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entertainment LAW SPECIAL ISSUE

BOXING MATCH

When copyright law and antitrust law collide, who wins?

by Robert G. Badal, Caroline Kane, and Bethany Stevens

FEDERAL CIRCUITS are split on whether the exercise of intellectual property rights may constitute an unreasonable restraint of trade in violation of antitrust laws. Some hold that intellectual property owners pursuing their rights are nearly immune from antitrust challenges. In contrast, others find that claims or defenses based on intellectual property rights only create a rebuttable presumption that the restraint is lawful.

A recent decision, *Redbox Automated Retail LLC v. Universal City Studios LLP*, raises a number of questions about balancing the rights of intellectual property owners with the requirements of the antitrust laws. In *Redbox*, a district court allowed a downstream retailer to pursue a Sherman Act Section 1 claim despite the copyright holder's claim of exclusive rights.[1] While the case is still being litigated, the district court's ruling nevertheless serves as a warning for owners of intellectual property regarding future claims deeming their conduct a restraint of trade.

Redbox rents and sells DVDs through a network of over 22,000 interactive, self-service kiosks at locations nationwide. The kiosks typically hold a maximum 700 DVDs (with as many as 200 different titles) and are updated weekly with new releases. A single Redbox kiosk might carry up to 45 DVDs of each of the most popular new releases. A DVD from a Redbox kiosk rents for $1 per night, which is roughly one-third what Redbox's competitors charge. Redbox is not a producer of DVDs and, therefore, is reliant on others to provide the DVDs that populate its kiosks.

Since its founding in 2002, Redbox has been successful in implementing its kiosk model for distributing DVDs to the viewing public. In the third quarter of 2009, Redbox's revenues were reported to be over $198 million—nearly double its revenue for the same quarter of the previous year. Additionally, Redbox substantially expanded its network of self-service kiosks from 12,000 at the end of 2008 to over 21,000 at the end of 2009.

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From its inception, Redbox acquired DVDs from distributors—such as Ingram Entertainment, Inc., and Video Product Distributors—that have agreements with studios, including Universal, to distribute studio-produced DVDs. In 2008, Universal allegedly told Redbox that it would prohibit its distributors from doing business with Redbox unless Redbox entered into a revenue sharing agreement that, among other provisions, would prohibit Redbox from renting or selling Universal DVDs until 45 days after they became available to the public through Universal's traditional means of distribution. Notably, Redbox gains 30 percent of its revenues on new DVDs in the first two weeks of their release and 60 percent of its revenues in the first 45 days. The revenue sharing agreement also would limit the number of copies of Universal DVDs that each Redbox kiosk could stock.

Although the terms of the revenue sharing agreement would limit Redbox's distribution, Redbox alleges that its competitors, who charge approximately three times more than Redbox, would not be so limited. According to Redbox, when Redbox refused to enter into this revenue sharing agreement, Universal asked Ingram and VPD to stop selling DVDs to Redbox. Since then, Redbox has attempted to stock its kiosks with Universal DVDs purchased from retailers. However, that temporary solution was apparently short lived. Redbox alleges that Universal demanded that Best Buy and Walmart refuse to sell or limit sales of Universal DVDs to Redbox.

On October 10, 2008, Redbox sued Universal in federal court in Delaware for copyright misuse, antitrust violations, and tortious interference with contractual relationships.[2] Universal moved to dismiss Redbox's complaint, and Redbox filed an amended complaint. Redbox alleges that Universal seeks to "eliminate the channel of low-cost, highly-convenient kiosk rental and resale; or…unlawfully eliminate competition from Redbox (and other kiosk outlets)…." Universal filed a supplemental motion to dismiss arguing, among other things, that as the holder of the copyrights for the movies embedded in the DVDs it has an absolute right to control distribution of its copyrighted content. In its supplemental motion to dismiss, Universal stated that "the law permits the conduct about which Redbox complains specifically because suppliers, not distributors, are best positioned to decide how to compete and how to distribute their products."

On August 17, 2009, the court granted in part and denied in part Universal's motion to dismiss. First, the court dismissed Redbox's claim of copyright misuse because the Third Circuit recognizes that claim solely as an affirmative defense and not as an independent claim. Second, the court dismissed Redbox's tortious interference with contractual relationships claim because Redbox's contracts with Ingram and VPD did not guarantee that Universal DVDs would be provided to Redbox. A breach of contract is a required element for a tortious interference claim, and the contracts with Ingram and VPD were not breached. Third, the court addressed the plaintiff's antitrust claim by concluding that it alleges "a vertical nonprice restraint or vertical boycott." The court held that the plaintiff sufficiently pled a Section 1 claim by alleging "that Universal has induced or otherwise convinced others to boycott Redbox in distribution of Universal DVDs, producing anticompetitive effects, specifically Redbox's inability to compete in the DVD rental and sales markets of Universal DVDs."

At the end of September 2009, Universal filed a motion to certify the court's August 17, 2009, order for 28 U.S.C. Section 1292(b) interlocutory appeal. The court has not yet ruled upon the motion.

In its present posture, the *Redbox/Universal* litigation brings to the surface a conflict between the principles that animate the antitrust laws and those that drive the intellectual property laws. While both bodies of law are intended to promote innovation and creativity, they employ contrasting means. The antitrust laws encourage innovation through increased competition by removing barriers to entry and attacking monopolistic and market-foreclosing conduct. The intellectual property laws accomplish the same goal with restricted competition by granting exclusive rights to property owners for a specified period and thus preventing others from using the property.

The *Redbox/Universal* litigation raises a perplexing dilemma: an intellectual property owner can exclude others from using its property but still risks potential antitrust liability for doing so. How can intellectual property owners ensure that they are not crossing the line into behavior prohibited by antitrust laws as they exercise the broad rights given to them by patent, copyright, or trademark laws? The answer to this question requires an understanding of what exclusionary rights intellectual property laws may—and may not—confer as well as an examination of when a refusal to deal is prohibited by antitrust laws.

It remains unclear which theory of antitrust liability Redbox is pursuing or which antitrust doctrine persuaded the Delaware judge to deny Universal's motion to dismiss. As the prior cases show, factual circumstances are central to the ultimate analysis.

Refusal to Deal

Although the *Redbox/Universal* litigation implicates only the rights of copyright holders, some of the relevant antitrust principles also apply to other forms of intellectual property. While the laws governing each type of intellectual property—patent, trademark, or copyright—are distinct and "confer[] somewhat different property rights and provide[] a different type of protection,"[3] each regime provides rights that allow property owners to control the use and distribution of their works. For example, the copyright owners of DVD content in the *Redbox/Universal* litigation relied in part on their "exclusive right," granted by 17 U.S.C. Section 106(3), to sell, license, or otherwise distribute copies of a copyrighted work.

Litigants and their counsel as well as judges and other commentators have likened the exclusive rights conferred by the intellectual property laws to "legal monopolies." Court decisions are replete with broad statements regarding the freedom of copyright holders to withhold their protected content

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The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. The antitrust laws generally permit companies to freely choose with whom they will deal.
True.
False.

2. According to rulings of the First and Ninth Circuits, a refusal to deal based on the exercise of intellectual property rights is presumptively unjustified.
True.
False.

3. A group boycott may constitute a violation of Section 1 of the Sherman Act.
True.
False.

4. The antitrust laws and intellectual property laws are both intended to encourage innovation—the former by increasing competition and the latter by restricting it.
True.
False.

5. A breach of contract is a required element of a claim for tortious interference with contractual relationships.
True.
False.

6. Redbox owns the copyrights to the DVDs it rents through its kiosks.
True.
False.

7. Unilateral refusals to license content protected by an intellectual property right are generally lawful.
True.
False.

8. A supplier and its distributor have a vertical relationship.
True.
False.

9. Redbox rents DVDs to consumers not only at its kiosks but also through the mail and at brick-and-mortar stores.
True.
False.

10. All concerted refusals to deal are presumptively anticompetitive.
True.
False.

11. 17 U.S.C. Section 106(3) grants exclusive rights to sell, license, or otherwise distribute copies of a copyrighted work.
True.
False.

12. The Third Circuit recognizes copyright misuse as an independent claim and an affirmative defense.
True.
False.

13. The determination of whether a refusal to deal is a justifiable business practice involves a question of fact.
True.
False.

14. The U.S. Supreme Court has recognized a group boycott as a cognizable Section 1 claim for over 60 years.
True.
False.

15. Although patents, trademarks, and copyrights are governed by distinct statutory schemes, the protections provided for each type of intellectual property right are identical.
True.
False.

16. One goal of the antitrust laws is to preserve the choices available to market participants.
True.
False.

17. If an intellectual property right is lawfully obtained, its subsequent exercise cannot be the basis for an antitrust claim.
True.
False.

18. Redbox's antitrust allegations appear to be based on a vertical boycott theory.
True.
False.

19. Some have described the exclusive rights conferred by the intellectual property laws as "legal monopolies."
True.
False.

20. While antitrust immunity may exist for the exercise of intellectual property rights, it is not without limits.
True.
False.

MCLE Answer Sheet #192

BOXING MATCH

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Mark your answers to the test by checking the appropriate boxes below. Each question has only one answer.

1.	☐ True	☐ False
2.	☐ True	☐ False
3.	☐ True	☐ False
4.	☐ True	☐ False
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16.	☐ True	☐ False
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18.	☐ True	☐ False
19.	☐ True	☐ False
20.	☐ True	☐ False

from any and all others as they see fit. As the Supreme Court has stated, "The owner of the copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property."[4] However, despite these statements, case law also recognizes limits to the exclusionary rights under the intellectual property laws—including those imposed by the antitrust laws.

A number of courts have considered whether and to what extent a defendant copyright or patent holder's refusal to sell, license, or supply its property rights can avoid antitrust liability based on a claimed right under the intellectual property laws. In cases involving unilateral refusals to license an intellectual property, or to sell or supply protected works or technology, courts generally decline to impose antitrust liability. Even here, however, caveats abound. Courts have recognized that in certain circumstances an intellectual property right does not confer an unfettered right to refuse to deal, and this potentially exclusionary conduct is not immune from antitrust liability.

For example, in *United States v. Microsoft*, a case brought by the United States and individual states accusing Microsoft of exclusive dealing and other exclusionary conduct, Microsoft argued that "if intellectual property rights have been lawfully acquired," then "their subsequent exercise cannot give rise to antitrust liability."[5] In rejecting Microsoft's contention that the exercise of intellectual property rights enjoyed antitrust immunity, the D.C. Circuit characterized the argument as a "bold and incorrect position of the law" and likened it to the "proposition that use of one's personal property, such as a baseball bat, cannot give rise to tort liability."[6]

The Federal Circuit has also recognized the limits of the exclusionary rights granted by the intellectual property laws. It did so in *Atari Games Corporation v. Nintendo of America, Inc.*,[7] which involved an antitrust challenge to Nintendo's use of its patents to prevent retailers from selling unauthorized Nintendo-compatible game cartridges. In assessing whether to grant a preliminary injunction against Nintendo, the court noted, "When a patent owner uses his patent rights not only as a shield to protect his invention, but as a sword to eviscerate competition unfairly, that owner may be found to have abused the grant and may become liable for antitrust violations when sufficient power in the relevant market is present."[8]

Several circuits have taken a further step to clarify when the exercise of exclusionary intellectual property rights may constitute an antitrust violation. They have adopted what amounts to a "rebuttable presumption" standard. For example, the First Circuit considered a copyright holder's refusal to deal in certain copyrighted software. The court held that "while exclusionary conduct can include a monopolist's unilateral refusal to license a copyright, an author's desire to exclude others from use of its copyrighted work is a presumptively valid business justification for any immediate harm to consumers."[9] After examining the historical relationship between intellectual property rights and antitrust liability, the court explained that rebutting the presumption—though not impossible—would only in rare cases be "unlikely to frustrate the objectives of the Copyright Act."[10]

The Ninth Circuit also adopted a form of rebuttable presumption in *Image Technical Services, Inc. v. Eastman Kodak Company*.[11] The plaintiff, a group of independent service organizations, challenged Kodak's practice of refusing to sell replacement parts to its product customers who purchased service contracts from the ISOs rather than from Kodak. The ISOs alleged that Kodak unlawfully monopolized or attempted to monopolize the market for servicing Kodak copiers. At trial, Kodak argued that it held numerous patents and copyrights for its photocopiers, diagnostic software, and service software and manuals, and these intellectual property rights provided a legitimate business justification for its alleged refusal to deal with the ISOs. The jury rejected this argument and instead returned a verdict in favor of the ISOs. Kodak appealed.

Although the Ninth Circuit noted that it could "find no reported case in which a court has imposed antitrust liability for a unilateral refusal to sell or license a patent or copyright," and that "courts do not generally view a monopolist's unilateral refusal to license a patent as 'exclusionary conduct,'" it held that the exercise of intellectual property rights creates only a rebuttable presumption that anticompetitive conduct is justified.[12] The court upheld the jury's verdict, finding it "more probable than not that the jury would have found Kodak's presumptively valid business justification rebutted" as pretextual.[13]

In a different factual context, the Second Circuit recently overturned the dismissal of an antitrust claim brought against major music publishers in *Starr v. Sony BMG Music Entertainment*.[14] The publishers—which each produce, license, and distribute music—established jointly owned Internet sites for the sale of digital music. According to the allegations in *Starr*, the publishers refused to provide music to independent Internet distributors. The Second Circuit held that this refusal to deal with independent Internet distributors was, at the very least, a factor that could be used to prove an unlawful restraint of trade.[15]

Group Boycott

The district court in the *Redbox/Universal* litigation indicated that the limits articulated in these refusal-to-deal cases may also apply to cases involving concerted refusals to deal undertaken by or involving a group of intellectual property rights holders. Although the court stated that the classic "group boycott" label does not reflect "the whole of [Redbox's] claim," the fact pattern relied on in the court's ruling is close to the group boycott line of antitrust cases.

These cases hold that although the antitrust laws generally grant an entity broad autonomy in deciding with whom it will deal, a dominant entity's use of its vertical relationships to coerce a customer or a distributor to refuse to deal with a competitor may give rise to a finding of a group boycott—a violation of Section 1. Supreme Court authority for more than 60 years holds that group boycotts limiting or restricting the choices available to market participants are unlawful. For example, the Court held in 1941 in *Fashion Originators' Guild of America, Inc. v. Federal Trade Commission* that a boycott designed to destroy a rival method of competition violated the antitrust laws.[16] The boycott was organized by a group of dress and textile manufacturers who sold original clothing. The manufacturers used their vertical relationships with retailers to coerce the retailers to refrain from doing business with a group of manufacturers selling "copied" designs. The defendants argued that they had legitimate business reasons to protect their designs from the copiers, but the Court rejected this argument. The purpose of the boycott, according to the Court, was "the intentional destruction of one type of manufacture and sale which competed with [the manufacturers]," so the manufacturers' conduct was well within the ambit of the antitrust laws.

Nearly two decades later, in *Klor's, Inc. v. Broadway-Hale Stores, Inc.*,[17] the Court again confronted and found a group boycott that was harmful to competition. In the case, the defendant, a large department store, demanded that manufacturers and distributors of household appliances stop selling their goods to the plaintiff, a low-cost department store, if they wanted to continue to do business with the defendant. The Supreme Court reversed the Ninth Circuit's grant of summary judgment to the defendant, observing that group boycotts "cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." The Court further noted that such a restraint "clearly has, by its nature and character, a monopolistic tendency" and thus constitutes the type of harm the antitrust laws were designed to prevent.

The concern about preserving free market choice also arose in *Blue Shield of Virginia v. McCready*,[18] which involved a health plan subscriber's antitrust claims that an insurer had conspired with a society of psychiatrists to boycott clinical psychologists. The Supreme Court found that the boycott's restriction of the subscribers' ability to seek the psychological treatment of their choice resulted in antitrust injury.

The Court summarized and reinforced the concerns and principles reflected in *Fashion Originators*, *Klor's*, and *McCready* in *Northwest Wholesalers Stationers, Inc. v. Pacific Stationery and Printing Company*. While observing that not all refusals to deal are predominantly anticompetitive, the Court stated that boycotts involving "joint efforts by a firm or firms to disadvantage competitors by 'either directly denying or persuading or coercing suppliers or customers to deny relationships the competitors need in the competitive struggle'" have typically been presumed to have anticompetitive effects.[19]

Although these cases do not directly involve the exercise of copyright, trademark, or patent rights, the common themes that emerge—including concern for preserving the unrestricted market choices of buyers—appear to have influenced the court in the *Redbox/Universal* litigation. More generally, the themes thread through and illuminate other cases, including *Kodak* and *Starr*, in which the exercise of intellectual property not only protects patented technology or copyrighted works but also allegedly eliminates a competitor and diminishes the selections available to consumers.

Crucial Lesson

What seems clear from these cases in which antitrust law and intellectual property law are intertwined is that a concerted refusal to deal—even when intellectual property rights are involved—can draw antitrust scrutiny in a number of different factual circumstances. Despite broad statements in some cases about the prerogative of intellectual property holders to control how they license—or, indeed, refuse to license—their content, it is likewise the case that the antitrust laws can constrain their ability to do so. Antitrust immunity may exist for the exercise of intellectual property rights, but it is not without limits.

It remains unclear which theory of antitrust liability Redbox is pursuing or which antitrust doctrine persuaded the Delaware judge to deny Universal's motion to dismiss. Nor is it possible at this point to determine what actual facts will be adduced. As the prior cases show, factual circumstances are central to the ultimate analysis. The allegations in the amended complaint and Redbox's opposition to Universal's motion to dismiss suggest that Redbox is pursuing a theory that Universal is using its vertical relationships with its distributors and retailers to keep Redbox from distributing DVDs. The district court's opinion stated that the classic group boycott label does not reflect "the whole of [Redbox's] claim," but it permitted the complaint to survive the pleading stage without a full explanation of any other label that might apply.

Only further development of the facts will reveal whether the concerns that animate the case law addressing the issues of refusal to deal and group boycott will apply to the *Redbox/Universal* litigation. Whether Redbox will be able to prove the elements of its claims, and whether Universal's conduct toward Redbox constitutes justifiable business practices and is procompetitive, must still be adjudicated. The crucial lesson for intellectual property owners is that a copyright holder was not able to escape Redbox's antitrust allegations at the pleading stage, notwithstanding its uncontested status as a copyright holder. The facts may end up undercutting Redbox's theory of liability. But for now, the court has determined that whatever antitrust protection the copyright laws might afford Universal, that protection is not absolute. ■

[1] Redbox Automated Retail LLC v. Universal City Studios LLP, Civil Action No. 08-766, 2009 WL 2588748 (D. Del. Aug. 17, 2009); *see* 15 U.S.C. §1.
[2] Redbox resolved a similar dispute with Warner Bros. *See* Ben Fritz, *Redbox Agrees to 28-Day Delay in Offering Warner Movies*, L.A. Times, Feb. 17, 2010, at B3.
[3] *See*, *e.g.*, Telecom Tech. Servs. v. Rolm Co., 388 F. 3d 820, 827 (11th Cir. 2004).
[4] Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932).
[5] United States v. Microsoft, 253 F. 3d 34, 63 (D.C. Cir. 2001).
[6] *Id.*
[7] Atari Games Corp. v. Nintendo of Am., Inc., 897 F. 2d 1572 (Fed. Cir. 1990).
[8] *Id.* at 1576. *Compare* In re Serv. Orgs. Antitrust Litig., 203 F. 3d 1322 (Fed. Cir. 2000) (With a few narrow exceptions, a unilateral refusal to deal is largely immune from antitrust liability.).
[9] Data Gen. Corp. v. Grumman Sys. Support Corp., 36 F. 3d 1147, 1187 (1st Cir. 1994).
[10] *Id.* at 1187 n.64.
[11] Image Tech. Servs., Inc. v. Eastman Kodak Co., 125 F. 3d 1195 (9th Cir. 1997).
[12] *Id.* at 1218.
[13] *Id.* at 1219-20.
[14] Starr v. Sony BMG Music Entm't, 592 F. 3d 314 (2d Cir. 2010).
[15] *Id.* at 323.
[16] Fashion Originators' Guild of Am., Inc. v. Federal Trade Comm'n, 312 U.S. 457 (1941).
[17] Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207 (1959).
[18] Blue Shield of Va. v. McCready, 457 U.S. 465 (1982).
[19] Northwest Wholesalers Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 294-95 (1985).