Federal Trade Commission

Some Thoughts on the Role of Intellectual Property in Innovation Market Cases and Refusals to License

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In 1995, the Department of Justice and the Federal Trade Commission issued Antitrust Guidelines for the Licensing of Intellectual Property.[1] Those Guidelines asserted three general principles. The first was that "for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property."[2] The second was that "the Agencies do not presume that intellectual property creates market power in

[*] The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners. I am grateful to my attorney advisors, Darren Tucker and Henry Su, for their invaluable assistance preparing this paper.

[1] U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property (1995), *available at* http://www.usdoj.gov/atr/public/guidelines/0558.pdf.

[2] *Id*. § 2.0.

the antitrust context."[3] The third was that "the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive."[4]

These remarks will advance three propositions. The first is that intellectual property is *not* comparable to other forms of property *for purposes of antitrust analysis*. Patents, copyrights, trade secrets, know-how and trademarks, while they possess attributes of property in that they can be acquired and conveyed, do not always exhibit a clear and direct linkage to the goods markets that are the central focus of the antitrust laws.[5] Consequently, the antitrust analysis may be even *less clear and more tenuous* when the focus shifts from goods markets to what the Intellectual Property Guidelines call "innovation markets," i.e., markets for research and development.

The second is that the notion that intellectual property is not presumed to create antitrust market power was only recently embraced by the Supreme Court—in 2006 in the *Illinois Tool Works v. Independent Ink* case. That was more than a decade after the Intellectual Property Guidelines were issued.[6] And the FTC has not interpreted *Illinois Tool Works* at least as enabling a firm with monopoly or near monopoly power to use its intellectual property in order to *maintain* its market power.

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[3] *Id*.

[4] *Id*.

[5] It goes without saying that when I am referring to goods or product markets, I mean markets for services as well.

[6] *Compare Illinois Tool Works v. Indep. Ink, Inc.*, 547 U.S. 28, 40 (2006), *with Jefferson Parish Hosp. Dist. No 2 v. Hyde*, 466 U.S. 2, 17 (1984).

The third proposition is that the Justice Department in a 2008 Report not only contended that the combination of complementary factors of production by intellectual property licensing is "generally procompetitive," but that a unilateral, unconditional refusal to license to a rival is generally per se legal.[7] The Justice Department subsequently withdrew the Report, including its statement on unilateral refusals to deal, in 2009.[8] Since the withdrawal, neither the courts nor the antitrust agencies have reached a consensus on how to evaluate that conduct if more than a *mere* refusal to deal is involved.

I. INTELLECTUAL PROPERTY IS NOT JUST PROPERTY

The 1995 Intellectual Property Guidelines asserted that the legality of the acquisition of intellectual property should be tested like the acquisition of any other property—that it should be considered illegal if the acquisition would further concentrate an already highly concentrated market and that it should be considered legal if it did not.[9] Such a consolidation could occur in a traditional goods market, or alternatively, in markets for technology or for research and development (the latter being referred to as an innovation market).[10] However, in the nearly

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[7] U.S. Dep't. of Justice, Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act 129 (2008) [hereinafter, Single Firm Conduct Report] (disavowed by the Federal Trade Commission in 2008 and withdrawn by the Department of Justice in 2009), *available at* http://www.justice.gov/atr/public/reports/236681.htm.

[8] Press Release, U.S. Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.htm.

[9] Of course, the Intellectual Property Guidelines, as their full title implies, are specifically directed at acquisitions of intellectual property rights through licensing arrangements.

[10] According to Section 3.2.1 of the Intellectual Property Guidelines, goods markets are determined by using the market definition methodology in the Horizontal Merger Guidelines. If the competitive effects of the transaction or business arrangement cannot be adequately assessed from the standpoint of the affected goods market(s), then the Guidelines prescribe the delineation of technology markets, which Section 3.2.2 defines as "the intellectual property that is licensed . . . and its close substitutes—that is, the technologies or goods that are close enough substitutes

120-year history of antitrust law, the concept of an "innovation market" is relatively new. Indeed, the question of whether the antitrust laws should even be in the business of regulating competition in innovation appears to have first arisen, to my knowledge, in the mid-1970s when a merger was challenged, among other grounds, on the theory that the consolidation would harm competition in an innovation market following the merger of Xerox and Rank-Xerox.

In *Xerox*, the Commission alleged that Xerox violated Section 5 of the FTC Act by creating and preserving a noncompetitive market structure in the market for office copiers and the submarket for plain paper copiers.[11] Xerox's challenged conduct included, among other things, its development of an extensive patent portfolio through acquisition of control over Rank Xerox, a joint venture in which Xerox had previously held a non-majority stake.[12] Because Xerox had acquired patents to all of the technologies needed to practice xerography, the Commission alleged that Xerox was eliminating competition in the development and creation of plain office copiers.[13] The Commission settled the *Xerox* suit in 1975 with a consent decree that

significantly to constrain the exercise of market power with respect to the intellectual property that is licensed[,]" and innovation markets, which Section 3.2.3 defines as "the research and development directed to particular new or improved goods or processes, and the close substitutes for that research and development."

[11] Complaint ¶ 16, Xerox Corp., FTC Docket No. 8909, *reprinted in Xerox Corp.*, 86 F.T.C. 364, 368 (1975). The *Xerox* case is discussed in detail in Willard K. Tom, *The 1975 Xerox Consent Decree: Ancient Artifacts and Current Tensions*, 68 Antitrust L.J. 967 (2001).

[12] *Id.* ¶¶ 14(a)-(c), 15, Xerox Corp., FTC Docket No. 8909, *reprinted in Xerox Corp.*, 86 F.T.C. at 367-68.

[13] *Id.* ¶ 14(j), Xerox Corp., FTC Docket No. 8909 ("Xerox has engaged in acts, practices and methods of competition relating to patents including, but not limited to, . . . (j) preventing actual and potential competitors from developing plain paper copiers while permitting them to develop coated paper copiers."), *reprinted in Xerox Corp.*, 86 F.T.C. at 367-68.

required Xerox to permit the use of any three of its dry paper copier patents on a royalty-free basis and to desist in pursuing certain of its infringement suits.[14]

Following *Xerox*, the agencies went for nearly two decades without any significant challenges to transactions and conduct affecting innovation markets. Beginning with Anne Bingaman's tenure as Assistant Attorney General for the Antitrust Division in 1993, however, the agencies began to chart a different course.[15] In *United States v. General Motors Corp.*, Bingaman and the Justice Department challenged the proposed acquisition of General Motors' Allison Transmission Division by ZF Friedrichshafen AG, a German company, on innovation market grounds.[16] Although the transaction would have resulted in very high levels of concentration in a few application-specific bus and truck transmission markets, as Bingaman later noted, the Justice Department's concern was "not limited to these narrow product markets where the two firms presently were alternative sources of supply."[17] Instead, it alleged that the acquisition would stifle competition in "worldwide technological innovation in the design and production of automatic transmissions for medium and heavy duty commercial and military vehicles" because ZF would not engage in the same vigorous research and development after the

[14] Order, §§ II to IV, Xerox Corp., FTC Docket No. 8909, *reprinted in Xerox Corp.*, 86 F.T.C. at 373-74.

[15] Richard M. Brunell, *Editor's Note*, 64 Antitrust L.J. 1, 1 (1995) ("The centerpiece of the Clinton Administration's 'new thinking' on innovation was its development of an 'innovation market' approach to merger enforcement; that is, an approach that specifically analyzes the effect of proposed mergers on innovation.").

[16] Complaint, United States v. General Motors Corp., Civ. No. 93-530 (D. Del. filed Nov. 16, 1993).

[17] Anne K. Bingaman, Assistant Attorney General, Dep't of Justice Antitrust Division, Antitrust and Innovation in a High Technology Society (January 10, 1994) [hereinafter Bingaman Remarks], *available at* http://www.usdoj.gov/atr/public/speeches/0108.htm.

merger.[18] The Justice Department's challenge proved short-lived, however: after it sought a preliminary injunction in federal district court in 1993, the parties abandoned the merger. Thereafter, under Chairman Pitofsky at the Commission and Assistant Attorney General Joel Klein at the Justice Department, the agencies routinely required the divestiture[19] or compulsory licensing[20] of intellectual property, particularly in pharmaceutical mergers, which resulted in a number of consent decrees.

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[18] General Motors Complaint, *supra* note 16. *See also* Bingaman Remarks, *supra* note 17 ("In this manner, our complaint captured the scope of the feared anticompetitive effect – innovation over the entire line of heavy-duty truck and bus transmissions, not just those few product lines that had been the subject of direct sales competition in the past."); *see also* Anne K. Bingaman, Assistant Attorney Gen., Dep't of Justice Antitrust Division, Speech Before the Commonwealth Club of Cal. (July 29, 1994), *available at* http://www.usdoj.gov/atr/public/speeches/innovate.htm ("Firms that prosper are more likely to be those that face fierce rivalry in their home markets than the sheltered monopolists. In a very real sense, it seems, the fear of being left behind is more likely to spur innovation than the security bred of stable market power.").

[19] *See United States v. Allied Signal Inc.*, No. 99-2959, 2000 U.S. Dist. LEXIS 15099 (D.D.C. March 22, 2000) (consent order required the parties, the two leading competitors in the development of certain aerospace products, to divest businesses and assets relating to those products); *Baxter Int'l*, 123 F.T.C. 904 (March 24, 1997) (consent order requiring Baxter International to, among other things, divest certain treatment assets in connection with Baxter's acquisition of Immuno International, which combined two of the leading commercial developers of the Factor VIII inhibitor treatments used to treat antibodies in hemophiliacs).

[20] *See United States v. Miller Indus.*, No. 00-0305 (TPJ), 2000 U.S. Dist. LEXIS 19542 (D.D.C. Dec. 12, 2000) (requiring Miller, in conjunction with its acquisition of Chevron—which increased Miller's ownership of valuable patent rights related to improvements in light-duty tow trucks and light-duty car carriers—to offer any third party nonexclusive licenses); *Summit Tech.*, FTC Docket No. 9286 (Feb. 23, 1999) (consent order), *available at* http://www.ftc.gov/os/1999/03/d09286summit.do.htm (requiring Summit and VISX, as a condition of a partnership arrangement, to license to each other, on a royalty free basis, the patents that each firm contributed to the partnership in order to recreate the incentive to conduct research and development that existed prior to the pooling arrangement); *Ciba-Geigy Ltd.*, 123 F.T.C. 842 (1997) (consent order in connection with the merger of Ciba-Geigy and Sandoz, the two leading commercial developers of gene therapy products, which required the combined firm to license the specified gene therapy technology and patent rights to Rhone-Poulenc so that Rhone-Poulenc could compete with the combined firm).

There are at least three *practical* issues that underlie any attempt to regulate innovation markets.

First, the most fundamental practical consideration is whether, from a policy standpoint, the application of antitrust laws to innovation markets provides consumers with better products or products that are developed more quickly. Critics of applying antitrust laws to regulate "innovation markets" assert that although it is generally accepted that increases in concentration of markets composed of "property" do tend to detrimentally affect *property prices*, the relationship between concentration and *innovation* is far more ambiguous.[21] Put another way, while there is generally agreement about what type of market structure fosters competition in product markets, "[t]here is not yet a universally accepted consensus as to the kind of market structure that best facilitates innovation."[22]

Is it better to lock scientists from competing firms in a room and let intellectual fermentation occur? Will that result in more innovation or at least quicker innovation than challenging such collaboration as an antitrust violation under Section 1 or Section 7?[23] Or, conversely, are consumers better off when the agencies use antitrust laws to increase

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[21] *See* M. Howard Morse, *The Limits of Innovation Markets*, Antitrust & Intellectual Property, Spring 2001; Richard Rapp, *The Misapplication of the Innovation Market Approach to Merger Analysis*, 64 Antitrust L.J. 19 (1995).

[22] Ronald W. Davis, *Innovation Markets and Merger Enforcement: Current Practice in Perspective*, 71 Antitrust L.J. 677, 681 (2003).

[23] The agencies' jointly issued Antitrust Guidelines for Collaboration Among Competitors contemplate this very question: "For example, two firms may be able to combine their research or marketing activities to lower their cost of bringing their products to market, or reduce the time needed to develop and begin commercial sales of new products." U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors § 2.1 (2000) [hereinafter, Collaboration Guidelines], *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

competition's role in innovation based on the premise that innovation declines when concentration increases? The jury is still out on that fundamental question.

A second practical consideration was raised by Chairman Muris in the *Genzyme-Novazyme* merger—namely, whether it is even possible to accurately measure market shares in innovation markets, particularly when the agency's theory of the case is that a merger will threaten potential competition in an as-yet undefined product (or property) market. *Genzyme-Novazyme*, for example, was a post-acquisition investigation[24] into a merger between the only two companies engaged in preclinical research related to Pompe disease—a rare, often fatal disorder affecting infants and children for which there was no known treatment. Despite the relatively early stage of research and development that Genzyme and Novazyme were engaged in, there was no dispute that enzyme replacement treatment (or "ERT") was the only therapeutic approach that showed promise for treating Pompe disease. As a result, the "universe" of research and development efforts was well-defined: before the merger, there were two companies engaged in that research; afterwards, there was just one. Notwithstanding that fact, in a 3-1-1 decision in January 2004, the Commission refused to challenge the merger.[25]

Chairman Muris voted with the majority and explained in a separate statement that there was little empirical research to suggest a direct relationship between concentration in research

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[24] The acquisition did not trigger the notification requirements of the Hart-Scott-Rodino Act and the Commission therefore did not have the ability to investigate the merger until after the transaction had closed.

[25] Press Release, Fed. Trade Comm'n, FTC Closes Its Investigation of Genzyme Corporation's 2001 Acquisition of Novazyme Pharmaceuticals, *available at* http://www.ftc.gov/opa/2004/01/genzyme.htm.

and development and the level of innovation.[26] He stated that "neither economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation (and hence patient welfare) based simply on observing that the merger changed the number of R&D programs."[27]

A third practical consideration is whether, notwithstanding the Intellectual Property Guidelines, it is accurate to view *all* intellectual property (i.e. patents, copyrights, trade secrets, know-how and trademarks) as akin to other species of property for purposes of antitrust analysis. Are there any limiting principles and if so, what are they? For example, one limiting principle might be that we should confine our conception of property to *patented* intellectual property rights. This would have the effect of focusing antitrust analysis on pre-existing, publicly recognized, property rights that may be clearly and directly linked to a relevant goods market (based on the nature and scope of the claims) and hence may potentially provide the owner with some measure of exclusionary power over that market.

Even patent rights may not provide a clear enough basis for antitrust analysis, however, when the relevant market of interest is not a goods market but an innovation market. This problem can be seen in the *Genzyme-Novazyme* merger I've just discussed, and also in the *SCM Corp. v. Xerox Corp.* case, which I will discuss next. It suggests another limiting principle, which is that in the context of regulating an innovation market, patent rights may be most

[26] *See* Statement of Chairman Timothy J. Muris in the Matter of Genzyme Corporation/Novazyme Pharmaceuticals, *available at* http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf .

[27] *Id.* at 5-6. In reaching that conclusion, Muris relied heavily on a 1996 report prepared by the Commission's staff, which he observed, acknowledged that "economic theory and empirical investigations have not established a general causal relationship between innovation and competition." *Id.* at 2-3 (citing Staff Report, Federal Trade Comm'n, Anticipating the 21st Century: Competition Policy in the New High-Tech Global Marketplace (May 1996)).

relevant, when they, like other specialized assets such as laboratories, are clearly associated with the capabilities of a firm to engage in particular research and development.[28] For example, if a patent covers a necessary input to research and development, such as an analytical procedure needed to see if a concept will work as intended, then securing the rights to practice that patent will obviously be crucial to competing in a relevant innovation market.

There are also at least two *legal* considerations that bear on when antitrust challenges to transactions affecting innovation markets are appropriate.

First, it cannot be ignored that, in the 35 years since the Commission first challenged a merger under an innovation market theory when it contested the Rank-Xerox merger in 1974, there still has not been a successful antitrust challenge (public or private) based on the theory that a defendant stifled or threatened competition in a pure innovation market (i.e., when there is no product market at the time that the patent is acquired).[29]

As I've stated, Rank-Xerox itself resulted in a consent decree that required compulsory licensing of Xerox's patents. The Second Circuit's 1981 decision in *SCM Corp. v. Xerox Corp.* followed, and as the main federal court decision to have considered whether and how antitrust laws should regulate innovation markets, *SCM* has arguably made future challenges more difficult.[30] Relying on the same facts that the FTC pleaded in its *Xerox* challenge, SCM alleged that by 1969, Xerox had willfully acquired monopoly power in a relevant product market that

[28] *See* Collaboration Guidelines, *supra* note 23, § 3.32(c) ("The Agencies define an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms.").

[29] ABA Section of Antitrust Law, *Antitrust Law Developments* 587 (6th ed. 2007) ("To date, no court has invalidated a transaction solely because it reduced competition in an innovation market.").

[30] *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981).

consisted of convenience office copiers using plain and coated paper and that Xerox had excluded SCM from that relevant market.

Following a fourteen-month trial, however, the jury answered several interrogatories and found, among other things, that "the only patent-related conduct of Xerox causally related to SCM's claimed injuries under its 1969 exclusion claim was the 1956 Xerox-Battelle agreement," which transferred title to Battelle's patents to Xerox and eliminated Xerox's obligation to sublicense the patents. Thus, the principal issue on appeal was whether Xerox's acquisition of the patents pursuant to the 1956 agreement constituted anticompetitive conduct that was cognizable under the antitrust laws.[31]

Relying on the jury's finding that a relevant product market did not exist until well after Xerox had acquired the patents from Battelle, the Second Circuit held that Xerox did not and could not have violated the antitrust laws when those acquisitions occurred in 1956 because acquisition of a patent in a defined market was a predicate to SCM's antitrust claim. The court noted that "[t]he patent system would be seriously undermined . . . were the threat of potential antitrust liability to attach upon the acquisition of a patent at a time prior to the existence of the relevant market and, even more disconcerting, at a time prior to the commercialization of the patented art."[32] The court thus held "that where a patent has been lawfully acquired, subsequent conduct permissible under the patent laws cannot trigger any liability under the antitrust laws."[33] The Second Circuit rejected SCM's claim that the patents had been unlawfully acquired, reasoning that "whether limitations should be imposed on the patent rights of an acquiring party

[31] *Id*. at 1203.

[32] *Id*. at 1206.

[33] *Id*.

should be dictated by the extent of the power already possessed by that party in the relevant market into which the products embodying the patented art enter."[34] Because no product market as yet existed in 1956, Xerox was not liable under the antitrust laws for acquiring patents in a pure innovation market.[35]

Thus, while the FTC and DOJ's appetite for challenging mergers under an innovation market theory demonstrably increased during the 1990s,[36] the agencies have yet to litigate to conclusion a case that involved an innovation market.

A second legal consideration as to whether antitrust challenges to innovation markets are appropriate is the one that Chairman Muris raised in conjunction with the Commission's closing of its investigation into the Genzyme-Novazyme merger. In merger cases, the courts typically require upfront market definition. And they certainly require such market definition if the plaintiff wishes to rely on the *Philadelphia National Bank* presumption, under which a merger is presumed illegal if it "produces a firm controlling an undue percentage share of the relevant

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[34] *Id*. at 1208.

[35] More recently, courts have reiterated in cases not concerning innovation that a pre-existing market is a prerequisite to liability under Section 7 of the Clayton Act. *See, e.g., Crucible, Inc. v. Stora Kopparbergs Bergslags AB*, 701 F. Supp. 1157, 1162-63 (W.D. Pa. 1988) (ruling that "the absence of a relevant [product] market . . . at the time of patent acquisition precludes the applicability of Section 7"); *Fraser v. Major League Soccer*, LLC, 97 F. Supp. 2d 130, 140-41 (D. Mass. 2000) ("Where there is no existing market, there can be no reduction in the level of competition . . . Competition that does not exist cannot be decreased."), *aff'd*, 284 F.3d 47, 71 (1st Cir. 2002) ("Even advocates of a broader reading of Section 7 concede that striking down a combination that does not threaten present competition could be justified . . . *only in already concentrated markets*." (emphasis added)).

For a critique of the Second Circuit's *SCM* decision as outdated and inconsistent with current enforcement policy, *see* Jonathan M. Jacobson, *Do We Need a 'New Economy" Exception for Antitrust?*, Antitrust, Fall 2001, at 89, 90-91.

[36] *See* David A. Balto & Andrew M. Wolman, *Intellectual Property and Antitrust: General Principles*, 43 IDEA 395, 424-28 (2003).

market."[37] But arguing over whether the parties to a merger have market power in an innovation market is a bit like trying to fit a square peg into a round hole. Traditional market definition analysis is, as a general matter, static by nature; it requires plaintiffs and courts to identify the market at issue with a snapshot of the products and markets at issue at the time the plaintiff challenges a merger.

This is not to say that all product markets are static. Indeed, in *General Dynamics* the Supreme Court recognized that product markets can be dynamic.[38] But innovation markets are *more dynamic* than product markets, and hence generally cannot be pinned down and identified with the certainty that *Philadelphia National Bank* requires.[39] So how does one define a market and measure market shares with sufficient accuracy to satisfy the courts when the so-called market is research and development? More succinctly, can the *Philadelphia National Bank* presumption ever be used when this is the theory

As I have noted on other occasions, any analysis that presumes upfront market definition is a necessary prerequisite to a correct merger analysis risks obscuring the ultimate question under Section 7 of the Clayton Act, which is whether the transaction is likely to substantially

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[37] *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 363 (1963).

[38] *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

[39] As *Washington Post* business columnist Steven Pearlstein recently noted in the context of describing the market for innovation in the pharmaceutical industry:

> [P]harmaceuticals is an industry that doesn't lend itself to traditional market analysis. Because the bulk of profits in the industry come from temporary monopolies—the government-granted patents—the current marketplace is not where the important competition takes place. Rather, the real rivalry takes place "upstream," as companies compete to innovate, either by developing medicines in their labs or by buying up promising patents and biotech start-ups.

Steven Pearlstein, *Not What the Doctor Ordered*, Washington Post, Jan. 28, 2009, at D1.

lessen competition.[40] While upfront market definition may be very helpful in determining the presence or likelihood of market power, I don't believe that it should be a threshold requirement in every instance. Courts, economists, and scholars have emphasized that market definition is merely an indirect means to assist in determining the presence or likelihood of market power.[41] And in cases brought under the Sherman Act, courts have increasingly focused on direct evidence of competitive effects to determine the lawfulness of completed or ongoing conduct.[42] Collaboration arrangements involving innovation markets illustrate another area in which an

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[40] J. Thomas Rosch, *Litigating Merger Challenges: Lessons Learned*, Remarks Presented at the Bates White Fifth Annual Antitrust Conference (June 2, 2008), *available at* http://www.ftc.gov/speeches/rosch/080602litigatingmerger.pdf. *See also* Concurring opinion of J. Thomas Rosch In the Matter of Evanston Northwestern Healthcare Corp., FTC Docket No. 9315 at 8, *available at* http://www.ftc.gov/os/adjpro/d9315/070806rosch.pdf (discussing, in the consummated merger context, the value in examining the merger's anticompetitive effects to determine whether there is a Section 7 violation and noting that "[m]arket definition is a tool for analyzing market power, but it is not the only tool, either as a matter of law or economics").

[41] *See Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 937 (7th Cir. 2000) ("The share a firm has in a properly defined relevant market is only a way of estimating market power, which is the ultimate consideration."); 2A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 531a, at 156 (2002) (stating that a relevant market definition simply serves as a surrogate for market power); Dennis Carlton, *Market Definition: Use and Abuse*, Competition Policy International (2007) ("[M]arket definition, together with the calculation of market shares, is a crude methodology"); Jonathan B. Baker, *Contemporary Empirical Merger Analysis*, 5 George Mason L. Rev. 347-61 (1997) ("If a merger can be shown to harm competition directly, antitrust should not need to spend much effort on market definition . . . .[I]f the likely harm to competition from a merger can be demonstrated directly, there exists a market where harm will occur, but there is little need to specify the market's precise boundaries.").

[42] *FTC v. Indiana Fed. of Dentists*, 476 U.S. 447 (1986); *Conwood Co., L.P. v. United States Tobacco Co.*, 290 F.3d 768, 783 n.2 (6th Cir. 2002) ("Whether a company has monopoly or market power 'may be proven directly by evidence of the control of prices or the exclusion of competition . . . .'"); *United States v. Microsoft Corp.*, 253 F.3d 34, 51 (D.C. Cir. 2001) (stating that in a Section 2 case, if "evidence indicates that a firm has in fact [profitably raised prices substantially above the competitive level], the existence of monopoly power is clear."); *Tops Markets, Inc. v. Quality Markets, Inc.*, 142 F.3d 90, 98 (2d Cir. 1993) (market power "may be proven directly by evidence of the control of prices or the exclusion of competition, or it may be inferred from one firm's large percentage share of the relevant market."); *Todd v. Exxon Corp.*, 275 F.3d 191, 207 (2d Cir. 2001) ("use of anticompetitive effects to demonstrate market power . . . is not limited to 'quick look' or 'truncated' rule of reason cases").

emphasis on anticompetitive effects rather than market share alone makes sense.[43] In such cases, direct evidence as to the likely competitive effects of an arrangement (such as evidence of the purpose or effects of the arrangement) is arguably more probative of competitive harm than evidence of relative market shares.

II. INTELLECTUAL PROPERTY IS NOT PRESUMED TO CREATE MARKET POWER

As I've said, the notion that intellectual property is not presumed to create market power in antitrust analysis dates back to 1995 at the Justice Department and the Commission. However, the law was not always this way. In fact, until 2006 the case law was just the opposite. Most of the case law on this point emanated from tying cases. Thus, in *IBM Corp. v. United States*[44] and *International Salt Co. v. United States*,[45] the Supreme Court held that monopoly power over the tying product would exist if that product were patented. Indeed, that view was acknowledged by the majority decision in the *Jefferson Parish* case as recently as 1984.[46] However, in 2006 the Supreme Court stated unanimously in *Illinois Tool Works* that "tying arrangements involving patented products should be evaluated under the standards applied [in other tying cases] rather than under the per se rule."[47] This surely means that a plaintiff alleging that the defendant used its power in the market for a patented product to tie in purchases of non-

[43] *See* Collaboration Guidelines, *supra* note 23, § 3.32 ("The Agencies typically identify and assess competitive effects in all of the relevant product and geographic markets in which competition may be affected by a competitor collaboration, although in some cases it may be possible to assess competitive effects directly without defining a particular relevant market(s).").

[44] 298 U.S. 131, 135-37 (1936).

[45] 322 U.S. 392, 395-96 (1947).

[46] *Jefferson Parish*, 466 U.S. at 16-17.

[47] *Illinois Tool Works*, 547 U.S. at 42.

patented products must present "proof of power in the relevant market" rather than rely on a "mere presumption".[48]

What else does this holding mean? Is the presumption of per se illegality to which Justice Stevens is referencing applicable just to tying cases where intellectual property is the tying product? I don't think so. Although I am speaking for myself alone, a majority of the Commission rejected a presumption of per se illegality in the Intel case. Some of Intel's conduct challenged by the Commission involved intellectual property but did not involve tying as such. Although I felt that Intel's conduct could and should have been challenged under Section 5 alone (a subject that is beyond the purview of my remarks here),[49] the Commission majority felt otherwise. Thus, the conduct was challenged under both Section 5 and Section 2 of the Sherman Act. The Commission's Aid to Public Comment made it clear that the challenge was based on the theory that the challenged conduct hobbled a rival from competing effectively with Intel. This is a species of the rule of reason analysis under Section 2 that the D.C. Circuit used in *Microsoft*.[50]

Conversely, in Google's acquisition of Admob, the Commission refrained from challenging the merger not just because Apple was an apparent new entrant into the mobile advertising market (as the closing statement explained).[51] Rather, the Commission's theory for standing down was much more nuanced and sophisticated. More specifically, the Commission

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[48] *Id*.

[49] Concurring and Dissenting Statement of Commissioner J. Thomas Rosch, In the Matter of Intel Corporation, Docket No. 9341 (Dec. 16, 2009), *available at* http://www.ftc.gov/os/adjpro/d9341/091216intelstatement.pdf.

[50] *United States v. Microsoft*, 253 F.3d 34, 59-64 (D.C. Cir. 2001).

[51] Statement of the Commission Concerning Google/AdMob**,** FTC File No. 101-0031 (May 21, 2010), *available at* http://www.ftc.gov/os/closings/100521google-admobstmt.pdf.

considered that Apple had unique advantages due to its control of the iPhone platform and its ability to regulate access of third party developers (like Admob) to information generated by using its platform.[52] Under these circumstances, it arguably made no sense to challenge Google's acquisition of Admob, where Admob's viability as a competitor was largely based on its access to the Apple platform. Thus, the theory underlying the Commission's enforcement decision was based on Apple's unique ability to hobble or eliminate competition with its own mobile advertising service.

III. REFUSALS TO LICENSE INTELLECTUAL PROPERTY SHOULD NOT BE CONSIDERED LEGAL PER SE

As I've said, in 2008 the Justice Department issued a report on single firm conduct, which went further than the Rule of Reason case law and essentially gave refusals to license intellectual property a free pass.

Let me begin with some background on the Justice Department's Report. From June 2006 to May 2007, the Justice Department and the Commission held a series of joint hearings to explore the antitrust treatment of single-firm conduct. The agencies' goal was "to explore how best to identify anticompetitive exclusionary conduct for purposes of antitrust enforcement under Section 2 of the Sherman Act."[53]

On September 8, 2008, the Justice Department issued a 213-page Report purportedly based on the hearings. Several things stood out about the Report. First, it included several safe harbors for actions by firms with monopoly or near monopoly power, which, by definition, are

[52] *Id*. ("Apple's ownership of the iPhone software development tools, and its control over the developers' license agreement, gives Apple the unique ability to define how competition among ad networks on the iPhone will occur and evolve.").

[53] Consumer Benefits and Harms: How Best to Distinguish Aggressive, Pro-Consumer Competition from Business Conduct To Attain or Maintain a Monopoly, 71 Fed. Reg. 17872 (Apr. 7, 2006).

the firms covered by Section 2. And second, the Report expressed great concern with harm caused by over-enforcement of Section 2, which is often called Type I error.

With respect to intellectual property issues, the Report stated that a monopolist's refusal to deal with rivals, including licensing intellectual property rights, "should not play a meaningful role in section 2 enforcement" in part because "judges and enforcement agencies are ill-equipped to set and supervise the terms on which" intellectual property rights are licensed.[54] The Report also described a variety of other problems with remedies involving mandatory sharing or licensing of intellectual property, including spillover effects on other economies.[55]

The Commission declined to join the Justice Department's Report. Three of the four Commissioners, including myself, issued a statement criticizing the Report as a "blueprint for radically weakened enforcement of Section 2 of the Sherman Act."[56] We explained that under the Report, firms with monopoly power or near monopoly power would be able to engage in a variety of exclusionary practices "with impunity, regardless of potential foreclosure effects and impact on consumers."[57] It is not hard to see how the Report's safe harbors could have crippled antitrust enforcement with respect to other aspects of patent licensing, such as tying or bundling the sale of patents or patented products.

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[54] Single Firm Conduct Report, *supra* note 7, at xi. *See also id*. at 124-27.

[55] *Id*. at 152-53, 170, 180.

[56] Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice 1 (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf. Then-Chairman Kovacic issued a separate statement. *See* Statement of Federal Trade Commission Chairman William E. Kovacic, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf.

[57] Statement of Commissioners Harbour, Leibowitz and Rosch, *supra* note 56, at 10.

The Report was Justice Department policy for only eight months. On May 11, 2009, the new Assistant Attorney General for Antitrust Christine Varney withdrew it, declaring that it "no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act."[58] She took particular exception to what she characterized as "an excessive concern with the risks of over-deterrence and a resulting preference for an overly lenient approach to enforcement."[59] The withdrawal of the Report made front-page headlines in the *New York Times* and *Washington Post*, notwithstanding the fact that the action had been widely expected based on comments made at Varney's confirmation hearing.

I had a number of objections to the Report, which I've described on a number of other occasions.[60] One problem with the Report was its suggestion that a monopolist's (or near-monopolist's) refusal to license intellectual property did not have Section 2 implications. To the contrary, neither the courts nor the federal enforcement agencies have reached a consensus on the appropriate legal standard for evaluating a firm's refusal to license intellectual property.

To be sure, a number of courts have held that a refusal to license intellectual property, standing alone, cannot be an antitrust violation.[61] It has been asserted that a contrary holding

[58] Christine A. Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Vigorous Antitrust Enforcement in this Challenging Era, Remarks prepared for the Center for American Progress 8 (May 11, 2009), *available at* http://www.usdoj.gov/atr/public/speeches/245711.pdf; *see also* Press Release, *supra* note 8.

[59] Varney, *supra* note 58, at 8.

[60] *See, e.g.*, J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Thoughts on the Withdrawal of the DOJ Section 2 Report, Remarks Before the IBA/ABA Conference on Antitrust in a Global Economy (June 25, 2009), *available at* http://www.ftc.gov/speeches/rosch/090625roschibareport.pdf.

[61] *See, e.g.*, *Hartford-Empire Co. v. United States*, 323 U.S. 386, 432 (1945) ("A patent owner is not in the position of a quasi-trustee for the public or under any obligation to see that the public acquires the free right to use the invention. He has no obligation either to use it or to grant its use to others."); *United States v. United Shoe Mach. Co. of N.J.*, 247 U.S. 32, 57 (1918)

could reduce the incentives for innovation both by the original inventors, as well as by rivals seeking their own alternatives to the monopolist's patents. Thus, the Commission stated in its 1980 *DuPont* case that the "imposition of a duty to license might serve to chill the very kind of innovative process that led to duPont's cost advantage."[62] Likewise, the Supreme Court has asserted that compelling firms to assist their rivals "may lessen the incentive for the monopolist, the rival, or both to invest in . . . economically beneficial facilities."[63]

Nevertheless, the Ninth Circuit in *Image Technical Services v. Eastman Kodak Company* held that a unilateral refusal to license intellectual property by a monopolist could violate Section 2 of the Sherman Act if it is not supported by a valid business justification.[64] In that case, the court found that Kodak's reliance on intellectual property rights as a justification for refusing to

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("[A patent's] strength is in the restraint, the right to exclude others from the use of the invention . . . . Its exertion within the field . . . is not an offense against the Anti-Trust Act."); *Intergraph Corp. v. Intel Corp.*, 195 F.3d 1346, 1362 (Fed. Cir. 1999) ("[T]he antitrust laws do not negate the patentee's right to exclude others from patent property."); *Cygnus Therapeutic Sys. v. Alza Corp.*, 92 F.3d 1153, 1160 (Fed. Cir. 1996) (patentee "under no obligation to license" under antitrust laws); *Data Gen. Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147, 1186 (1st Cir. 1994) ("The courts appear to have partly settled an analogous conflict between the patent laws and the antitrust laws, treating the former as creating an implied limited exception to the latter."); *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1204 (2d Cir. 1981) ("A patent holder who lawfully acquires a patent cannot be held liable under Section 2 of the Sherman Act for maintaining the monopoly power he lawfully acquired by refusing to license the patent to others."); *United States v. Westinghouse Elec. Corp.*, 648 F.2d 642, 647 (9th Cir. 1981) ("The right to license [a] patent, exclusively or otherwise, or to refuse to license at all, is 'the untrammeled right' of the patentee."); *W.L. Gore & Assocs., Inc. v. Carlisle Corp.*, 529 F.2d 614, 623 (3d Cir. 1976) ("right to refuse to license is the essence of the patent holder's right").

[62] *E.I. DuPont de Nemours & Co.*, 96 F.T.C. 653, 748 (1980); *see also* U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property § 2.2 (1995), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,132 (an intellectual property owner has no general duty to license its protected product).

[63] *Verizon Communs. Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407-08 (2004).

[64] 125 F.3d 1195 (9th Cir. 1997).

license was largely pretextual. This may have been the first time a federal court imposed antitrust liability for the refusal to license a patent.

When confronted with a similar issue a few years later in the *Xerox*/*ISO* case, the Federal Circuit rejected the Ninth Circuit's approach.[65] The Federal Circuit concluded that the refusal to license intellectual property cannot be an antitrust violation regardless of the reason for the refusal.[66] The court explained that we "will not inquire into [the patent holder's] subjective motivation for exerting his statutory rights, even though his refusal to sell or license his patented invention may have an anticompetitive effect, so long as that anticompetitive effect is not illegally extended beyond the statutory patent grant."[67]

An arguably more significant development was the Supreme Court's 2004 *Trinko* decision,[68] which suggests that the Court may not look favorably on the Ninth Circuit's approach. In *Trinko*, Justice Scalia wrote that monopolists do not have a duty to deal with rivals except under narrow circumstances.[69]

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[65] *Compare In re Independent Serv. Org. Antitrust Litig. (ISO)*, 203 F.3d 1322 (Fed. Cir. 2000, *with Image Tech. Servs., Inc. v. Eastman Kodak Co*., 125 F.3d 1195 (9th Cir. 1997); *see also Intel v. Intergraph*, 195 F.3d 1346 (Fed. Cir. 1999). Chief Justice John Roberts represented the plaintiffs on appeal in both the *Xerox* case and the *Intel* case when he was in private practice.

[66] The opinion suggested that a patent holder would be subject to antitrust liability under only three circumstances: (1) where it had fraudulently obtained the patent; (2) where it had fraudulently engaged in infringement litigation; and (3) where it had attempted to enlarge the scope of its patent by, for example, tying the sale of the patented good to the sale of an unpatented good. *ISO*, 203 F.3d at 1327.

[67] *Id.* at 1327-28. The Seventh Circuit likewise rejected the Ninth Circuit's approach in a 2006 decision in favor of the Federal Circuit's approach. *See Schor v. Abbott Labs*., 457 F.3d 608 (7th Cir. 2006).

[68] *Trinko*, *supra* note 63.

[69] *Id.*, 540 U.S. at 411.

That said, a circuit split remains, and *Trinko* did not resolve the split because that portion of Justice Scalia's opinion was dictum, not holding. Nor can it be said that the federal enforcement agencies have reached a consensus on the issue. In 2007 the Commission and the Justice Department issued a report on antitrust enforcement and intellectual property rights that weighed in on this subject. The report concluded that "antitrust liability for mere unilateral refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections."[70] However, as the Commission majority explained in criticizing the Justice Department's 2008 Report on single firm conduct,[71] the word "mere" must be emphasized; if and to the extent that the refusal to license does not stand alone, it may be challenged, if exercised by firms with monopoly power.[72]

IV. TAKE AWAYS

So where does that leave the state of Section 2 enforcement with respect to intellectual property? Of course, I can't comment on the Antitrust Division's plans, but regardless of what happens at the Justice Department, the Commission remains ready, willing, and able to challenge violations of the antitrust laws involving intellectual property. For example, the Commission has brought two monopolization cases since 2000 involving intellectual property in the standard setting context: *Unocal* and *Rambus*. In the first case, we alleged that Unocal failed to disclose its clean-fuel patents while helping to establish industry standards for reformulated gas that incorporated its technology. We reached a consent agreement with Unocal shortly after trial

[70] Staff Report, U.S. Dep't of Justice & Fed. Trade Comm., Antitrust Enforcement and Intellectual Property Rights: Protecting Innovation and Competition 30 (2007).

[71] Single Firm Conduct Report, *supra* note 7.

[72] Statement of Commissioners Harbour, Leibowitz and Rosch, *supra* note 56, at 8-9.

before an FTC ALJ.[73] In the second case, the Commission found that Rambus had failed to disclose certain DRAM patents to a standard setting organization that ultimately adopted standards covered by the intellectual property. The Commission found that this conduct violated Section 2, but the Court of Appeals for the D.C. Circuit reversed for lack of causation between the deception and the selection of the standard.[74]

Not all of the Commission's activities with respect to intellectual property involve enforcement, however. Both the Commission and the Justice Department have programs to provide guidance to the business community with respect to proposed conduct. Under these programs, the Justice Department issues so-called Business Review Letters,[75] while the Commission issues Advisory Opinions.[76] A number of these have involved intellectual property arrangements. For example, a standard setting organization asked the Justice Department to consider a proposed new policy that would allow patent holders to publicly commit to specific restrictions on their future licensing terms and conditions for the use of patents that were essential to proposed standards.[77] The DOJ stated that it had no objection to the proposed policy because it could help promote the adoption of proposed standards. In another Business Review Letter, the Justice Department expressed no objection to a proposed arrangement under which

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[73] Decision and Order, In re Union Oil Co. of Cal., FTC Docket No. 9305 (July 27, 2005), *available at* http://www.ftc.gov/os/adjpro/d9305/050802do.pdf.

[74] *Rambus, Inc. v. FTC*, 522 F.3d 456, 469 (D.C. Cir. 2008).

[75] Information regarding DOJ business reviews is available at http://www.justice.gov/atr/public/busreview/index.htm.

[76] Information regarding FTC competition advisory opinions is available at http://www.ftc.gov/bc/advisory.shtm.

[77] Business Review Letter from Thomas O. Barnett, Assistant Attorney Gen., U.S. Dep't. of Justice, to Michael A. Lindsay, Dorsey & Whitney LLP (Apr. 30, 2007), *available at* http://www.justice.gov/atr/public/busreview/222978.htm.

Toshiba would offer a package license to patents held by six different companies that were essential to manufacturing products in compliance with certain DVD standards.[78] The Department concluded that "the proposed arrangement is likely to combine complementary patent rights, thereby lowering the costs of manufacturers that need access to them in order to produce [DVD] discs, players and decoders."[79] These are just two of many instances where the agencies have helped facilitate a potentially pro-competitive patent policy, patent pool, or licensing practice.

V. CONCLUSION

We are now two years into the new administration and have a new FTC Chairman and a new Assistant Attorney General for the DOJ's Antitrust Division. So far neither agency has brought a merger enforcement case alleging harm to an innovation market or brought a case involving a refusal to license intellectual property. But that isn't to say that the agencies have been silent in these areas. Last year, the two agencies issued updated Horizontal Merger Guidelines. Under Section 6.4 of the Guidelines, the agencies may challenge a merger that results in "a reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products."[80] In contrast, the prior iteration of the Horizontal Merger Guidelines said little about innovation markets.[81] The other significant

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[78] Business Review Letter from Joel I. Klein, Assistant Attorney Gen., U.S. Dep't. of Justice, to Carey R. Ramos, Paul, Weiss, Rifkind, Wharton & Garrison (June 10, 1999), *available at* http://www.justice.gov/atr/public/busreview/2485.htm.

[79] *Id*.

[80] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines § 6.4 (2010), *available at* http://www.ftc.gov/os/2010/08/100819hmg.pdf.

[81] U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines § 4 (1992, rev. 1997, superseded 2010) ("Other efficiencies, such as those relating to research and development, are potentially substantial but are generally less susceptible to verification and may

development, as I have already mentioned, is the Justice Department's withdrawal of its Section 2 Report. As a result, the Department is no longer bound by the prior Administration's claim that a monopolist's refusal to license intellectual property does not raise any Section 2 concerns. Both of these are positive developments which, I hope, will portend greater enforcement activity that will help resolve the policy and legal questions still waiting to be answered in both of these areas.

be the result of anticompetitive output reductions."), *available at* http://www.ftc.gov/bc/docs/horizmer.shtm.