FTC AND DOJ ISSUE JOINT REPORT REGARDING ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS

Interesting and difficult questions lie at the intersection of intellectual property rights and antitrust enforcement. The U.S. Department of Justice and the Federal Trade Commission (the "Agencies") recently released a long-awaited joint report on that intersection entitled "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition" (the "Report"). The Report reaffirms the Agencies' past approach to these issues and synthesizes various views that were expressed during a 24-day series of hearings jointly conducted by the Agencies in 2002, including over 300 panelists and over 100 written comments. The overall theme of the Report is that, while the characteristics of intellectual property may differ from other types of property, "agreements involving intellectual property can be analyzed using the same antitrust rules applied to agreements involving any other property." The Report does not address some of the more controversial topics in this area of the law, such as how settlements of patent litigation should be analyzed under antitrust law.

Overview

The Report is significant for several reasons. First, the Report highlights the growing importance of intellectual property ("IP") to the economy generally as well as to the Agencies' enforcement of antitrust laws specifically. Second, the Agencies' conclusions affirm that "agreements involving intellectual property can be analyzed using the same antitrust rules applied to agreements involving any other property." This sentence is consistent with their prior statement in 1995, in Section 2 of the U.S. Dep't. of Justice & Federal Trade Comm'n, Antitrust Guidelines for The Licensing of Intellectual Property (1995) (the "1995 Guidelines"). Consequently, the Agencies affirm the need to prove that a defendant has market power, rather than assuming that IP necessarily confers market power. The Report proceeds to analyze antitrust enforcement issues involving IP using the same principles that apply to issues involving other forms of property, while taking into account the characteristics of IP that are unique. Third, an overarching theme that permeates the Report is the view that agreements involving IP are typically procompetitive and, in most cases, are appropriately analyzed under the rule of reason.

The Report addresses six specific topics: (1) unilateral refusals to license patents, (2) incorporation of patents into collaboratively set industry standards, (3) antitrust analysis of portfolio cross-licensing agreements and patent pools, (4) variations on IP licensing practices, (5) antitrust issues in the tying and bundling of IP rights, and (6) practices that extend a patent beyond its statutory term. Notably missing from the Report is any discussion of settlements of patent or other IP-related litigation. That absence may be explained by the Agencies' apparent disagreement regarding settlements of patent litigation, at least those settlements that involve the unique regulatory scheme applicable to pharmaceuticals under federal law. Highlights of each of the six main topics are provided below.

1. Unilateral Refusals To License Patents

The Agencies first address the extent to which patentees should be subject to antitrust liability for unilaterally refusing to license their patents. The discussion focused, in particular, on the divergent holdings of the two circuit courts that have addressed the issue.

In *Image Technical Services, Inc. v. Eastman Kodak Co*., 125 F.3d 1195 (9th Cir. 1997) ("*Kodak*"), and *In re Independent Service Organizations Antitrust Litigation*, 203 F.3d 1322 (Fed. Cir. 2000) ("*CSU*"), the Ninth Circuit and the Federal Circuit, respectively, addressed claims that original equipment manufacturers had violated Section 2 of the Sherman Act by refusing to sell patented parts and refusing to license patented software to competing repair vendors. In *Kodak*, the Ninth Circuit took a subjective approach, holding that, while refusal to sell patented parts is presumptively motivated by legitimate business justifications, the presumption can be (and was, in that case) rebutted by evidence that the refusal was a pretext for an improper attempt to exclude competition. By contrast, the Federal Circuit in *CSU* held that a unilateral refusal to sell or license patented products is lawful regardless of the patentee's subjective motivation. Without taking a firm position on how this issue should be treated, the Agencies conclude that, while patentees have no antitrust immunity for refusing to license their patents, "liability for unconditional, unilateral refusals to license will not play a meaningful part in the interface between patent rights and antitrust protections." (Report at 30.)

2. Incorporation Of Patents Into Collaboratively Set Standards

The Agencies note the competition concerns that may arise through efforts of standard-setting organizations ("SSOs") to prevent members from using the incorporation of their patents into industry standards to extract higher royalties than they otherwise would have been able to obtain. To deter such behavior, typically referred to as "hold up," SSOs often require members to disclose their relevant IP rights *ex ante* (*i.e.*, during the standard-setting process) and/or to license their IP on fair, reasonable, and non-discriminatory terms if and when the IP is incorporated into a standard. Some SSO members have suggested, however, that "well-defined licensing commitments could be introduced into the standard-setting process through *ex ante* unilateral announcements of licensing terms by IP holders or through *ex ante* multilateral licensing negotiations between IP holders and the group of SSO members." (Report at 49.)

The Agencies state that they "take no position as to whether SSOs should engage in joint *ex ante* discussion of licensing terms but recognize that joint *ex ante* activity to establish licensing terms as part of the standard-setting process will not warrant *per se* condemnation." (*Id.* at 55.) Rather, "[b]ecause of the strong potential for procompetitive benefits, the Agencies will evaluate joint *ex ante* activity to establish licensing terms under the rule of reason." (*Id*. at 54.) The Agencies note that activities that mitigate hold up and that take place before deciding which technology to include in the standard "could take various forms, including *joint ex ante* licensing negotiations or an SSO rule that requires intellectual property holders to announce their intended (or maximum) licensing terms for technologies being considered for adoption." (*Id.* (footnote omitted).)

3. Antitrust Analysis Of Portfolio Cross-Licensing Agreements And Patent Pools

The Report explains that procompetitive efficiencies can result from portfolio cross-licensing and patent pooling, most notably in the form of decreased transaction costs. On the other hand, portfolio cross-licensing and patent pooling also may facilitate anticompetitive behavior, such as price fixing, coordinated output reduction, or reduced incentives to innovate. In this regard, the Report observes that pooling arrangements generally receive greater antitrust scrutiny from the Agencies than do cross-licensing arrangements, due primarily to the greater number of market participants involved.

The Report concludes that the Agencies typically will continue to analyze portfolio cross-licensing and patent pooling under a rule-of-reason standard, due to the potential for procompetitive benefits of these arrangements. The Report distinguishes between combinations of *complementary* patents, which are generally procompetitive, and combinations of *substitutable* patents, which are more likely to have anticompetitive effects. The Agencies indicated, however, that they will engage in a fact-specific examination of portfolio cross-licensing and patent pools regardless of whether the patents involved are complementary or substitutable.

4. Variations On Intellectual Property Licensing Practices

The Report discusses three licensing practices in particular—non-assertion clauses,[1] grantbacks,[2] and reach-through licensing[3]—and evaluates whether the 1995 Guidelines provide adequate instruction on analyzing such arrangements.

The Report finds that the procompetitive effects of non-assertion clauses and grantbacks are similar to cross licenses (discussed above) in that they allow the parties to avoid transaction costs associated with negotiating IP licenses or litigating over IP rights. On the other hand, these licensing practices may be anticompetitive if they: (1) are overbroad or of indefinite duration; (2) help to maintain an illegitimate monopoly or duopoly; (3) discourage innovation; or (4) otherwise grant protection to patents of questionable validity. As to reach-through licensing, the Report states that such licensing creates efficiencies, most prominently the ability to value a research tool and to share innovation risks among parties.

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1 Non-assertion clauses provide that parties will not assert IP rights against each other, even where one party is engaging in an infringing use of another party's IP right.

2 Grantbacks are arrangements by which a licensee will grant the licensor the right to use the licensee's improvements to the licensed innovation.

3 Reach-through licensing agreements allow the owner of a patent on an "upstream research tool" the right to be compensated for the license by receiving payments based on eventual sales of downstream products created by the tool.

The Report concludes that the 1995 Guidelines contain appropriate instruction regarding IP licensing arrangements. The Agencies note that, because such arrangements are generally procompetitive, bright line, *per se* prohibitions would risk chilling efficient conduct. Instead, the Agencies address each arrangement on a fact-specific basis and apply the rule of reason to determine whether the arrangement has a procompetitive or anticompetitive effect.

5. Antitrust Issues In The Tying And Bundling Of IP Rights

Tying and bundling refer to practices by which the sale of one item is conditioned on the buyer's purchase of one or more additional items. Under the 1995 Guidelines, the Agencies, in their discretion, use a rule-of-reason analysis when examining tying and bundling involving IP rights. The Report affirms this approach, although it acknowledges that fact-specific determinations inherently pose difficulties for assessing the likely antitrust implications of proposed arrangements. The Report notes the "ubiquitous" use of tying/bundling arrangements in modern business, often by companies without market power, and concludes that in most instances such practices will not lead to anticompetitive effects.

6. Practices That Extend A Patent Beyond Its Statutory Term

Finally, the Agencies address competitive issues that may arise through practices that effectively extend a patent beyond its statutory term. The Agencies recognize that such practices do not pose competitive harm unless "the patent at issue confers market power upon its holder." (Report at 122.) If the patent does indeed bestow market power, the Agencies will (absent market division or other practices subject to the *per se* rule) examine the practice at issue under the rule of reason and will condemn the behavior only if it *unreasonably* extends such market power beyond the statutory term of the patent.

The Agencies explicitly note that "many restrictions that have the potential to extend the market power conferred by a valuable patent beyond its term can have demonstrable efficiencies." (*Id.*) For example, "contracts that require exclusive dealing may encourage a licensee to further develop the licensed technology." (*Id.*) The Agencies also argue for a narrow reading of existing Supreme Court precedent regarding when royalties might be paid past the expiration of a patent. The Agencies note that it is "possible that collecting royalties over a longer term than the patent grant will reduce the deadweight loss associated with a patent monopoly and allow the patent holder to recover the full value of the patent, thereby preserving innovation incentives." (*Id.*)

Implications

Although the Report is not binding on courts, it suggests that the enforcement of antitrust laws with respect to conduct involving IP will typically require a detailed understanding of the relevant facts and a careful assessment of such conduct under the rule of reason. Even so, predicting the outcome of such an assessment is often difficult. Indeed, weighing the antitrust risks raised by specific conduct involving IP is particularly challenging because, as the Report acknowledges, "the boundaries of intellectual property rights are often uncertain and difficult to define, so that neither the intellectual property holder nor competitors know the precise extent of protection afforded by the intellectual property right without a decision from a court or binding arbiter." Left unsaid by the Report is the point that such uncertainty will continue to make antitrust assessments of settlements of IP litigation particularly challenging.

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For further information regarding this memorandum or on antitrust or competition issues generally, please contact our practitioners in our U.S. or European offices: William H. Rooney (212-728-8259, wrooney@willkie.com) or David K. Park (212-728-8760, dpark@willkie.com) in our New York office; Bernard A. Nigro, Jr. (202-303-1125, bnigro@willkie.com) or Theodore C. Whitehouse (202-303-1118, twhitehouse@willkie.com) in our Washington, D.C. office; Jacques-Philippe Gunther (33-1-53-43-4538, jgunther@willkie.com) or David Tayar (33-1-53-43-4690, dtayar@willkie.com) in our Paris office; or the attorney with whom you regularly work.

For further information regarding this memorandum or on intellectual property issues generally, please contact Kelsey I. Nix (212-728-8256, knix@willkie.com) in our New York office.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

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