Advanced Patent Seminar: Antitrust update

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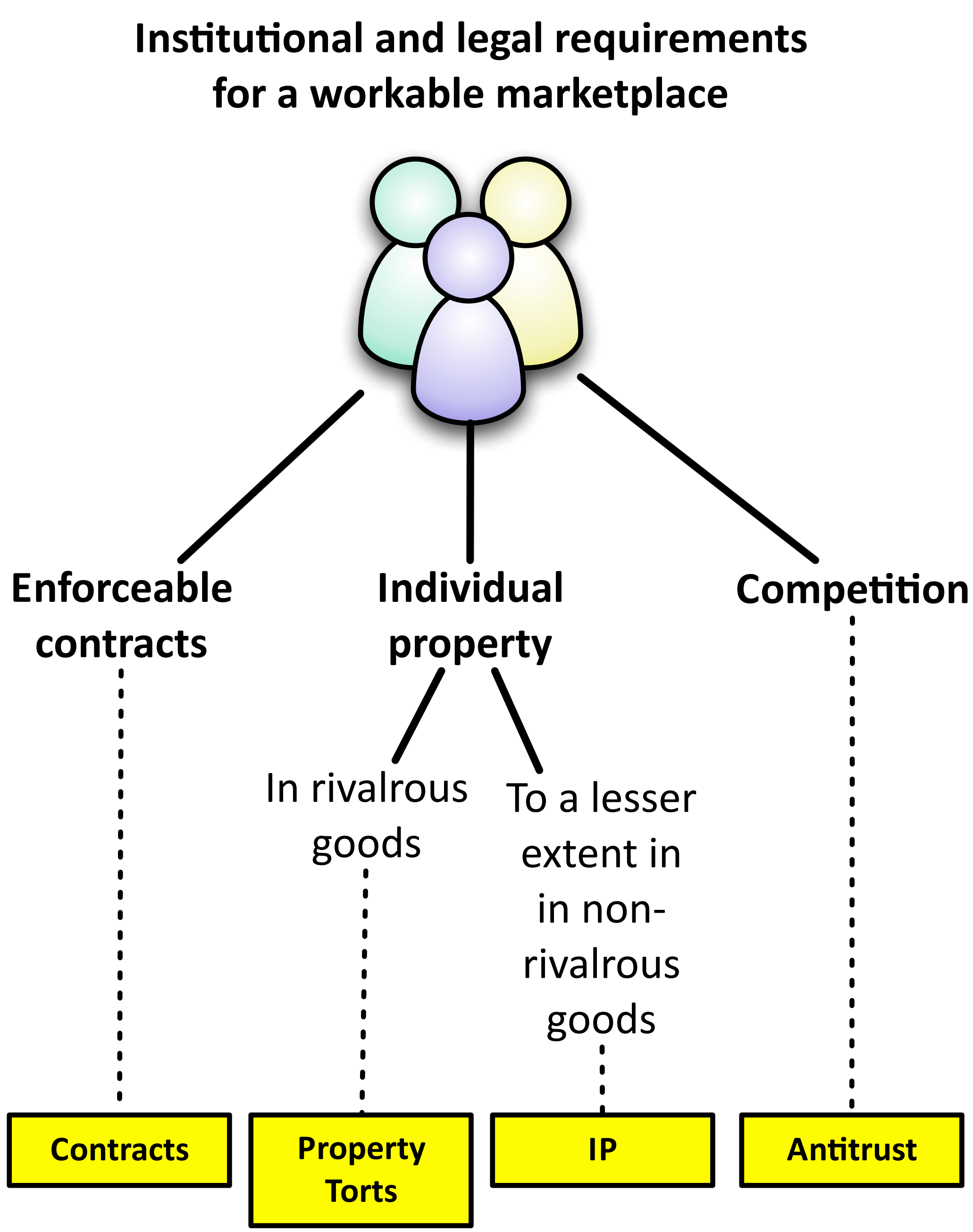
Agenda

- Antitrust and IP, a stormy relationship
- Patent pools, misuse, and the impact of *Princo v. ITC*
- Standard setting organizations
  - 2010 EU Draft Horizontal Cooperation Guidelines
  - Monopolization (abuse) by way of deception
- The "single entity" debate in light of *American Needle*

Achieving "universal opulence" through a mix of contract, property, and competition



- Markets align individual (firm) incentives with aspects of the common good
- Antitrust protects the minimum level of competition required for markets to work
- To that end, antitrust prohibits
  - Agreements that unduly restrain trade (§1, Art. 101 TFEU)
  - Dominant firms excluding weaker competitors by means other than competition (§2, Art. 102)
  - Mergers that reduce competition below the required minimum level (§7, ECMR)
- EU competition law also includes aspects of trade law (single market objective)

AT & IP: Conflict

"By their nature, patents create an environment of exclusion, and consequently, cripple competition."

Schering-Plough v. FTC, 402 F.3d 1056, 1066 (11th Cir. 2005)

AT & IP: Harmony

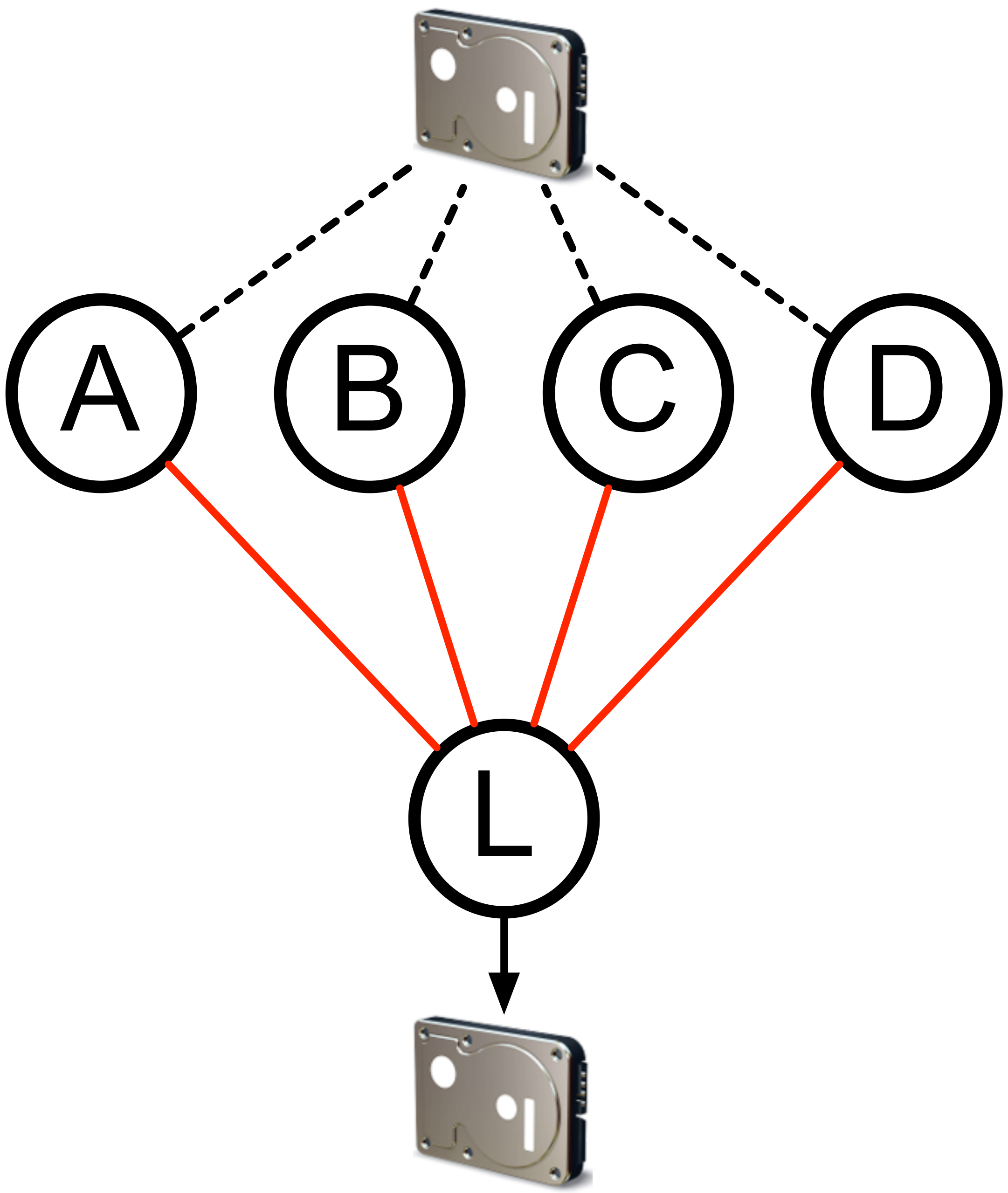
The AT and IP laws "are actually complementary, as both are aimed at encouraging innovation, industry, and competition."

Atari Games Corp. v. Nintendo of Am., Inc., 897 F.2d 1572 (Fed. Cir. 1990)

Key principles for the modern antitrust analysis of license agreements

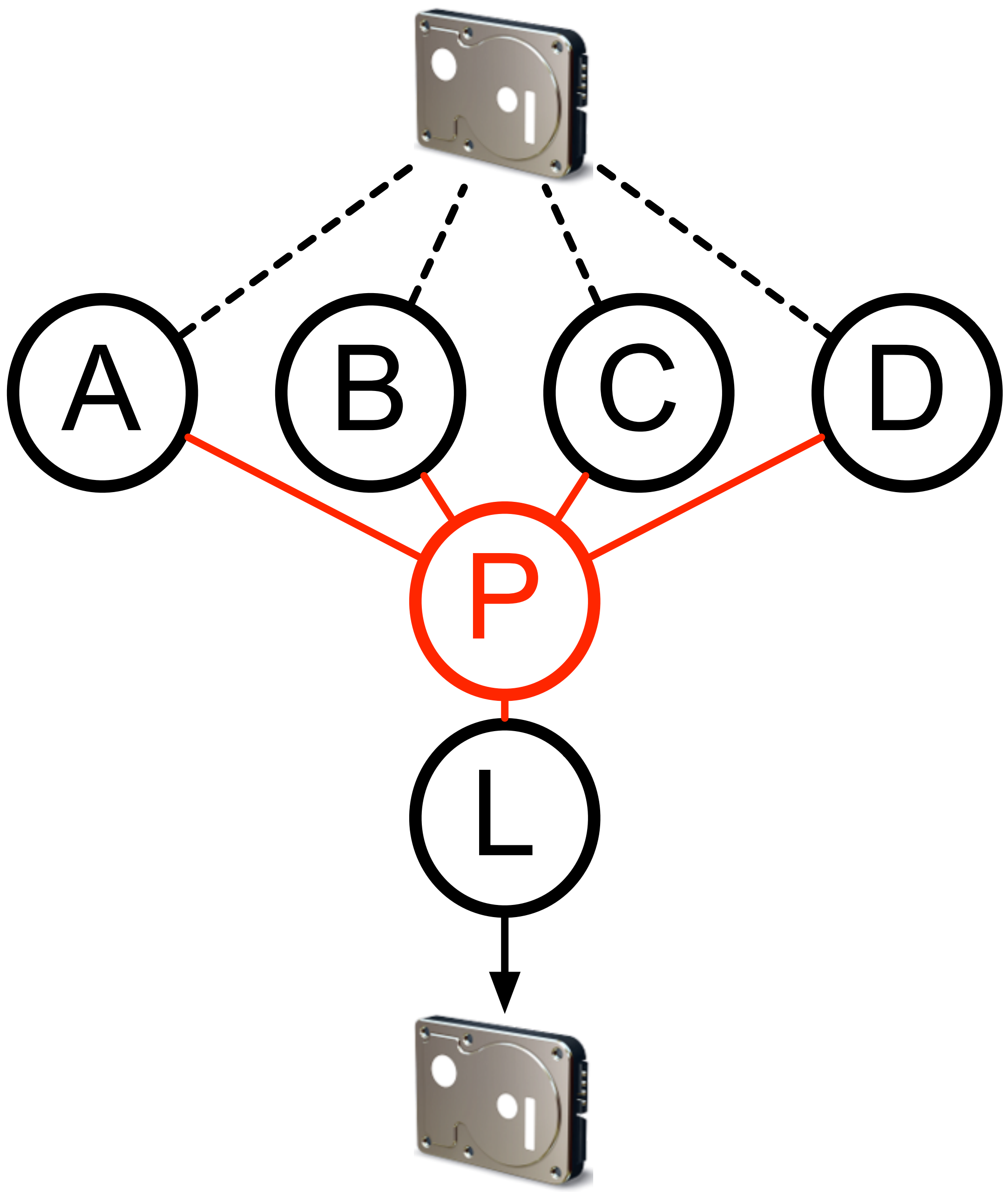
- Despite conflicting tactical goals (exclusion v. participation) IP and AT both strive to promote a common strategic goal (innovation)
- IP is comparable to any other form of property
- IP does not, by itself, create market power
- IP licensing is usually output-enhancing and thus procompetitive
  - Licensing combines IP with complementary factors of production (other IP or goods)
  - If IP(A) cannot be used without infringing IP(B), licensing can remove the block
  - FOU and territorial limitations generally increase the incentive to invest in the licensed technology
- *See* 1995 IP Licensing Guidelines and 2007 "IP2" Report
- *See* Draft EC 2010 Horizontal Cooperation Guidelines

Before the patent pool



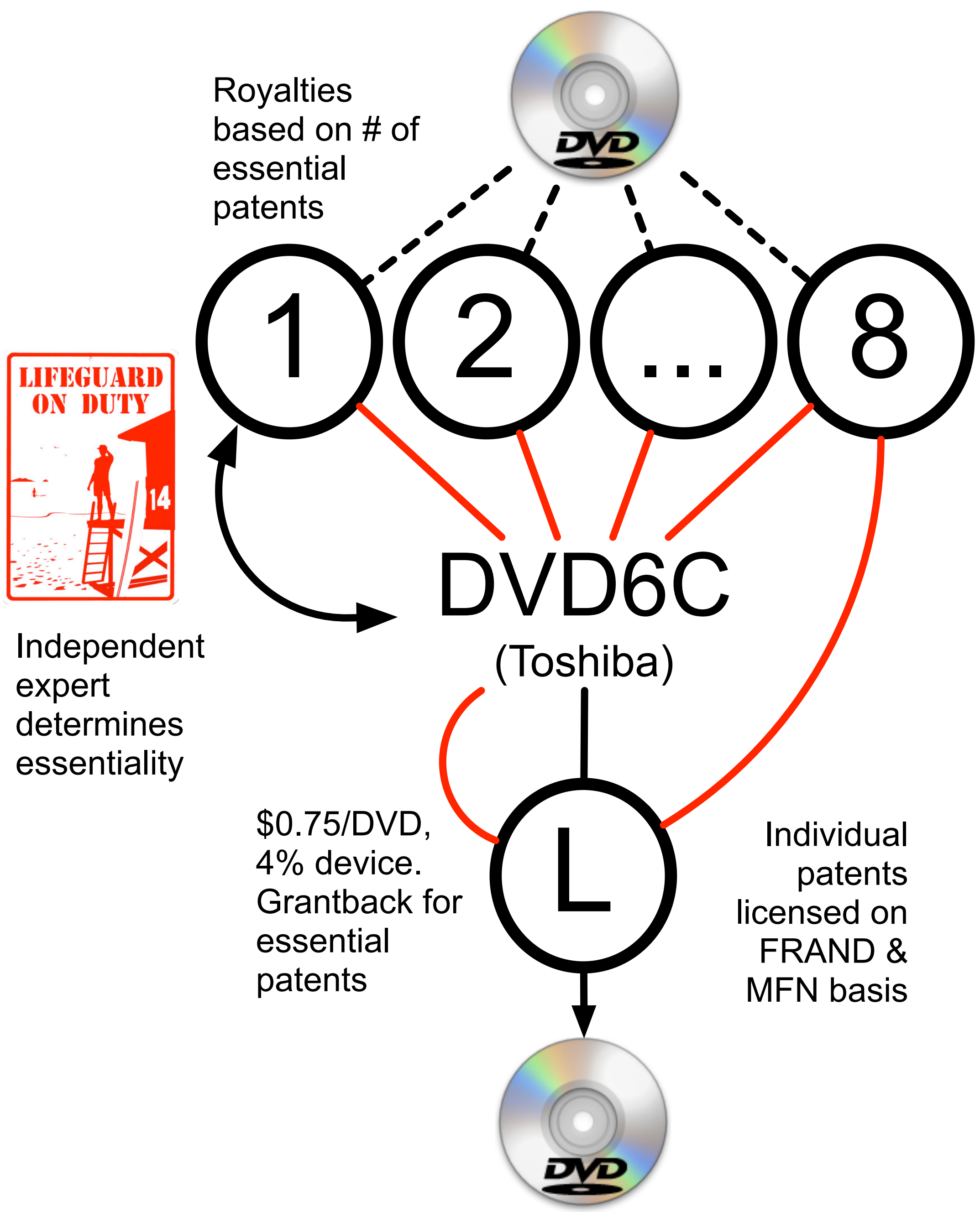
- A, B, C, and D each have essential patents required to make the product
- L needs to negotiate four license agreements
- Significant inefficiencies
  - A, B, C, and D each have an incentive to charge monopoly prices (“royalty stacking”)
  - A, B, C, and D each have an incentive to hold out
  - Transaction costs are significant
- A cross license won’t solve the problem
  - E.g., L has no patents, A-D are not manufacturers or there are simply too many patent holders

After the patent pool



- A patent pool enhances output and cuts costs
  - P has an incentive to charge the monopoly price for the bundle of rights, which will be lower than the price for four independent licenses
  - Single license eliminates hold out problem
  - Single license for all essential patents reduces transaction costs (“one stop shop”)
- Potential competitive concerns
  - Product market: Pool members deny competitors access to key IP ("group boycott", discriminatory rates); price fixing
  - Technology market: Price fixing for substitute patents (e.g., per-use license fees, LASIK); inclusion of non-essential complementary patents (similar to "tying" foreclosure)
  - Innovation market: Exclusive grant-backs by licensees diminish incentives to create leapfrog technologies

The DVD6C patent pool
Factors in the DOJ rule of reason analysis



6C DVD Business Review Letter (1999)

- No substitute patents (≠ price fixing)
- Royalty split based on number of essential patents provides incentives for selecting an expert who <u>reduces</u> the number of essential patents (of the other pool members).
- Keeping the number of essential complementary patents small reduces the foreclosure effects
- No downstream coordination; royalty is sufficiently small
- Bypassing the pool is permitted
- No adverse effect on innovation because (i) grantback limited; and (ii) pool limited to essential patents only

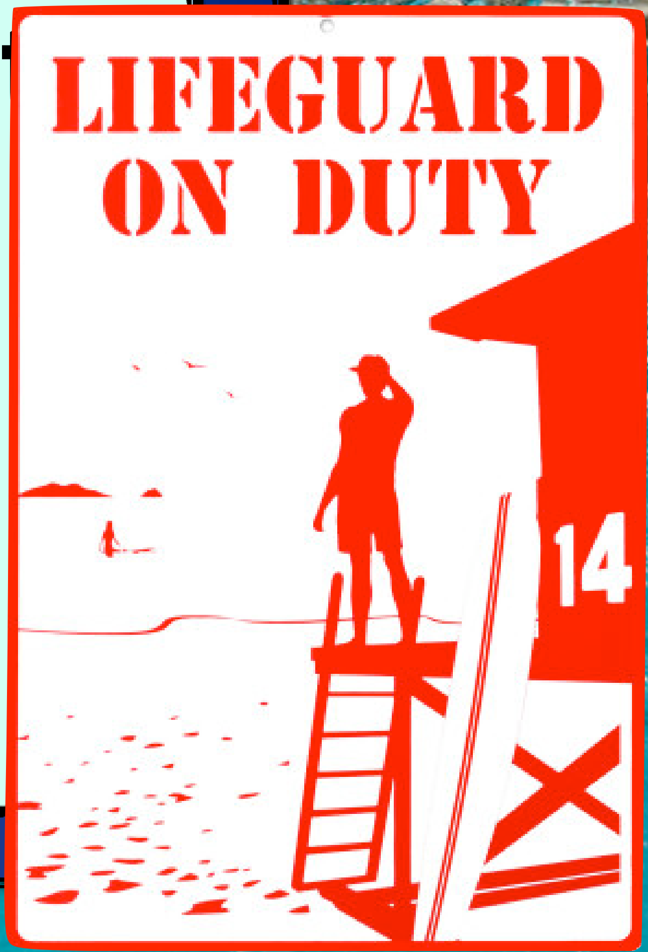
POOL RULES

No non-blocking substitutes

No invalid patents

No weak patents

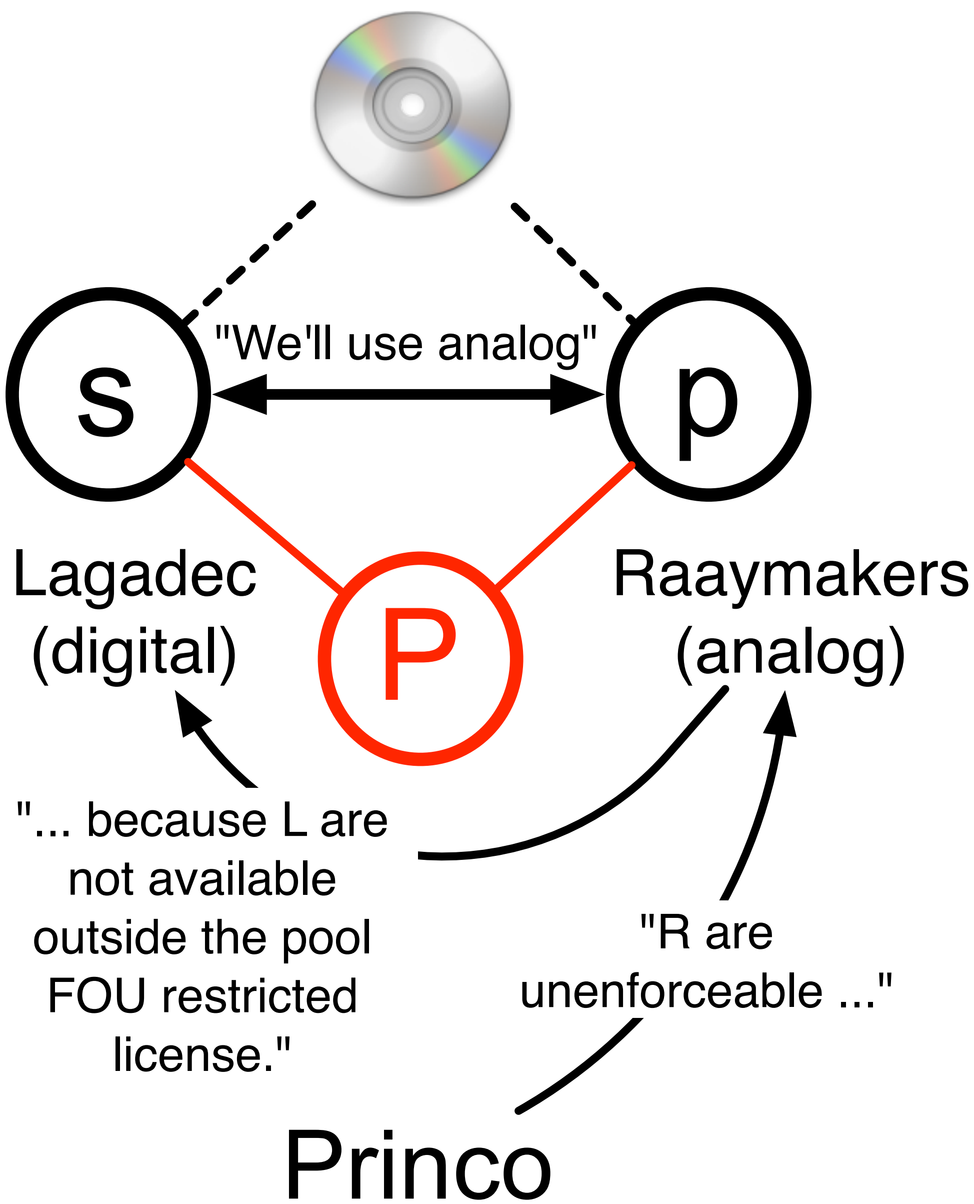
No non-essential complement



Strong, valid, complements and blocking substitutes are welcome!

Princo v. ITC

Princo Corp. v. International Trade Commission, 616 F.3d 1318 (Fed. Cir. 2010)



- Sony and Philips contributed patents to the CD-R/RW patent pool, including Lagadec (L) and Raaymakers (R). Sony and Philips agreed to use R. Sony did not license L separately, and the pool license is FOU restricted to making CD-R/RWs.
- Princo stopped paying for the pool license. Philips sued to stop Princo from importing CDs made without a license.
- Princo raised a misuse defense. Philips should be enjoined from enforcing <u>the R patents</u> because Philips and Sony agreed not to separately license <u>the L patent</u>.

The Fed. Cir. (en banc) adopts a narrow "leveraging" standard for misuse

"[T]he key inquiry under the patent misuse doctrine is whether, by imposing the condition in question, the patentee has impermissibly broadened the physical or temporal scope of the patent grant and has done so with anticompetitive effect."

Princo v. ITC, 616 F.3d 1318 (Fed. Cir. 2010)
Virginia Panel v. MAC Panel, 133 F.3d 860 (Fed. Cir. 1997)

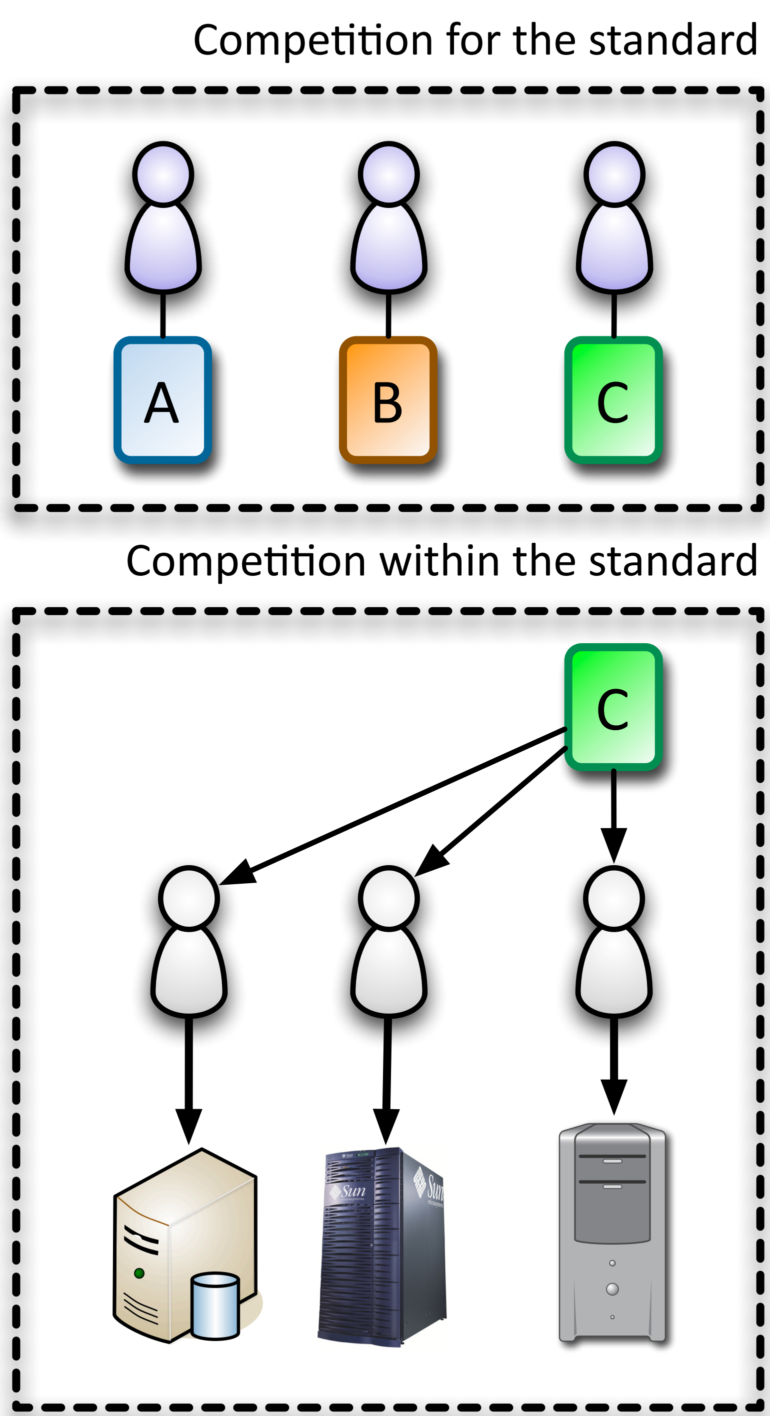
Agreeing “not to license A” is not the same as “impermissibly leveraging B”

- Impermissible broadening (“leveraging”)?
  - No. “At bottom, Princo's complaint is not that its license to the Raaymakers patents is unreasonably conditioned, but that the Lagadec patent has not been made available for non-Orange Book uses. And that is not patent misuse under any court’s definition of the term.”
- Anticompetitive effect (“rule of reason”)? *(dictum?)*
  - No actual or prospective effect on the market, because no evidence that (1) Lagadec is a competing technology; (2) that it works; or (3) that anyone ever tried to license it from Sony and was denied.
- Restraints only loosely connected to the patent may find a remedy in antitrust but not in patent law

Dissent: Limitation of misuse to leveraging is unwarranted

"[T]he agreement to promote the Raaymakers patents <u>cannot be separated</u> from the agreement to suppress the Lagadec patent. This misconduct renders <u>both</u> the Raaymakers and Lagadec patents <u>unenforceable</u>." (Id., at 1349)

Antitrust enforcement in the SSO context is focused on patent holdups

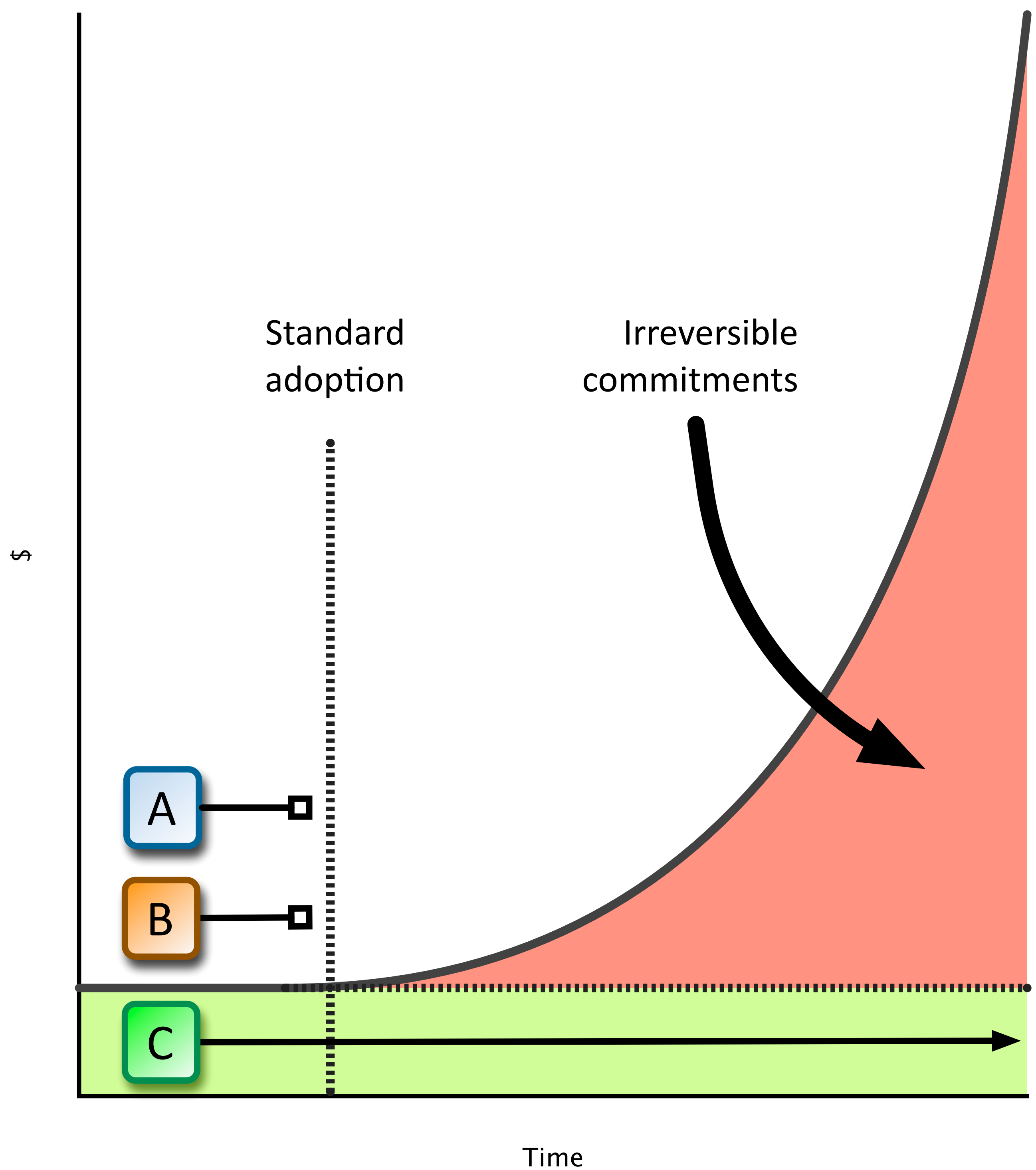


- Standard setting organizations (SSOs) set up a two-step competitive process
  - Step 1: Upstream firms compete for inclusion of their IP in the standard (competition for the standard)
  - Step 2: Downstream firms compete for implementations of the standard (competition within the standard)
- Common antitrust concerns
  - Licensor cartel ("We won't license our essential IP for less than $x")
  - Licensee cartel ("We won't license your IP for more than $x")
  - Manipulation of the SSO process to disadvantage competitors ("No plastic conduits for fire safety reasons")
  - **Patent holdup ("Deception, adoption, infringement litigation")**

EC 2010 Draft Cooperation Guidelines address SSOs specifically

- Includes technical standards and standard contract terms
- "Safe harbor": No application of Art. 101 (1) if:
  - Unrestricted participation in the standard setting process (¶278)
  - Transparency, regular updates re upcoming, ongoing, finalized standards (¶279)
  - Avoidance of hold-ups through (i) mandatory disclosure of essential patents; (ii) *ex ante* FRAND commitment.
  - Unilateral *ex ante* royalty disclosures are encouraged (¶287)
- Application of Art. 101 (1) if:
  - Standard includes substitute technologies
  - Exclusive access to standard IP for members of the standards process
- "Abuse of the market power gained by virtue of IPR being included in a standard constitutes infringement of Art. 102." (¶284)

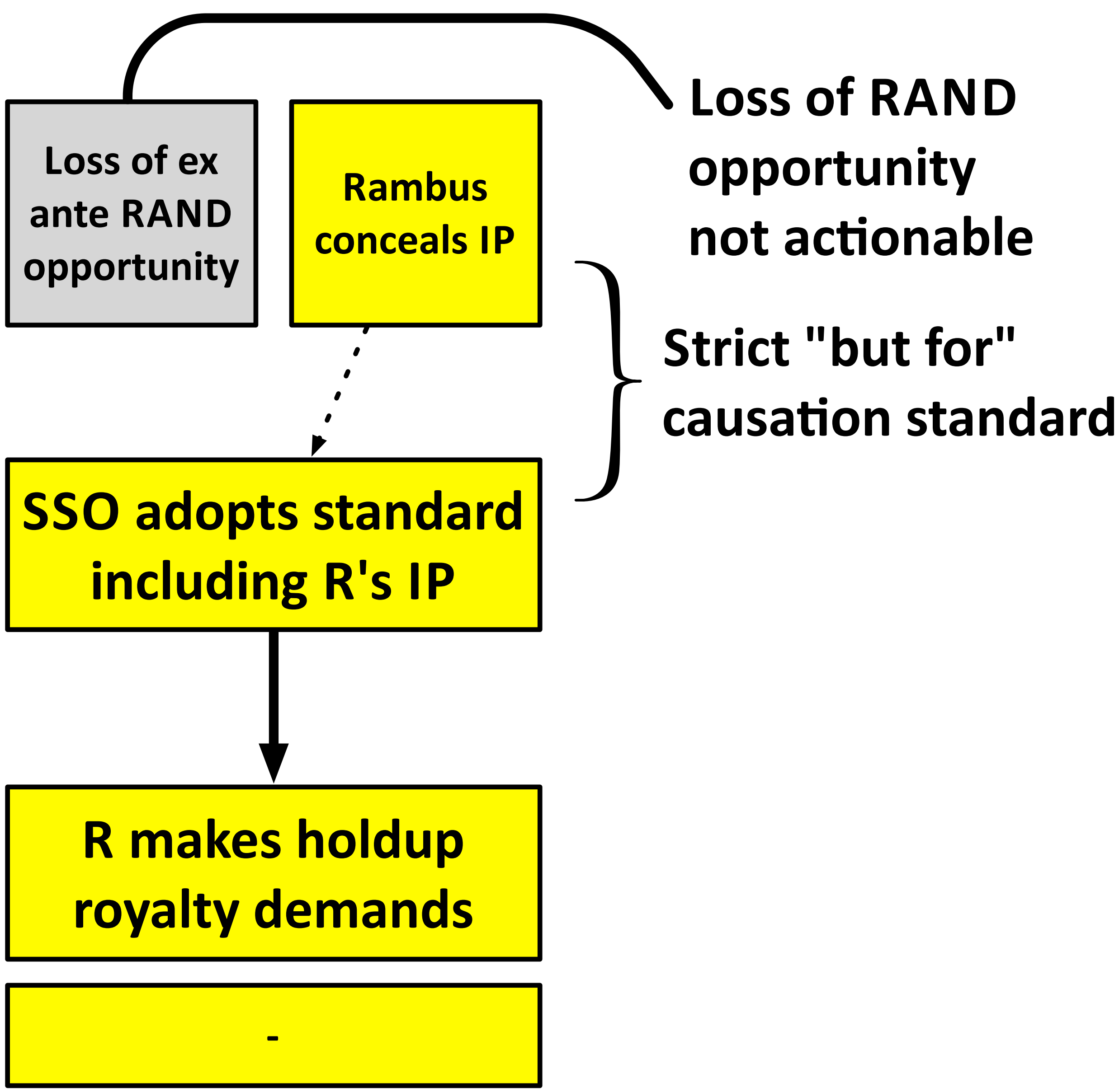
A holdup extracts rents above the value of the inventive contribution



- In the context of the standard setting process, deception by a patentee <u>may</u> lead to signifiant market power
  - Not if the patent is truly essential and if there are no alternatives to begin with
- Before the adoption of a standard, a licensee's willingness to pay is determined by available alternatives (Value 1)
  - E.g., $5/unit for process A versus $8/unit for alternative process B
- After the adoption of a standard (process A), a licensee's willingness to pay is (also) determined by its irreversible investments (Value 2)
  - E.g., $1,000,000 in already manufactured goods, or hundreds of millions for a chip factory
- If a patentee can get the SSO to adopt a standard incorporating its undisclosed IP (= <u>deception</u>), then it can profit from the delta between Value 1 and Value 2 by way of strategic litigation

The D.C. Cir limits the reach of §2 for standard holdups: *Rambus v. FTC* (2008)

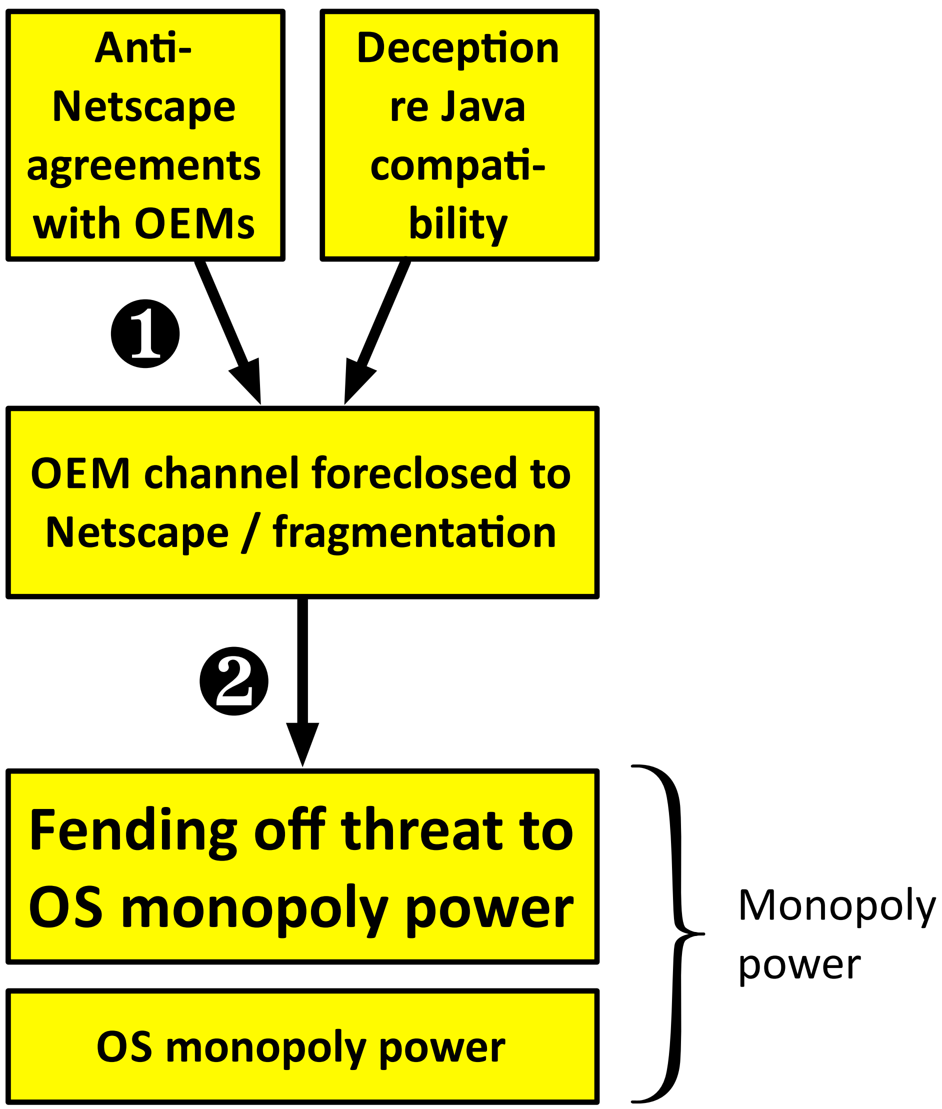
Rambus Inc. v. FTC, 522 F.3d 456 (D.C. Cir. 2008)



- Rambus didn’t disclose IP to the SSO. The IP was included in the standard. Post-adoption, Rambus demanded holdup royalties. The FTC found Rambus liable under §5 (§2) because, had Rambus disclosed its IP:
  1. The SSO would not have included Rambus’s IP in the standard; or
  2. The SSO would have included Rambus’s IP but demanded *ex ante* RAND commitments.
- In 2008 the D.C. Cir. reversed and held
  - The loss of a RAND negotiation opportunity by itself does not constitute a **cause of action**; and
  - The FTC didn’t prove that the deception was a **“but for”** cause of inclusion of Rambus’s IP in the standard
- In February 2009, the Supreme Court denied cert.

Causation: Tensions between *Rambus* and *Microsoft* (both D.C. Cir.)

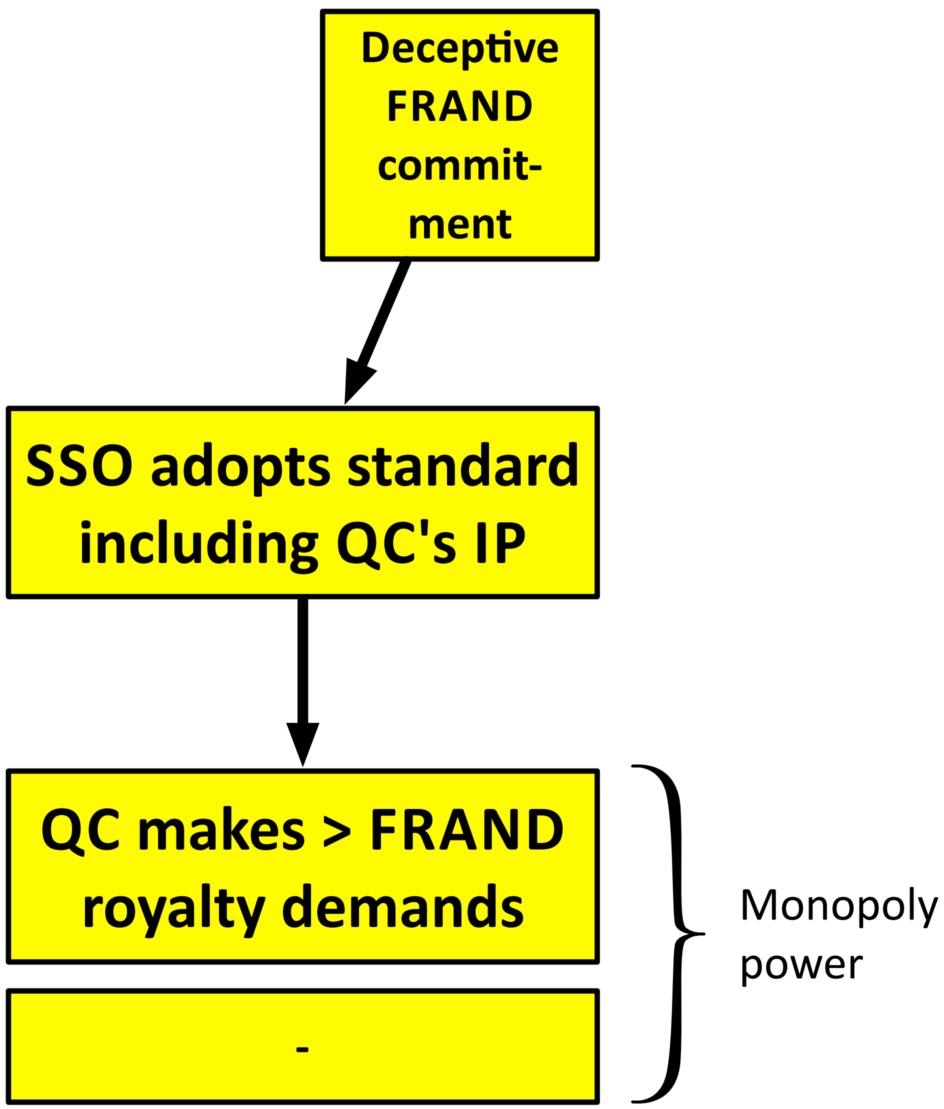
U.S. v. Microsoft, 253 F.3d 34 (D.C.Cir. 2001)



- The D.C. Cir relies on two *prima facie* contradictory causation requirements
  - *Microsoft's weak contributing factor causation standard*: §2 causation requires conduct "reasonably capable of contributing significantly to Δ's continued monopoly power." (Id., 79)
  - *Rambus's strong but-for causation standard*: It is **<u>not</u>** enough for §2 causation "that Rambus's nondisclosure made the adoption of its technologies somewhat more likely than broad disclosure would have." (*Id*., at 463-64). Citing Hovenkamp, et al. for "but-for" causation requirement. (Id., 466)
  - "Dramatic shift away from *Microsoft*." (Rosch)
- A possible solution to the puzzle
  - The *Rambus* standard applies to ❶
  - The *Microsoft* standard applies to ❷
- In any event, *Rambus* makes it significantly harder for πs to challenge holdups

Cause of action: Tensions between *Rambus* (D.C. Cir.) *and Broadcom* (3rd Cir.)

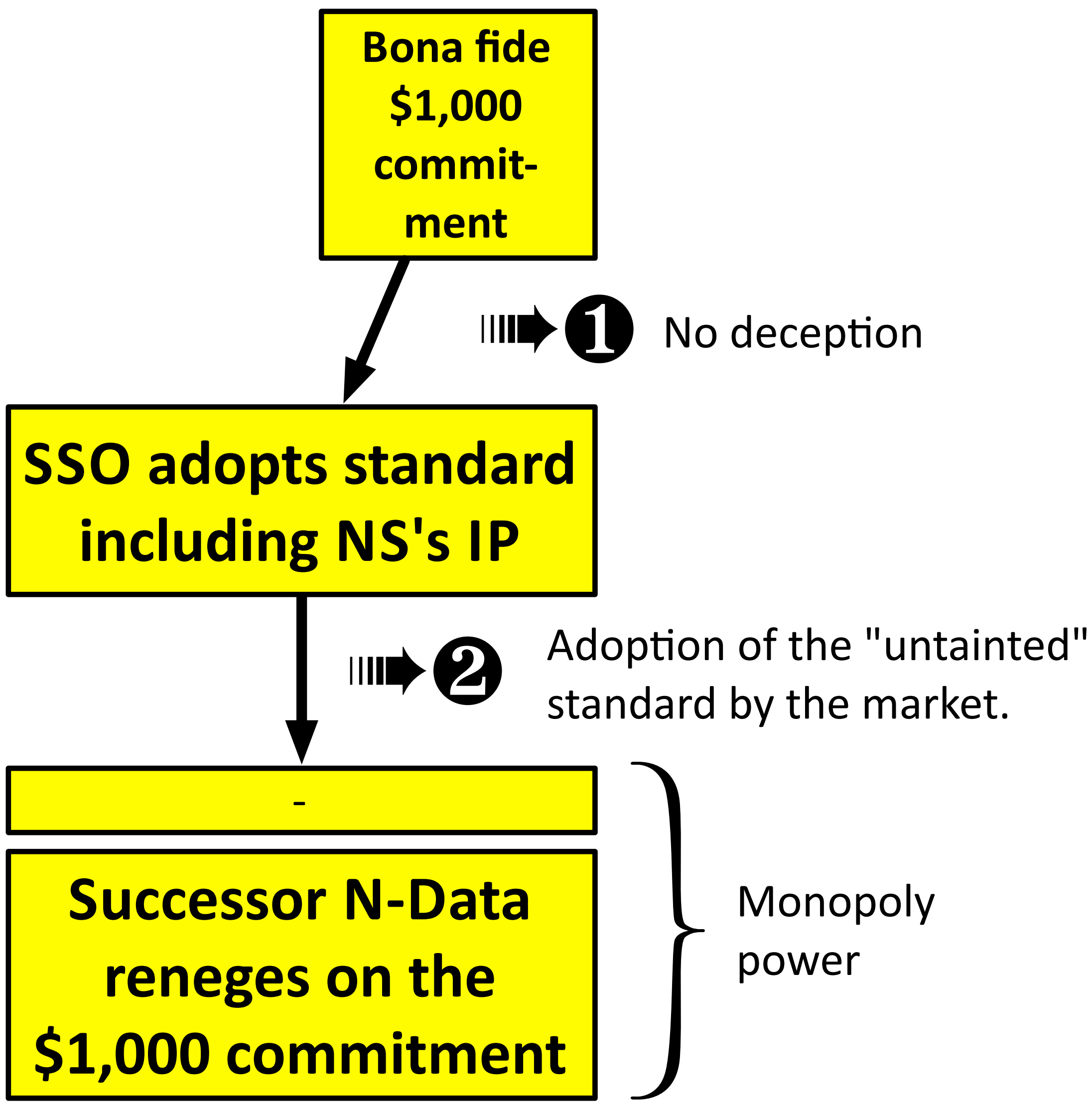
Broadcom v. Qualcomm, 501 F.3d 297 (3rd. Cir. 2007)



- Qualcomm (QC) promised to license mobile phone IP under FRAND terms. As a result, the SSO included the IP into the standard. Post-adoption, QC reneged on the promise and charged holdup royalties.
  - The 3rd. Cir. held that false FRAND promises may constitute a **cause of action** under §2.
- Tensions between the 3rd and D.C.Cir
  - *Broadcom* (3rd Cir.): "Deceptive FRAND commitments, no less than deceptive nondisclosure of IPRs, may result in ...[anticompetitive] harm." (*Id*., 314)
  - *Rambus* (D.C. Cir.): JEDEC's "loss of [a RAND] commitment is is not a harm to competition from alternative technologies." (*Id*., 466)
- Is there a distinction?
  - "Loss of [RAND] commitment" (*Id*., 466) language clashes more directly with *BRCM* than "loss of opportunity to seek favorable licensing terms" (*Id*., 467).

Liability for holdup *without* deception: *FTC v. N-Data* (2008)

N-Data LLC, FTC Docket No. 4234 (Complaint, 9/22/08)

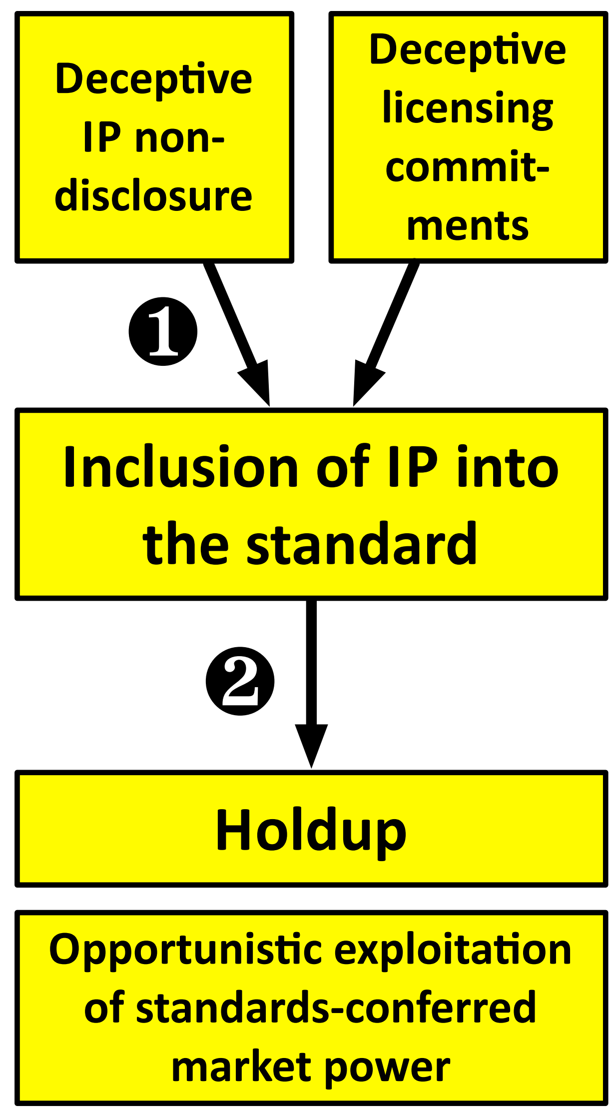


- Natl. Semi. (NS) disclosed its Ethernet patents to the SSO and made nominal license commitments ($1,000). The SSO adopted the standard. Post-adoption, NS honored the commitment for many years. Then N-Data acquired the patents and started charging > $1,000 royalties.
- No deceptive (exclusionary) conduct during the SSO process; no adoption of a "tainted" standard; no causation
  - No §2 liability
- Unfair ex post exploitation of properly acquired, standards-based market power is sufficient for §5 FTC Act liability
  - Both "unfair competition" and "unfair practice"

Deception in the standard setting context: Putting it all together

Valid cause of action (*Broadcom*). Not adopted by the D.C. Cir. (*Rambus*)

Strict "but for" causation standard (*Rambus*)

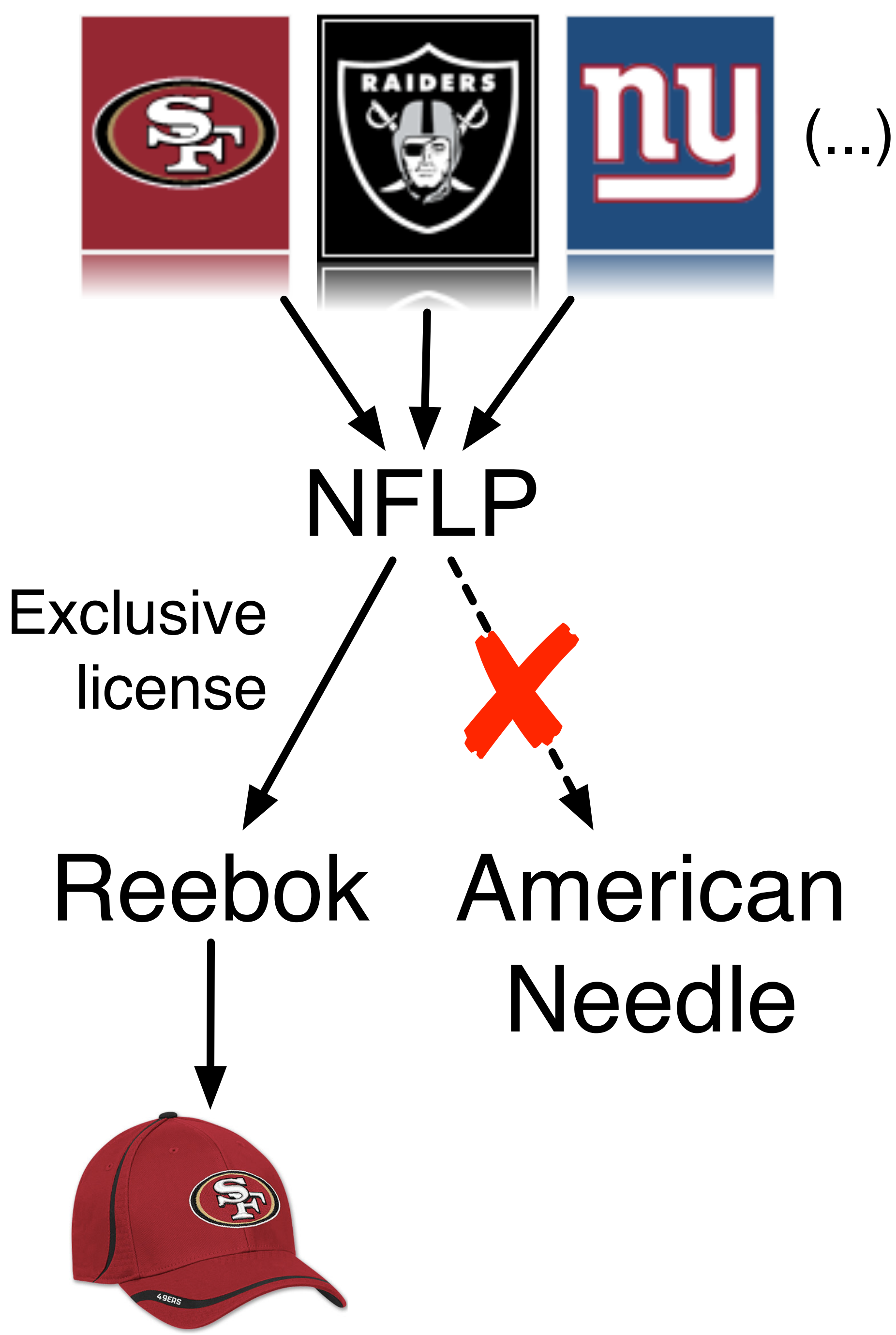


Weak "capable of making a significant contribution" causation standard (*MSFT*)

Valid cause of action under §5 FTC Act, even in the absence of deception or exclusion (*N-Data*)

American Needle, Inc. v. NFL

American Needle, Inc. v. NFL, 130 S. Ct. 2201 (2010)



- The NFL is an unincorporated association of 32 independently owned teams.
- In 1963, the teams formed NFLP to market their trademarks. From 1963-1999, NFLP granted non-exclusive licenses to apparel vendors. In 2000, the teams voted to have NFLP grant an exclusive license, which Reebok won.
- American Needle sued, alleging a conspiracy among the teams and the NFL in violation of §1 (and §2)
- The Supreme Court rejected the NFL's argument that with respect to IP licensing, the teams are a single entity and thus unable of conspiring.
  - The agreement will be analyzed under the rule of reason.

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