Legal Backgrounder

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INTERSECTION OF IP RIGHTS & ANTITRUST ILLUMINATED IN DOJ/FTC REPORT

by

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This past spring, the Federal Trade Commission (FTC) and the Department of Justice (DoJ) issued "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition" ("Report").[1] The report reflects what the agencies learned from a series of hearings held in 2002, 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.

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 pro-competitive 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 is probably unsurprising given the agencies' apparently divergent 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.[2]).

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

[2]Similarly, in *Joblove v. Barr Labs., Inc. (In re Tamoxifen Citrate Antitrust Litigation)*, the Supreme Court declined to review a Second Circuit decision upholding the dismissal of a challenge to an alleged reverse payments scheme. 2007 U.S. LEXIS 8328 (June 25, 2007). DoJ supported the denial of *certiorari* after the Supreme Court invited the views of the United States. *See* http://www.usdoj.gov/atr/cases/f223500/223525.htm; http://www.supremecourtus.gov/docket/06-830.htm. The

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The report makes clear that the agencies are highly attuned to potential pro-competitive 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 emphasize their rejection of traditional bright-line rules as a matter of enforcement policy, even when those rules may continue to have some life in the case law.

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

Unilateral Refusals to License Patents. The FTC/DoJ hearings devoted considerable attention to the long-controversial issue of whether there are circumstances in which a patent holder may be required to license to a competitor. 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.[3] In addressing this issue, the agencies first discussed the teachings of *Trinko* and observed that the caselaw 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. However, the agencies declined to endorse a "categorical exemption from antitrust liability for unilateral, unconditional refusals to license," *id.* at 30, in part because "immunity from the antitrust laws is both exceptional and disfavored," and because Congress did not specifically create an antitrust immunity for refusal to license in 35 U.S.C. § 271(d)(4) (providing that refusal to license a patent cannot constitute patent misuse or "illegal extension of the patent right"). *Id.* at 25-27.

Balancing these competing considerations, the agencies arrived at the 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.* at 30. 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.* 30-31.

Standard Setting Activities. The activities of standard setting organizations (SSO) have been subject to extensive antitrust scrutiny in recent years. The report discusses 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 firms became "locked in" to the technology.[4] 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 devote particular attention to "*ex ante*" licensing discussions, in which owners of patented technology that the SSO is

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Supreme Court did not request the views of the FTC, which had opposed dismissal of the case in an *amicus* brief filed with the Second Circuit. *See* http://www.ftc.gov/os/2005/12/051202amicustamoxifen.pdf.

[3]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 result in liability.

[4]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, Feb. 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, Feb. 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, Nov. 26, 2003), *available at* http://www.ftc.gov/os/caselist/d9305.shtm.

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considering incorporating into 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. *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* licensing 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.*

Shortly after releasing the Report, DoJ provided further encouragement to SSOs seeking to facilitate *ex ante* licensing commitments, issuing a business review letter indicating that it would not challenge a new intellectual property rights policy adopted by the Institute for Electric and Electronics Engineers (IEEE).[5] The IEEE's new patent policy permitted – but did not require – holders of essential patents unilaterally to commit to offer licenses on terms no less favorable than those specified during the standard setting process (such as a specific license fee). Under the IEEE policy, patent holders were permitted to summarize their proposed terms in a sample licensing agreement, but joint negotiations over the actual terms licensees would receive was prohibited. The policy also prohibited discussion of specific terms during standard development meetings.

Patent Pools. Patent pooling arrangements typically involve two or more patent holders pooling and offering multi-patent licenses. Patent pools often provide substantial pro-competitive benefits by, among other things, integrating complementary technologies, providing an efficient mechanism to resolve patent claims, and reducing transaction costs. Antitrust IP Guidelines § 5.5. DoJ has issued several business review letters endorsing specific patent pools in the DVD and wireless technology industries.[6] Report at 66-69.

Although the DoJ letters recognize the pro-competitive 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. Tying arises when a seller conditions the sale of one product (the "tying" product) on the purchase of another product (the "tied" product).[7] Although the report recognizes the that the pro-competitive benefits of tying arrangements have become increasingly well accepted, *id.* at 103-104, courts

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[5]Letter from Thomas O. Barnett, Assistant Attorney General, US Dept. of Justice, Antitrust Division to Michael A. Lindsay, Esq. (Apr. 30, 2007), http://www.usdoj.gov/atr/public/busreview/222978.htm.

[6]*See*, *e.g.*, Letter from Charles A. James, Assistant Attorney General, U.S. 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, U.S. 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)..

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

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),[8] the tie is illegal, even absent proof of actual anti-competitive effects in the market for the tied product. *See Jefferson Parish Hosp. No. 2 v. Hyde*, 466 U.S. 2, 9, 16-18 (1984).[9] The report re-confirms, however, that the agencies will not 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 Guidelines. *See* Antitrust IP Guidelines § 5.3. The agencies will make a fact-specific inquiry to determine whether any anti-competitive impact in the market for the tied product is outweighed by the overall pro-competitive 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 royalty payments for patent licenses that extend beyond the term of patent. The courts historically have often condemned this practice, creating what has been termed one of the few *per se* rules against a licensing practice. *See, e.g., Scheiber v. Dolby Labs., Inc.*, 293 F.3d 1014 (7th Cir. 2002).[10] This approach reflects 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* beyond the term of the patent – 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 other 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 usefully illuminates the agencies' current views about conduct at the intersection of antitrust and intellectual property. As in other areas of antitrust law, the agencies continue carefully to study and re-assess 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 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.

[8]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.

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

[10]More recently, courts have declined to apply a per se rule in certain circumstances: for example, arrangements in which post-expiration royalties are paid to compensate the patent holder only for pre-expiration use. Report at 116-119.