy natural gas and store it for use during periods of peak demand. Thus, the FTC alleges that the acquisition may diminish pricing and innovation competition in the sale of LNG liquefaction units for use in LNG peak shaving plants by foreclosing one or more competitors to Chicago Bridge from selling LNG liquefaction units.

Airgas. The third case, challenging Airgas, Inc.’s (Airgas) \$90 million acquisition of the Puritan Bennett medical gas business from Mallinckrodt, Inc., was filed simultaneously with a proposed settlement.

Airgas agreed to divest two nitrous oxide plants to Air Liquide America Corporation, to resolve charges stemming from its January 2000 acquisition, which the FTC alleged resulted in a monopoly in the production of nitrous oxide. The settlement agreement also requires Airgas to supply Air Liquide with a sufficient amount of bulk liquid nitrous oxide in order to ensure that Air Liquide has the same volume of

nitrous oxide as Airgas did before its acquisition of Puritan Bennett.

Nitrous oxide is a clear, odorless gas mainly used in dental and surgical procedures as an analgesic agent or as a supplement to anesthesia. The FTC alleged that there are no alternatives for nitrous oxide in dental procedures and the few potential substitutes for use in surgical procedures are far more expensive or have other detriments. The complaint alleges that Airgas' acquisition of Puritan Bennett effectively eliminated any competition in the North American market for the production and sale of nitrous oxide. According to the FTC, at the time of its acquisition, Puritan Bennett was Airgas' only competitor in the production and sale of nitrous oxide.

FTC ADDRESSES FOOD AND BEVERAGE INDUSTRY MERGERS

The FTC addressed three food industry mergers in recent months that warrant attention from other companies in those industries, and may be the first signs of Bush Administration merger policy.

General Mills/Pillsbury. On October 23, 2001, as a result of a 2-2 vote split along party lines, with Chairman Timothy Muris recused, the FTC declined to take any action against General Mills, Inc. in connection with its \$6.1 billion acquisition of the Pillsbury baking business of Diageo Ltd. despite recognized substantive antitrust concerns. The deadlock among the commissioners meant that there was no Commission majority to authorize a challenge to the merger. But there was also no Commission majority to support a consent order. The result of the impasse was that the parties were able to proceed with their underlying merger transaction, with only their unilateral assurances that they would proceed with a divestiture to ameliorate antitrust concerns.

General Mills, whose brands include Betty Crocker, is the nation's leading cereal maker. Pillsbury, symbolized worldwide by the Pillsbury Doughboy, is the leading producer of refrigerated doughs in the United States. While most of the transaction was

competitively benign, the FTC staff, all four participating commissioners and the parties recognized problems with overlaps in products principally sold in the "baking aisle" of supermarkets including such items as baking mixes, ready-to-spread frosting, flour products, and pancake and potato mixes. In these markets, the transaction was arguably a 3-to-2 or a 2-to-1 merger.

The parties proposed that the overlapping products be sold to International Multifoods Corporation ("IMC"), which operates a food manufacturing business in Canada and foodservice distribution business in the United States. The adequacy of this remedy was the main issue on which the Commission was sharply divided. Under the proposed remedy, IMC would be licensed to use the "Pillsbury Doughboy" and Pillsbury barrelhead trademarks for baking products where the overlap existed, and the acquirer, General Mills, would own and control the trademark and use it on other food products. The two Democrat commissioners—who favored a challenge to the merger—opposed permitting this so-called "brand splitting" remedy because in their view it would diminish competition and cause confusion among consumers. By contrast, the two Republican commissioners observed that there is ample Commission precedent for "brand splitting" trademarks and opined that it did not create any competitive problems.

Furthermore, the two commissioners who favored attacking the merger voiced a concern that IMC, the proposed acquirer, did not have the same financial strength and the same "clout" with supermarkets that Pillsbury enjoyed. In their view, this made IMC a relatively poor candidate for divestiture where the goal is to replicate the competition that would otherwise be lost through a merger. The other two commissioners observed that what IMC lacked in clout would be balanced by a greater focus because the divested business would be likely to get more attention in the IMC organization than it got at Pillsbury, which was owned by the liquor manufacturer Diageo.

There were also concerns expressed that production would be transferred from one plant to another to be divested. The government generally prefers a “clean” divestiture of an ongoing business. However, IMC apparently expressed a preference for the newer plant, and two commissioners were willing to defer to IMC’s judgment.

It is somewhat surprising that the Commission could not agree on a single outcome, suggesting that potentially deep divisions are likely to recur in future close cases. The Republican commissioners issued a statement indicating they would have preferred to see the divestiture “commitments . . . memorialized in a formal Commission order.” They explained, “imposition of an order, however, would require an affirmative vote of at least three commissioners in this situation, and a third vote could not be obtained.” The statement expressed “regret” that the Democrat commissioners could not have found a way to express their concerns but still vote to include the commitments in an order that the agency can enforce.

The divisions in this case, even with Chairman Muris recused, suggest some retreat by the Bush Administration on the tough rhetoric heard during the Clinton years about remedies.

Nestlé/Ralston. In December 2001, the FTC accepted a settlement agreement with Nestlé Holdings, Inc. (Nestlé) and Ralston Purina Company (Ralston) resolving antitrust concerns raised by Nestlé’s \$10.3 billion acquisition of Ralston. Under the terms of the proposed order, Nestlé will divest two of Ralston’s dry cat food brands to a private equity investment firm that owns Hartz Mountain, a leading manufacturer and distributor of pet supplies in the United States.

According to the FTC, the acquisition would have given Nestlé a nearly 45 percent share of the U.S. dry cat food market across all levels of distribution and control of “Meow Mix,” the best-selling dry cat food brand in the country. The FTC distinguished wet and dry cat foods, emphasizing differences in production, ingredients, appearance, packaging, aroma,

price, and convenience. According to the FTC, Ralston has a 34% share and Nestlé an 11% share in a market the FTC characterized as “moderately concentrated.” The merger would substantially increase concentration, raising the Hirschman-Herfindahl Index or “HHI” to more than 2400, an increase of more than 750 points. The FTC alleged a unilateral theory of competitive harm, not a likelihood of coordinated interaction, in the market.

While the Commission came together to support the consent, separate statements make clear there is substantial division over the approach to remedy. Commissioner Anthony characterized the divestiture as including two cat food brands “and little else” rather than a “complete, ongoing business.” She argued that the buyer will have to “create a new competitor largely from whole cloth,” building its own research and development program, manufacturing facilities, distribution system, and sales and marketing operations.

Commissioner Mozelle Thompson expressed concern that the buyer might in the near term re-sell the assets in question to a buyer who will operate the business poorly or not at all, thus defeating the purpose of the Commission’s order. These concerns were met by an order provision requiring prior approval of any sale within five years. That provision drew a concurring statement from Commissioner Orson Swindle, expressing concern about such prior approval provisions. In the past the Commission has generally been satisfied that assets will be put to their “highest and best use” and has not put restrictions on resale of assets once divested.

Diageo/Seagram. Late in the year, the FTC also accepted a consent agreement with Diageo plc (Diageo) and Vivendi Universal S.A. (Vivendi) resolving competitive concerns raised by Diageo’s and Pernod Ricard S.A.’s (Pernod) joint \$8.15 billion purchase of Vivendi’s Seagram Spirits and Wine Business (Seagram). Earlier in the fall, the FTC announced it would seek a preliminary injunction enjoining the transaction.

The acquisition would have combined the second and third largest sellers of rum in the United States, giving the combined firm, together with Bacardi, 95 percent of all U.S. premium rum sales. The FTC explained, in announcing that it would file a lawsuit, that the rum market would effectively become a duopoly and would “create a dangerous likelihood of reduced competition and higher prices for consumers of rum.” The FTC contended that in the post-merger environment, the firms would be able to engage in coordinated interaction that would injure competition and, ultimately, cause injury to consumers.

The consent order also addressed concerns that competitively sensitive information not be transferred to Diageo. Under the terms of the originally proposed transaction, for up to one year, Diageo would continue to operate a “back office” administrative operation for Pernod in connection with the Seagram brands Pernod would be acquiring. This arrangement allegedly would provide Diageo with competitively sensitive information about the brands going to Pernod (that Diageo for competitive reasons could not acquire). Diageo and Pernod also agreed that Diageo would bottle some of the Seagram products to be acquired by Pernod that are sold in the United States under a “co-packing” agreement. This arrangement also could provide Diageo, a direct competitor, with competitively sensitive information about those brands.

The FTC order would prevent Diageo from obtaining or using competitively sensitive business information related to Seagram’s brands sold to Pernod. Independent consultants will segregate business information that should go to Diageo from the business information that should go to Pernod. In addition, Diageo will implement a series of “firewalls” to keep confidential information from the back office operations it will be conducting for the benefit of Pernod and confidential information obtained through its co-packing arrangement from reaching Diageo marketing personnel.

The need to restrict exchange of confidential information in joint ventures between competitors is reinforced by this enforcement action.

DOJ FAILS TO BLOCK COMPUTER INDUSTRY ACQUISITION

The first merger challenged in court and litigated to conclusion by the Bush Administration resulted in a loss for the Department of Justice. The DOJ’s loss is most notable for the speed with which the case was litigated, in addressing what the court characterized as a “highly sophisticated and technical industry.”

Drinker Biddle was actively involved in this litigation representing an affected third party, before the DOJ and in the litigation.

In a mid-November decision, the D.C. District Court denied DOJ’s request for a preliminary injunction to block SunGard Data System, Inc.’s (“SunGard”) proposed acquisition of Comdisco, Inc. (“Comdisco”). The Department’s complaint alleged that the transaction would combine two of three leading providers of external “hotsite” data recovery services. Such services are used by businesses to minimize the impact of a significant interruption to their information technology systems resulting from a disaster, such as an earthquake, flood, power or utility outage, or critical hardware or software failure.

This lawsuit was resolved quickly principally because Comdisco was in bankruptcy and had competing bids for its disaster recovery business. SunGard was the highest bidder at an auction held for Comdisco’s disaster recovery business in October, pursuant to order of the Illinois bankruptcy court. The DOJ filed its complaint on October 22, 2001, on the eve of bankruptcy court confirmation of the auction, in federal court in D.C. DOJ sued Comdisco as well as SunGard, potentially raising questions whether the action should have been filed in the bankruptcy court. The companies did not challenge jurisdiction but pressed for a quick resolution. The parties quickly exchanged paper discovery, conducted depositions, and filed written testimony and briefs. The court heard cross-examination of expert witnesses and oral arguments, and rendered its decision on November 14, just three weeks after the complaint was filed.

The decision turned largely on traditional market definition issues. Under the government's view of the market, the proposed acquisition would create a duopoly in which the merged firm would control about 70 percent of the market and IBM would control the remainder. The court did agree with the government that a number of alleged alternatives—cold-sites, work area recovery, mobile recovery services and high-availability services—were properly excluded from the relevant product market. The court reasoned that these alleged substitutes were complements and not substitutes, were unacceptable to most customers, or were significantly more expensive than shared hot-site services.

The court, however, refused to exclude so-called “quick-ship” services and internal hot-sites from the relevant product market, concluding that DOJ had failed to meet its burden of proof. In the face of conflicting evidence, the court found that the DOJ did not meet the burden of demonstrating that these alternative solutions to external hot-sites were not acceptable substitutes for a substantial number of customers, an evidentiary hurdle no doubt made more difficult to overcome given the compressed timeframe. The court reasoned that generalizations regarding customer behavior could not be arrived at with any certainty, and ultimately, concluded that the extreme heterogeneity of the market undercut the DOJ's market definition and prevented the government from meeting its burden.

Of most interest for future high-tech cases was the court's reaction to SunGard's argument that the government's market share statistics were “unreliable because they [did] not reflect the rapidly changing technologies in the disaster recovery industry.” The court, while not discounting market share statistics, emphasized the “rapid changes in computer capabilities and the reduced costs of both hardware and communications” in rejecting the government's market definition. The court noted the trend toward smaller distributed servers and the increasing availability of internal hot-site solutions for certain customers. Indeed, the court quoted language from the DC Circuit's *Microsoft* decision that “rapid techno-

logical change leads to markets in which firms compete through innovation for temporary market dominance, from which they may be displaced by the next wave of product advancements.”

DOJ AND FTC PROPOSE TO STREAMLINE MERGER REVIEWS

While promising continuity in substantive antitrust law, with changes only at the margin, both DOJ Assistant Attorney General Charles James and FTC Chairman Timothy Muris have proposed to reform the Hart-Scott-Rodino Second Request process to make it more efficient and reduce burdens imposed on both merging parties and agency staff.

Both James and Muris promise improved communication by the staff so that parties and the government may join issue on critical aspects of mergers as early as possible. We have found that a proactive approach is often the best way to avoid a Second Request in a close case—and a time-consuming, costly investigation of a proposed transaction—and also the best way to work through the process efficiently in cases where a Second Request cannot be avoided. Senior agency officials setting a tone encouraging greater dialogue is helpful.

The Second Request process has long been burdensome and time-consuming. Interestingly, recent problems are in large part attributable to changes in technology. A decade ago, 100 boxes of documents from a single company in response to a Second Request would not have been unusual. Today, document productions of 500 to 1,000 boxes are commonplace, and document productions are often larger. A major reason for the change is email and other electronic document formats. Most firms generate massive amounts of electronic documents that have to be collected, reviewed, and produced to the government in order to respond to a Second Request. To some extent, the burden of large volumes of electronic documents may be reduced by using improved methods of handling electronic document production and working closely with the agency staff who are gaining more experience with electronic documents.

At DOJ, James has instituted a formal process under which Antitrust Division staff will negotiate a plan and schedule for investigations. Under such plans, dates can be set for submitting documents, interrogatory responses, economic data and white papers as well as dates for depositions in exchange for which government investigators commit to timetables for making final enforcement decisions regarding the proposed transaction. Such a scheme has some potential for mischief, and may in fact increase, rather than reduce, the burden of the Second Request depending upon how such agreements are negotiated in practice. DOJ, for example, promises to endeavor to identify dispositive issues as soon as possible and to reach interim investigative conclusions, but refuses to be estopped from later raising issues not discussed early in the process.

While Second Request efficiency always depends to a large extent on the attitude of the particular antitrust investigators assigned to a particular transaction, a process dependent on interim milestones that can be offered on a unilateral basis may not offer a significantly better alternative than the existing Second Request process. The process-oriented nature of the DOJ Second Request reform recalls FTC experiments during the 1990s — and continuing today — with a “Quick Look” approach, in which the government agrees to specify certain documents and interrogatory responses to be produced up front in order to show that there is no antitrust problem with the merger in question. The arguably necessary shortcoming of this approach is that the FTC has always reserved the right to come back and ask for a complete response to the original Second Request.

The government is again promising procedural reform while reserving all of its rights. Parties generally ought to cooperate with agency staff during Second Request investigations, but must do so with their eyes open.

Intellectual Property and Antitrust

STATES SUE PHARMACEUTICAL COMPANY FOR IMPROPER PATENT LISTING

Antitrust challenges to pharmaceutical industry practices took a new turn in December when 29 state attorneys general sued Bristol-Myers Squibb Co. The states allege that Bristol-Myers violated state and federal antitrust laws by listing a new patent—purporting to cover its BuSpar anti-anxiety drug—with the Food and Drug Administration on the eve of generics entering the market after the original Bristol-Myers patent issued in 1980 expired.

Under the Hatch-Waxman Amendments to the Food, Drug and Cosmetic Act, listing in the so-called “Orange Book” of a patent that claims a drug or a method of using a drug requires prospective generics to certify that the patent is invalid or not infringed. If the pioneer company sues for infringement, the Act imposes an automatic 30-month stay on generic entry. Since the FDA has a long-standing policy of accepting at face value the accuracy of patent information received from patent holders, and filings can extend exclusivity, the incentives are great to make sham filings. This case reminds companies that such filings may lead to treble damages under the antitrust laws.

The states’ complaint, filed in the Southern District of New York, alleges that Bristol-Myers knowingly made false representations to the FDA in listing a BuSpar patent which were contrary to statements made to the Patent Office in Bristol-Myers’ efforts to obtain the patent. According to the suit, the patent at issue covered systemic administration of a metabolite of BuSpar, created when the drug interacts with other chemicals in the body, yet Bristol-Myers represented to the FDA that it covered a method of using the drug itself.

Bristol-Myers had over \$700 million in sales of BuSpar in 2000, according to the states. Mylan Laboratories, Inc. succeeded in suing Bristol-Myers to force delisting of its patent in March 2001, though

that decision was subsequently reversed on appeal on the ground that the declaratory judgment action was a private attempt to enforce the Food, Drug and Cosmetic Act. Sales of BuSpar reportedly slumped more than 80% in the third quarter of 2001 as the cheaper copycats cut into Bristol-Myers' market share.

This case is significant in several respects. First, it represents a new chapter in antitrust challenges to pharmaceutical industry efforts to maximize the value of drugs and raises a new patent antitrust issue. Additional investigations of Orange Book listing issues can be expected. Second, it is notable that the state attorneys general moved out in front of the FTC in bringing this suit. The states have typically followed earlier FTC enforcement actions in the pharmaceutical industry with their own suits for damages. But here, the states acted first, signaling that they have gained expertise in the industry and that FTC resources are tied up on ongoing administrative litigation. Bristol-Myers' strongest defense is likely to be that its petitioning the FDA was protected under the *Noerr-Pennington* doctrine. The states will argue the petition was a sham, given the alleged misrepresentation, even if aimed at obtaining government action. Finally, the suit could affect not only Bristol-Myers but the industry as a whole, in swaying public opinion and influencing legislation, as well as helping to draw the lines of how far intellectual property protection can go.

FTC AND DOJ TO CONDUCT INTELLECTUAL PROPERTY HEARINGS

The Federal Trade Commission and Department of Justice are set to conduct a series of potentially significant public hearings on "Competition and Intellectual Property Law in the Knowledge-Based Economy" beginning in January 2002 and continuing through the spring. The hearings are formally aimed at developing a better understanding of how to manage issues that arise at the intersection of antitrust and intellectual property law and policy.

These upcoming hearings call to mind hearings conducted by the FTC early in the Clinton

Administration on "Competition in the New Global High-Tech Economy." Those hearings led to revisions to the government's Horizontal Merger Guidelines to take efficiencies into account, led to joint venture guidelines (the "Competitor Collaboration Guidelines"), and influenced case selection throughout the Clinton Administration. Thus, all those with an interest in intellectual property issues ought to pay close attention to further developments.

The 2002 hearings reflect the growing importance of intellectual property to the economy and uncertainty surrounding issues at the intersection of antitrust and intellectual property law.

Among the issues that the 2002 hearings are expected to address are:

- Patent licensing, cross-licensing and pooling;
- The creation of patent thickets that made it difficult for rival inventors to sell competing products without cross-licenses;
- Refusals to license and restrictive provisions in licenses;
- Standard setting;
- Extensions of patents beyond their legal lives;
- The scope of patents;
- The impact of broad patents on follow-on inventions;
- The impact of procedural patent rules on competition; and
- The role of the Federal Circuit in developing antitrust law, given its exclusive jurisdiction over cases based "in whole or in part" on federal patent law and its decision to develop its own antitrust law rather than apply regional circuit law.

In announcing the hearings, FTC Chairman Timothy Muris surprisingly attacked the U.S. Patent and Trademark Office (USPTO) policy of sometimes

rubber-stamping patent applications. Muris said, “if the patent review process is too permissive—e.g., patents are granted too easily for trivial or non-existent improvements that do not meet statutory requirements for patentability—competition through entry and expansion by others may be impeded.”

Muris went further and stated that, in the 1970s, antitrust law and policy lacked a “sufficient appreciation of the incentives for innovation that intellectual property and intellectual property licensing can provide.” Now, he said, some observers say that “perhaps it is intellectual property doctrine that is not showing a proper appreciation for the innovation that competition may spur.” He also questioned the scope of some patents, noting, “some allege that . . . important patents . . . are overbroad, and that overbroad patents can inhibit follow-on innovation.”

These are the first hearings to be conducted in recent years by the DOJ together with the FTC. We suspect DOJ officials decided to take part in the hearings because they expect important developments to flow from the hearings and do not want to be left out or let the FTC set the agenda.

DB&R partner Howard Morse, who chairs the American Bar Association Antitrust Section Intellectual Property Committee, will be spearheading Antitrust Section participation in these hearings. He will also be moderating a program at the Antitrust Section Spring Meeting in April in Washington, D.C. with FTC and DOJ officials who will be coordinating the hearings.

Other Government Developments

UNITED STATES V. VISA OFFERS LESSONS FOR JOINT VENTURES, INNOVATION THEORIES AND NETWORK INDUSTRIES

Three years after the Justice Department filed its complaint against Visa and MasterCard the government’s suit is resolved—for now.

The Southern District of New York concluded, in a 157 page opinion, that the two associations, which

account for more than 70% of all general purpose credit and charge cards, cannot prohibit banks from issuing competing cards from American Express and Discover. That is, the government prevailed in its challenge to Visa’s and MasterCard’s “exclusivity” rules that have prevented banks from issuing cards on other networks.

The court concluded, however, that the DOJ trial team failed to prove that the two card networks’ “duality in governance” caused anticompetitive effects. The court refused to enjoin Visa and MasterCard’s practice of permitting members not only issuing cards on each other’s network, but also allowing banks to have formal decision-making authority in one system, including board representation, while issuing a significant percentage of its cards on a rival system. DOJ had argued that dual issuance was procompetitive but that dual governance had inhibited innovation and limited competition.

The final word may not be heard until appeals have been exhausted. Still, there is much to learn from the district court decision. The decision in *United States v. Visa USA Inc.* is noteworthy for its analysis of issues relating to joint ventures, innovation theories and network markets.

Critically, the *Visa* court distinguished between the market for credit and charge card issuance and the market for network services that support the use of such cards. The card market, with cards issued by hundreds of banks, is unquestionably competitive. In the network services market, however, the only competitors are Visa, MasterCard, American Express and Discover. It is at the network level that the Visa and MasterCard associations design card products, promote their brands, implement technologies to authorize and settle transactions, and set interchange fees. The decision reflects a new sophistication in dealing with network issues that is likely to have important implications for analyzing future ventures in high-tech industries.

Interestingly, the court departed from precedent in this area. Previously, courts had found that credit cards were part of the same market as other payment

forms such as checks, cash, ATM cards and debit cards. Here, the court relied on economic testimony, customer surveys, and evidence that neither cardholders nor merchants have changed to other payment mechanisms when faced with higher interchange fees, the fees paid to the issuing bank for handling transactions. Thus, credit cards were found to comprise their own market and Visa and MasterCard were found to possess market power.

With respect to exclusivity, the court found that the defendants' policies limited American Express and Discover's ability to compete by reducing their access to bank relationships and access to demand deposit accounts. In the court's view, there were no comparable distribution channels available to competitors, although they could still solicit customers through direct mail, retailers, corporate employee programs and other channels. The court concluded, as did the D.C. Circuit in *Microsoft*, that exclusivity is problematic when competitors are excluded from the most efficient distribution channels even if not foreclosed from the market. That principle, established in two important cases, is a noteworthy development.

Before ruling for the government, the trial judge rejected arguments that the rules alleviated free-riding concerns and were necessary to maintain the viability of the networks themselves. The court rejected these arguments based on evidence that the defendants' real justification was to stop competition, the fact that there was no effort to prevent free-riding between the Visa and MasterCard brands, and the fact that the networks remain viable in foreign countries where banks issue American Express cards.

In challenging dual governance, DOJ attempted to prove that the practice was designed to reduce rivalry between the two networks and reduced competition by: (1) dampening new product development, particularly smart cards; and (2) limiting comparative advertising and other promotional activities. Significantly, despite some evidence that dual governance dampened new product development in a number of areas, the court concluded that in each case there were alternative, legitimate business reasons for

not introducing or for delaying the introduction of the innovative product or service. The court thus concluded that despite DOJ positing a theory as to how dual governance might create disincentives for the associations to compete, DOJ failed to demonstrate that duality had anticompetitive effects and thus found no conscious commitment to an unlawful conspiracy. The court's analysis suggests a heavy burden for proving a harm to innovation.

The court also noted that, as a practical matter, emerging trends in the industry were bringing the alleged effects of dual governance to an end. The court pointed to the emergence of "dedication agreements," which provide incentives to banks to issue cards on a single network. The court's suggestion that the government's focus on dual governance "has been rendered largely irrelevant" by these agreements leading to board compositions that are virtually dedicated, creates some ambiguity as to whether the court's decision might have been based in part on pragmatic considerations as well as legal analysis. Indeed, the court seemed to be concerned that implementing the government's proposed remedy requiring 100% future card issuance by board members would inhibit the largest banks from issuing American Express or Discover cards.

Drinker Biddle was also involved in this matter representing a third party witness through the investigation and litigation.

PHYSICIANS AGREE TO STOP JOINT NEGOTIATIONS TO RESOLVE DOJ LAWSUIT

The Department of Justice has reached a settlement with the Federation of Physicians and Dentists (the "Federation") which will stop the national organization from engaging in joint contract negotiations and boycotts to force health plans to pay increased physician fees. The consent agreement, announced this fall on the eve of trial, resolves a three-year-old lawsuit pending in federal court in Delaware. The settlement is significant in validating use of the "messenger model" as a means of collectively dealing with managed care contracting while avoiding antitrust scrutiny.

DOJ asserted in its suit filed in August 1998 that the Federation and its orthopedic surgeon members in Delaware orchestrated an unlawful group boycott of Delaware Blue Cross & Blue Shield (“Blue Cross”), with the aim of increasing fees paid to the surgeons. The Department alleged that the Federation recruited nearly all of the private practice orthopedic surgeons in Delaware as members, who then agreed to designate the Federation’s executive director as their agent to negotiate fees that they would accept. Key evidence, highlighted in the DOJ’s complaint, included a letter sent by the Federation to the physicians encouraging them to act jointly because “the Federation will only be effective if every orthopedic group is in.” The Federation ultimately persuaded the orthopedists to deal with Blue Cross only through the Federation and to terminate their contracts with Blue Cross to force Blue Cross to accede to their fee demands.

The settlement agreement prohibits the Federation from (1) participating in, encouraging or facilitating any agreement or understanding among competing physicians about payer contracts or terms, (2) negotiating, collectively or individually, on behalf of competing physicians any contract or contract term, (3) making recommendations to competing physicians about payer contract or contract terms, (4) communicating competitively sensitive information to competing physicians, (5) discouraging physicians from making an independent business judgment whether to deal directly with payers, or (6) encouraging or facilitating any agreement between competing physicians to deal with any payer exclusively through a third-party messenger.

The settlement does not prohibit legitimate negotiating activities of the Federation, such as operating as a certified collective bargaining agent for doctors who work as employees of public hospitals and other entities. It also allows the Federation to serve as a “third-party messenger” in negotiations between independent physicians and health insurance plans, provided that the Federation abides by restrictions on such activities.

Spelling out what is permitted under a messenger model, the settlement allows the Federation, at a physician’s request, to “communicate to the requesting physician accurate, factual, and objective information about a proposed payer contract offer or contract term, including, if requested, objective comparisons with terms offered to that physician by other payers.” Under the messenger model, a third party negotiator collects terms from individual physicians, who do not know the terms others have offered. The messenger conveys the information to purchasers who can make offers to members through the messenger. Each member must make a unilateral decision to accept the contract conveyed by the messenger. The government has warned that arrangements step over the line when a messenger coordinates providers’ responses, disseminate to providers the views or intentions of other providers, or expresses an opinion on the terms offered. The Federation claimed to be acting as a messenger all along, while DOJ argued that the Federation went well beyond acting as a messenger that merely provided objective information, and instead facilitated illegal collusion by doctors to maintain inflated fees.

The messenger model, when implemented with adequate safeguards, may be used to facilitate information exchange between health care plans and physicians. The messenger model likely will, however, come under antitrust scrutiny when it is used to strengthen the bargaining power of physician participants.

This settlement is a clear sign that the Bush Administration has no intention of backing down from previous antitrust opposition to joint negotiations by independent physicians over fees (which has been the subject of legislative proposals). In announcing the settlement, Assistant Attorney General Charles James made clear, “The Antitrust Division is committed to stopping illegal boycotts that harm the public and ultimately increase the prices that consumers pay for health care.”

AN END TO THE MICROSOFT CASE?

In November 2001, the Department of Justice and Microsoft Corp. announced a settlement of what has been one of the most closely-watched antitrust cases ever. The settlement of the *Microsoft* case filed in 1998, which came after a remand from the D.C. Circuit and a period of intense court-ordered negotiations, was joined by nine of the 18 states pursuing similar antitrust claims against the software company.

The core conduct remedies in the consent—disclosure obligations, software design restrictions, contract limitations, non-discrimination requirements, and retaliation limits—are all intended to strengthen competition in so-called “middleware”, such as internet browsers that may be a threat to market power in operating systems. Critics of the proposed settlement have complained that it does not address tying arrangements and does not restore competition that purportedly would have existed in the absence of Microsoft’s earlier conduct.

The new presiding judge in the *Microsoft* case, Judge Colleen Kollar-Kotelly, must now decide whether to approve of the settlement as in the “public interest,” as required by the Tunney Act. For those states not joining in the settlement, further proceedings on remand are scheduled for March 2002.

Private Litigation Decisions

FIRST CIRCUIT SAYS SLOTTING FEES ARE O.K.

Tired of hearing how retailers’ extractions from their suppliers of upfront payments or “slotting fees” are destroying the entire American way of life? If so, you may applaud the First Circuit’s recent decision affirming the dismissal of a challenge to this practice in the wholesale magazine distribution industry even though it caused the plaintiff distributor’s demise as retail chains moved all of their business to a larger rival. The Court of Appeals, in *Augusta News Co. v. Hudson Newsco*, held the payments were “simply

price reductions offered to the buyers for the exclusive right to supply a set of stores under multi-year contracts”; and the “antitrust laws are not automatically hostile to price reductions or to exclusive dealing.”

Plaintiff’s invocation of Section 2(c) of the Robinson-Patman Act, which flatly prohibits brokerage payments “except for services rendered,” was rejected on the ground that this provision should be narrowly applied to “sham” brokerage arrangements disguising unlawful discriminations; it is “not a mechanical prohibition on all price reductions cast in the form of one-time payments.” Plaintiff’s invocation of Section 1 of the Sherman Act was rejected on the ground that the payments were nothing more than “discounts on vertical prices of the kind that are ‘fixed’—and quite lawfully so—every time a buyer buys something from a seller.” A seller like this plaintiff “who will not compete [by matching the payments] will lose business. But this is not an agreement to restrain trade; it is just competition at work.”

The pervasive use of slotting fees in the grocery industry was the subject of Congressional hearings two years ago. The FTC followed up with a two-day workshop in mid-2000, the FTC staff issued a lengthy report on the record from it in February 2001, and the staff is now using a special Congressional appropriation to pursue an industry-wide slotting fee investigation. Meanwhile, last August, a group of family-owned tortilla manufacturers filed a broad-ranging Sherman Act suit against Mission Foods, the leading tortilla manufacturer, attacking multifarious uses of slotting fees to maintain dominance over the tortilla market generally.

So the First Circuit’s *Augusta News* decision is by no means a “final” chapter of the slotting fee book. It does, however, caution against easy or simplistic approaches to the application of the antitrust laws to a spreading phenomenon in a growing number of consumer markets.

THIRD CIRCUIT TO REVIEW CLASS CERTIFICATION DECISION

On December 18, 2001, the United States Court of Appeals for the Third Circuit decided to review a class certification decision in an antitrust class action involving the corrugated paper industry, *In re Linerboard Antitrust Litigation*. The appeal, taken by the defendants pursuant to Rule 23(f) of the Federal Rules of Civil Procedure, presents the Court of Appeals with a rare opportunity to address class issues in an antitrust context.

The complaints in the *Linerboard* case were filed in 1998 and 1999 as proposed class actions against Stone Container and a number of other linerboard manufacturers. Drinker Biddle represents one of the defendants, Georgia-Pacific Corp. The named plaintiffs in those complaints, which purport to represent purchasers of sheets and boxes made from linerboard, claim that the defendants in 1993 conspired to coordinate production downtime for the purpose of raising the price of linerboard and, thereby, the downstream prices of sheets and boxes. The district court certified two classes of plaintiffs, consisting of purchasers of corrugated sheets and purchasers of corrugated boxes. Significantly, in an effort to address the defendants' objection that plaintiffs failed to demonstrate common impact from the alleged conspiracy, the district court made a limited exception to the two classes, excluding those purchasers who bought boxes or sheets pursuant to contracts not "tied" to the price of linerboard.

In their Rule 23(f) petition for interlocutory review, the defendants raised a number of grounds for reversing the district court's class certification decision. First, despite the limited exception to the classes carved out by the lower court, the defendants argued

to the Third Circuit that the plaintiffs failed to identify common proof of impact. In particular, given the relatively small amount of production downtime allegedly taken in 1993 (1% of total production) and the relatively long class period (October 1993 to November 1995), the defendants pointed out that any impact on sheets and box prices would not be susceptible to class-wide proof, as required by Rule 23. Second, the defendants argued that the individual notice issues raised by the plaintiffs' claims of fraudulent concealment far outweighed any issues common to the two classes. Finally, since testimony elicited from the named plaintiffs raised unique statute of limitations issues, the defendants argued that they were not adequate class representatives.

Rule 23(f) was promulgated in 1998 to give the Court of Appeals more discretion to review class action decisions on an interlocutory basis. The Advisory Committee notes accompanying the 1998 amendments to Rule 23 recognize that, absent an interlocutory appeal, an order granting or denying certification may never be reviewed, because the case is subsequently either abandoned by the plaintiffs or settled by the defendants. In exercising its discretion under Rule 23(f) to allow an interlocutory appeal in *Linerboard*, the Third Circuit has signaled that the issues raised by the defendants in their petition are, at least, considered to be appeal-worthy certification issues. A decision in the appeal, which is not expected for several months, is likely to be an important precedent for antitrust class actions.

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Please contact one of our authors or any other of our antitrust lawyers listed below if you would like more information on these topics, or if you would like us to send you a copy of any of the materials discussed above.

ANTITRUST LAW GROUP

Authors: M. Howard Morse, Paul H. Saint-Antoine, Robert A. Skitol, Robert N. Cook, Robin Sampson, Jeff A. Almeida, Isabel C. Duffy, David A.J. Goldfine and Tanya A. Petroff.

Jeff A. Almeida.....	almeidja@dbr.com	215-988-2846
David J. Antczak	antczadj@dbr.com	215-988-2558
Gary R. Battistoni	battisgr@dbr.com	215-988-2657
Kathleen Benway	benwayk@dbr.com	202-842-8875
Wilson M. Brown, III	brownwm@dbr.com	215-988-2718
David P. Bruton	brutondp@dbr.com	215-988-2711
Neil S. Cartusciello.....	ncartusciello@dbr.com	973-549-7190
John Chesney	chesneyj@dbr.com	215-988-2842
Gail Conlon.....	conlong@dbr.com	202-842-8852
Robert N. Cook.....	cookrn@dbr.com	202-842-8885
Charles D. Donohue, Jr.	cdonohue@dbr.com	973-549-7832
Isabel Duffy	duffyic@dbr.com.....	215-988-2674
James Eiseman, Jr.	eisemanj@dbr.com	215-988-2930
Michael O'S. Floyd	floydmo@dbr.com	215-988-2941
William M. Garrett	garretwm@dbr.com	215-988-2725
David Goldfine	goldfida@dbr.com	202-842-1330
Mary E. Kohart	kohartme@dbr.com	215-988-2827
Marc A. Marshall.....	marsham@dbr.com	215-988-2966
Philip J. Mause	mausepj@dbr.com	202-842-8819
M. Howard Morse	morsemh@dbr.com	202-842-8883
Julianne Peck	peckj@dbr.com	215-988-1996
Tanya Petroff.....	petrofta@dbr.com	215-988-2697
Edward M. Posner	posnerem@dbr.com	215-988-2716
Patricia Proctor	proctorp@dbr.com.....	215-988-2808
Rebecca S. Rimmer	rimmerrs@dbr.com	215-988-2506
Paul H. Saint-Antoine	saintaph@dbr.com	215-988-2990
Robin Sampson	sampsonr@dbr.com	215-988-2561
Robert A. Skitol	skitolra@dbr.com	202-842-8824

Drinker Biddle & Reath LLP, a Pennsylvania Limited Liability Partnership, is a full service law firm headquartered since 1849 in Philadelphia, PA. Drinker Biddle & Reath LLP practices as Drinker Biddle & Shanley LLP in New Jersey. With more than 425 attorneys, the firm represents a broad spectrum of public and private, commercial, financial and educational enterprises, governmental authorities, charities and individuals throughout the United States and abroad.

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PHILADELPHIA

Drinker Biddle & Reath LLP
One Logan Square
18th and Cherry Streets
Philadelphia, PA 19103-6996
215-988-2700
215-988-2757 (fax)

BERWYN

Drinker Biddle & Reath LLP
Suite 300
1000 Westlakes Drive
Berwyn, PA 19312-2409
610-993-2200
610-993-8585 (fax)

PRINCETON

Drinker Biddle & Shanley LLP
Suite 300
105 College Road East
Princeton, NJ 08542-0627
609-716-6500
609-799-7000 (fax)
Jonathan I. Epstein, Partner in charge

WASHINGTON, DC

Drinker Biddle & Reath LLP
Suite 1100
1500 K Street, N.W.
Washington, DC 20005-1209
202-842-8800
202-842-8465/66 (fax)

LOS ANGELES

Drinker Biddle & Reath LLP
Wells Fargo Building
333 South Grand Avenue
North Tower, 17th Floor
Los Angeles, CA 90071-1504
213-253-2300
213-253-2301 (fax)

SAN FRANCISCO

Drinker Biddle & Reath LLP
225 Bush Street, 15th Floor
San Francisco, CA 94104-4207
Phone: 415-397-1730
415-397-1731 (fax)

FLORHAM PARK

Drinker Biddle & Shanley LLP
500 Campus Drive
Florham Park, NJ 07932-1047
973-360-1100
973-360-9831 (fax)
Daniel F. O'Connell, Partner in charge

NEW YORK

Drinker Biddle & Reath LLP
*Please contact our
Florham Park, NJ office.*

www.dbr.com

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