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ANTITRUST UPDATE

Readers of this second issue of the *Antitrust Update* in 2002 will find, for the first time in many issues, no significant coverage of the government's high profile case against Microsoft Corp. The settlement with the federal government was reported in the last issue and, while the case is still proceeding against the software company on behalf of several non-settling states, we have made a conscious decision to turn our attention to other important antitrust developments during the first half of this year.

We have covered in this issue of the *Update* several significant decisions from the federal appellate courts, involving issues such as "bundled" rebates, standard-setting and information exchanges, as well as news from the federal enforcement agencies. Included among these articles is a report on the hearings in Washington, D.C. addressing intellectual property rights and antitrust enforcement and the rather unusual story of a powerful U.S. Senator who single-handedly quashed an agreement between the FTC and the DOJ for reform of the merger review process.

With this issue, we are also pleased to announce the publication of a new American Bar Association handbook on the *Federal Antitrust Guidelines for the*

Licensing of Intellectual Property. This second edition of the handbook, which was written in part and edited by Drinker attorneys, covers the many antitrust developments involving intellectual property since the *Guidelines* were issued seven years ago.

Third Circuit Grants En Banc Review of its Decision to Reverse Jury Award in LePage's Case Against 3M

Earlier this year, the Third Circuit vacated its initial opinion in LePage's monopolization case against 3M and granted rehearing en banc. See *LePage's Inc. v. 3M*, 2002 U.S.App. LEXIS 3254. LePage's basic claim was that 3M was unlawfully monopolizing or attempting to monopolize the transparent tape market by its policy of granting higher rebates to customers purchasing a number of different product lines. The jury awarded LePage's damages of \$22,828,899 on its monopolization claims, which the district court later trebled to \$68,486,697. The initial opinion by the Third Circuit, overturning the jury verdict, was challenged by LePage's as inconsistent with the appellate court's earlier decision in *SmithKline Corp. v. Eli Lilly & Co.*, 575

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E2d 1056 (3d Cir. 1978). Whatever the outcome of the rehearing en banc, the Third Circuit's ultimate decision is expected to be an important precedent on the issue of "bundled" rebates.

Although 3M offered a variety of different rebate programs to its customers, they all centered around the company's famous Scotch® brand of transparent tape. LePage's alleged in its complaint that office supply stores, given the popularity of the 3M brand among customers, were compelled to stock at least some of the Scotch® tape on their shelves. To entice these retailers to purchase more of the popular tape and more of 3M's other products, such as Post-It® Notes, the company offered various "bundled" rebates, in which the size of the rebate was linked to the number of product lines in which the retailer met certain specified targets. LePage's claimed that the rebates were intended by 3M to monopolize the transparent tape market by eliminating competition to Scotch® tape from the private label tape offered by LePage's. 3M's rebate program eliminated competition, according to LePage's, because customers attempting to meet the purchasing targets set by 3M were forced to drop LePage's as a supplier and purchase all (or at least most) of their transparent tape from 3M.

In support of its monopolization claims, LePage's identified a number of large customers, such as Wal-Mart and Staples, which appeared to have either reduced or eliminated their purchases from competing tape suppliers after 3M instituted its rebate program. 3M responded that such changes in customers' purchasing patterns were simply a reflection of price competition in the marketplace. Moreover, 3M argued that, under the Supreme Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), LePage's failed to prove that 3M's prices were predatory or below cost. LePage's disavowed any reliance on a predatory pricing theory.

Instead, LePage's relied primarily on the Third Circuit's 1978 decision in *SmithKline*. Specifically, LePage's argued that a company can be found liable for unlawful monopolization if it links the sale of a product on which it does not face competition with a product on which it does face competition. In *SmithKline*, the

defendant, Eli Lilly, had two products, Keflin and Keflex, which faced no competition, and Kefzol, which faced competition from SmithKline's Ancef. By offering a substantial rebate if all three products were purchased together, Eli Lilly was found to have eliminated the competition between its Kefzol and Ancef. Likewise, LePage's contended that 3M eliminated competition from private label brand tape by linking sales of all of its products to the sale of its popular Scotch® tape brand.

In its initial Opinion, the Third Circuit found LePage's case distinguishable from the one brought by SmithKline. The appellate court held that LePage's had failed to demonstrate, as SmithKline had done, that it could not lower the price on its private label brand and remain competitive with 3M's products. LePage's expert testified that the company would have gone out of business if it had attempted to compete with 3M on price. Yet, two of the judges on the Third Circuit panel rejected this testimony as not sufficiently supported by basic pricing information. The third and dissenting judge concluded that LePage's had offered enough evidence on anti-competitive effects to get the issue to the jury.

The parties have completed their briefing in connection with the rehearing en banc, and a decision from the Third Circuit is expected soon. Among other things, the new opinion is likely to clarify the relationship between the Third Circuit's earlier decision in *SmithKline* and the Supreme Court's more recent predatory pricing decision in *Brooke Group*. More generally, the opinion is expected to offer useful guidance on what companies can and cannot do in offering "bundled" rebates to their customers.

Fourth Circuit Finds Lower Court's "Quick Look" Analysis in Carry-On Baggage Case To Be Too Quick

A unanimous Fourth Circuit panel reversed a district court's grant of summary judgment to a plaintiff, Continental Airlines, which had challenged the use of templates on Dulles International Airport x-ray machines. These templates were championed by

defendant United Airlines to limit the size of baggage that passengers could carry through security checkpoints at the airport. Many companies involved in collaborations among competitors to establish open standards must have breathed a sigh of relief, because the logic of the district court decision could arguably have called much private-sector standard-setting activity into question.

The Fourth Circuit found the district court's "quick look" analysis to be, in essence, too quick and inconsistent with the Supreme Court's decision in *California Dental Association v. FTC*. The Fourth Circuit's decision reflects the difficulties faced by plaintiffs seeking to prevail on summary judgment, without a full trial on the merits, and the decision should be read as discouraging attempts to use "quick look" analysis to avoid potentially thorny factual issues in the summary judgment context.

The district court had rejected out of hand the procompetitive justifications proffered by United—safety, timely departures, and onboard passenger comfort—finding them implausible because of a perceived lack of support in the record. The district court thus granted summary judgment to Continental, ruling that the template program constituted a horizontal restraint on output. Noting that *per se* condemnation was inappropriate because airlines must cooperate in order to share airport facilities, the district court instead employed an abbreviated or "quick look" rule-of-reason analysis and concluded that, given the "manifest" anticompetitive impact of the baggage templates, no further proof of anticompetitive effects was needed.

According to the Fourth Circuit panel reviewing the summary judgment decision, this issue of competitive effects was not so clear. The appellate court identified a factual issue as to whether the effect of using the baggage templates was anticompetitive, as Continental contended, or procompetitive, as United contended. "The district court may ultimately have to choose between two procompetitive claims," the appellate court wrote, "either outcome would both help and hurt competition, and which helps competition more than the other may be far from plain." The Fourth

Circuit also took special note of the fact that the parties had not cited, and that the appellate court had not found, a single case (other than the very district court decision on appeal) entering summary judgment for a plaintiff on the basis of a "quick look" analysis.

In the Fourth Circuit's view, the district court's "quick look" methodology was flawed in two respects. First, the Fourth Circuit concluded that the district court was too hasty in assuming that the template program had anticompetitive effects. Second, the Fourth Circuit faulted the district for requiring United to come forward with hard evidence in support of its asserted procompetitive justifications of improved on-board safety, more timely departures, and a better on-board experience for passengers.

In the Fourth Circuit's view, the "quick look" is appropriate when it can be applied to a set of facts in which judicial experience is sufficient to permit condemnation after a truncated application of the analytical tools of the rule of reason. Once Continental and United had each offered plausible, yet mutually contradictory explanations of the competitive impact of the use of the xray machine baggage templates, a "quick look" approach was deemed inappropriate.

Legality of Concerted Action on License Terms for Patents Included in Standards Emerges as Key Issue at FTC/DOJ Hearings on IP/Antitrust

One of the most contentious but potentially most significant parts of the ongoing FTC/DOJ hearings on the intersection between IP and competition policies was the April 18, 2002 all-day session on "Intellectual Property Strategies in Standards Activities." No less than 20 prominent experts from industry, academia and standard-setting organizations exchanged perspectives on a central problem confronting groups engaged in developing interoperability standards throughout the high-technology sector: incorporation into these standards of patented technologies that enable the patent holders to extract royalties and other onerous

license terms from rivals who must comply with the standards to maintain their competitive viability.

All speakers shared disapproval of “patent ambush” situations of the sort highlighted by the FTC’s action against Dell Computer seven years ago, in which Dell failed to disclose its possession of a patent essential to comply with a new computer bus standard until after the standard was adopted and widely employed, thereupon demanding onerous licenses from its rivals. Although several similar situations have emerged in the years since that Dell action, speakers disagreed sharply over the extent to which standards groups need better policies aimed at preventing patent holders from acting opportunistically in this fashion. Some speakers defended the adequacy of procedures now followed in many organizations that encourage disclosure of expected patent claims during a standard-setting process and advance commitments to offer licenses on “reasonable and non-discriminatory” terms. Other speakers urged more precise and effective disclosure, licensing and related requirements.

The most provocative suggestion to emerge from the ensuing dialogue was that standard-setting participants be encouraged to consider and indeed even collectively negotiate license terms during the standard development process, thereby preventing a patent holder from unilaterally imposing anticompetitive terms after the standard has been adopted. Some participants expressed the concern that such activity would expose the group to antitrust liability under “licensee cartel” or “boycott” theories. Other participants argued to the contrary that such activity should be eminently defensible as a form of “group buying” under “joint venture” rules since these kinds of standard development processes are, in essence, engaged in joint technology development for which joint acquisition of technology “inputs” is an essential feature.

That disagreement presents an issue on which the agencies can be expected to offer constructive guidance in the months ahead. Some parties are urging the agencies to issue formal “guidelines” in this area, a step aggressively opposed by others and unlikely to appeal to the agencies under their current leadership. At a

minimum, however, it is reasonable to anticipate in the agencies’ final report on these hearings some focus on procedures under which collective consideration of patent license terms can safely occur during the course of a standard-setting process.

The joint FTC/DOJ hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, which began in early February and have continued into this month, are intended to develop a better understanding of issues that arise at the intersection of antitrust and intellectual property law and policy. The hearings are being transcribed and placed on the public record, along with any written comments received by the antitrust agencies. A public report will be prepared by the two agencies after the hearings.

Two Drinker lawyers were among the contributors to these hearings. Howard Morse, co-chair of the firm’s Antitrust Group, presented a paper on “Cross-Licensing and Patent Pools,” while Drinker’s Bob Cook participated in a panel discussion of “Patent Settlements: Efficiencies and Competitive Concerns.”

Second Circuit Holds that Exchange of Salary Information Has Antitrust Implications

In a decision that could have widespread ramifications, the Second Circuit in *Todd v. Exxon* recently held that the sharing of salary and benefit information among competing employers may constitute an unlawful information exchange under precedent set by the Supreme Court in *United States v. Container Corp. of America*.

While noting that, under the Supreme Court’s decision in *United States v. U.S. Gypsum*, an exchange of information does not invariably have anticompetitive effects, the Second Circuit nonetheless recognized that evidence of information exchange may support a finding of antitrust liability. Factors that may support such a finding include whether the structure of the industry is susceptible to the exercise of market power through tacit coordination and the nature of the information

exchanged. The presence of those factors in this case weighed against dismissal of the complaint for failure to state a claim, the Second Circuit held.

The complaint alleged that the defendants—oil and petrochemical industry employers—exchanged information on current and future salaries paid by each other to certain nonunion managerial, professional, and technical (“MPT”) employees. The complaint alleged that such information was exchanged frequently, was broken down in small subsets of as few as three employers (as opposed to being summarized in an industry average), was not made publicly available, and was exchanged with assurances that the participants would primarily use the information in setting the salaries of MPT employees.

The district court dismissed the complaint for failure to allege product market or market power, concluding that the alleged market of MPT employment opportunities was too broad in the absence of any allegation as to how accountants, lawyers, chemical engineers and other MPT employees are reasonably interchangeable with one another.

In reversing, the Second Circuit held that where buyer-side conduct is challenged, the relevant market should not be defined by buyers’ ability to substitute among sellers but rather by sellers’ ability to substitute among buyers. The focus should thus have been on the reasonable interchangeability of job opportunities involving the specialized skills of the MPT employees in question, and on supply elasticity rather than demand elasticity.

According to the Second Circuit, “the relevant question is whether jobs *within* each category are fungible enough across the oil and petrochemical industry” to allow for coordination of salaries. Although MPT employees may indeed possess skills with application beyond the oil and petrochemical industry, “[i]t is consistent with common sense and empirical research that employees’ industry-specific experience may cause them to suffer a pay cut if forced to switch industries.” Furthermore, “[i]t is not implausible that less technical MPT employees develop industry-specific expertise that affects their value in the labor market.”

The Second Circuit also rejected the district court’s conclusion that the 14 defendants were too numerous to constitute an oligopolistic market, noting that arrangement condemned by the Supreme Court in *Container Corp.* involved the exchange of information among 18 firms. The Second Circuit viewed large groups as more likely than small groups to engage in the type of anticompetitive conduct in question, since “a very small handful of firms in a more highly concentrated market may be less likely to require the kind of sophisticated data dissemination alleged in this case.”

Finally, the Second Circuit held that a plaintiff can prove market power by direct evidence of anticompetitive effects, even if evidence of large market share is lacking. Because it was not clear on the record whether the plaintiffs had sufficiently alleged market power through anticompetitive effects, the Second Circuit remanded for further proceedings on that issue.

DOJ Comments Favorably on Proposed Expansion of Credit Information Exchange

Information exchanges were also at issue in a recent DOJ business review letter, which addressed the National Consumer Telecommunications Data Exchange Company (“NCTDE”) credit information exchange program. This recent business review letter provides useful insight into how the government analyzes information exchange issues and what features are likely to make an information exchange program acceptable to the government.

The NCTDE program was created to provide member telecommunications carriers with credit information about prospective customers, as well as “skip tracing” to help members locate customers that have moved without paying their bills. NCTDE obtained a favorable business review letter from the DOJ upon its startup in 1997 and subsequently sought this second business review letter to cover the expansion of its membership base to include utility companies such as gas, power, electric, and water companies.

In this more recent business review letter, the DOJ concluded that competition is not likely to be harmed by opening up NCTDE membership to utility companies and that, in fact, the cost savings and other efficiencies attributable to the addition of utility companies to the membership base may be procompetitive. The DOJ commented favorably on the fact that participating members provide and seek credit information from an independent vendor that does not identify which member firm supplied or requested particular information, thus preventing members from using the program to communicate with each other about specific customers. The program is also designed to prevent information exchanges about consumer accounts, individual members' credit terms or practices, or about how members determine whether to approve particular customers for service. As a result, members must act independently in deciding whether, or on what conditions, to provide service to (or to pursue debt collection against) any particular customer or potential customer.

Agencies' Plans to Expedite Merger Reviews Are Quashed

A recent "inside the ballpark" reform jointly instituted by the DOJ and the FTC which promised to reduce the time needed for the government to confirm that certain mergers do not merit a full-blown Second Request investigation was quashed after a savage attack from the Chairman of the Senate's Commerce Committee.

Many firms with mergers subject to federal antitrust review have over the years found themselves bedeviled by an obscure and often unpredictable process known in the trade as "agency clearance." Agency clearance refers to the negotiations between the DOJ and the FTC as to which of the two agencies will review a particular merger. The government does not begin a merger review in earnest until after agency clearance is resolved, and the entire process (including agency clearance) must be completed within the initial HSR waiting period, which normally ends 30 days after an HSR filing is made. That means too much time wasted on agency clearance can be prejudicial for "close call" mergers in which the government

requires significant input from customers or other third-party sources. There have been instances of the agency clearance process eating up three weeks or more of the 30-day review period, so that Second Requests went out to companies that might have avoided them if agency clearance had been resolved more promptly.

Earlier this year, the DOJ and the FTC instituted reforms to reduce delay in the agency clearance process. The centerpiece of these reforms was an expanded list of areas in which matters were to be automatically allocated to a particular agency. The reform of the agency clearance process incorporated the input of a panel of former antitrust officials from both political parties, but apparently not the input of Congress or of FTC Chairman Timothy Muris's fellow Commissioners. As a result, the reform drew criticism after it was proposed in January. One criticism, for example, was that the proposed allocation of expertise gave cable television mergers to the DOJ under the broader rubric of "media and entertainment," even though the FTC, which investigated the AOL/Time Warner merger, arguably has greater cable television expertise than the DOJ.

The Senate Commerce Committee was not notified, either, which has enraged at least one powerful senator. Committee Chairman Ernest F. Hollings told the press, "I am trying to eliminate" FTC Chairman Muris in retaliation for taking such action without even a "heads up" to the agency's oversight committee. Senator Hollings has also requested a study of cost savings that might be realized if the FTC were to eliminate the salaries of FTC Commissioners, senior managers and public affairs staff—a total of approximately 50 jobs out of a workforce of 1,100. Because Senator Hollings also chairs the Senate Appropriations Committee, he wields considerable influence over the FTC's annual budget.

Despite the favorable experience in the initial weeks after the clearance procedures went into effect, the reforms did not survive this criticism. On May 20, 2002, the DOJ announced that it was no longer going to adhere to this agreement with the FTC, "in view of the opposition expressed by Senator Hollings."

Final Hart-Scott-Rodino Rules Published

In other merger enforcement news, HSR Act rules first published last year as “interim” or “proposed” rules have been finalized with few changes. As expected, proposals to conform rules to new notification thresholds were adopted without comment or change. A handful of provisions were modified in their publication as final rules: the “transition” rule for additional acquisitions below the next notification threshold and the rules delimiting the maximum nexus with the U.S. for exempt acquisitions of foreign assets or foreign issuers.

Longer exemption period for “transitional” filers.

Rule 802.21 exempts additional acquisitions from the HSR filing requirements, as long as the acquisitions do not exceed the next higher notification threshold. The exemption applies if (1) an initial filing was made, (2) the notification threshold described in the initial filing was crossed within one year, and (3) no more than five years have passed since the expiration of the initial waiting period. When the notification thresholds were changed in 2001, the FTC published an interim rule regarding “transitional” filers whose Rule 802.21 exemption period had not yet expired when the new threshold became effective. The interim rule allowed transitional filers, until February 1, 2002, to make additional acquisitions up to the next threshold without a HSR filing. Thereafter, Rule 802.21 would exempt only those who filed for one of the new (2001) notification thresholds. The final rule restores the full five-year period for making acquisitions up to the next notification threshold under the old notification scheme (adopted in 1978), even if a 2001 threshold would be crossed as a result of the acquisition. The final rule is retroactive to February 2, 2002.

Foreign Acquisitions. As expected, the maximum nexus with the U.S. for exempt foreign transactions has been increased to \$50 million. Foreign acquisitions are exempt if the foreign assets or voting securities to be acquired did not generate more than \$50 million of

sales in or into the U.S. in the most recent recent year or, in the case of the acquisition of a foreign issuer, did not hold assets in the U.S. (other than investment assets) with an aggregate total value greater than \$50 million. Where multiple foreign issuers are being acquired from the same ultimate parent, the assets located in the U.S. and the sales in or into the U.S. will be aggregated across all foreign issuers.

The proposed rule would have calculated the sales in or into the U.S. for the most recent year *plus* the stub period. However, the final rule has abandoned the counting of the stub period and measures only the sales in the most recent fiscal year. Despite criticism, the FTC confirmed that for purposes of the exemptions of foreign acquisitions, the value of U.S. assets held by a foreign person is their fair market value. This is different from the nexus test from the “size-of-person” test, which permits assets to be measured by their book value.

ABA Publishes New Handbook on Antitrust Guidelines for IP Licensing

The ABA Section of Antitrust Law has released a new handbook on the enforcement agencies’ *Antitrust Guidelines for the Licensing of Intellectual Property* covering developments in this area over the seven years since the *Guidelines* were issued. The co-chairs of Drinker’s Antitrust Practice Group, Howard Morse and Paul Saint-Antoine, led this effort. Howard is chair of the Section’s Intellectual Property Committee that sponsored the project and Paul served as Editor-in-Chief of the handbook. In addition, Drinker’s Bob Cook was a co-author of the book.

A great deal has happened at the intersection of the antitrust and intellectual property law regimes since the publication of the agencies’ *Guidelines* and the final edition of the ABA’s handbook on the *Guidelines*. The new publication addresses all of the relevant case law and enforcement policy developments that practitioners should understand to be up to date on this front:

- how the law has evolved on IP owners' rights to refuse to license their IP to competitors as a result of the outcome of cases against Intel, Kodak and Xerox;
- the D.C. Circuit's treatment of IP defenses to monopolization charges in its tome on the Microsoft appeal;
- enlightenment on critical aspects of patent cross-licensing and patent pools from the DOJ Business Review Letters and the FTC's Summit/VISX enforcement proceeding;
- how the agencies have applied and developed the guidelines' concepts of "innovation markets" and "innovation effects" in both merger and non-merger cases;
- agency and private challenges to settlements of patent infringement litigation between proprietary and generic pharmaceutical manufacturers and their implications for IP litigation settlement practices generally; and
- the impact of the Supreme Court's *California Dental* decision and the agencies' new *Antitrust Guidelines on Collaborations Among Competitors* on the analysis of IP licensing arrangements between competitors.

The new ABA handbook provides thorough analysis and fresh insights to all of these subjects. Readers will also find of particular value five special "sidebar" sections: "The Right to Refuse to Deal: A Split in the Circuits"; "The Government's Case Against Microsoft"; "Good and Bad Patent Pools"; "The Consent Decree in Intel: Compulsory Licensing Revisited"; and "Abbott-Geneva and Hoechst-Andrx Agreements: Antitrust Challenges to Pharmaceutical Settlements."

There is one feature of growing import at the intersection between antitrust and IP law that remains unaddressed by either the agencies' *Guidelines* or the new handbook: controversies over the incorporation of IP rights in industry standards, particularly when an IP owner does not fully disclose its cards during a standard development process or does not offer "reasonable" license terms to all affected parties after the standard has been adopted. As discussed in this issue of the *Update*, above, this frontier was addressed in some depth at the FTC/DOJ Hearings on Competition and Intellectual Property Law and Policy in a Knowledge-Based Economy. Indeed, some parties are already promoting the idea of new FTC guidelines on the use of IP in standard-setting processes.

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