2007-1386

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PRINCO CORPORATION AND PRINCO AMERICA CORPORATION,
Appellants,

v.

INTERNATIONAL TRADE COMMISSION,
Appellee,

and

U.S. PHILIPS Corporation,
Intervenor.

On Appeal from the United States International Trade Commission
Investigation No. 337-TA-474

BRIEF OF AMICUS CURIAE FEDERAL TRADE COMMISSION ON REHEARING *EN BANC* SUPPORTING NEITHER PARTY

WILLARD K. TOM,
General Counsel
JOHN F. DALY,
Deputy General Counsel for Litigation
DAVID L. SIERADZKI, Attorney
Office of General Counsel

FEDERAL TRADE COMMISSION
600 Pennsylvania Ave., NW
Washington, DC 20580
(202) 326-2092

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INTEREST OF THE FEDERAL TRADE COMMISSION AS AMICUS CURIAE

The Federal Trade Commission ("FTC") is an independent federal agency charged with promoting a free and competitive marketplace and protecting the interests of consumers. *See* 15 U.S.C. §§ 41 *et seq*. The FTC has substantial experience with enforcing antitrust law and addressing allegedly unreasonable restraints on competition involving patents and other forms of intellectual property. The FTC also has conducted economic research, issued reports, and, together with the U.S. Department of Justice ("DOJ"), developed guidelines governing antitrust enforcement and intellectual property rights.[1]

The FTC submits this amicus brief in order to bring its antitrust expertise to bear on the important competition policy issues presented here. This Court's precedents establish that, apart from the realm of *per se* patent misuse, application of the patent misuse doctrine is to be informed by antitrust principles. *See infra* Part I. The FTC accepts this principle as a given, and expresses no view on whether differences

[1] *See, e.g.*, DOJ & FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* (April 1995) <http://www.ftc.gov/bc/0558.pdf> ("*Antitrust/IP Licensing Guidelines*"); DOJ & FTC, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (April 2007) <http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf> ("*2007 Innovation Report*"). *See also* DOJ & FTC, *Antitrust Guidelines for Collaborations Among Competitors* (April 2000) <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf> ("*Competitor Collaboration Guidelines*").

between antitrust law and the patent misuse doctrine may warrant different approaches in some cases, or in this particular case. Moreover, the FTC supports neither Princo's nor Philips' positions on the ultimate outcome of this case.[2]

Instead, this brief has only one purpose: to assist the Court by providing a discussion of modern antitrust jurisprudence as it would apply to the underlying situation presented here, so that the Court can make a fully informed decision as to whether and how to apply antitrust principles to the patent misuse issues before it. This is consistent with the FTC's expressed "commitment to the filing of amicus briefs in important patent cases that can affect competition" in order "to present its perspectives regarding the implications of certain issues for consumer welfare."[3]

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[2] We assume for the sake of discussion that this matter is properly before the Court, and take no position on whether Princo properly raised its arguments on this issue to the ITC. ITC Br. 35-52; Philips Br. 56-57.

[3] FTC, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, Exec. Summary at 17 (Oct. 2003) <http://www.ftc.gov/os/2003/10/innovationrpt.pdf> ("*2003 Innovation Report*").

ISSUES PRESENTED ON REHEARING *EN BANC*

The issues presented are those addressed in Section II of the panel opinion, *Princo Corp. v. ITC*, 563 F.3d 1301, 1313-19 (Fed. Cir. 2009) (reproduced as addendum to Philips Br. ("Panel Op.") at 21-32), *en banc reh'g granted*, 583 F.3d 1380, 1381 (Fed Cir. 2009) (*en banc, per curiam*). We address only the following issues:

1. If Philips' and Sony's alleged collusion to restrict the licensing of Sony's Lagadec patent was reasonably necessary for the companies' productive collaboration on CD-R and CD-RW technologies and standards, can it be condemned as an agreement by competitors to suppress a competing technology?

2. Should Princo be able to show that Philips' and Sony's alleged collusion was anticompetitive without proving that an alternative technology based on Sony's Lagadec patent would in fact have been commercialized successfully absent the restraint?

SUMMARY OF ARGUMENT

To the extent that antitrust principles are used to test the misuse defense asserted in this case, innovation will best be served if the Court gives more credence to efficiency justifications than some of the language of the panel majority might suggest, and closer adherence to the methods for analyzing restraints of trade under the rule of reason, as the courts have laid out in antitrust cases, than the panel dissent might suggest.

With respect to efficiency justifications, a proper analysis under antitrust principles would require resolution of the parties' sharply contrasting factual assertions about the nature and timing of the allegedly exclusionary restriction on the licensing of Sony's Lagadec patent. Such an agreement might be justified if it was reasonably necessary to achieve an efficient collaboration on recordable and rewritable CD technology. On the other hand, if the Lagadec and competing technologies were developed prior to, and independent of, any collaboration between Philips and Sony, the proffered justification for the restraint might easily be dismissed.

With respect to competitive effect, an analysis in conformity with modern antitrust principles should recognize the flexibility inherent in the antitrust rule of reason. Specifically, the courts have recognized that certain types of trade restraints – such as "inherently suspect" practices that can be readily identified as tending to harm competition – can be condemned without any elaborate analysis of the firms' market power or proof of actual harm to competition. Imposing a higher standard of proof – at least in an antitrust context – would give established incumbents in a market free rein to squash nascent, albeit unproven, competitive entrants, and would be harmful to both competition and innovation.

ARGUMENT

I. IF THE COURT USES ANTITRUST LAW TO INFORM ITS DECISION IN THIS PATENT MISUSE CASE, IT SHOULD BE GUIDED BY THE PRO-INNOVATION PRINCIPLES OF MODERN ANTITRUST

In patent infringement cases, when defendants raise the "equitable defense of patent misuse," this Court has held that the "key inquiry is whether, by imposing conditions that derive their force from the patent, the patentee has [(1)] impermissibly broadened the scope of the patent grant, [(2)] with anticompetitive effect." *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986) (numbering added); *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 870 (Fed. Cir. 1997); *C.R. Bard, Inc. v. M3 Systems, Inc.*, 157 F.3d 1340, 1372 (Fed. Cir. 1998)*; U.S. Philips v. ITC,* 424 F.3d 1179, 1184-85 (Fed. Cir. 2006) ("*Philips I*").[4]

This inquiry has been formulated as two distinct "prongs" (*see* III P. Areeda & H. Hovenkamp, ANTITRUST LAW ¶ 710b3(B) (3d ed. 2008)): first, whether the

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[4] This standard does not apply to the limited categories of conduct that are either *per se* patent misuse or are excluded from the patent misuse defense under 35 U.S.C. § 271(d).

practice at issue improperly "attempts to broaden the physical or temporal scope of patent monopoly" granted by the statute, *Blonder-Tongue Labs. Inc. v. Univ. of Illinois Found.*, 402 U.S. 313, 343 (1971); and second, whether "the overall effect of the licens[ing] [arrangement or other practice] tends to restrain competition unlawfully in an appropriately defined relevant market." *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 706 (Fed. Cir. 1992) (quoting *Windsurfing*, 782 F.2d at 1001-02). This brief addresses only the second of these prongs – the "tends to restrain competition" (or "with anticompetitive effect") element of the patent misuse defense.[5]

In the patent misuse context, "[w]here an anticompetitive effect is asserted, the rule of reason is the basis of determining the legality of the provision." *Mallinckrodt*, 976 F.2d at 706. According to the ITC, this Court "has indicated that the rule of reason standard to be applied is that developed in antitrust law." *In the Matter of Certain Recordable Compact Discs and Rewritable Compact Discs*, USITC Inv. No. 337-TA-474, Commission Opinion, 2007 WL 1256290, at 26 (Feb. 5, 2007) (subsequent history omitted). A leading treatise specifies that the rule of reason

[5] Princo contends (Br. 53-55) that an infringement defendant should be able to sustain a patent misuse defense by satisfying *either* of these elements (and that the *en banc* Court should overrule certain misuse precedents to make this clear). By contrast, Philips argues (Br. 46-55) that a patentee accused of misuse may exonerate itself if *either* of the two elements is not present – *i.e.*, that the infringement defendant must establish *both* elements (and therefore, that Philips' alleged anticompetitive misconduct, standing alone, cannot support a misuse finding). We express no view on the merits of these arguments.

analysis used in this context is "largely coextensive" with that applied in antitrust law, although not necessarily identical. *See* H. Hovenkamp, IP AND ANTITRUST, ¶ 3.2d (2d ed. 2010); *see also id.*, ¶ 3.2e ("By relying on the language and doctrine of antitrust cases, the court [in *Virginia Panel*] presumably meant to invoke the considerable legal and economic structure that has been developed in substantive antitrust rule of reason cases."); Panel Op. 26-27 (563 F.3d at 1315-16); *Philips I*, 424 F.3d at 1185; *Virginia Panel*, 133 F.3d at 869. Thus, in a number of recent patent misuse cases, this Court has assessed competition issues using a rule of reason analysis akin to that developed in the antitrust context.

In the following sections, we analyze the issues addressed solely with reference to the standards for antitrust liability – *i.e.*, whether particular alleged agreements would be subject to condemnation as unreasonable restraints of trade under Section 1 of the Sherman Act, 15 U.S.C. § 1. We express no views as to whether and to what extent the specific policies of patent law might require an infringement defendant asserting a patent misuse defense to make a showing beyond the existence of an agreement that would violate Section 1, or whether such policies might dictate a finding of misuse in the absence of a violation of Section 1.[6] Nevertheless, to the

[6] Even under the antitrust laws themselves, plaintiffs seeking certain types of relief – such as a private plaintiff seeking an award of damages – must make specified showings beyond the existence of an agreement that violates Section 1. *See* note 13, *infra*.

extent that this Court incorporates antitrust principles into its analysis, innovation will best be served if the Court gives more credence to efficiency justifications than some of the language of the panel majority might suggest, and greater adherence to the analytical methods laid out in recent antitrust jurisprudence than the panel dissent might suggest.[7] Both of these refinements serve the purpose of encouraging innovation: the first recognizes that collaborative innovation sometimes requires restraints against competing with the collaboration, and the second recognizes that unjustified restraints on nascent competition can hinder innovation, even when the ultimate success of that nascent competition cannot be proven with any degree of certainty.

[7] For example, the majority states without qualification that "there are no benefits to be obtained from an agreement between patent holders to forego separate licensing of competing technologies," Panel Op. 26 (563 F.3d at 1315). *Cf.* Part II, *infra*. And although much of the dissent is directed to issues concerning the state of the record (on which we take no position), it concludes by stating that, "[i]n any event, Princo still needed to show that [the alleged] agreement * * * would have had some anticompetitive effect," and that such a showing required a demonstration that the nascent Lagadec technology "would have competed" with the Orange Book technology. Dissenting Op. 10 (563 F.3d at 1326). *Cf.* Part III, *infra*.

II. AN AGREEMENT NOT TO LICENSE THE LAGADEC PATENT EXCEPT FOR USES COMPLYING WITH PHILIPS' AND SONY'S PROPRIETARY PRODUCT STANDARD MIGHT BE JUSTIFIED IF REASONABLY NECESSARY TO ACHIEVE AN EFFICIENT COLLABORATION

A. Some Restraints May Be Justified If They Are Reasonably Necessary to Achieve the Benefits of a Collaboration

In general, antitrust law recognizes that the incentive to invest and engage in cooperative productive economic activity often can be furthered by "ancillary" restrictions on competition if those restrictions "may contribute to the success of a cooperative venture that promises greater productivity and output." *Polk Bros., Inc. v. Forest City Enterprises, Inc.*, 776 F.2d 185, 188 (7th Cir. 1985). Economic collaborations among horizontal competitors may be beneficial and procompetitive if they enable the "combination[] of different capabilities or resources," and thereby "enable participants to offer goods or services that are cheaper, more valuable to consumers, or brought to market faster than would be possible absent the collaboration." *Competitor Collaboration Guidelines*, § 2.1. In the context of such a lawful joint venture, agreements among parties to limit competition regarding the venture's "core activities," such as agreements setting prices for the venture's products, are not unlawful *per se* if they are "necessary to market the product at all." *Texaco, Inc. v. Dagher*, 547 U.S. 1, 7-8 (2006), (citing *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 23 (1979) ("*BMI*").

On the other hand, purported justifications for arrangements that restrain competition will not stand if "the challenged conduct is not reasonably necessary to achieve the legitimate objectives or that those objectives can be achieved in a substantially less restrictive manner." *Law v. NCAA*, 134 F.3d 1010, 1019 (10th Cir. 1998); *United States v. Visa USA, Inc.*, 344 F.3d 229, 238 (2d Cir. 2003). "[A] restraint that is unnecessary to achieve a joint venture's efficiency-enhancing benefits may not be justified based on those benefits." *Major League Baseball Properties, Inc. v. Salvino*, 542 F.3d 290, 339 (2d Cir. 2008) (Sotomayor, J., concurring). If "similar efficiencies" could be achieved through "practical, significantly less restrictive means," then the restrictive aspects of the agreement cannot be considered "reasonably necessary to their achievement." *Competitor Collaboration Guidelines*, § 3.36(b). In other words, there must be a "specific link between the challenged restraint and the purported justification." *Polygram Holding, Inc.*, 136 F.T.C. 310, 347 (2003), *aff'd*, *Polygram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005).

Each of these antitrust principles applies with equal force to justifications for ancillary restraints related to the licensing and use of intellectual property as to other forms of competitive restraints. *See, e.g., Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 547 U.S. 28, 38-43 (2006); *see also BMI, supra*; *Salvino, supra*; *Polygram, supra*; *United States v. Microsoft Corp.*, 253 F.3d 34, 58-59 (D.C. Cir. 2001) (*en banc, per curiam*); *Antitrust/IP Licensing Guidelines*, § 2.1.

B. The Challenged Restriction May Be Justified as an Ancillary Restraint If – But Only If – It Was Reasonably Necessary to Further Procompetitive Collaboration Between Philips and Sony

A central question in this case is whether Philips' and Sony's alleged agreement[8] to restrict the licensing of the Lagadec patent for use only for Orange Book-compliant purposes (which inevitably would have had the effect of suppressing any possible alternative technology based on Lagadec) was a reasonably necessary ancillary restraint to enable Philips and Sony to collaborate in developing CD-R and CD-RW technology. In their briefs, Philips and Princo present starkly contrasting versions of the facts pertaining to (i) the nature of the collaboration itself, and (ii) the relationship between the alleged exclusionary agreement and the collaboration.

In Philips' telling, Philips and Sony engaged in a comprehensive collaboration to develop an entirely new product. Philips Br. 4. In the course of their collaboration, they jointly identified a technical challenge that needed to be surmounted in order for the product to function. *Id.* 5. Although the engineering teams of the two companies then separately worked on finding a solution to the technical problem, and ended up with separate patents to their respective solutions, *id.* 5-6, the prospect that one

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[8] This brief assumes for the sake of discussion that Philips' and Sony's arrangements specifically included such an agreement, but takes no position on whether or not this assumption is correct (Princo Br. 21-24) – a point that Philips neither denies nor concedes in its *en banc* brief (Philips Br. 4-8, 56-58) – or on whether or not the Court should remand the case to the ITC to resolve any uncertainty over this question. Panel Op. 33-35 (563 F.3d at 1319-22).

company could "free-ride" on the joint efforts of both companies necessitated restrictions on competing with the venture, else the respective companies would lack the incentive to have their engineering teams invest the energy and resources to solve this and other technical problems. *Id.* 26, 30. Thus, they agreed to license their patents through the pool, subject to a restriction preventing licensees' from using the patents for any purpose inconsistent with Philips' and Sony's Orange Book standard. *Id.* 6-8. Although ultimately only one of the two technologies could be chosen to solve the particular technical problem, Philips argues that an agreement prohibiting both companies from competing with the joint standard (assuming *arguendo* that such an agreement existed) would have been a necessary restriction to provide the incentive for *either* company to invest the effort on a technical solution. *Id.* 27.

In Princo's account, Philips and Sony independently developed competing technologies and competing patents. Princo Br. 14-16. Only after the investments and inventions were already made did the companies come together and agree to license their patents jointly through a patent pool arrangement, and otherwise prohibit the use of such patents in competition with Orange Book standard technology. *Id.* 20-21. Accordingly, the restriction on licensing for non-Orange Book purposes was nothing but an agreement between two potential competitors not to compete with one another, and to prevent third parties from using Lagadec to develop alternative technology that might have competed with Philips' and Sony's proprietary Orange Book standard. *Id.* 20-25; Panel Op. 26-27 (563 F.3d at 1315-16).

It is not the FTC's role to determine which portrayal is closer to the truth. However – as both Philips and Princo recognize by opening their briefs with their respective versions of precisely the same factual issue – the factual circumstances of the alleged agreement to suppress the Lagadec technology matter greatly in ascertaining the correct means of analyzing it under the antitrust rule of reason.

If, as Philips contends, its alleged agreement with Sony that neither company would license its respective patents except for uses consistent with their jointly-created product standard (the Orange Book) was reasonably necessary to facilitate Philips' and Sony's technological collaboration to create the CD-R and CD-RW technology in the first place, then the allegedly restrictive licensing arrangement could be justified as ancillary to that collaboration. That condition is more likely to be met, of course, if the collaboration began very early, at or near the very beginning of the research and development to create CD-R technology, and was very broad in scope, entailing cooperation on the invention of the technology itself, as well as the establishment of technical standards and licensing arrangements.

Modern antitrust law recognizes that, in legitimate joint ventures involving substantial "integration of economic activity" and a high degree of collaboration, *Antitrust/IP Licensing Guidelines*, § 3.4, it may be appropriate for participants to agree not to compete with the venture, where such a non-compete agreement is reasonably necessary to promote investment and innovation. *Competitor Collaboration Guidelines*, § 3.36(b) & Ex. 10; *cf. Addyston Pipe & Steel Co.*, 85 F. 271, 281-82 (6th Cir. 1898), *aff'd on other grounds*, 175 U.S. 211 (1899). Such restrictions, although facially reducing competition between participants in the venture, may pass antitrust muster if they are reasonably necessary to enable the collaboration to "generate significant efficiencies that benefit consumers," such as "offer[ing] goods or services that are cheaper, more valuable to consumers, or brought to market faster than would otherwise be possible." *Competitor Collaboration Guidelines*, § 3.36 & Ex. 10.

Patent pooling activities have often fallen within this rubric. *See, e.g., 2007 Innovation Report*, note 1, *supra*, at 85 ("exclusivity in patent pools can provide incentives for procompetitive investment"). Indeed, Philips' and Sony's collaborative patent pool licensing arrangements, implemented in tandem with their joint development of the Orange Book standard, have themselves been recognized as procompetitive overall. *See Philips I*, 424 F.3d at 1187-94.

Philips asserts that the part of those arrangements in which both parties purportedly committed not to compete against the Orange Book standard was necessary to prevent either party from "free riding" on the other party's venture-related activities, and would "maintain each other's commitment to Orange Book development given the resources each was investing * * * by ensuring that neither would use the fruits of their joint development efforts, such as Lagadec, in competition against the collaboration itself." Philips Br. 32. Philips' argument is, in form, consistent with numerous antitrust cases holding that preventing "free riding" can justify competitive restrictions in the context of joint ventures. If participants in a joint venture were allowed to "free ride" on the other participants' investments, their own incentives to invest in promotion and development of the venture's products would be undermined. *See, e.g., Salvino*, 542 F.3d at 340 (Sotomayor, J., concurring); *Polk Bros.*, 776 F.2d at 189-90; *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986).[9]

In response, Princo makes two main arguments. First, it argues that Philips' and Sony's exclusionary agreement not to license Lagadec for non-Orange Book uses was not the least restrictive means to achieve those benefits. "Each of the

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[9] A "free riding" justification will not be persuasive, however, where there is a mechanism for the party incurring the investments to collect appropriate payments so that "the 'ride' is not free," *Chicago Professional Sports, L.P. v. NBA*, 961 F.2d 667, 675 (7th Cir. 1992), or where the justification is merely a pretext to "protect a less-demanded, higher-priced product from competition [from] a lower-priced product that consumers may prefer more strongly." *Realcomp II Ltd.*, Opinion, FTC Docket No. 9320, File No. 061-0088, at 31 (Oct. 30, 2009) http://www.ftc.gov/os/adjpro/d9320/091102realcompopinion.pdf ("*Realcomp*"), *appeal pending* (6th Cir.) (citing *National Collegiate Athletic Ass'n v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 116-17 (1984) ("*NCAA v. Regents*")); *Premier Electrical Construction Co. v. National Electric Contractors Ass'n, Inc.*, 814 F.2d 358, 370 (7th Cir. 1987).

procompetitive purposes of patent pooling that this Court identified in *Philips I* can be achieved by a nonexclusive patent pool without any agreement not to compete." Princo Br. 47. Notwithstanding Princo's argument, however, antitrust does not always condemn intellectual property licensing arrangements with exclusivity restrictions. Such a restriction may be justified as procompetitive if it "promotes the exploitation and development of the licensor's technology." *Antitrust/IP Licensing Guidelines*, §5.4. *See, e.g.*, *Salvino*, 542 F.3d at 340 (Sotomayor, J., concurring) ("exclusivity and profit-sharing provisions" of competing Major League Baseball teams' agreement to jointly license intellectual property were justified as "reasonably necessary to achieve efficiency-enhancing purposes" of the venture); *Baxter Int'l, Inc. v. Abbott Labs.*, 315 F.3d 829, 832 (7th Cir. 2003) (Easterbrook, J.) (non-compete agreement accompanying grant of exclusive patent license "was a lawful ancillary agreement designed to induce [the licensee] to make the investments needed to bring the new drug to market."); *cf. County Materials Corp. v. Allan Block Corp.*, 502 F.3d 730 (7th Cir. 2008) (non-compete agreement accompanying exclusive patent license was not patent misuse under rule of reason). Thus, the issue of whether a restraint was reasonably necessary cannot be answered simply by characterizing the arrangement as exclusive or non-exclusive, but instead requires testing the need for exclusivity against the investment or other procompetitive activity sought to be protected by such exclusivity.

Beyond the issue of exclusivity, however, Princo also contends that the challenged restraints cannot be justified as reasonably necessary to achieve the benefits of the standard-setting collaboration, because the companies adopted the licensing restriction as part of agreements entered in 1993, "*after* the Orange Book standard was already developed" (first published in 1990), and long after the invention of the Lagadec patent (which Sony first applied for in Japan in 1986).[10] Princo Br. 35 (emphasis in original). "'Something can serve as an inducement only if received at the time an entry decision is to be made.'" *Id.* (quoting XIII P. Areeda & H. Hovenkamp, ANTITRUST LAW ¶ 2134d(2) (2d ed. 2005)); *see also Polk Bros.*, 776 F.2d at 189 ("a court must ask whether an agreement promoted enterprise and productivity *at the time it was adopted*") (emphasis added by Princo (Br. 32)). Accordingly, Princo argues, the challenged restraint at issue could not possibly have had any effect on the parties' incentives to invest in inventing Lagadec in developing the Orange Book product standard.

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As noted above, the FTC expresses no view on whether Philips' or Princo's version of the facts is correct. However, the foregoing discussion highlights that the question whether the benefits of Philips' and Sony's technology collaboration justifies

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[10] ALJ Initial Decision at 358, ¶ 19 (ITC, Oct. 24, 2003); *see also* U.S. Patent No. 4,942,565 (Lagadec) (issued July 17, 1990).

their allegedly restrictive licensing arrangement cannot be answered by simple labels such as "exclusivity" or "agreement to suppress a competing technology," but only by resolving these pivotal factual disputes about the justification for the restraint.

III. AN AGREEMENT BETWEEN COMPETITORS TO SUPPRESS A POTENTIALLY COMPETING TECHNOLOGY, NOT SUPPORTED BY PROCOMPETITIVE JUSTIFICATIONS, COULD BE CONDEMNED WITHOUT PROOF THAT SUCH TECHNOLOGY WOULD HAVE BEEN COMMERCIALIZED

At the same time that antitrust has developed greater sophistication about the procompetitive benefits of particular restraints on competition in certain contexts, it has also developed economically sound principles to (1) dispense with the need for elaborate market analysis and proof where confident conclusions about the anti-competitive nature of a restraint can be reached more efficiently, and (2) ensure that true harms to competition do not escape detection and correction merely because the effects of a restraint cannot be measured with precision.

The Supreme Court has set forth the process by which it applies the rule of reason to alleged concerted restraints on competition in a series of antitrust cases, beginning with *NCAA v. Regents* and *BMI*, and culminating in *Indiana Federation of Dentists v. FTC*, 476 U.S. 447 (1986) and *California Dental Ass'n v. FTC,* 526 U.S. 756 (1999). As these cases reflect, the Court "has backed away from any reliance upon fixed categories and toward a continuum." *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 35 (D.C. Cir. 2005) (D. Ginsburg, J.). It applies "an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint." *California Dental*, 526 U.S. at 779-81.

Building on the principles laid out by the Supreme Court, several Courts of Appeals, as well as the FTC, have enunciated a structured framework to guide the analysis. *See Polygram Holding, Inc. v. FTC*, 416 F.3d at 34-37, affirming 136 F.T.C. 310, 344-52 (2003); *North Texas Specialty Physicians v. FTC*, 528 F.3d 346 (5th Cir. 2008), affirming 140 F.T.C. 715 (2005); *Chicago Professional Sports*, 961 F.2d at 674; *Realcomp* at 16-20. This rule of reason framework commences with a "quick look" to consider whether the challenged business practice should be deemed "inherently suspect" – *i.e.*, one as to which "no elaborate industry analysis is required to demonstrate its anticompetitive character." *Indiana Federation*, 476 U.S. at 459. Inherently suspect practices include agreements that limit price and output, agreements to withhold a particular desired service, or other arrangements that inherently limit consumer choice or obviously impede the workings of the competitive market. *See California Dental*, 526 U.S. at 769-71 and cases cited therein.[11]

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[11] If a restraint does not qualify as "inherently suspect" a plaintiff may still demonstrate that a challenged practice has an anticompetitive effect in one of two ways: either "indirectly, by proving that the defendant possessed the requisite market power within a defined market, or directly, by showing actual anticompetitive effects." *Law v. NCAA*, 134 F.3d at 1019. *See Indiana Federation*, 476 U.S. at 460 ("inquiry into market power * * * is but a surrogate" for "proof of actual detrimental effects, such as a reduction of output") (quoting VII P. Areeda, ANTITRUST LAW ¶1511, at 429 (1986)); *see also Tops Markets, Inc. v. Quality Markets, Inc.*, 142 F.3d

Participants in "inherently suspect" arrangements have the opportunity to demonstrate that those arrangements are not anticompetitive, such as by showing that they are not likely to harm competition in the context of the particular market in question, or by showing ways in which they are likely to benefit consumers. *Polygram Holding, Inc. v. FTC*, 416 F.3d at 36, quoting *Polygram Holding, Inc.*, 136 F.T.C. at 345.[12]

Philips argues that one can only demonstrate that an agreement constitutes an unreasonable restraint of trade under Section 1 by showing actual anticompetitive effect and "market power." According to Philips, "[a]ny standard rule of reason analysis would start with proof of a relevant market" and "proof of actual or probable harm to competition in the larger market." Philips Pet. for *En Banc* Reh'g 9-10; *see also* Philips Br. 33; AIPLA Amicus Br. 12-14. Philips' assertion does not accurately portray the current state of the law. *See, e.g.*, *NCAA v. Regents*, 468 U.S. at 110 n.42

90, 96 (2d Cir. 1998) (plaintiff has "two independent means by which to satisfy the adverse-effect requirement" – direct proof of "actual adverse effect on competition" or "indirectly by establishing * * * sufficient market power to cause an adverse effect on competition"); *United States v. Brown Univ.*, 5 F.3d 658, 668 (3d Cir. 1993); *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 937 (7th Cir. 2000); ITC 2007 Op. *26.

12 *See also supra*, Part II, and *infra* at 26-27; *California Dental*, 526 U.S. at 775 n.12. Here and throughout our analysis, we proceed on the premise that the challenged actions do not fall within any of the traditional categories of *per se* antitrust violations, such as price fixing. Such violations are condemned without any opportunity to advance countervailing justifications. *See, e.g.*, *United States v. Andreas*, 39 F. Supp. 2d 1048, 1058-61 (N.D. Ill. 1998) (rejecting arguments that rule of reason can apply to criminal case charging price fixing and volume allocation imposed to restrict output), *aff'd*, 216 F.3d 645, 666-68 (7th Cir. 2000).

(“There was no need for the [plaintiffs] to establish monopoly power in any precisely defined market for television programming in order to prove the restraint unreasonable.”); *Indiana Federation*, 476 U.S. at 460 (restraint may be condemned even “in the absence of specific findings by the Commission concerning the definition of the market in which the Federation allegedly restrained trade and the power of the Federation's members in that market”).

On the contrary, as the cases discussed above establish, no such “‘detailed market analysis’” is needed to shift the burden to defendant to justify a restrictive practice, if “a confident conclusion about the principal tendency of a restriction” is possible. *See California Dental*, 526 U.S. at 769-70 (quoting *NCAA*, 468 U.S. at 110), 781. Applying these principles, the D.C. Circuit in *Polygram* specifically rejected arguments that there must be proof that a restraint “actually harms competition * * * [i]f, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition * * * .” 416 F.3d at 36. The burden is then on the defendant to “identify some reason the constraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm.” *Id*. Accordingly, the *Polygram* court upheld the Commission’s conclusion that the practice at issue there was “inherently suspect,” and could be condemned under Section 1 of the Sherman Act in the absence of a competitive justification.[13]

Thus, an inherently suspect practice "may be condemned even absent proof that it resulted in higher prices or * * * the purchase of higher priced services, than would occur in its absence." *See Indiana Federation*, 476 U.S. at 447; *see also North Texas Specialty Physicians*, 528 F.3d at 367 ("The fact that there is no evidence in the record that NTSP obtained higher prices for its physicians than other physicians received does not foreclose a determination that NTSP's practices had anticompetitive effects."); *Detroit Auto Dealers Ass'n v. FTC*, 955 F.2d 457, 472 & n.15 (6th Cir.

[13] The principle that a trade practice found to be "inherently suspect" and not otherwise justified may be condemned without a showing of actual adverse effects on competition is pertinent to the issue of *liability* for an unreasonable restraint of trade under Section 1. Plaintiffs seeking particular types of relief may be required to make additional showings. For example, a private antitrust plaintiff seeking treble damages under § 4 of the Clayton Act, 15 U.S.C. § 15, must not only establish the defendant's liability, but also must show that it was directly affected by the defendant's misconduct, *see, e.g.*, *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), and that it sustained such injuries in a quantifiable and proven amount, *see, e.g.*, *Bigelow v. RKO Pictures*, 327 U.S. 251 (1946).

A conclusion of patent misuse does not result in an award of treble damages, yet it may nevertheless entail a substantial sanction on the accused party, by rendering a patent unenforceable. We express no view as to whether the differing standing requirements or the nature of the remedial scheme warrants imposing on the proponent of a misuse claim any additional requirements with respect to the effects of a challenged agreement. If the Court determines to impose any such requirements, however, it should make clear that it is doing so as a matter of patent misuse law, rather than as a rule generally applicable to Section 1 analysis.

1992) (affirming FTC's conclusion that the challenged practice was "an unreasonable restraint of trade," even though "the damages to users or customers * * * [were] speculative," and "despite lack of evidence of increase in prices").

The Supreme Court, in *Indiana Federation*, confirmed that, where an antitrust defendant takes steps to exclude a potential competitive threat, plaintiffs need not prove that the threat actually would have come to fruition absent those steps. In *Indiana Federation*, the FTC did not need to prove that insurance companies would necessarily achieve their goal of cost-containment by obtaining X-rays from dentists; and here, Princo need not prove that a licensee attempting to develop new technology using the Lagadec methodology actually would have succeeded in creating a technically and commercially viable technology that could have competed successfully against Philips' and Sony's Orange Book standard. Such a "showing * * * is not an essential step in establishing that the [defendants'] attempt to thwart its achievement * * * was an unreasonable restraint of trade." *Indiana Federation*, 476 U.S. at 461.

The teachings of these cases are particularly salient in situations – like the present one – in which the gravamen of the claimed restraint is that it has squelched development of a nascent, alternative technology. As the D.C. Circuit concluded in its unanimous *en banc* decision in the *Microsoft* case, "neither plaintiffs nor the court can confidently reconstruct a product's hypothetical technological development in a world absent the defendant's exclusionary conduct." *United States v. Microsoft Corp.*, 253 F.3d at 79. And "[t]o require that [Sherman Act] liability turn on a plaintiff's ability or inability to reconstruct the hypothetical marketplace absent a defendant's anticompetitive conduct would only encourage monopolists to take more and earlier anticompetitive action." *Id.*

Thus, the stringent proof of actual anticompetitive effects that would be required under the standard set forth in Philips' briefs would be fundamentally inconsistent with the goal of promoting opportunities for innovation. It also "would be inimical to the purpose of the Sherman Act to allow monopolists free reign to squash nascent, albeit unproven, competitors at will – particularly in industries marked by rapid technological advance and frequent paradigm shifts." *Id.*[14] As the Supreme Court explained in *Standard Oil Co. of California v. United States*, 337 U.S. 293, 309-310 (1949): "[T]o demand that * * * inference be supported by evidence as to what would have happened but for the adoption of the practice that was in fact

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[14] *See also* Panel Op. 30 (563 F.3d at 1317-18) ("It cannot be the case that horizontal competitors can insulate themselves from misuse liability simply by agreeing to suppress competing technologies before they are fully developed. If that were the rule, then patentees engaging in such suppression of potential alternative technologies could never be called to account. In short, * * * requiring stringent proof of the destruction of future competition, with its accompanying imponderables, would effectively immunize from misuse manufacturers who agree to suppress competition from alternative technologies.").

adopted * * * would be a standard of proof, if not virtually impossible to meet, at least most ill-suited for ascertainment by courts."

Applying these principles to the present case, the first question is whether the restraint is one properly characterized as "inherently suspect." *But see* note 13, *supra*. On its face, an agreement between Philips and Sony – the holders of distinct patented technologies that are alleged to have the potential for licensing in competition with one another – that the latter would withhold its technology from the market is "an agreement not to compete in terms of price or output." *See NCAA v. Regents*, 468 U.S. at 109. As leading commentaries have explained, an agreement between patent holders not to compete in licensing is indeed an agreement not to compete, and raises core antitrust concerns:

> [I]t is clear that significant * * * antitrust concerns would be raised by an agreement among competitors not to develop a new technology. Among other things, such an agreement could be characterized as a naked restraint on output, long condemned as per se illegal.[15]

As President Reagan's first antitrust chief once stated:

[15] J. Cohen & A. Burke, *An Overview of the Antitrust Analysis of Suppression of Technology*, 66 ANTITRUST L.J. 421, 436-37 (1998).

> What [a patentee] is not entitled to do is to suppress rivalry between technologies. He cannot enter into an agreement with somebody who owns the other technological route to building a satisfactory mousetrap, that they will combine and jointly set royalties on their two different patents, for example.[16]

At the very least, there is "a close family resemblance between the [alleged] practice and another practice that already stands convicted in the courts of consumer welfare." *Polygram*, 416 F.3d at 37.

Characterization of the agreement as "inherently suspect" is not the end of the matter, and Philips has a variety of ways of escaping summary condemnation. Most notably, as discussed above, a colorable showing that the agreement was reasonably necessary to further the development of new technologies or other procompetitive ends would necessitate a more fulsome rule of reason analysis to ascertain whether the agreement could be upheld as an ancillary restraint. Also, Philips might be able to show that the Lagadec technology was so plainly incapable of implementation that it

[16] William F. Baxter, *Luncheon Address: the Definition and Measurement of Market Power in Industries Characterized by Rapidly Developing and Changing Technologies*, 53 ANTITRUST L.J. 717, 725 (1985). *See also California Dental*, 526 U.S. at 770 ("no elaborate industry analysis is required to demonstrate the anticompetitive character of horizontal agreements among competitors * * * to withhold a particular desired service") (citing *Indiana Federation*, 476 U.S. at 462 ("The Federation is not entitled to pre-empt the working of the market by deciding for itself that its customers do not need that which they demand.")).

and Sony could not meaningfully be considered to be "competitors" with respect to it.[17]

Nevertheless, if the Court were to determine that there was an agreement to suppress the Lagadec technology and that there was no indication that such an agreement was justified as reasonably necessary to the development of new technologies, this Court could reasonably condemn such an agreement as anticompetitive[18] without any showing by Princo of actual market effects. Such an agreement could prevent potential licensees from developing competing technologies premised on the Lagadec patent's digital method for encoding compact disc position data, and thus pose a "significant risk of retarding or restricting the development of new or improved goods or processes," *Antitrust/IP Licensing Guidelines*, § 4.1.1. When "the anticompetitive effects [of a restraint] are sufficiently apparent, and the claimed integrative efficiencies are sufficiently weak or not reasonably related to the restraints, * * * challenge of the arrangement without an elaborate analysis of particular industry circumstances" is warranted. *Antitrust/IP Licensing Guidelines*, § 5.1 Ex. 9.

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[17] As discussed above, however, once Princo shows that there was at least a potential for such competition, it should *not* bear the burden of proving that the Lagadec technology was commercially viable.

[18] Again, this assumes that antitrust analysis applies and that misuse analysis is not different. *Cf. supra* at 20-21 n.13.

CONCLUSION

For the foregoing reasons, to the extent that the Court relies on antitrust principles in resolving this appeal, it should give full consideration to possible efficiencies, and should be guided by recent teachings regarding flexible rule of reason analysis.

Respectfully submitted,

WILLARD K. TOM,
General Counsel

JOHN F. DALY,
Deputy General Counsel for Litigation

____
DAVID L. SIERADZKI, Attorney
Office of General Counsel

FEDERAL TRADE COMMISSION
600 Pennsylvania Ave., NW
Washington, DC 20580
(202) 326-2092

February 16, 2010

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with Fed. R. App. P. 32(a)(7)(B)(i) with respect to word type-volume. It contains 6788 words, excluding those portions exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(b).

David L. Sieradzki
Attorney
Federal Trade Commission

February 16, 2010

CERTIFICATE OF SERVICE

I hereby certify that on February 16, 2010, I caused two copies of the Brief of Amicus Curiae Federal Trade Commission on Rehearing *En Banc* Supporting Neither Party, to be deposited in the U.S. Mail, postage prepaid, to each of the following:

Roy T. Englert, Jr.
Robbins, Russell, Englert, Orseck, Untereiner & Sauber LLP
1801 K St., NW
Suite 411
Washington, DC 20006

Eric L. Wesenberg
Garret G. Rasmussen
Matthew Poppe
Kenneth J. Halpern
Orrick, Herrington & Sutcliffe LLP
1000 Marsh Rd.
Menlo Park, CA 94025

John D. Vandenberg
Klarquist Sparkman, LLP
One World Trade Center
121 SW Salmon St.
Suite 1600
Portland, OR 97204
Attorneys for Appellants Princo Corp. and Princo America Corp.

James M. Lyons, General Counsel
Wayne W. Herrington, Assistant General Counsel
Clara Kuehn, Attorney
U.S. International Trade Commission
600 E St., SW
Washington, D.C. 20436
Attorneys for Appellee U.S. International Trade Commission

William J. Kolasky
Edward C. DuMont
Perry A. Lange
Sue-Yun Ahn
Wilmer Cutler Pickering Hale & Dorr LLP
1875 Pennsylvania Ave., NW
Washington, DC 20006
Attorneys for Intervenor U.S. Philips Corp.

Alan J. Kasper, President
American Intellectual Property Law Association
241 18th St., Suite 700
Arlington, VA 22202

Richard S. Taffet
Bingham McCutchen LLP
399 Park Ave.
New York, NY 10022

David B. Salmons
Patrick Strawbridge
Bingham McCutchen LLP
2020 K St., NW
Washington, DC 20006
Attorneys for American Intellectual Property Association, Amicus Curiae

Richard M. Brunell
Jonathan L. Rubin
American Antitrust Institute
2919 Ellicott St., NW
Washington, DC 20008
Attorneys for American Antitrust Institute, Amicus Curiae

Steven W. Miller, President
Richard F. Phillips
Intellectual Property Owners Association
1501 M Street, NW
Suite 1150
Washington, DC 20005

Robert P. Taylor
Mintz, Levin, Cohen, Ferris, Glovsky and Pepo, P.C.
5 Palo Alto Square, 6th Floor
Palo Alto, CA 94306

Henry C. Su
Howrey LLP
1950 University Avenue, 4th Floor
Palo Alto, CA 94303

Attorneys for Intellectual Property Owners Association, Amicus Curiae

Charles A. Weiss
Kenyon & Kenyon LLP
1 Broadway
New York, NY 10004

Mark J. Abate
Goodwin Procter, LLP
620 Eighth Ave.
New York, NY 10018

David F. Ryan
New York Intellectual Property Law Association
1214 Albany Post Rd.
Croton-on-Hudson, NY 10520

Attorneys for New York Intellectual Property Law Association, Amicus Curiae

DAVID L. SIERADZKI
Attorney for the Federal Trade Commission

Dated: February 16, 2010