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Antitrust Agencies Release Intellectual Property Report, Cover Little New Ground

Nearly five years after they held joint hearings on the intersection of antitrust and intellectual property, the Federal Trade Commission and Department of Justice have issued a report on the topic. Although touted as providing the first insight into the agencies' views since their 1995 *Antitrust Guidelines for the Licensing of Intellectual Property* ("Antitrust-IP Guidelines"), the *Joint Report on Antitrust Enforcement and Intellectual Property Rights* ("Joint Report") breaks relatively little new ground.

The 2002 hearings, entitled "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy," featured over 10 months of testimony from more than 300 commentators offering views on biotechnology, computer hardware and software, Internet, and pharmaceutical industries, and others. Issues covered include refusals to license patents, collaborative standard-setting, patent pooling, intellectual property licensing, the tying and bundling of intellectual property rights and methods of extending market power conferred by a patent beyond the patent's expiration. Perhaps the two most significant issues explored are refusals to license and patent pools.

The Agency's Attitude towards Intellectual Property Has Evolved

In the Antitrust-IP Guidelines, the agencies pointed out that, "for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property." In contrast, the Joint Report goes to some lengths to explain why intellectual property is different from traditional property, noting how:

- intellectual property may be easier to steal (copy);
- intellectual property may be used without interfering with the ability of others to use it;

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- the fixed costs of creating intellectual property are high and the marginal costs of using it are low; and
- the boundaries of intellectual property may be difficult or expensive to define.

The agencies are working through the implications of this evolved view and the Joint Report reflects some of that process.

Unconditional Refusals to License Treated Permissively

The case law has reflected some conflict about how to approach unilateral refusals to license, specifically with respect to whether (and how) to consider the subjective intent of the licensor. Attempting to resolve this dispute, the agencies conclude that antitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections. Antitrust liability for refusals to license competitors would compel firms to reach out and affirmatively assist their rivals, a result the agencies believe conflicts with the antitrust laws. On the other hand, conditional refusals to license that cause competitive harm will continue to be subject to antitrust scrutiny.

Standard-Setting Viewed As Pro-Competitive

The Joint Report marks the first time the agencies formally recognize the importance of standard-setting organizations (SSOs) in the marketplace, specifically their significance at increasing output and lowering costs. Standard-setting activities were the subject of several U.S. Supreme Court decisions between the 1960s and 1980s that dealt principally with exclusionary practices and the "capture" of an SSO by a group of competitors. These cases influenced the strict antitrust compliance rules and procedures adopted by many SSOs. The agencies reinforce that joint negotiation of licensing terms by standard-setting organization participants *before the standard is set* ("*ex ante*") can be pro-competitive. Specifically, doing so can be the most effective way to address the problem of switching to a competing standard after one is selected by the SSO, when the owner of the standard has the power to extract higher royalties or other terms that reflect the absence of acceptable alternatives (the problem of "hold-up").

The agencies conclude that *ex ante* negotiations are unlikely to constitute a *per se* antitrust violation because they are the most effective way to address hold-up. To address hold-up, some SSOs may require participants to disclose the existence of IP rights that may be infringed by a potential standard in advance to commit to license such IP rights on "reasonable and non-discriminatory rates and terms," or

even to commit to specific rates and terms if their standard is chosen. The agencies will usually apply a rule of reason analysis when evaluating such joint negotiations.

The agencies recognize that the evaluation of rates and terms before standards are set can pose substantial challenges and costs. Although the agencies will condemn as *per se* illegal activities designed to reduce or eliminate competition among SSO members—such as bid rigging by members who otherwise would compete in licensing technologies for adoption by the SSO or naked price-fixing on downstream products by members who otherwise would compete in selling downstream products compliant with the standard—multilateral *ex ante* licensing negotiations legitimately supporting the standard-setting process will be accorded rule of reason treatment balancing the potential pro-competitive benefits against the perceived anti-competitive risks.

Other Issues Lack Further Development Since 1995

Many of the other topics addressed in the Joint Report are not substantially developed from their treatment in the 1995 Antitrust-IP Guidelines. The agencies will evaluate the competitive effects of cross licenses and patent pools under the rule of reason framework articulated in the 1995 Antitrust-IP Guidelines. The agencies conclude that combining complementary patents within a pool is generally pro-competitive. A combination of complementary intellectual property rights, especially those that block the use of a particular technology or standard, can be an efficient and pro-competitive way to disseminate those rights to would-be users of the technology or standard. **Importantly, the agencies note that including substitute patents in a pool does not make the pool presumptively anti-competitive.** Instead, competitive effects are ascertained on a case-by-case basis.

The agencies will apply the rule of reason to assess intellectual property licensing agreements, including non-assertion clauses, grantbacks, and reach-through royalty agreements. Meanwhile, the Antitrust-IP Guidelines will continue to guide the agencies' analysis of intellectual property tying and bundling. The agencies consider both the anti-competitive effects and the efficiencies attributable to a tie, and would be likely to challenge a tying arrangement if:

- the seller has market power in the tying product,
- the arrangement has an adverse effect on competition in the relevant market for the tied product, and
- efficiency justifications for the arrangement do not outweigh the anti-competitive effects.

If a package license constitutes tying, the agencies will evaluate it

under the same principles they use to analyze other tying arrangements.

According to the report, the starting point for evaluating practices that extend beyond a patent's expiration is an analysis of whether the patent in question confers market power. If so, these practices will be evaluated under the agencies' traditional rule of reason framework unless the agencies find a particular practice to be a sham cover for naked price fixing or market allocation. According to the report, collecting royalties beyond a patent's statutory term can be efficient. Although there are limitations on a patent owner's ability to collect royalties beyond a patent's statutory term, that practice may permit licensees to pay lower royalty rates over a longer period of time, which can 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.

Resources

Copies of the report can be found on the Department of Justice's Web site here.

The Antitrust Guidelines for the Licensing of Intellectual Property can be found here.

Transcripts and written submissions from the 2002 intellectual property hearings are available here.

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