SECTION OF ANTITRUST LAW

The Threshold

The Newsletter of the Mergers & Acquisitions Committee

Volume V

Number 3

Summer 2005

CONTENTS

Letter From the Chair

To all Committee Members:

Welcome to the Summer Issue of The Threshold. This issue revisits some old ideas and explores some new ones. Liz Kraus has provided us with an update from the recent ICN conference in Bonn. David Balto provides some insight on advising clients that oppose a merger. Finally, Scott Sher has provided an article on the settlement of IP disputes through a merger, a hot topic as the agencies continue to grapple with the implications of the 11th Circuit's decision in Schering Plough v. FTC.

This is the last "Chair's Letter" that I will author, as I will be stepping down as Chair of the M&A Committee this August. I have thoroughly enjoyed leading the Committee during these last four years. The M&A Committee (and its predecessors) has always been one of the most active committees in the Section. We started out four years ago to continue that record by expanding the Committee's activities, growing its membership, and increasing the valuable products and services that the Committee can bring to its members. I think we accomplished a great deal in each of these areas due to a tremendous amount of help from our members and a terrific set of Vice Chairs. My sincerest thanks go to current and former Vice Chairs Cliff Aronson, Molly Boast, Billy Vigdor, Tom Fina, Jerry Swindell, Mike Knight, and Bob Schlossberg, for all their help, and to the many Committee members who assisted on a great number of projects.

The new Chair of the Committee starting in August will be Bob Schlossberg, and I know I leave it in good hands. I know that Bob and his Vice Chairs–Jerry Swindell, Mike Knight, Ken Ewing, Jim Wade, and Jim Lowe–will continue to make the M&A Committee one of the most dynamic Committees in the Section and I look forward to working with them as a continuing member of the Committee. Have a great summer!

Joe Krauss
Chair, Mergers and Acquisitions Committee

International Competition Network–Update [top]

Elizabeth F. Kraus & Maria B. Coppola*

Federal Trade Commission, Bureau of Competition

In our May 2004 article, we provided background on an innovative organization, the International Competition Network ("ICN"), describing how this nascent "virtual network" was changing the face of international antitrust.[1] In this update, we aim to inform you of the ICN's recent activities, examine whether and how the initial considerations for future success (highlighted in our 2004 article) have been addressed, and note new challenges for the ICN.

In the past year, the ICN has expanded in membership, participation and work product. Nearly all of the world's competition agencies are now members, with membership exceeding 90 agencies from over 80 jurisdictions, from Albania to Zambia. The fourth annual conference, held in Bonn, Germany on June 6–8th, 2005, was the best-attended ICN event to date, with over 400 participants, representing more than 80 competition authorities and non-governmental advisors ("NGAs") from the private sector and academia. Agency representatives and NGAs, working together, prepared materials in four substantive areas (mergers, cartels, competition policy implementation and antitrust enforcement in regulated sectors), primarily for presentation and discussion at the annual conference and in workshops presented over the course of the year. These materials, discussed below, are all available on the ICN's website.[2]

Recent ICN Activities and Work Product

In the mergers area, the ICN's membership adopted two additional Recommended Practices for Merger Notification and Review Procedures, presented by the Notification and

* The views expressed are those of the authors and do not necessarily reflect the views of the Federal Trade Commission or any of its individual members. The authors wish to thank Randolph W. Tritell for his helpful comments on an earlier draft of this update.

[1] See E. Kraus & M. Coppola, "The International Competition Network: A Virtual Reality," Mergers and Acquisitions Newsletter, Vol. IV., No. 3, Summer 2004, available at http://www.abanet.org/antitrust/committees/at-mergers/mergers-newsletter.html. In this article, we noted that the ICN was meeting its objectives of facilitating procedural and substantive convergence and providing support for new antitrust agencies by promoting dialogue among enforcers, practitioners and interested academics, and addressing practical antitrust enforcement and policy issues of common concern. We described the ICN's formation, structure and development, highlighting key projects and work product realized to date, and focused on the Merger Notification and Procedures subgroup as an example of how the ICN's subgroups use the network's flexible working style to achieve results.

[2] Consult the ICN's website, at http://www.internationalcompetitionnetwork.org, for access to ICN materials, including documents prepared for the fourth annual conference.

Procedures subgroup, on remedies[3] and competition agency powers.[4] The full set of Recommended Practices, adopted by the ICN's membership over the past four years, addresses thirteen priority areas related to merger notification procedures.[5] As discussed in the subgroup's Implementation Report, prepared for the conference, over 50% of ICN members with merger review laws have made or planned revisions to their merger regimes that bring these regimes into greater conformity with the Recommended Practices.[6] In addition to the Implementation Report, which identifies and provides solutions to challenges agencies face in implementing the Practices, the subgroup developed a model waiver of confidentiality form and accompanying paper on the use of confidentiality waivers, and also completed a comparative study on merger notification filing fees. The Mergers Analytical Framework subgroup discussed a preliminary draft checklist on merger guidelines and, in an effort to provide practical guidance on the choice, design and implementation of merger remedies, presented a study on merger remedies that complements the remedies Recommended Practices. Following on its successful October 2004 workshop, in which agency staff lawyers and economists from 49 jurisdictions learned tools and techniques relevant to merger investigations with the help of 16 NGAs, the Investigative Techniques subgroup finalized and presented key concepts from its Investigative Techniques Handbook for Merger Review.

The Cartel Working Group has been extremely active during its first year. In Bonn, the General Framework subgroup presented its report, "Building Blocks for Effective Anti-cartel Regimes," covering the definition of "hard core cartel," effective institutions for cartel detection, investigation and prosecution, and effective penalties. The Enforcement Techniques subgroup, presented the first two chapters of its "Anti-cartel Enforcement Manual," addressing searches, raids and inspections and drafting and implementing an effective leniency program. This subgroup also presented an NGA-led role-playing exercise, which was developed for the subgroup's Leniency Workshop, one of two ICN cartel workshops held in Sydney, Australia, in November 2004. The subgroup also presented its anti-cartel enforcement template, which, once completed for each agency, will provide basic information about anti-cartel programs in all ICN member jurisdictions.

---

[3] The remedies practice addresses the object of a remedy, advocates a transparent framework for the proposal, discussion, and adoption of remedies, and recommends that: (i) procedures be established to ensure that remedies are effective and easily administrable and (ii) appropriate means are provided to ensure implementation, monitoring of compliance and enforcement of the remedy.

[4] The agency powers practice recommends that agencies have the authority and tools necessary to enforce their merger laws as well as the necessary staffing and expertise, and advocates that agencies have sufficient independence to ensure the objective application and enforcement of merger review laws.

[5] The Recommended Practices for Merger Notification and Review Procedures are available at http://www.internationalcompetitionnetwork.org/guidingprinciples.html and cover: (1) sufficient nexus between the transaction's effects and the reviewing jurisdiction; (2) clear and objective notification thresholds; (3) flexibility in the timing of merger notification; (4) merger review periods; (5) requirements for initial notification; (6) conduct of merger investigations; (7) procedural fairness; (8) transparency; (9) confidentiality; (10) interagency coordination; (11) remedies; (12) competition agency powers; and (13) review of merger control provisions. The format consists of a short statement of the Recommended Practice followed by explanatory comments.

[6] See Implementation of the Recommended Practices for Merger Notification and Review Procedures, April 2005 at 4, available at http://www.internationalcompetitionnetwork.org/050505Merger_NP_ImplementationRpt.pdf.

The Competition Policy Implementation ("CPI") Working Group addressed issues of particular importance to newer competition agencies. The technical assistance subgroup presented the first in-depth, quantitative examination of the effectiveness of technical assistance to competition agencies, based on the experience of 32 recipients of such aid.[7] The report identified key elements of successful programs and activities, producing a number of results that run counter to many donors' conduct in the design and implementation of technical assistance programs. These preliminary results will serve as the basis for recommendations to technical assistance donors and providers.

The consumer relations subgroup, as part of a focus on building a competition culture through consumer outreach efforts, produced a video on outreach strategies. While the "competition cat" used in television commercials in Japan was particularly popular, the video contained a number of methods and messages that can easily be adapted by other agencies.[8] The advocacy subgroup prepared detailed studies of advocacy initiatives in regulated sectors, highlighting process issues, to ensure that the lessons learned can be replicated across sectors and jurisdictions.[9]

The Antitrust Enforcement in Regulated Sectors ("AERS") Working Group presented a report on the increasing role for competition in the regulation of banks, with a set of recommendations related to antitrust in the banking sector. Its second subgroup discussed its report on the interrelation between antitrust and regulatory authorities, focusing on institutional frameworks, competition principles as a foundation for regulation, costs of concurrent jurisdiction and the importance of informal relations between the authorities.

The ICN's leadership also presented a mission and achievements statement that examines the ICN, its role and accomplishments.[10] This document marks an important transition for the ICN in that it demonstrates the network's commitment to focus efforts on implementation of its work product. This focus also was exemplified by the conference's implementation panel, which demonstrated how much of the ICN work product, e.g., the merger investigative techniques handbook, the technical assistance assessment tools, and the Recommended Practices, has been put to use by its membership. As the Chairman of the ICN's Steering Group noted in his closing remarks, "…the shift in focus towards implementation

[7] The report on technical assistance is available at http://www.internationalcompetitionnetwork.org/assessing_technical_assistance.pdf.

[8] The subgroup also prepared a report on lessons learned in outreach activities. Earlier in the year, in February 2005, the subgroup held a workshop for ICN members, observers and NGAs on consumer outreach, producing a conference report for Bonn. Finally, the subgroup also prepared a short paper on the effects of institutional structures on consumer relations. All of the subgroup's materials are available at http://www.internationalcompetitionnetwork.org/annualconferences_bonn.html.

[9] The Advocacy Report is available at http://www.internationalcompetitionnetwork.org/bonn/CPI_WG/SG3_Advocacy_in_Regulated_Sectors/Competition_Advocacy_Review.pdf.

[10] "A Statement of Mission and Achievements up until May – 2005," available at http://www.internationalcompetitionnetwork.org/bonn/Work_Plans/achievements/ICN_Mission_and_Achievements_Statement.pdf.

shows us that the ICN has reached a new level of maturity."[11]

Stocktaking One Year Later

With the conclusion of the ICN's successful fourth annual conference, now is a good time to review the possible institutional challenges highlighted in our 2004 article to assess whether and how the ICN has addressed these concerns. The challenges identified concerned: (i) the ICN's ability to engage and ensure participation of all of its member agencies, particularly younger agencies, both in developing work product of interest and promoting participation in ICN activities; (ii) fostering additional avenues for NGA participation, and (iii) cautioning against overextension of the ICN and its resources.

Regarding increased participation by younger agencies, the ICN's leadership has recognized that to remain relevant the ICN must address issues of interest to this constituency. To better understand these concerns, Bonn conference attendees heard directly from young agencies in a plenary panel dedicated to "ICN Participation: Expectations and Challenges for Younger Competition Agencies." A number of suggestions were made, from greater opportunities for cooperation, e.g., through information exchanges and/or mentoring programs, to calls for coverage of additional topics, e.g., unilateral conduct, as well as more focused coverage of, inter alia, investigative techniques and economic analysis and additional workshops. Funding of various projects and conference attendance also was highlighted as a key concern.

These issues were among the first items to be discussed in the Steering Group meeting immediately following the conference and efforts to address them have been and will continue to be the subject of much work. For example, an initial discussion of possible ICN mechanisms for increasing cooperation among member authorities is scheduled for July, with project proposals to follow.

With respect to the scope of ICN's projects, the comments of certain younger agency representatives highlighted the tension between wanting to push the ICN to achieve the most that it can and exhausting its resources and membership, many of whom do not have sufficient staffing to participate in and/or monitor ICN developments in an increasing number of working groups and subgroups. This tension was taken into account when developing the ICN's future work plans. For example, the Mergers Working Group (the first working group to be established) is beginning to refocus its activities on implementation of its work product. In doing so, the working group has streamlined its structure from three to two subgroups. Similarly, the AERS Working Group was concluded upon the expiration of its two-year mandate. Related work regarding the telecommunications sector will continue as a one-year project,[12] with a new working group on monopolization/dominance expected to be established at the next annual conference.

[11] Closing Speech of Ulf Boge at 3, available at http://www.internationalcompetitionnetwork.org/bonn/2005speeches/closingspeech.pdf.

[12] This group expects to: review existing work on competition policy and the telecommunications sector, examine major antitrust cases in the sector, and survey the state of competition in the sector in selected developing countries. Based on this information, the group will identify lessons learned and, possibly, optimal approaches to addressing antitrust in the telecommunications sector. The proposed work plan for this group is available at http://www.internationalcompetitionnetwork.org/bonn/Work_Plans/Telecoms_2005-06_Work_Plan.pdf.

In this way, the ICN has attempted to focus its projects on topics of interest to its membership without overburdening the network, its members and interested NGAs, on which it increasingly relies.

Concerning funding, a separate not-for-profit, corporate entity has been established to receive and disperse member contributions in support of the ICN. In addition, the Steering Group has proposed a suggested minimum annual contribution for members exceeding a GDP threshold. Contributions from a handful of such members helped ICN members from less developed jurisdictions to attend the Bonn conference, though many also received stipends from German foundations supporting the conference. The ICN's new funding mechanisms are likely to be tested over the coming year, when the ICN produces two workshops (on Implementation of the Recommended Practices for Merger Notification Procedures and Cartels) as well as the annual conference.

Through these measures, the ICN hopes to increase participation and involvement of its members, particularly younger agency members, in its daily work, conferences and workshops. Similarly, the ICN is interested in promoting increased NGA participation in the network's activities. The ICN has benefited from increased NGA involvement over the past year, with NGAs active in a greater number of subgroups, participating as speakers in ICN conferences and workshops, and designated as key resource persons in annual conference breakout sessions. Of note, the ABA's Antitrust Section has provided the ICN with key NGA input, and members from this committee played a lead role in the development of the ICN's merger model waiver and accompanying report. The ICN should continue to involve NGAs in its activities, including by reaching out to a broader range of non-governmental advisors from additional jurisdictions (to date, the majority of NGA participants are from North American and European jurisdictions) and backgrounds, e.g., in-house counsel and academic participants.

New Challenges

The ICN's flexible nature and working style continue to serve the organization well. This flexibility, however, can come at the cost of certain administrative and organizational inefficiencies, including, for example, uneven surges in demand for member participation (e.g., survey responses) without a central coordination mechanism. A number of the inefficiencies can be remedied without the addition of a heavy bureaucratic overlay and consideration may be given to formalizing a limited number of responsibilities to complement the organization's flexibility. For example, within the existing structure, Steering Group members and vice chairs, and/or Working Group chairs can be tasked with additional responsibilities to ensure project target goals are identified and met in a timely manner.

An additional challenge for the network concerns outreach and how the ICN can publicize its work product beyond its current active participants as well as promote implementation of this work product within ICN member jurisdictions. The design of a more effective communications strategy, drawing on existing instruments such as the website and listserv, and development of new tools that reach a wider audience, appear warranted. In addition, efforts to increase the involvement of NGAs from a broader range of jurisdictions and backgrounds also can help to garner support for ICN work product within these jurisdictions, which, over time, can foster implementation of the ICN's work across its membership.

Such steps may further the success of the ICN in building consensus and convergence towards sound competition principles across the global antitrust community.

Should You Complain: Opposing A Proposed Merger [top]

David A. Balto

Partner–Robins, Kaplan, Miller & Ciresi L.L.P.
Washington, D.C.

Introduction

The merger wave is predicted to return. There are already early signs that merger activity has begun to flourish: In 2004, merger activity once again increased in volume with the number of Hart-Scott-Rodino filings increasing 42 percent from fiscal year 2003.

Mergers are investigated by the Antitrust Division of the Department of Justice, the Federal Trade Commission and/or state attorneys general. When mergers are announced, both customers and competitors have an important decision: Should they complain about the merger? Although many mergers benefit competition and consumers by allowing companies to operate more efficiently and by lowering prices, in certain cases, a merger can result in higher prices and reduced market entry and expansion by new or existing companies in the industry. Talking to the antitrust authorities can help assure that competition is not lost from the merger. Moreover, if the agencies require a divestiture or other remedy to cure the anticompetitive effects, a complainant may be the "white knight" acquiring the divested assets and entering the market to restore competition.

The underlying concern of the antitrust laws is whether a merger will harm competition by enabling the merged firm (either individually or with its rivals) to raise prices or decrease service or innovation. The purpose of the antitrust laws is to protect consumers. Thus, where the agencies believe that a merger has the potential to result in higher prices, substantial market concentration, less innovation, or create difficulty for new companies to enter the market or rivals to expand, they will be more likely to investigate and challenge such transactions.

The merger review process is critical to protecting competition and the ability to compete. First, if one is concerned about possible anticompetitive activity from the merger, it is far preferable to convince the antitrust agencies to stop the merger in the first place. Once the merger is completed it is far less likely that the government will launch enforcement action to stop anticompetitive practices such as price increases. The agencies bring only one or two cases a year, usually challenging only fairly egregious abuses of market power. As a result, customers or competitors need to rely upon private antitrust litigation to challenge post-merger anticompetitive conduct. It is simply better to try to stop the conduct before it occurs.

Second, a merger investigation is an intense review of an industry by the agency. It offers the opportunity for the agency to identify potentially anticompetitive activities in a given market. In fact, some prominent criminal and anticompetitive conduct cases have resulted from merger investigations. A merger investi-

gation may lead the agencies to attack some other form of anticompetitive conduct.

Best Practices for Bringing a Complaint

What do the agencies pay attention to when considering whether a merger raises potential concerns, and how do you best alert the agencies to possible competitive problems with mergers? Here are some of the factors to consider when going through the process:

- **Bring concerns to the attention of the agencies as early as possible.** Once a merger filing is made, the agencies have 30 days to decide whether to conduct a more extensive investigation. Thus, it is crucial to make contact with the agencies during that initial period. By bringing concerns to the attention of the agencies early, your company may be able to help focus the agencies' staff on relevant issues and frame the discussion.

- **Recognize that this could be a time consuming and expensive process**. As in many areas, be careful what you wish for. As an instigator of an investigation, a party does not control the scope, timing, direction and level of intrusiveness involved in an investigation. Staff for the agencies will want to engage in dialogue with your business people and economists. They will desire a productive and ongoing relationship during the course of the investigation and will want to know that, as a complainant, your company will make available personnel who are knowledgeable about the industry and that you will devote time and resources in cooperating with any necessary interactions, formal presentations to the agencies, producing documents and follow-up queries.

- **Retain and involve experienced antitrust legal counsel.** While agency staff will want to interact with and engage your business people and economists, legal counsel should be involved at all stages of the investigation as an intermediary. Antitrust counsel will know the process and often know many of the key government players. In a sense, they can forge separate relationships with agency staff while protecting your company throughout the investigation. In particular, counsel can be invaluable in discussions and negotiations over any sensitive topics or data and, as discussed below, the confidentiality of information made available to the agencies.

- **Always be respectful and professional with the agencies and their staff**. Agency attorneys and economists are key to any merger investigation and many investigations are won or lost at this level. They know legal antitrust theory and are adept at applying the facts at issue in any particular investigation. Try to find a sympathetic ear among agency staff and attempt to provide an understanding of the relevant facts in early discussions. In almost all circumstances, never go over the heads of staff to higher level agency officials. Typically, such officials will defer to the staff and decline to intervene until the staff analysis is complete and the investigation is formally sent up to their level for review. Nothing can be gained by being disrespectful or dismissing the efforts of staff. However, much can be lost, as your arguments could be viewed with skepticism.

- **Secure a confidentiality agreement from the agencies**. The agencies go to great lengths to assure that the identity of complainants is not disclosed and that information cannot be secured, absent litigation, by the merging parties. While it is extremely

unlikely that the merging parties will ever discover the identity of complainants, a confidentiality agreement provides additional protection for any disclosures your company may make. All interviews are kept strictly confidential and government attorneys go to great lengths to guarantee they stay that way in order to encourage cooperation in merger reviews. Materials and testimony gathered pursuant to the Hart-Scott-Rodino Act or under subpoena (Civil Investigative Demand) do enjoy certain additional protections from disclosure. However, if an investigation actually evolves into an enforcement case which goes to trial, a complainant could be selected as a witness.

- **Prepare and focus your arguments in advance, and be specific in documenting them with factual assertions.** This approach will allow all parties and the agency staff to focus on the most critical concerns and may increase the likelihood of a complaint being taken seriously. In addition to having a sound basis for believing a violation of the applicable antitrust statutes would occur if a proposed merger went forward, the agencies' review and response is guided by careful application of sound legal and economic principles to the particular facts of the case at hand.[1] Thus, such reviews are factual inquiries, and establishing a strong, credible argument early in the process is important for complainants, particularly if you are a competitor. Agency staff will likely focus their third–party inquiries on market definition, competitive effects of the proposed merger, and barriers to market entry. When appropriate, take advantage of questions raised by staff to submit additional materials to the agencies which could assist in better focusing the staffs' attention on the most critical concerns with the proposed merger.

Evaluation of Whether to Bring a Complaint

Do you really want to complain about a proposed merger? Before committing to and becoming involved in any antitrust agency merger review, your company should carefully consider the following:

- **What are your future business plans**? Remember that the market conditions you discuss with and define to agency staff will be on record and could affect your own business plans in the future. For example, if you plan to conduct acquisitions in the same market, it may not be in your interest to initiate a complaint or cooperate and explain to authorities why an acquisition is problematic. If the deal is blocked, you may find the same arguments presented against your future proposed acquisition.

- **Could your complaint or comments backfire?** While the agencies welcome comments and information from any interested parties regarding a proposed merger, agency staff acknowledge that they find information from suppliers and customers of the merger parties to be the most helpful and unbiased. If you are a competitor, the information and data you provide must be credible and can assist in providing useful insight on market conditions and effects on competition. Nevertheless, the agencies also recognize that a competitor could be complaining out of concern that the proposed merger could actually increase competition and lower prices. So one must fashion the argument carefully.

[1] See "Antitrust Division Policy Guide to Merger Remedies", U.S. Department of Justice, October 2004, Section II.

- **Could you be the beneficiary of relief secured by the agency?** In the end, if these antitrust agencies conclude that a merger would lessen competition, they can address the matter in several ways. Two of these are to prevent the merger from going forward or negotiating a settlement (a Consent Decree including structural or conduct provision) that allows the merger to move forward with certain modifications to preserve market competition. This leads to a final point for consideration, discussed below.

A complaining competitor may often be the "white knight" to restore competition. Sometimes the agencies will require the divestiture of an ongoing business or business segment. Sometimes it will require licensing of intellectual property or resolution of intellectual property disputes. If you have been trying to break into a particular geographic market in which the two merging companies must divest some of their assets, the agencies may approve your purchase of the assets. Perhaps IP litigation between you and one of the merging parties has kept you out of the market. In that case the government may force the parties to resolve the litigation or provide a license. Typically they will approve a purchaser if they believe the acquirer has the incentive and ability to use the divested assets to fully restore competition.

Conclusion

Competitors and customers should carefully consider the risks and benefits of bringing a complaint. If a decision is made to complain, it needs to be done in a well considered manner so as to maximize the impact and minimize the potential downside. When approached carefully, a complainant can add valuable insight and provide factual basis for supporting any agency decision regarding a proposed merger. Ultimately, the complainant may be the "white knight," acquiring the divested assets to restore competition.

The Settlement of IP Disputes Through Merger and the Thicket of Probabilistic Competition [top]

Scott Sher*

Partner–Wilson Sonsini Goodrich & Rosati, PC

Introduction

Consider this increasingly common scenario: Party A ("A") and Party B ("B") each manufacture one product. A claims that B's product practices A's valid and enforceable patent portfolio. A sues B for patent infringement.

The case proceeds through a long and convoluted pre-trial discovery and motion practice period, costing both parties millions of dollars in legal fees. In the middle of this expensive litigation, A decides to (i) settle the litigation, which, to date, has cost the companies an incredible amount of time, resources, and money, and (ii) as part of that settlement, acquire B. No court has made a final determination as to whether B's products infringe A's patents. Summary judgment motions were pending.

Combined, A and B would have a high share of sales in the product market in which they compete, command a substantial portion of a locked-in customer base, and there would be, at best, only a remote chance of new entry or expansion. Further complicating the antitrust analysis, A's internal documents discussing the deal with B make reference to the ability to sustain long-term price hikes, with no fear of discipline from other vendors once the merger is complete.

When the parties notify the agencies of the proposed acquisition under the Hart-Scott-Rodino Act, how should the agencies evaluate the transaction in light of this pending IP dispute?

*****

This scenario will become increasingly common over time. High-tech companies today employ litigation–and most prominently IP litigation–as an important component of their competitive arsenal, e.g., alleging patent infringement, trade secrets theft, and other violations of IP rights. Even where the outcome of a lawsuit is fairly predictable, litigation is still costly and time-consuming. Faced with the uncertainty, parties often settle, and some even decide to merge as part of that global settlement. The antitrust agencies are then placed in the position of deciding whether the merger passes muster under Section 7 of the Clayton Act, which in turn forces them to consider the impact of the IP litigation on the competitive landscape in the market. As a result, a consistent, clear and manageable antitrust framework is necessary in order to ensure that these settlement/merger arrangements are afforded suf-

* The author would like to thank Scott Russell, Noah Brumfield and Charles Reichmann for their helpful guidance.

ficient review by the agencies, and at the same time, are not necessarily subject to the same full-blown litigation in the antitrust tribunal that the parties sought to avoid by settling the litigation in the first place.

The Questions Raised by IP Settlements in the Merger Process

Fortunately, in most circumstances, the settlement of IP litigation and simultaneous corporate combination likely will not raise significant antitrust issues, and will be in fact procompetitive.[1] However, in limited circumstances, where, for example, the market in which the parties compete is highly concentrated (as in the example of the acquisition of B by A, discussed above), the acquisition will be subject to antitrust scrutiny. The agencies will be forced to consider the motivations of the parties in settling their IP dispute and the potential impact of the IP suit on competition in the market, if that dispute were to be resolved through litigation, rather than by settlement and acquisition.

These settlement/acquisitions can raise significant antitrust questions when the proposed settlement/merger results in significant market consolidation, and none of these questions have easy or obvious answers. This article raises questions regarding some issues that agencies and parties must consider:

- As a threshold matter, should the antitrust agencies even consider the effects of pending IP litigation in determining whether a combination is likely to reduce competition? Or should the agencies instead ignore the pending IP litigation, and presume that absent a court order to the contrary, B and A lawfully compete?

- If the agencies are to consider the impact of the litigation on the state of future competition between the feuding parties, who should bear the burden of demonstrating the likely outcome of the IP litigation–the agencies or the merging parties? Recognizing that the antitrust agencies are not the ideal setting to conduct a trial into the merits of the parties' respective positions in the IP dispute, how much evidence is necessary before the agencies are able to make their determination?

- Should the agencies pay substantial deference to the parties' decision to resolve a patent dispute through settlement as the Eleventh Circuit suggested in Schering-Plough,[2] or should the parties instead be required to put forth affirmative evidence that the IP dispute was likely to result in the acquired party's exit from the market?

- If the agencies consider the merits of the IP dispute and conclude that it was likely that the acquired party's products infringed upon the acquiring party's patent portfolio, how should the agencies assess the outcome of such a finding? Should the agencies have to investigate further and ascertain whether the acquired party could "work around" the patent, or whether it would be forced to stop selling its product? Should the agencies take into account the costs of having to work around the infringement, and determine whether it is

[1] See, e.g., Schlegel Mfg. Co. v. U.S.M. Corp., 525 F.2d 775, 783 (6th Cir. 1975).

[2] See Schering-Plough Corp. et al. v. Federal Trade Comm'n, 402 F.3d 1056 (11th Cir. 2005) (pending the Commission's motion for rehearing en banc).

plausible, possible or likely that the infringer would develop a work-around?

- On a related point, how do the agencies assess whether there is a "less restrictive alternative" to a merger? If, for example, the acquired company had other products in development that did not infringe upon the acquiring party's patents, should the agencies consider something "less than a merger" (e.g., a patent cross-license on the infringing product) as a viable and less anticompetitive result that would enable the allegedly infringing party to continue competing in the market?

- Should the agencies consider the consumer welfare associated with interim competition between the parties? When and how much weight should such interim competition be afforded in the competitive effects analysis? Where a dispute is likely to be long and drawn out, should the agencies conclude that–even if it is likely that the acquired party infringed and would exit–consumers benefit from competition between the parties in the market prior to the resolution of the dispute? More fundamentally, if it is relatively clear that the acquired party did indeed infringe upon the acquiring party's patents, should interim competition be a factor in the antitrust analysis, or is it appropriate to conclude that such interim competition is irrelevant in an antitrust analysis because consumers are not entitled to the benefit of that unlawful competition?

Both because the agencies have not yet articulated a framework by which they will analyze such two-step transactions and because the law on the antitrust implications of IP settlements is in flux (see, e.g., Schering-Plough), there is considerable uncertainty in the business world as how best to approach the agencies with their antitrust arguments when advocating transactions involving these issues. There is also a natural hesitation–among members of the bar and the agencies themselves–to demand that the antitrust agencies conduct in depth analyses of patent disputes that the parties themselves determined was too difficult to litigate fully in the court system. Depending upon one's perspective, this hesitation may lead to one of two arguments–(1) that the agencies should pay substantial deference to the good faith decision of the parties to resolve their IP disputes, and should not interfere with that determination;[3] or (2) that these disputes are too difficult to resolve, and in the absence of conclusive evidence that both parties believed that the result of the litigation would be that the acquired party would exit the market, that the agencies should simply ignore the existence of the IP dispute.[4] Neither argument sits well with this author. As is the case with many issues lying at the intersection of antitrust and intellectual property, a more substantial architecture for analysis is necessary.

An Overview of the Analytical Rubric

Analysis of Burdens in the IP Litigation Context: Proving Infringement and Validity

Without delving into the analysis in any great detail, it is fairly clear that the party advocat-

[3] See, e.g., Kevin McDonald, Hatch Waxman Patent Settlements and Antitrust: On Probabilistic Patent Rights and False Positives, 17 Antitrust 68 (Spring 2003).

[4] See, e.g., Carl Shapiro, Antitrust Limits to Patent Settlements, 34 RAND J. Econ. 391 (2003), available at http://faculty.haas.berkeley.edu/shapiro/settle.pdf; see also In re Schering-Plough Corp. et al., Dk. No. 9297, 2003 WL 22989651 (F.T.C.), rev'd by Schering-Plough v. F.T.C., 402 F.3d 1056 (11th Cir. 2005).

ing infringement in IP litigation has the burden of demonstrating infringement, and doing so by a preponderance of the evidence: "To establish infringement, every limitation set forth in a patent claim must be found in an accused product. . . . The patentee bears the burden of proving infringement by a preponderance of the evidence."[5]

When a patentee moves for a preliminary injunction in a patent infringement suit, it bears the burden of demonstrating "(1) a reasonable likelihood of success on the merits; (2) irreparable harm if an injunction is not granted; (3) a balance of hardships tipping in its favor; and (4) the injunction's favorable impact on the public interest."[6]

As we will see below, courts have created a significant degree of confusion in this area by shifting the burden of proof away from the patentee in the context of analyzing patent settlements.

Analysis of Burdens in Demonstrating Valid Settlements: The Uncertainty Following Schering-Plough

There is considerable confusion as to who bears the burden of proof in the determination of whether a settlement of an intellectual property dispute is immune from (or largely shielded from) antitrust liability. In Schering-Plough, the Eleventh Circuit held that because "[b]y their nature, patents create an environment of exclusion and consequently, cripple competition," once the parties demonstrate that a settlement was a good faith attempt to resolve a patent dispute, a court (or the FTC) should not interfere with that resolution.[7]

In Schering-Plough, the FTC challenged a patent infringement settlement between two drug companies that had the effect of keeping one party from entering the market for several years. The FTC alleged that the settlement was an unlawful market allocation between two firms. The central issue before the Eleventh Circuit was who had the burden of demonstrating that the patent settlement was valid. This, in turn, required the court to decide whether to require the patentee (i.e., the party who brought the infringement suit) to demonstrate that the company it sued actually infringed its patent, or the FTC to demonstrate that the settlement was a sham.

By its terms–if it remains good law–Schering-Plough suggests that the settling parties' only burden in demonstrating the appropriateness of an intellectual property dispute resolution is showing that they believed in good faith that the acquiring party's patent was valid. At that point, according to Schering-Plough, the burden shifts to the antitrust agency to prove invalidity or non-infringement. The Eleventh Circuit there held:

> By virtue of its '743 patent, Schering obtained the legal right to exclude Upsher and ESI from the market until they proved either that the '743 patent was invalid or that their products . . . did not infringe Schering's patent.[8]

This seems to stand on its head traditional patent law which requires the patentee to demonstrate infringement by a preponderance of the

[5] Kegel Co., Inc. v. AMF Bowling, Inc., 127 F.3d 1420, 1425 (Fed. Cir 1997); see also Laitram Corp. v. Rexnord Inc., 939 F.2d 1533, 1535 (Fed. Cir. 1991).

[6] Amazon.com, Inc. v. barnesandnoble.com, inc., 239 F.3d 1343, 1350 (Fed. Cir. 2001).

[7] 402 F.3d at 1065-66.

[8] Id. at 1066-67 (emphasis added).

evidence.[9] Presciently, three years before the Schering-Plough decision, Professor Joseph Scott Miller, in an excellent article on the subject in Antitrust Law Journal, responded to the Eleventh Circuit's proposed analytical framework:

> The proponents of a dubious patent license agreement may urge that, because the patent enjoys a statutory presumption of validity . . . the agency cannot challenge a license agreement as anticompetitive without proving by clear and convincing evidence that the patent is invalid. By doing so, the license proponents ignore the question of infringement altogether. A patentee has no right to exclude from the market persons who are not infringing, i.e., not practicing the claimed invention in all its detail. As a result, a patent cannot justify the change from competition in fact between rivals to coordination under a license between now-friendly firms until the patentee caries its usual burden of showing that the licensee's conduct actually meets every limitation of at least one claim in the patent. The patentee's usual burden in this regard does not vanish merely because it walks through the door of an antitrust enforcement agency.[10]

Professor Miller's position, however, creates tension with the legal presumptions afforded to the patentee's decision to enforce its patent rights. As courts have held, most prominently the Federal Circuit in Loctite,[11] a patentee's decision to enforce its IP rights generally should be shielded from judicial review. In Loctite, the Federal Circuit reviewed the dismissal of a defendant's counterclaim alleging bad faith enforcement of a patent based on the patentee's alleged knowledge that the defendant did not infringe the relevant patent. In holding that a "clear and convincing evidence standard" should apply to an antitrust claim based on allegations of bad faith enforcement, the court concluded that the "threat of antitrust liability should not be used to thwart good faith efforts at patent enforcement."[12] In other words, when a patentee brings suit to enforce its patents, the courts should respect that constitutionally granted right in the absence of clear and convincing evidence that such a suit was brought in bad faith.

Analysis of Burdens in the Merger Context: Positioning the Effects of the IP Litigation and Settlement in Failing Firm Defense and Competitive Effects Analysis

IP disputes often lead to "bet-the-company" litigation. Patent infringement suits, if successful, can lead to an injunction prohibiting

[9] For two excellent articles on the subject, see Herbert Hovenkamp, Mark Janis & Mark Lemely, Anti-competitive Settlement of Intellectual Property Disputes, 87 Minn. L. Rev. 1719 (2003); Carl Shapiro, Antitrust Analysis of Patent Settlements Between Rivals, 17 Antitrust 70 (Summer 2003).

[10] See Joseph Scott Miller, The Bitter Has Some Sweet: Potential Antitrust Enforcement Benefits from Patent Law's Procedural Rules, 70 Antitrust L.J. 875, 884 (2003).

[11] Loctite Corp. v. Ultraseal Ltd., 781 F.2d 861 (Fed. Cir. 1985).

[12] Id. at 876-77.

the infringing parties from selling the offending products (in antitrust parlance, the infringer must "exit the market"). Thus, where competitors merge, and the agencies commence an inquiry into whether the merger is likely to reduce competition, how should the agencies consider the possibility that the unresolved IP dispute could have resulted in the exit of the merger target/alleged infringer from the relevant market? Alternatively, where the IP dispute had only the possibility of harming the infringer, and was not likely to force a full exit by the infringer, how should the agencies consider the evidence of this weakened competitor in its analysis?

One thing seems certain: if it is 100% clear that the merger target/alleged infringer infringed upon the IP rights of the acquiring party and the result of that infringement would be an order requiring that company to exit the market, antitrust liability for merging should not attach. Under the Merger Guidelines, the transaction should not raise any competitive concerns because the target is tantamount to an "Exiting Asset."[13]

Where it is certain that the target would be required to exit the market because of an adverse finding in an infringement suit, that company is in no different a position than a true failing firm as recognized under the Merger Guidelines. "[A]bsent the acquisition, the assets of the firm would exit the relevant market"[14] and in the face of an order from a court so demanding, there is no possibility that it could reorganize under the Bankruptcy Act (because it has no product that it could lawfully sell), and there would be no other firm interested in such assets (because they would be enjoined from participating in the market).

Most cases are not so clear, however, creating a tension as to who should bear the burden–the merging parties or the government–in setting forth the role of an IP dispute in the merger analysis. On the one hand, as noted by Professor Miller, "an antitrust agency should be no worse off when assessing the erstwhile competitor's good faith basis for sacrificing its independence to the patentee than it would be if it were challenging a merger that the parties defend on failing firm grounds."[15] Thus, where the merging parties are attempting to demonstrate that the IP dispute would force the acquired party out of the market, Professor Miller believes that their burden of proof should be the same as the high hurdles erected by the failing firm defense.

On other hand, in the context of a Section 7 analysis where it is the government's–not the parties'–ultimate burden to demonstrate that a merger will likely result in anticompetitive effects, placing too high of a burden on the merging parties to prove the outcome of the IP dispute is inappropriate and contradicts two fundamental jurisprudential principles: First, it will frustrate the judicial intent behind promoting litigation settlements. Second, and perhaps more fundamentally, by placing a high

[13] See Dep't of Justice and Federal Trade Comm'n, 1992 Horizontal Merger Guidelines, § 5.1 (1997), available at http://www.ftc.gov/bc/docs/horizmer.htm. See also Joint Statement in Matter of The Boeing Co./McDonnell-Douglas Corp., available at http://www.ftc.gov/opa/1997/07/boeingsta.htm ("Our decision not to challenge the proposed merger was a result of evidence that (1) McDonnell Douglas, looking to the future, no longer constitutes a meaningful competitive force . . . and (2) there is no economically plausible strategy that McDonnell Douglas could follow . . . that would change that grim prospect").

[14] Dep't of Justice and Federal Trade Comm'n, 1992 Horizontal Merger Guidelines, § 5.1 (1997).

[15] See Miller, The Bitter Has Some Sweet: Potential Antitrust Enforcement Benefits from Patent Law's Procedural Rules, supra note 10, 70 Antitrust L.J. at 884.

burden upon the merging parties, the agencies may be undercutting the presumption that a patentee's decision to bring its patent infringement suit was in good faith, and under decisions such as Loctite, this presumption should only be undercut where the government can produce "clear and convincing evidence" of bad faith.

Regardless, even where it is not clear that the acquired party will have to exit the market (regardless of the level of deference paid by the agencies to the settlement), the IP dispute and its likely outcome still can have a significant impact on the merger analysis. It should not be irrelevant, for example, that the acquiring party had a strong–albeit uncertain–case against the acquired party.

The Merger Guidelines allow room for such arguments. Section 1.52 of the Merger Guidelines provides that "in some situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market or the impact of a merger."[16] Where the IP dispute (if followed through to judgment) would have debilitated the acquired party or lessened its competitive impact going forward, then surely this would be a significant factor in explaining that current high market shares "overstate the likely future competitive significance of" the acquired party, and the agencies should most certainly consider that in their analysis.[17]

Understanding the role of the settlement of the IP dispute in the merger analysis is only the first–and arguably easier–step in this process. Practically, the most difficult issue confronting the parties is how to demonstrate the likely effects of the IP litigation without being required to reenact the entire IP litigation before the antitrust tribunal during a fast-paced merger investigation.

The Most Significant Issues Lying in the Intersection: How do the Parties Meet Their Burden?

For the merging parties to demonstrate infringement–or under Schering-Plough, for the FTC to demonstrate non-infringement–is no small task, and some proclaim the job is outside the jurisdictional expertise of the antitrust agencies. Without the benefit of a full-blown trial, how does a party demonstrate infringement or lack thereof with certainty sufficient to permit the agencies to conclude that the acquired party's product would have exited the market were the litigation allowed to proceed?

This article offers several observations. First and foremost, the antitrust agencies are ill-equipped to independently determine whether a product infringes upon a patent. Conducting claims construction hearings, accepting expert testimony on the issue of infringement, and surveying the evidence to determine the consequence of infringement is a difficult task. If the agencies conducted that analysis each time they were confronted with determining the question of infringement then the benefits of settlement–certainty, cost reduction, and closure–would largely be eliminated. And in the merger context, where speed is essential, such a full investigative hearing seems implausible and ill-advised.

Does that mean that ultimately the antitrust agencies should simply ignore the pending lawsuit because its outcome is too difficult and time consuming to predict? Surely not. There

[16] See Dep't of Justice and Federal Trade Comm'n, 1992 Horizontal Merger Guidelines, § 1.52, available at http://www.ftc.gov/bc/docs/horizmer.htm.

[17] See also United States v. General Dynamics Corp., 415 U.S. 486 (1974).

are alternative ways for the parties to put forth sufficient circumstantial evidence to convince the agencies of the likely impact of the IP litigation on the future of the market without having to conduct a full trial. This article points out two sources of potentially significant information:

- Opinions of IP Counsel: The opinion of IP litigation counsel of both parties, as conveyed to the decision makers throughout the progress of the trial, should be informative when assessing the strength of the parties' claims, and the likely impact of the final remedy on the acquired company (and competition). If the parties agree (or are forced) to waive privilege in order to advance their affirmative "failing firm defense," then conceivably the agencies could rely on the opinions of counsel as a proxy for the likely outcome of the lawsuit.

  The reliability and probative value of opinion letters and other evidence reflecting the opinion of IP counsel is a function of how informed the parties are of the underlying facts. Thus, this evidence is likely to be most valuable if the IP litigation has progressed into the advanced stages, and genuinely reflects the opinions of an advocate attempting to prevail in the IP litigation (rather than manufactured record designed to convince the antitrust agencies of a different outcome).[18]

  Interestingly, the parties could prove too much: if they demonstrate to the agencies that they believed that the acquiring party was going to prevail in establishing liability and also in forcing the acquired party to exit the market, they will be in the position of having to defend any merger consideration offered beyond the sum of the cost of defense and the spoliation of assets (such as lost engineering talent, compromised good will, and the loss of positive network externalities as the customer base declines). Thus, if the parties' IP counsel represent this conclusion to the agencies, then they must explain any consideration paid to the acquired party by the acquiring party beyond (1) the cost avoided of defending the action and (2) the savings accrued from an early resolution, rather then a gradual decline in asset value during the pending litigation, while the acquired company's customers and derivative product/service providers switch to other alternatives, knowing that their provider will be forced to exit the market.

- Market Guidance. Market guidance is less reliable than an opinion of counsel because it presupposes that the market has perfect information about the likely outcome of an IP litigation dispute. However, if the agencies require confirmation of their conclusions regarding whether the acquired company would be forced to exit, the agencies could look to, for example, (i) pronounced drops in share price of the acquired party, signaling that the market believed that the likely outcome of the litigation would harm (or destroy) the alleged infringer; and (ii) whether customers have shifted buying patterns away from the acquired company, fearing that they would be required to exit the market.

This evidence is relevant whether the parties are seeking to satisfy the burdens of the failing

[18] There are complex issues related to waiver of privilege. Although the merging parties could shield against using waived materials against each other in the event that the litigation is forced to resume (because, for example, the antitrust agencies blocked the merger) by signing an agreement so promising, that agreement only protects against waiver with regard to the signatories of the agreement–privilege is still waived, and any third party potentially could gain access to that information in the discovery process.

firm defense, or attempting to position the acquired party as a diminished competitive presence because of the pending IP dispute and its likely outcome. In the latter scenario, the agencies must evaluate the merger's impact on competition, which necessarily includes a comparison to a baseline state of the world where the parties continue to compete and litigate, rather than merge. If the acquired company was instead forced to litigate, and faced dire–but not completely debilitating–results from the pending litigation, it would be in the position of losing a significant quantity of sales, and likely would not provide the acquiring company with the same competitive threat in the goods or innovation markets absent the litigation. The parties should present evidence normally produced in defending its merger, including a demonstration that the IP litigation has resulted in lost or deferred sales; decreasing levels of support from service/product vendors in derivative markets; decreasing value of the alleged infringer's products to consumers (if, for example, it was a network product) as the user base declines because of the uncertainty posed by the litigation; lost engineering talent (or other harm to the acquired company's assets which compromises its ability to compete); and continuing declines in share value and revenue streams that cause the company to forego R&D projects that are necessary to ensure its competitive viability.

Conclusion

The settlement and simultaneous merger between parties engaged in bet-the-company litigation could raise substantial antitrust issues–issues that have not yet been resolved by the courts or private parties. Where such a corporate combination raises antitrust concerns which could be eliminated if the underlying litigation was resolved in favor of the acquiring party, the antitrust agencies are placed in the uncomfortable position of having to decide whether to ignore the existence of that dispute or attempt to determine the likely outcome of the litigation. While it typically would be a mistake for an antitrust agency to ignore the existence of a dispute, an agency also should not attempt to litigate the underlying patent dispute. In this next frontier of merger antitrust review, many open issues remain that need to be confronted and placed in the appropriate framework for an adequate antitrust analysis of the role of probabilistic competition.

Committee News & Events [top]

Recent activities include:

- 2005 Spring Meeting Programs:

  Coordinated Effects Theories for Mergers–Recent Experience and Beyond

  Minority and Partial Interests in Competitors

  Cooks in the Kitchen: Combining the Best Ingredients for a Successful Merger or Acquisition

- Brown Bag lunch program on New HSR Rules–Closing a Loophole (April 25, 2005)

- Videoconference Brown Bag lunch program on the recently issued Canadian Merger Enforcement Guidelines (May 3, 2005)

- Co-sponsored Teleseminar on Nonparties at the Party: CIDs, Subpoenas, and Other Nonparty Discovery in Merger Investigations (May 10, 2005)

- Brown Bag lunch program on Second Request Compliance: Procedural Challenges and Governing Legal Standards (July 19, 2005)

For more information about Committee events, please visit the Committee's web page. The Committee also is undertaking a broad range of additional projects. To help out on any project or to volunteer generally, contact any of the Committee Officers listed below.

About the Mergers and Acquisitions Committee [top]

The Mergers and Acquisitions Committee focuses on issues relating to mergers, acquisitions and joint ventures under Section 7, and premerger notification under Section 7A. Committee activities and projects cover private litigation, both state and federal enforcement, and international merger enforcement activities.

Chair:

- Joseph G. Krauss
  Hogan & Hartson, LLP
  202–637–5832
  jgkrauss@hhlaw.com

Vice–Chairs:

- Thomas Fina
  Howrey Simon Arnold & White, LLP
  202–383–7261
  finat@howrey.com

- Michael H. Knight
  Federal Trade Commission
  202–326–2441
  mknight@ftc.gov

- Robert S. Schlossberg
  Freshfields Bruchhaus Deringer LLP
  202–777–4500
  robert.schlossberg@freshfields.com

- Jerome A. Swindell
  Johnson & Johnson Law Department
  732-524-3965
  jswindell@corus.jnj.com

- William R. Vigdor
  Vinson & Elkins LLP
  202–639–6737
  wvigdor@velaw.com

About The Threshold [top]

The Threshold is published periodically by the Mergers and Acquisitions Committee of the American Bar Association Section of Antitrust Law. The views expressed in the Newsletter are the authors' only and not necessarily those of the American Bar Association, the Section of Antitrust Law, or the Mergers and Acquisitions Committee. If you wish to comment on the contents of the Newsletter, please write to American Bar Association, Section of Antitrust Law, 321 North Clark, Chicago, IL 60610.

Co–Editors–in–Chief:

- Diana L. Dietrich
  Baker Botts LLP
  202–639–7726
  diana.dietrich@bakerbotts.com
- Kenneth P. Ewing
  Steptoe & Johnson, LLP
  202–429–6264
  kewing@steptoe.com
- Alan D. Rutenberg
  Foley & Lardner LLP
  202–672–5491
  arutenberg@foley.com

American Bar Association
321 North Clark
Chicago, IL 60610

Non–Profit Organization
U.S. POSTAGE
PAID
American Bar Association