Abuse of Dominance Involving Intellectual Property

The First International Seminar on
Intellectual Property, Standards, and Anti-Monopoly Law

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Antitrust and IP

Outline of presentation

1. Background principles of IP and antitrust laws in United States
2. Defining a relevant market when IP is involved
3. Evaluating unilateral conduct involving IP

Antitrust and IP

1. **Background principles of IP and antitrust laws in United States**

Antitrust and IP

- Three propositions about U.S. law regarding antitrust and IP:
  1. A company is generally free to choose with whom it will deal.
  2. The same antitrust rules apply to conduct involving IP as apply to other conduct.
  3. Patents do not necessarily confer market power.

Antitrust and IP

Proposition 1: A company is generally free to choose with whom it will deal

- Long-standing rule in United States.

Antitrust and IP

Proposition 2: The same antitrust rules apply to conduct involving IP as apply to other conduct

- Recognized in:
  - 1995 FTC/DOJ Guidelines for Licensing Intellectual Property
  - 2007 FTC/DOJ Report on Intellectual Property Rights
- Antitrust law is flexible and can account for the special characteristics of IP.

Antitrust and IP

- Intellectual property laws provide incentives for innovation by establishing enforceable property rights that:
  - allow intellectual property owners to appropriate value derived from their intellectual property;
  - facilitate the commercialization of inventions and ideas;
  - encourage public disclosure.

Antitrust and IP

- Competition promotes innovation by preserving incentives for firms to engage in innovation and research and development in order to:
  - be the first to enter a market.
  - increase market share.

Antitrust and IP

- There is common ground between the goals of antitrust law and of intellectual property law.
  - IP laws grant the right to exclude others from an invention or creative expression.
  - Antitrust law disfavors exclusionary conduct that undermines competition on the merits, but it respects property rights.
- Ultimate goals of both laws are the same: promoting innovation and competition.

Antitrust and IP

Proposition 3: The possession of a patent does not necessarily create market power

- Recognized in FTC and DOJ reports on IP and Supreme Court cases.

Relevant Markets Involving IP

2. **Defining a relevant market when IP is involved**

Relevant Markets Involving IP

- A patent allows its holder to exclude others only from making, using, or selling a specific product or process.
- However, there are often alternatives, sometimes many, to that patented product or process.
  - In the United States, numerous patents have issued for products such as toothbrushes and paperclips.

Relevant Markets Involving IP

- The existence of alternatives means that possession of a patent does not necessarily create market power.
- Recognized in:
  - 1995 FTC/DOJ Guidelines for Licensing Intellectual Property
  - 2007 FTC/DOJ Report on Intellectual Property Rights
  - *Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006)

Relevant Markets Involving IP

- What is a relevant market?
  - That group of products that significantly constrain each other's pricing, when viewed from the perspective of both consumers and producers.

Relevant Markets Involving IP

- General approach: determine a product market for products involving the IP and possible substitute products using alternative IP (or no IP at all).
  - Consider a patent on a touch screen for a tablet computer
  - Other tablet computers may offer a touch screen using technology that does not infringe this patent.

Relevant Markets Involving IP

- Alternative approach: determine a technology market for the type of IP.
  - This approach may be appropriate when the IP is licensed separately and is not incorporated in a product, *e.g.*, a patented manufacturing process.
  - Consider other processes that do not infringe the IP, and whether they are reasonable substitutes.

Relevant Markets Involving IP

- To determine a relevant market, the most common approach is to use the “hypothetical monopolist test.”
- The test determines whether a “hypothetical monopolist” would impose a “Small but Significant and Non-transitory Increase in Price (“SSNIP”) of a product.
- A monopolist would impose this price increase if it would be profitable.
  – Would consumers switch to other products in sufficient numbers so that the monopolist would lose enough sales to reduce its profits?

Relevant Markets Involving IP

- Defining markets involving IP usually involves products or technologies. Accordingly, the SSNIP test still applies.

Relevant Markets Involving IP

- The big challenge of market definition in monopolization cases is the "*Cellophane*" fallacy:
  - If a company has substantial market power, it likely is pricing above the competitive level
  - At that high price level, other products may appear to be reasonable substitutes because they perform a similar function at a similar price.
  - However, if the company's product were priced at a competitive level, then those alternatives would be much more expensive and not reasonable substitutes.
  - Error made by U.S. Supreme Court in *United States v. E.I. du Pont de Nemours & Co*, 351 U.S. 377 (1956), in case involving du Pont's "Cellophane" product (clear plastic wrapping).

Conduct Involving IP

3. **Evaluating unilateral conduct involving IP**

Conduct Involving IP

- In the United States, monopolization is illegal when a firm:
  - Willfully acquires or maintains market power in a relevant market, and does so by means other than:
    - Superior product
    - Superior business acumen
    - Superior service
    - Good luck, or similar factors
- The mere existence of a monopoly is not illegal. The focus is on the exclusionary nature of conduct.

Conduct Involving IP

- In general, any company – even a monopoly – may choose with whom to deal.
  - *United States v. Colgate & Co.*, 250 U.S. 300 (1919)
  - *Verizon Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398 (2004)

Conduct Involving IP

- In certain circumstances, there may be limits on this freedom for a firm that is dominant.
  - *Aspen Highlands Skiing Corp. v. Aspen Skiing Co.*, 472 U.S. 585 (1985)
    - Refusals to sell a product or service to a competitor that the monopolist makes available to others.
    - Stops doing business with a competitor that the monopolist has done business with before, and no legitimate business reason for the change.
- Such cases are extremely rare.

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- Denial of access to an “essential facility” is a related form of conduct.
  - The U.S. Supreme Court has never held that this is a form of conduct that violates the antitrust laws.

Conduct Involving IP

- This approach arises from concerns that granting access to such facilities will reduce incentives for investment and innovation
  - Also concerns about having to set the terms of access if a violation is found.

Conduct Involving IP

- Tying: Seller conditions sale of one product or service (“tying product”) on customer’s agreement to buy a second product or service (“tied product) through technology or contract.
- Bundling: Seller typically sells a number of products or services in a package.
- Tying and bundling practices are very common in the economy; terms are sometimes used interchangeably.

Conduct Involving IP

- Linking IP with products or other IP can take many forms, for example:
- “Contractual tying”: Patented tying good (e.g., copy machine) and unpatented tied good (e.g., ink or paper).
- “Technological tying”: Products bundled together physically or produced so as to be compatible only with each other.
- Multiple IP rights may themselves be combined into bundles or packages (e.g., copyrighted music, software programs).

Conduct Involving IP

- Many economists believe tying and bundling are likely to be procompetitive given their potential efficiencies, *e.g.*, Evans & Salinger (Yale J. Reg. 2005).
- Documented instances of anticompetitive tying appear to be rare (Salinger, 2006).

Conduct Involving IP

- Key possible efficiencies of tying include:
  - Economies of joint sales;
  - Quality assurance (*e.g.*, warranty repairs);
  - Cheating on a cartel (extras in the bundle may serve as a secret price discount);
  - Metering may allow more markets to be served than under single price monopoly.

Conduct Involving IP

- Tying may create anticompetitive harms in some circumstances:
  - Tying arrangement can enable monopolist in tying market to reduce demand for rival products in tied market.
    - If there are scale economies in tied product and competitors exit, higher prices may result and product variety falls. However, impact on overall welfare uncertain. (Whinston, 1990).
  - Tying may be used to preserve market position in tying product (Carlton & Waldman, 2002).
  - Tying allows monopolist to capture some profits of maker of complementary good. (Carlton, Gans & Waldman, 2007).

Conduct Involving IP

- Although U.S. courts were previously skeptical of tying arrangements, economic learning changed courts' views.
- Today U.S. courts recognize that "many tying arrangements . . . are fully consistent with a free, competitive market." *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006) (Supreme Court) (discussing possible efficiencies of tying).
- In short, courts now focus on case-specific analysis and efficiencies as well as potential anticompetitive effects.

Conduct Involving IP

- FTC and Justice Department: “Rule of reason” approach to IP tying and bundling.
- Agencies consider both anticompetitive effects and efficiencies from an IP tie.
- Agencies would challenge if:
  1. Seller has market power in tying product;
  2. Harm to competition in tied product market; and
  3. Efficiencies do not outweigh anticompetitive effects.
- Agencies evaluate package license that constitutes tying under same principles.

Conduct Involving IP

- In its 2001 *Microsoft* decision, the U.S. Court of Appeals for D.C. applied "rule of reason" to platform software IP tying.
  - Court reasoned application of per se rule would risk condemning beneficial ties.
- Contains a key idea: Innovation may lead companies to combine two products to make an improved product.
  - Calls for caution in evaluating a new product combining two old products.