

Antitrust Issues in High-Tech Industries: Recent Developments

By M. Howard Morse

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We live in an information economy where it has been said what we produce is increasingly a line of computer code or a gene sequence rather than an ingot of iron or a barrel of oil or a bushel of wheat. High-tech issues, however, affect all industries, as the ingot of iron is made with computer-controlled equipment and the bushel of wheat is grown from recombinant seeds. Just as we were all Keynesians once, we are all techies now.

Recent years have seen substantial antitrust focus on high-tech industries, with some asking whether the US antitrust laws enacted over a hundred years ago to manage the emergence of industrial and natural resource monopolies of the late 19th and early 20th centuries are relevant to and capable of addressing the technology and intellectual property giants of the 21st century.

The short answer is that antitrust is alive and well, and fully engaged in the high-tech area, eyeing companies both large and small, and examining issues both traditional and particular to high-tech companies. And, just as technological advances have led to changes in the market that have had a dramatic impact on company fortunes, so too is antitrust law changing, especially as overlaid by intellectual property law, shifting its emphasis and growing more complex and less predictable, at least for those not paying close attention to developments.

The Bush administration makes its mark

With a new administration installed in Washington, we must wait to see if the political appointees at the Federal Trade Commission (FTC) and Department of Justice (DoJ) Antitrust Division will agree with their predecessors that “the new economy is fundamentally no different from the old when it comes to antitrust enforcement”.

Critics of the Clinton administration would have the Bush administration conclude that dominant firms are inevitable in high-tech markets, forecasting the future is difficult, and market power is, at most, fleeting. The critics argue that antitrust’s traditional static focus on price competition and aggressive enforcement can inhibit innovation. They note that ‘goods’ in the information-based world typically require very large fixed costs and much smaller marginal costs and assert that in such an environment, the possession of ‘temporary monopoly power’ is a natural and essential ingredient. Some suggest that high-tech products are too sophisticated for regulators and the courts to understand, and that the judicial system is too slow for litigation to have any impact on high-tech industries, other than to impose costs and distract management. Reflecting an extreme view, the *Wall Street Journal* in an editorial on

the *Microsoft* litigation questioned whether the antitrust laws are “anything but a license for Washington’s army of shakedown artists and policy tinkerers to slow the wheels of progress”.

Preliminary statements by the new ‘sheriffs in town’ suggest that change is likely to be at the margins. Charles James, the assistant attorney general for antitrust, has said “anyone who is expecting a major shift in enforcement policy is likely to be disappointed”. Timothy Muris, the chairman of the FTC, gave a speech entitled “Antitrust Enforcement at the Federal Trade Commission: In a Word – Continuity”. Mr. Muris has explicitly said that in his view, “merger analysis in ‘high-tech’ industries is not fundamentally different than in other industries”. He has even argued for “especially close scrutiny” of mergers of dominant firms with actual or potential competitors in high-tech industries.

On the other hand, Mr. Muris has openly said that he has “disagreed with some of the Pitofsky Commission’s initiatives”, most famously its prosecution of Intel for using its market power to force firms that sought to assert intellectual property rights against it to give up their intellectual property, by denying continued access to its technical information. At the same time, Mr. Muris has said he agrees that “the potential for anti-competitive abuse of intellectual property is an increasingly important area”. The FTC and DOJ will be conducting hearings during 2002 on “Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy” that should both shed light on Bush administration enforcement priorities and influence the development of antitrust law in this important area.

The core principles of antitrust

The ‘core principles’ of antitrust – concern with horizontal agreements among competitors that lessen competition and the acquisition or maintenance of market power through mergers and exclusionary practices – ought to be as applicable to high-tech industries as the US Constitution’s protection of freedom of speech is applicable to the Internet. Still, those principles must be applied sensibly, so as not to prevent or distort the development of fast-growing markets, recognising the unique characteristics of high-tech industries.

US antitrust law in fact has long held that the pursuit of monopoly is perfectly legitimate so long as it is accomplished through “skill, foresight and industry” and not exclusionary practices. Indeed, the “successful competitor, having been urged to compete, must not be turned upon when he wins”. At the same time, antitrust law is built on a recognition that the “possession of unchallenged economic power deadens initiative...that immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress”. In the new economy, more than ever, it is the ‘creative destruction’ that results from the constant pursuit of monopoly power that is the engine of growth.

For high-tech businesses, the fact of the matter is that there is antitrust enforcement in their industries. The computer hardware and software, pharmaceutical and biotech, and other high-tech industries are regular targets of investigations and enforcement action. That may be because they are of growing importance to the economy, application of the law is not clear, or they attract press coverage. Whatever the reason, high-tech companies need to be aware of recent developments to avoid becoming the next headline.

The Justice Department suit against Microsoft continues to get the biggest headlines and the unanimous *en banc* DC Circuit decision in that matter is perhaps the most important antitrust decision of the past 20 years. But merger policy, particularly innovation market

analysis, rules applicable to joint ventures, and decisions affecting the rights of intellectual property owners and licensees are also important to high-tech companies. This chapter addresses significant developments in the *Microsoft* case and in each of these areas.

What makes high-tech industries different?

Characteristics of high-tech industries that ought to impact antitrust analyses include:

- **The rapid pace of innovation:** these are extremely dynamic industries, changing rapidly, with short product cycles. The pace of change often makes the future difficult to predict and tends to undermine or erode existing market power. The jury is still out as to whether concentrated markets are less likely to foster innovation, which is increasingly a focus of government antitrust enforcement.
- **The critical importance of intellectual property:** the key assets of the information age are not bricks and mortar but ideas, protected by patent, copyright and other intellectual property, that typically know no geographic borders and are easily copied in the absence of legal protection.
- **The presence of network effects:** high-tech industries are often characterised by a ‘positive feedback loop’ or ‘network effects’, generating increasing returns to scale. That is, the value of products or services often increases with the number of users. Network effects generate substantial efficiencies, but also tend to lock in customers and raise barriers to entry to those without an established network or an ability to interface with one. High-tech industries are, nonetheless, littered with once dominant firms whose products were leapfrogged into obsolescence as a result of a disruptive paradigm shift levelling the competitive playing field.
- **Large fixed costs, low marginal costs:** as already noted, many high-tech industries, heavily dependent on intellectual property, incur large upfront fixed costs, and have relatively small marginal costs of production. New investment will not occur in such industries unless firms anticipate earning a return on fixed costs in the long run.
- **First mover advantage:** in part because of intellectual property protection and network effects, as well as steep learning curves and economies of scale, there is often a substantial advantage to being the first in a high-tech industry to develop and introduce a new product or the first to gain a significant market presence.

United States v Microsoft

By now, nearly every living person on earth has heard about the DC Circuit’s June 28, 2001 decision in *United States v Microsoft*. One suspects that Bill Gates breathed a huge sigh of relief that day, as the most well-known aspect of the decision is the reversal of the lower court’s break-up order.

The DC Circuit heard the case *en banc* after the trial judge certified the matter for direct appeal to the Supreme Court pursuant to the rarely invoked Expediting Act of 1903, as a matter of “general public importance”. The Supreme Court turned down the direct appeal, and after the DC Circuit ruled unanimously in a 125-page decision, the Supreme Court turned down

Microsoft's request that the court review the case. Microsoft, not the DOJ, requested Supreme Court review since the decision, while reversing the breakup order, affirmed the trial court's conclusion that Microsoft is a "monopolist" and had engaged in unlawful "exclusionary" practices.

For the record, the Court of Appeals:

- upheld most of the trial court's holdings on unlawful maintenance of monopoly power in operating systems;
- reversed holdings on attempted monopolisation of browsers;
- remanded for retrial of the charges on unlawful tying;
- remanded for hearings on remedy issues; and
- disqualified the District Court judge from further participation in light of judicial misconduct.

Those who have focused on the media coverage reporting what the decision means for Microsoft and its competitors may have missed noteworthy points of antitrust law and their ramifications for the high-technology sector generally. Here in a nutshell is the story on this front.

Monopoly power

The Court of Appeals rejected the argument that because the software industry is "uniquely dynamic", direct proof, rather than circumstantial evidence, should be required to prove market power. Applying longstanding antitrust doctrine, the court held that even in high-tech industries, monopoly power "may be inferred from a firm's possession of a dominant share of a relevant market...protected by entry barriers". To define the relevant market, one must apply a "test of reasonable interchangeability...consider[ing] only substitutes that constrain pricing in the reasonably foreseeable future." The court reasoned further that entry barriers are factors "that prevent new rivals from timely responding to an increase in price above the competitive level" and that only new rivals "likely to materialise in the relatively near future perform this function to any significant degree." Emphasising the "applications barrier to entry" based on network effects, the Court of Appeals concluded that the District Court properly found Microsoft to possess monopoly power in an operating system market under those standards.

Monopolisation conduct

Much of the case focused on restrictions in Microsoft's OEM licences that it defended as within its rights to control uses of its intellectual property; exclusive agreements with Internet service providers and other third parties that it defended as within its rights to promote distribution and usage of its products; and product design decisions that it defended as within its sacred "freedom to innovate". Rejecting all broad assertions of this sort, the Court of Appeals upheld most of the District Court's findings of unlawful monopolisation conduct. It did so under the following articulation of the conduct standard for the monopolisation offence: "to be condemned as exclusionary, a monopolist's acts must have an 'anti-competitive effect'" by harming the competitive process and thus harming consumers. If the plaintiff makes that showing, "the monopolist may proffer a 'pro-competitive justification' for its conduct" – i.e. a "non-pretexual claim" that its conduct results in "greater efficiency or enhanced consumer appeal." The plaintiff must then either rebut that claim or "demonstrate that the anti-competitive harm of the conduct outweighs the pro-competitive benefit." The court affirmed

most allegations of exclusionary conduct focused on Microsoft preserving its monopoly in operating systems, while rejecting allegations of wrongdoing focused on extending that monopoly into other markets.

Intellectual property defence

Microsoft claimed “an absolute and unfettered right to use its intellectual property as it wishes”. The DC Circuit disdainfully characterised this claim as “border[ing] upon the frivolous,” reasoning it is “no more correct than the proposition that use of one’s personal property, such as a baseball bat, cannot give rise to tort liability”. While the court did uphold the defence as applied to one of the licence restrictions at issue since it was designed to protect against “drastic alteration of Microsoft’s copyrighted work”, none of the other challenged restrictions withstood scrutiny on this ground. The court’s bottom line on this part of the case was that “intellectual property rights do not confer a privilege to violate the antitrust laws”.

Product design defence

Microsoft defended challenges to its product design decisions on ‘freedom to innovate’ grounds. Again, the DC Circuit rejected any such ‘absolutist’ defence. As the court noted, “courts are properly very sceptical about claims that competition has been harmed by a dominant firm’s product design changes”; but “judicial deference to product innovation...does not mean that a monopolist’s product design decisions are *per se* lawful”. The court went on to condemn two of the means by which the Microsoft browser was bound into Windows as resulting in an anti-competitive effect, thereby reducing interest in rival browsers without any pro-competitive justification. A third challenged means was upheld on the basis of Microsoft’s showing of “integrative benefit”, since the plaintiffs neither rebutted that showing nor demonstrated that it was outweighed by anticompetitive effects.

Tying law

The government relied on the same browser-Windows integration practices at issue in the monopolisation count to support the separate claim of illegal tying. Here, the Court of Appeals made new law by holding that “the rule of reason, rather than *per se* analysis, should govern the legality of tying arrangements involving platform software products”. The court reasoned that this case involved “the first up-close look at the technological integration of added functionality into software that serves as a platform for third-party applications”, an integration with substantial potential for consumer benefit. “There being no close parallel in prior antitrust cases, simplistic application of *per se* tying rules carries a serious risk of harm” and in particular “detering welfare-enhancing innovation.” The court on this ground remanded the tying count for a new trial. The court explained that the plaintiffs’ burden on remand will be to demonstrate that the integration practices had substantial anti-competitive effects in the browser market; Microsoft can then offer pro-competitive justifications; and plaintiffs must then either rebut the proffered justifications or prove that they are outweighed by the anti-competitive effects.

Interestingly, on an analogous technological tying claim in *Caldera Systems Inc v Microsoft Corp*, involving DR-DOS and Windows, a federal judge in Utah rejected the DC Circuit standard set forth in its earlier order violation ruling, which cautioned that “a court’s evaluation of a claim of integration must be narrow and deferential” to the innovator, as providing “too much deference to the technology arguments and not enough to current antitrust law”. The Utah court held that a defendant can escape antitrust liability if the evidence shows that “a valid, not insignificant”, technological improvement has been achieved by the integration of two products so that “a new product has been created”. The court also rejected Microsoft’s contention that on

a product design incompatibility claim, the plaintiff must show each alleged incompatibility had no purpose other than to preclude competition.

In November 2001, the Justice Department and Microsoft announced a consent agreement resolving their litigation. That agreement is subject to Tunney Act “public interest” review, which means that the DoJ had to publish a competitive impact statement analysing the consent and consider comments for 60 days. The core conduct remedies in the consent: disclosure obligations, software design restrictions, contract limitations, non-discrimination requirements, and retaliation limits, are all aimed at preventing Microsoft from stopping future middleware threats to its operating system monopoly. The consent has drawn criticism with the principal objections along three lines: (1) it does not address tying, bundling and leveraging; (2) it does not restore competition that would have existed if Microsoft had not violated the law; and (3) it is ineffective, with the devil, of course, in the details. Those who would like a final court ruling in the case may get their way as nine of the 18 plaintiff state attorneys general in the case refused to sign on to the consent and are pursuing the case.

Mergers in high-tech industries

In the most recent merger case involving high-tech industries, *United States v SunGard Data Systems Inc*, the DOJ lost in its effort to block SunGard’s acquisition of Comdisco Inc in November 2001. This matter proves antitrust can move quickly and address what the court characterised as a “highly sophisticated and technical industry”. The case was resolved in just three weeks, from complaint to decision. The outcome turned largely on traditional market definition issues, with the court concluding that the DoJ had not met its burden of establishing that customers would not switch from shared hotspots used to provide disaster recovery services to so-called quick-ship and internal hotspot solutions.

Of most interest for future high-tech cases, SunGard argued that the government’s market share statistics were “unreliable because they [did] not reflect the rapidly changing technologies in the disaster recovery industry”. The DOJ had rejected the argument that the market was undergoing “revolutionary change” and historic market shares should be ignored. The court, while not discounting market share statistics, emphasised the “changing nature of the technology” in rejecting the government’s market definition, noting the trend toward smaller distributed servers and declining prices of computer hardware. Indeed, the court quoted language from the DC Circuit’s *Microsoft* decision that “rapid technological change leads to markets in which firms compete through innovation for temporary market dominance, from which they may be displaced by the next wave of product advancements”.

Innovation markets

In dynamic industries, innovation is often more important than price in determining consumer welfare over the long run. Therefore it is not surprising that merger enforcement in these industries often focuses on so-called ‘innovation markets’ in which firms compete in research and development. Unfortunately, the innovation market concept is not even addressed in the current DoJ/FTC Horizontal Merger Guidelines and the contours of the doctrine remain vague and controversial. The government’s Guidelines for the Licensing of Intellectual Property indicate that such markets are relevant where there is an effect on the development of goods that do not yet exist or on new or improved goods or processes where there is not actual or likely potential competition. Thus, firms in high-tech industries must consider not only existing product overlaps, but also research and development efforts when contemplating mergers and acquisitions.

Economic theory is in fact ambiguous as to whether high concentration leads to a decrease in innovation. Indeed, senior government officials have observed that “though it is possible to have coordinated effects, we most often expect to see some type of unilateral effect”, since firms’ research efforts are usually heterogeneous and secret, and the rewards of innovation are great, making collusion difficult. Nonetheless, both the DOJ and FTC have in recent years challenged mergers among two of four leading firms in a market, theorising the combination would lessen competition in development of new products. The government thus appears to be moving beyond earlier enforcement actions involving acquisitions by dominant firms and mergers among firms closest to market or the only firms capable of conducting R&D, which stand on firmer theory.

Typical of the government’s aggressive prosecutions are the charges involving one of four markets that were challenged before the FTC allowed Pfizer Inc to complete its US\$90 billion merger with the Warner-Lambert Company. The FTC insisted, among other relief in that case, that Pfizer give up assets related to a drug under development to treat solid tumour cancers. The FTC alleged the merging companies produced “two of the most advanced” compounds currently being developed and they were among a “relatively small number” of companies working on these types of drugs. According to the FTC, Pfizer “could” delay or fail to develop one of the two drugs post-merger, “potentially reducing the number of drugs reaching the market”.

The most recent example of an innovation market challenge to a merger between two of several firms in a market is the FTC’s complaint against the US\$182 billion merger of Glaxo Wellcome plc and SmithKline Beecham plc. The FTC alleged that merger would lessen competition in nine different markets, the most significant of which from a precedential standpoint involve allegations where there was not current direct competition between the merging firms. The FTC alleged anti-competitive effects, for example, with respect to research and development of drugs for the treatment of irritable bowel syndrome, where in addition to Glaxo and SmithKline’s development efforts, there were two other drugs in clinical development. Similarly, the FTC alleged that with respect to a narrow class of drugs used to treat solid tumour cancers, the merger might eliminate one of few research and development efforts. According to the FTC, the merged firm “likely would” or “could” decide to “delay, terminate or otherwise fail to develop” one of its drugs. The FTC thus asserted that the merger would be likely to lead to reduced innovation even where there was a race among the remaining firms to gain the first-mover advantage.

Acquisitions of disruptive technologies

Another important recent high-tech merger case is a little noticed suit filed by the DOJ to block Compuware Corporation’s proposed acquisition of Viasoft Inc, which was abandoned in the face of the government’s suit. The DOJ alleged that in a mainframe testing/debugging software market, Compuware had about a 60 per cent share and Viasoft was its “closest competitive alternative”. Of more interest, the government alleged that in a mainframe fault management software market, Compuware had an 80 per cent share and Viasoft, which had recently begun marketing a product, was a “nascent competitor” with “a promising product” that was “poised” to become Compuware’s “most significant competitor”. The theory that the acquisition by a leading firm of a new entrant with a “disruptive technology” may lessen competition has been a common theme of other non-public investigations involving high-tech markets.

The importance of network effects in merger analysis is evident in the complaint filed against the proposed WorldCom Inc/Sprint Corp merger. The DOJ alleged that WorldCom and Sprint operate the largest Internet backbone networks, together accounting for over 50 per cent of all Internet traffic, and post-merger would have had a disproportionate size advantage over competitors. According to the DOJ, the combined firm would have had the incentive and ability to increase the price and degrade the quality of interconnections with rivals, ultimately facilitating a “tipping” of the backbone market to monopoly.

The significant role of intellectual property in high-tech merger analysis is reflected in an August 2001 DOJ challenge to an acquisition involving rapid prototyping equipment, used to transform computer designs into three-dimensional objects, speeding the design process. The DOJ alleged that 3D Systems’ purchase of DTM Corporation would reduce the number of competitors in the US market from three to two, combine the firms with the “most sophisticated systems”, and eliminate competition that was “the driving force behind the development of innovative...technology”. The DOJ also alleged the merger would “enhance 3D’s already formidable patent position”, creating what has been called a “killer patent portfolio”. The government agreed to settle the charges when the firms agreed to “lift the patent entry barriers” for a firm producing equipment outside the United States but prevented from selling systems in the US.

Finally, the FTC’s October 2001 issue of an administrative complaint against MSC Software Corporation alleging its acquisitions of two small software firms were illegal demonstrates that no deal is too small to escape antitrust scrutiny. The FTC alleges that MSC was the “dominant” supplier of a type of advanced computer-aided engineering software with a 90 per cent share of a US\$60 to US\$70 million worldwide market. Small competitors were acquired for US\$8 and US\$10 million in two transactions below Hart-Scott-Rodino reporting thresholds. Nonetheless, the FTC is seeking an order requiring that MSC provide two new entrants with up-to-date versions of the MSC source code in order to restore competition. Companies considering mergers in high-tech industries need advance antitrust counselling to avoid a similar fate.

Joint ventures in network industries

Antitrust is sometimes perceived as being extremely sceptical of any agreement among competitors. Fortunately, in recent years, antitrust enforcers have increasingly recognised that in high-tech industries collaboration among competitors is often pro-competitive.

Guidelines

The most significant recent joint venture development is the issue of Antitrust Guidelines for Collaborations Among Competitors. In releasing the guidelines, the FTC suggested they were “encouraging and permissive” and emphasised the goal of diminishing the possibility that pro-competitive joint ventures might be abandoned because of antitrust uncertainty. They recognise, for instance, that R&D ventures, by combining complementary assets, technology and know-how, often enable participants to more quickly or efficiently research and develop new or improved goods.

Three issues in the guidelines bear particular note. Firstly, ancillary restraints in joint ventures may be condemned as illegal *per se* unless “reasonably necessary” to achieve the venture’s legitimate pro-competitive benefits. Secondly, there are “safety zones” for collaborations between firms with a combined market share of less than 20 per cent, and where there are three or more independently controlled research efforts in addition to those of the collaboration. The latter test is a bit more generous than that provided for in the Antitrust Guidelines for the Licensing of Intellectual Property for licensing agreements affecting R&D. Thirdly, the government takes the position that the competitive effects of an agreement may change over time and therefore may be assessed long after formation. Thus, a venture to develop a new product may be challenged years later if successful. To partially placate concerns, the guidelines indicate the government will be “sensitive to the reasonable expectations of participants whose significant sunk cost investments in reliance on the relevant agreement were made before it became anti-competitive”.

Network markets

The most notable recent case involving joint ventures is *United States v Visa USA Inc* in the Southern District of New York, which upheld the DOJ’s challenge to Visa and MasterCard exclusivity rules that restrict banks from issuing American Express and Discover cards. At the same time, the trial court rejected the DOJ’s challenge to the card networks’ “duality” in management because the DOJ failed to demonstrate that such duality had anti-competitive effects. While the DOJ alleged that dual governance dampened new product development in a number of areas, the court concluded that in each case the evidence provided alternative explanations for the perceived lack of innovation.

Critically, the Visa court distinguished between the market for credit card issuance – which is unquestionably competitive – and the market for network services that support the use of credit cards in which the only competitors were Visa, MasterCard, American Express and Discover. It is at the network level that the associations design card products, promote their brands, implement technologies to authorise and settle transactions, and set interchange fees. The court concluded, as did the DC Circuit in *Microsoft*, that exclusivity was problematic when competitors were excluded from the most efficient distribution channels even if not foreclosed from the market. Still, before ruling for the government, the court rejected the defendants’ justifications that the rules alleviated free-riding concerns and were necessary to maintain the viability of the networks themselves. The decision ultimately reflects a new sophistication in dealing with network issues that is likely to have important implications for analysing future ventures in high-tech industries.

Non-compete clauses

High-tech firms should also be aware of *United States v LSL Biotechnologies Inc*, a pending case in which the DOJ is seeking to prohibit enforcement of contractual provisions alleged to limit competition in markets for research and development of seeds to grow long-shelf life tomatoes. The DOJ alleges that non-competition agreements ancillary to an international R&D joint venture to develop such tomatoes were “not reasonably necessary to any legitimate joint activity between defendants” and “so overbroad as to scope and unlimited as to time as to constitute a naked restraint of trade”. The DOJ is challenging particular clauses that cover products developed by the venture partners on their own and a termination clause that prohibits one firm from competing even after the end of the venture. The case reminds us that joint venturers must

ensure that non-compete clauses are limited to what is “reasonably necessary to effectuate the contemplated transaction...to achieve integrative efficiencies”.

Antitrust issues affecting intellectual property

As noted above, the FTC and DOJ have scheduled hearings to address “Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy” to begin in early 2002. These hearings call to mind hearings conducted early in the Clinton administration on “Competition Policy in the New High-Tech, Global Marketplace” which set the tone for enforcement actions and led to revision of the government’s Horizontal Merger Guidelines to take efficiencies into account.

Among the issues that the 2002 hearings are expected to address are: the creation of patent thickets that make it difficult for rival inventors to sell competing products without cross-licences; extension of patents beyond their legal lives; the scope of patents; the impact of broad patents on follow-on inventions; the implication of procedural rules on competition; and the role of the Federal Circuit in developing antitrust law, given its exclusive jurisdiction over cases based “in whole or in part” on federal patent law and its decision to develop its own antitrust law rather than apply regional circuit law. Stay tuned for future developments.

Refusals to deal

The most controversial recent development at the intersection of antitrust and intellectual property (IP) is the Federal Circuit’s decision in *In re Independent Service Organisation Antitrust Litigation*, also known as *CSU LLC v Xerox Corp.* The court there affirmed summary judgment for Xerox in a class action brought by independent service organisations (ISOs) claiming Xerox’s refusal to sell patented parts and copyrighted manuals violated antitrust law. In very broad language, the Federal Circuit held that an IP holder can refuse to license or sell products covered by its IP unless:

- the IP was obtained through fraud;
- the IP holder brings a ‘sham’ infringement suit; or
- the IP was used as part of an unlawful ‘tying’ arrangement.

The Federal Court rejected the Ninth Circuit’s approach in the *Kodak ISO* litigation which had held Kodak’s last-minute reliance on intellectual property was a pretext. The Federal Circuit reasoned that the “subjective motivation” for Xerox exerting its statutory right to exclude is irrelevant even where a refusal to sell or license may have an anti-competitive effect. The precise scope of patent holders’ rights to refuse to deal or to deal only on anti-competitive terms remains subject to debate.

Settlement of litigation

Another area of increased enforcement action which deserves attention involves challenges to intellectual property litigation settlements. To date, these actions have primarily affected pharmaceutical companies, but any settlement of intellectual property litigation that potentially has an impact on competition should be reviewed by antitrust counsel.

All of the recent cases have involved payments to alleged infringers that have kept products off the market. The issue is particularly complicated in the pharmaceutical industry, where the first generic developer to file with the US Food and Drug Administration gets six months’ exclusivity to market its drug, starting when it begins marketing or a court rules that

patents on the drug are invalid or not infringed. Accordingly, the FTC has argued that payments to a generic to delay marketing can create a bottleneck that keeps others off the market. The FTC has now brought and settled two suits challenging agreements among firms not to market drugs while patent litigation was pending, rejecting arguments that such agreements were justified as stipulated preliminary injunctions. The FTC consent orders suggest the Commission is most concerned about unjustifiable restraints in these agreements prohibiting transfers of exclusivity and introduction of non-infringing generic drugs. A third case is currently in litigation challenging a settlement agreement that resolved litigation allowing the generic to enter the market before the patent would otherwise expire.

It remains unclear whether these agreements will be subjected to *per se* or rule of reason analysis, what justifications may be allowed, and the precise limitations on acceptable conduct. What is clear is that the government has a keen interest in this field and is likely to continue to scrutinise closely similar patent settlement agreements, and class action lawyers have followed suit to collect from the deep-pocket defendants.

Standard-setting

Finally, substantial government resources are being devoted to investigations of standard-setting, suggesting future enforcement actions are likely. Collective standard-setting in high-tech industries is generally pro-competitive, ensuring compatibility and interoperability, and preferable to unilateral standard-setting by dominant firms. Any time competitors get together to set standards, however, antitrust limitations should be imposed. Particularly in high-tech industries, where traditional standard-setting organisations and rules providing for procedural due process, maximum openness and consensus decision-making can be cumbersome and unwieldy, it is important to ensure that firms do not manipulate the process to disadvantage rivals. The latest hot issue, raised by *Rambus v Infineon*, is whether firms involved in standard-setting have a duty to disclose their intellectual property or at least a duty not to mislead, or whether they can ‘ambush’ firms with infringement litigation after a standard is adopted that invests a patent with market power. Firms with patents relevant to standards risk losing their intellectual property if they do not consider these antitrust risks in seeking adoption of standards.

One thing is clear from this summary of recent developments. High-tech industries remain of keen interest to antitrust enforcement officials and raise unique issues that require sophisticated counsel to keep companies out of trouble.

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M. Howard Morse is a partner of Drinker Biddle & Reath LLP, a full service law firm of more than 375 attorneys that was founded in 1849. Mr. Morse is based in Washington, DC, and is a former Assistant Director of the FTC's Bureau of Competition. He is Chair of the ABA Antitrust Section's Intellectual Property Committee.

DrinkerBiddle&Reath
LLP
1500 K Street, N.W.
Suite 1100
Washington, DC 20005-1209

202-842-8883
202-842-8465/66 (fax)
morsemh@dbr.com

Philadelphia Washington Berwyn New York Princeton Florham Park Los Angeles San Francisco

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This article first appeared in *The Antitrust Review of the Americas 2002* "A Global Competition Review special report."