Antitrust and Competition

WILMERHALE

Federal Trade Commission and Department of Justice Issue Important Report on Antitrust and Intellectual Property

On April 17, 2007, the Federal Trade Commission (FTC) and Department of Justice (DoJ) issued a joint report entitled "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition."[1] The report reflects what the agencies learned from a series of hearings held in 2002 on antitrust and intellectual property, where they heard testimony from participants in a wide range of IP-focused industries as well as from academics and practicing lawyers. The report provides some significant insights into the agencies' views on several important and unsettled issues.

At a broad level, the report emphasizes the agencies' continuing view that standard methods of antitrust analysis are appropriate for conduct involving intellectual property. The agencies also make clear that they will continue to rely on their 1995 Antitrust Guidelines for the Licensing of Intellectual Property (Antitrust IP Guidelines) and evaluate the great majority of conduct relating to intellectual property under the rule of reason, balancing any anticompetitive effects against procompetitive benefits.

The report also includes in-depth discussion of certain recurring issues involving the interplay between antitrust and intellectual property, incorporating both views from hearing participants and agency conclusions. The main topics covered are: unilateral refusals to license patents; standard-setting activities; cross-licensing arrangements and patent pools; particular licensing practices; tying and bundling involving intellectual property rights; and attempts to extend market power and royalties beyond a patent's statutory term.

Notably, the report does not cover one controversial issue that was discussed in depth at the hearings: settlements of patent disputes. This omission is probably unsurprising, given the agencies' apparently diverging views, at least in the context of settlements involving name brand and generic drug manufacturers. (In *FTC v. Schering*, 402 F.3d 1056 (11th Cir. 2005), *cert. denied*, 126 S.Ct. 2929(2006), DoJ opposed the FTC's efforts to obtain Supreme Court review of an Eleventh Circuit decision vacating an FTC decision that held a "reverse payment" settlement illegal.)

The report makes clear that the agencies are highly attuned to potential procompetitive benefits from agreements among intellectual property holders, and believe that most such agreements present relatively little risk to the competitive process. The agencies will focus intensively on whether a particular agreement or activity produces or is likely to produce demonstrable anticompetitive effects. On several topics, the agencies, as a matter of enforcement policy, emphasize their rejection of traditional bright-line rules, even when those rules may continue to have some life in the case law.

We briefly summarize some of the agencies' more interesting observations about their enforcement policies. Although these observations are useful guides to predicting how the agencies are likely to view particular types of conduct, they obviously do not bind the courts. Further, antitrust investigations are highly fact-specific. Parties should consider seeking legal advice before engaging in any of these activities.

Unilateral Refusals to License Patents

Whether there are circumstances under which a patent holder may be required to license to a competitor has long been a subject of controversy and received considerable attention during the FTC/DoJ hearings. In the interim between the hearings and the report, the Supreme Court, in *Verizon Communications Inc. v. Trinko*, 540 U.S. 398 (2004), made clear that a competitor may be obligated to aid a rival only in very narrow circumstances.[2] In addressing this issue, the agencies first discussed the teachings of *Trinko* and observed that the case law generally reflects "the traditional understanding that the unilateral right to decline the grant of a license is a core part of the patent grant." (Report at 29-31.) The agencies then put forth a somewhat Delphic conclusion "that liability for mere unconditional, unilateral refusals to license will not play a meaningful part in the interface between patent rights and antitrust protections." (*Id.*) The agencies emphasize, however, that antitrust liability may be appropriate for conduct beyond a mere unilateral refusal to license, such as concerted refusals to license involving two or more patent holders or conditional agreements to license (e.g., licensing one patent on the condition that licensees agree to license another patent, or imposing resale price restrictions on licensees). (*Id.*)

Standard-Setting Activities

The activities of standard-setting organizations (SSO) have been subject to extensive antitrust scrutiny in recent years. The report discusses at length the potential for the holder of a patent on technology that is incorporated in an industry standard to "hold up" firms wishing to implement the standard by setting higher royalties or less favorable terms than it would have been able to obtain before the standard was established (and before firms became "locked in" to the patented technology).[3] The report also evaluates approaches that SSOs have used to mitigate the "hold up" problem—including mandatory disclosure of patents and licensing rules—and some of the pitfalls with those approaches. (*Id.* at 41-48)

The agencies then devote particular attention to the use of "*ex ante*" license discussions, where owners of patented technology that the SSO is considering incorporating in a standard discuss licensing terms with SSO participants before the standard is set. (*Id.* at 49-56.) Such *ex ante* discussions have the potential to improve the SSO selection process by allowing participants to evaluate competing technologies, taking into account both technical merit and licensing cost. The report observes, however, that many SSOs and participants have been reluctant to engage in any discussions about licensing terms because of fears about potential antitrust liability, e.g., because the discussions could lead to coordination on the price of downstream products or allow SSO participants to exercise group buying power in negotiating licensing terms. (*Id.* at 50-53.) The agencies strongly emphasize that they will evaluate under the rule of reason *bona fide* joint activities to establish licensing terms before a standard is set, recognizing that such activities "have strong potential for procompetitive benefits." (*Id.* at 53-56.) The agencies will continue to treat as *per se* violations sham *ex ante* license discussions. (*Id.* At 55.) Such discussions might serve as a cover for competing patent holders to reach naked agreements on licensing terms among themselves or for SSO members to reach price-fixing agreements on standardized products they sell. (*Id.*)

Patent Pools

Patent pooling arrangements typically involve two or more patent holders contributing patents to a pool and offering multi-patent licenses. Patent pools often provide substantial procompetitive benefits by, among other things, integrating complementary technologies, providing an efficient mechanism to resolve patent claims and allow products to go to market, and reducing transaction costs associated with licensing. *See* Antitrust IP Guidelines § 5.5. DoJ has issued several business review letters endorsing specific patent pools in the DVD and wireless technology industries.[4] (Report at 66-69.)

Although the DoJ letters recognize the procompetitive potential of patent pools, they have generally been interpreted to suggest that including patents for competing technology (rather than just patents for **complementary** technology) in a pool may raise substantial competitive concerns. The report, however, arguably takes a more permissive approach to pools that include competing patents. The agencies seem to suggest that their rule of reason analysis will focus on the **overall** competitive impact of the pooling arrangement, rather than on the incremental competitive impact of including each particular patent in the pool (e.g., patents that are potential substitutes for other patents in the pool). (*Id.* at 78.) The report also clarifies the relatively uncontroversial proposition that, under normal circumstances, the agencies will not police the reasonableness of royalties that the pool demands from licensees. (*Id.* at 82-83.)

Tying and Bundling

A tying arrangement arises when a seller conditions the sale of one product (the "tying" product) on the purchase of another product (the "tied" product).[5] The report recognizes that the procompetitive benefits of tying arrangements have become increasingly well accepted as tying arrangements have become better understood. (*Id.* at 103-104). Courts, however, generally still apply a modified *per se* rule to tying arrangements: if the seller has market power in the market for the tying product (and some other elements are satisfied),[6] the tie violates the antitrust laws, even absent proof of actual anticompetitive effects in the market for the tied product. *See*, e.g., *Jefferson Parish*

Hosp. No. 2 v. Hyde, 466 U.S. 2, 9, 16-18 (1984).[7] The report reconfirms, however, that the agencies will not simply presume competitive harm in the market for the tied product based on market power in the tying market. The rejection of this bright-line rule is consistent with the approach to tying arrangements announced in the 1995 Antitrust IP Guidelines. *See* Antitrust IP Guidelines § 5.3. The agencies will make an intensive, fact-specific inquiry to determine whether any anticompetitive impact in the market for the tied product is outweighed by the overall procompetitive impact of the agreement, and thus "whether the [tying arrangement] is likely to be anticompetitive on balance." (Report at 111.)

Post-Patent-Expiration Royalties

Patent holders sometimes seek licencing royalty payments that extend beyond the term of patent. Historically, the courts have often condemned this practice, creating what has been termed one of the few *per se* rules against a patent licensing practice.[8] *See*, e.g., *Scheiber v. Dolby Labs., Inc.,* 293 F.3d 1014 (7th Cir. 2002). This reflected a traditional concern that the practice would enable patent holders to extend market power conferred by a patent beyond the patent term. In *Brulotte v. Thys Co.,* 379 U.S. 29 (1964), the Supreme Court held unenforceable a licensing agreement under which owners of hop-picking machines were required to pay royalties for the use of the machines even though all patents on technology actually incorporated in the machines had expired. The report announces that the *Brulotte* rule will not dictate the agencies' enforcement policy. Rather, the FTC and DoJ will review "agreements that have the potential to extend the market power conferred by a valuable patent beyond that patent's expiration pursuant to the rule of reason." (Report at 122.) Importantly, this inquiry focuses on whether the licensing practice enables the patent holder to use its patent to exercise market power after the patent expires—not simply on whether the patent holders will continue to obtain royalty payments post-patent expiration. The agencies reason that a bright-line prohibition on post-expiration royalties can prohibit efficient licensing practices that allow licensees to amortize payments or allow parties to contract for efficient arrangements. (*Id*. at 118-19.) The agencies appear skeptical that many royalty arrangements (other than sham arrangements) will successfully extend market power, observing that "few practices that could extend the market power conferred by a patent beyond the patent's expiration actually do so." (*Id*. at 122.)

Conclusion

The FTC and DoJ report is important reading for anyone seeking to understand the agencies' current views about conduct at the intersection of antitrust and intellectual property. As in other areas of antitrust law, the agencies continue to carefully study and re-assess their enforcement policies, aided by input from industry participants, academics, and practitioners. Notably, the agencies are willing to state views that do not always hew precisely to the contours of traditional antitrust jurisprudence, especially when they believe the case law establishes bright-line rules of illegality that unduly truncate inquiry into actual competitive effects. As economic learning and practical experience in this complex area continue to evolve, the agencies will further refine their enforcement approaches.

NOTES

1. The full report is available at http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

2. The Court in *Trinko* took a narrow view of prior cases, holding that a monopolist's refusal to deal with a competitor could give rise to antitrust liability in certain circumstances. *See*, e.g., *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,* 472 U.S. 585 (1985). *Trinko* did not, however, overrule *Aspen* or otherwise hold that a unilateral refusal to deal could never give rise to antitrust liability.

3. The FTC has alleged that deceptive conduct allowed firms to engage in such "hold ups" on three occasions. *In re Dell*, 121 F.T.C. 616 (1996); *In re Rambus*, No. 9302 (Final Order, February 5, 2007), *available at* http://www.ftc.gov/os/adjpro/d9302/index.shtm (but see also *In re Rambus*, No. 9302 (Respondent's Motion for Stay of Order Pending Appeal, February 16, 2007), *available at* http://www.ftc.gov/os/adjpro/d9302/index.shtm); Statement of the Federal Trade Commission: *In re Union Oil Co. of California*, No. 9305 (Initial Decision, November 26, 2003), *available at* http://www.ftc.gov/os/caselist/d9305.shtm.

4. *See*, e.g., Letter from Charles A. James, Assistant Attorney General, US Dept. of Justice, Antitrust Division to Ky P. Ewing, Esq. (Nov. 12, 2002), http://www.usdoj.gov/atr/public/busreview/200455.htm; Letter from Joel I. Klein, Assistant Attorney General, US Dept. of Justice, Antitrust Division to Carey R. Ramos, Esq. (June 10, 1999), http://www.usdoj.gov/atr/public/busreview/2485.htm; Letter from Joel I. Klein, Assistant Attorney General, Antitrust Division, to Garrard R. Beeney, Esq. (Dec. 16, 1998), http://www.usdoj.gov/atr/public/busreview/2121.htm; Letter from Joel I. Klein, Assistant Attorney General, Antitrust Division, to Garrard R. Beeney, Esq. (June 26, 1997), http://www.usdoj.gov/atr/public/busreview/215742.htm. These business review letters have provided guidance to the private bar and have also proven influential to at least some courts. *See*, e.g., *Matsushita Elec. Indus. CO., LTD v. Cinram Int'l, Inc,.,* 299 F. Supp.2d 370, 379 (D. Del. 2004) (observing that due to "the DoJ's familiarity and experience analyzing complex pooling arrangements;" the court was "strongly persuaded" by the DoJ's business review letter concluding that a DVD pool did not violate antitrust laws).

5. The report did not discuss any distinctions between tying and bundling in the context of intellectual property that might impact the agencies' enforcement approach.

6. The report reiterates that intellectual property rights do not necessarily create market power, consistent with the agencies' position in the 1995 Antitrust IP Guidelines and the Supreme Court's recent holding in *Illinois Tool Works Inc. v. Independent Ink, Inc.,* 126 S. Ct. 1281, 1292 (2006). (Report at 87-88.)

7. As the report observes, however, in certain circumstances some lower courts have required proof that the tying arrangements caused actual anticompetitive effects. *See* Report at 104 (citing *United States v. Microsoft Corp.,* 253 F. 3d 34 (D.C. Cir. 2001).

8. More recently, courts have declined to apply a *per se* rule in certain cases, e.g., when a licensee pays royalties post-expiration for practicing the patented technology only before the patent expired. (Report at 116-119.)

FOR MORE INFORMATION ON THIS OR OTHER ANTITRUST AND COMPETITION MATTERS, PLEASE CONTACT:

Leon B. Greenfield leon.greenfield@wilmerhale.com +1 202 663 6972

Daniel J. Matheson daniel.matheson@wilmerhale.com +1 202 663 6887