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Antitrust and IP
Joint Agency Hearings

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Hearings convened by the FTC and DOJ on the relationship between antitrust and intellectual property will conclude in October.

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Both the antitrust laws and the intellectual property (IP) laws seek to promote innovation and consumer welfare. But, as Commissioner Thomas B. Leary of the Federal Trade Commission (FTC) stated at an FTC hearing earlier this year, the two legal regimes "approach the objective from opposite directions." IP rules encourage innovation by granting creators exclusive rights to exploit their works; antitrust does so by outlawing unreasonable restraints of trade and abuses of monopoly power.

Tensions arise between the two because the IP laws sometimes place monopoly power in the hands of successful IP holders, and the antitrust laws, though tolerant of monopoly power achieved through "superior skill, foresight and industry," limit its use for anticompetitive purposes. IP supporters charge that aggressive antitrust enforcement in this area stifles innovation, while antitrust advocates assert that overbroad IP rules create competitive choke points that actually stifle innovation.

This ongoing tension prompted the FTC and the Antitrust Division of the Department of Justice (DOJ) to convene far-reaching joint hearings on the relationship between antitrust and intellectual property. The hearings, which began in February and will conclude in October, with a report expected thereafter, reflect the growing importance of intellectual property as a generator of economic value, and the agencies' growing interest in competition issues raised by the IP laws.

While the hearings address a broad range of subjects, three major areas of focus are strategic use of patent pools; competitive abuses in the context of standard-setting organizations; and refusals to license IP. In each instance, agency attention is focused on potentially anticompetitive means of extending whatever market power may be conferred by IP rights beyond those contemplated by the statutory regimes.

The strategic use of patent pools and cross-licensing

In his opening statement at the hearings, Assistant Attorney General Charles James indicated that patent pools continues to be an area of interest for antitrust officials. A patent pool is an agreement among patent owners to interchange licenses or to grant licenses to third parties. Because pools often combine multiple patents needed for a product, they can reduce transaction costs for firms that manufacture the product, and thus have significant pro-competitive effects. But pools can raise antitrust concerns where they inhibit competition, as recent agency actions show.

Consider, for example, a business review letter that DOJ issued in June 1999 regarding a proposed patent pool for technologies used to implement DVD technology. Six holders of patents necessary for the implementation of DVD standard specifications pooled their patents for licensing to makers of DVD products. DOJ, applying the same analysis it applied regarding the MPEG patent pool in 1997, approved the DVD pool because it was limited to only those patents that were "essential" to make, use and sell DVD products and was not likely to impede competition.

The DVD pool's essentiality requirement served both to lower licensees' costs of complying with DVD standard specifications and to ensure that competition between alternate viable options would not be foreclosed. Any potential anticompetitive effects were limited by factors such as the small royalty amount, rules imposing compulsory, non-discriminatory licensing, the limited duration of the licenses, the continued existence of incentives to innovate, and the unlikelihood that the joint licensor could access competitively sensitive proprietary information. Thus the DVD patent pool passed DOJ scrutiny because it pro-competitively combined complementary patents without creating the likelihood of anti-competitive effects.

In contrast, in 1998, the FTC challenged the Summit Technology/VISX patent pool because it involved the only two firms legally able to market laser equipment used for Lasix eye surgery, and eliminated competition between them. See In re Summit Technology Inc. and VISX Inc., No. 9286 (FTC March 24, 1998) (complaint). According to the FTC's complaint, Summit and VISX placed their patents in a pool, and paid the pool an agreed-upon licensing fee each time a laser produced by either one of the companies was used to perform Lasix eye surgery. Additionally, each company had to approve any license granted by the other to a third party. DOJ charged that VISX and Summit used this scheme to reduce competition and raise prices. The parties eventually settled the case by an order dissolving the pool and granting each firm nonexclusive royalty-free cross-licenses so they could compete with one other.

As these cases make clear, in evaluating patent pools the antitrust agencies consider first whether the proposed licensing program integrates complementary patent rights and, if so, whether the resulting competitive benefits are likely to be outweighed by competitive harm posed by other aspects of the program. Under the first prong, the agencies weigh several factors. For example, if a pool combines patents used to create substitutes, the pool is more likely to stifle competition than if the pool only includes complementary patents needed to produce a single product or product. One way to ensure that only complementary patent rights are integrated into the pool is thus to limit the pool to patents that are truly "essential" to a product or process.

The agencies then look at the benefits achieved by integrating complementary technologies, reducing transaction costs, clearing blocking positions and avoiding costly litigation. These benefits are weighed against any anti-competitive effects brought about by reduced innovation incentives or restricting competition among firms in the pool or products that incorporate the pooled patents.

Standard-setting organizations (SSOs), in which industry participants agree on common rules for a product or process, play a valuable role in facilitating the development of standards for widely used products or technologies. Standardization can provide significant consumer benefits, particularly in "net-work" markets, where the value of a product or service increases as more consumers use that product or service.

On the other hand, standard-setting activities can be abused and adversely affect competition. For example, the FTC recently filed a complaint against Rambus, Inc. alleging that it violated antitrust laws by deliberately failing to disclose its key patents to an SSO. In re Rambus, No. 9302 (FTC June 18, 2002). According to the FTC, Rambus amended its existing patents in response to the SSO's developing standards without disclosing either the patents or amendments to the SSO, in violation of the SSO's rules. Rambus thus placed itself in a position to charge royalties from the many competitors that had adopted the standards. The FTC's enforcement action against Rambus makes clear that inadequate patent disclosure to an SSO poses antitrust risks.

At hearings on April 18, FTC staff acknowledged that questions regarding disclosure can arise when SSO members' patented technology is incorporated into the SSO standard. The greatest concerns arise when the licensor retains the ability to exclude competition by refusing to license or by charging high licensing fees. While neither agency has issued guidelines regarding disclosure obligations in the context of SSOs, the FTC's Rambus complaint indicates that willful failures to disclose IP rights to SSOs are susceptible to challenge.

Refusals to license intellectual property

The hearings also focused on the particularly vexing issues raised by two conflicting decisions regarding the antitrust rules governing unilateral refusals to license IP:

the 9th U.S. Circuit Court of Appeal's decision in Image Tech. Servs. Inc. v. Eastman Kodak, 125 F.3d 1195 (9th Cir. 1997), and the Federal Circuit's decision in In re Indep. Servs. Orgs. Antitrust Litig., 203 F.3d 1322 (Fed. Cir. 2000), cert. denied, 531 U.S. 1143 (2001). In Kodak, the 9th Circuit ruled that while a refusal to license IP is presumptively valid, such a presumption may be overcome where the plaintiff can show that the defendant's refusal lacks a legitimate business justification. The Federal Circuit appears broadly to have rejected the notion that antitrust liability could attach for a unilateral refusal to license absent tying, fraud on the Patent and Trademark Office, or sham litigation.

The antitrust laws generally permit a property holder unilaterally to refuse to deal with others, except in certain very limited circumstances. A consensus view at the hearings was that IP should be treated similarly to other forms of property for antitrust purposes, but that the IP laws should be interpreted as modifying the antitrust laws. Accordingly, in the IP area, particular attention should be paid to the scope of the statutory rights conferred by Congress.

The patent laws, for example, confer an exclusive right to "make, use or sell" a patented product; that right necessarily includes some right to refuse to license IP. The question is: What factors place an otherwise permissible refusal to license beyond the scope of the statutory grant? There is little consensus on this issue. Among the factors that are likely to be considered are the impact of the refusal to deal on barriers to entry, the duration of the exclusive right and possibly the subjective intent of the IP holder. Antitrust concerns are likely to be greater if a refusal to deal has the effect of increasing entry barriers for competing firms or extending the rights created by the IP beyond the statutory period.