Antitrust Pitfalls in Licensing Agreements

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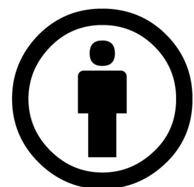

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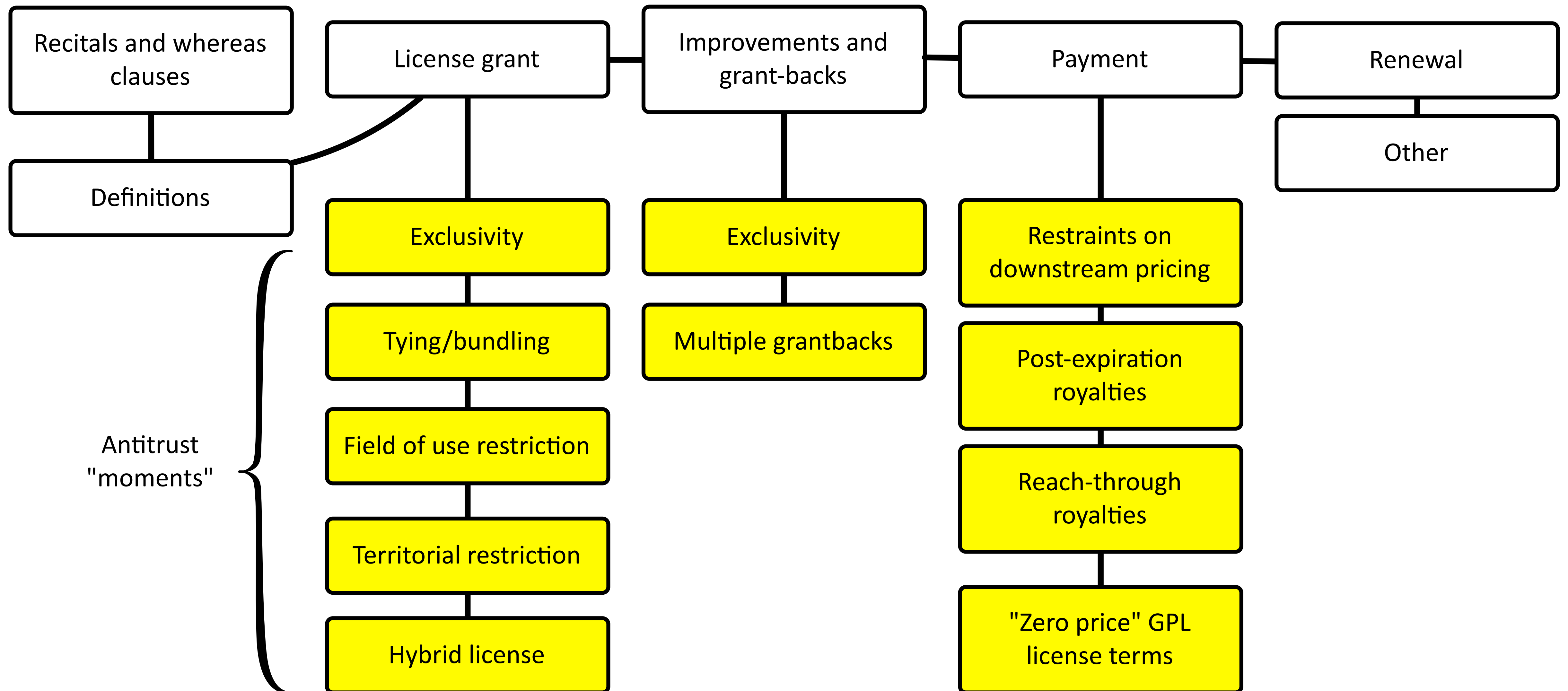
Syllabus

- Antitrust-relevant clauses in a license agreement
- The goals of antitrust regulation and the AT/IP interface
- Analyzing restraints in license agreements, a step-by-step guide
  - Horizontal or vertical?
  - Market power?
  - How will the restraint harm competition?
  - How will the license increase output?
  - Is the restraint reasonably necessary to achieve the increased efficiencies?
- Goods, technology, and innovation markets
- Unilateral "duties to license?"

Antitrust-relevant clauses in a license agreement



Traditional antitrust law is based on a simple, idealized view of the economy

Compete

Compete

Cooperate

- 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)
  - Dominant firms excluding weaker competitors by means other than competition (§2)
  - Mergers that reduce competition below the required minimum level (§7)

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 unified strategic goal (output)
- 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

Standards of review: Rule of Reason, per se, ancillary restraints

- **Easy cases** = Restraints that are almost always anticompetitive are "per se" illegal
  - Price fixing, market allocation, some forms of group boycotts, (tying)
  - Lack of actual AE ("nothing happened!") is not a defense
  - May be prosecuted criminally by DOJ
- **Hard cases** = Restraints where "it depends" on market power, market structure, efficiencies, etc. whether they are pro- or anticompetitive. Those are governed by the "rule of reason"
  - "Market power is the ability to profitably maintain prices above, or output below, competitive levels for a significant period of time." §2.2, 1995 IP Licensing Guidelines.

Key to understanding AT & IP: Licenses are never the issue. Restraints are.

- **Antitrust and license grants** – No issues. A license by definition increases output. After the grant, the licensee can do something that she couldn't do before.
- **Antitrust and restraints in licensing agreements** – License grants are almost always conditional ("I license you my patents, if ..."). (Exclusivity, exclusive dealing, tying, territorial or customer restraints, grantbacks, etc.)
- **The conditions, not the license, cause antitrust problems.**

Ancillary restraints analysis is the default for license agreements

- There are (almost) always **two agreements**

  (a) Underlying, efficiency enhancing agreement ("I will give you a license ...")

  (b) Some restrictive term ("... if you don't sell my competitors products.")

- The ROR applies if the restraint is reasonably necessary to achieve the efficiencies from the underlying agreement
  - Even if the restraint in isolation would be *per se* illegal ("naked restraint")
  - Not if there are "practical and significantly less restrictive alternatives" to the restraint
  - Not if the duration of the restraint exceeds what's reasonably necessary to achieve the efficiencies

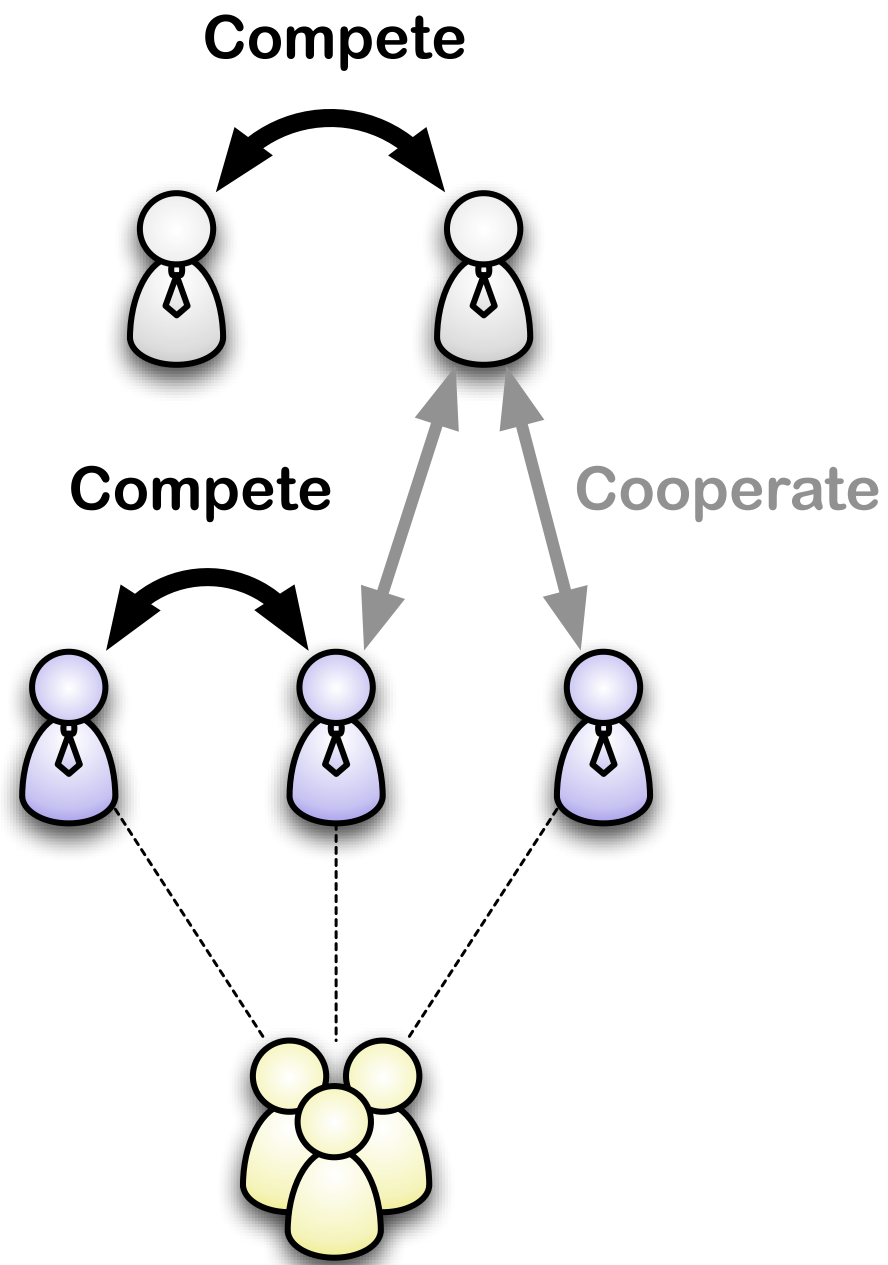
A non-compete clause is an intuitive "ancillary restraints" example

- A sells his bakery to B and agrees not to open another bakery in town for 3 years.
  - Underlying agreement = sale of the bakery
  - Restraint = Non-compete
- In isolation, the non-compete would be *per se* illegal. But without the non-compete, there would be no sale, or if so only at an inefficiently low price.

Analyzing license agreements under the antitrust laws (a checklist)

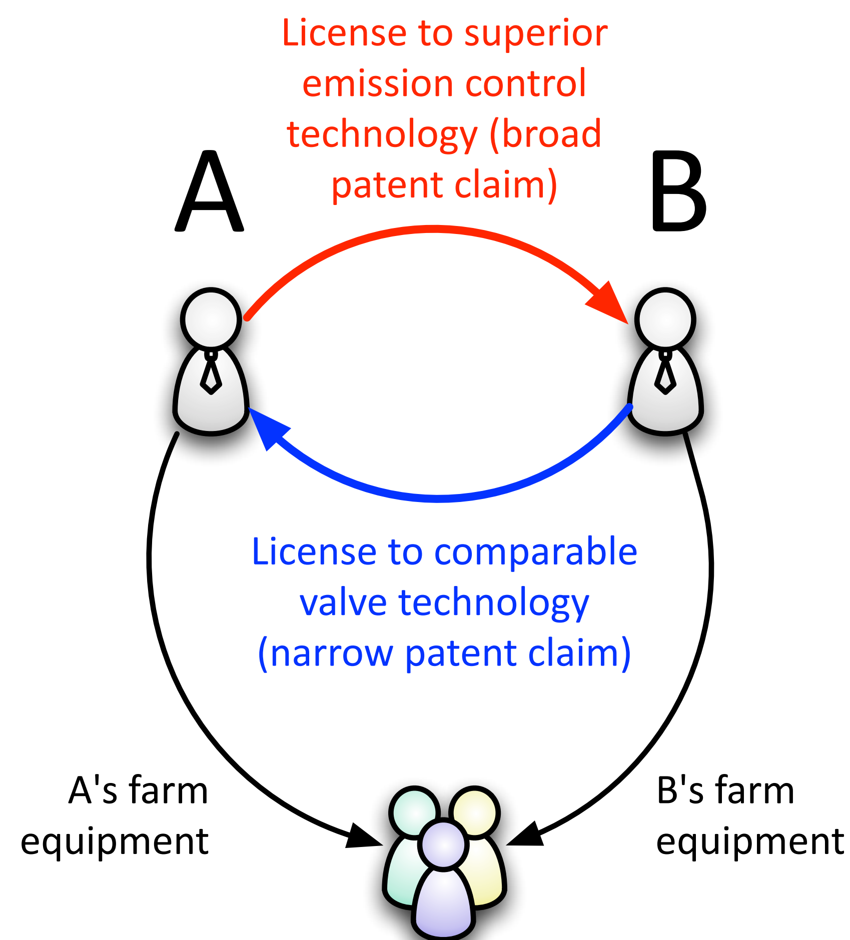
1. Is the restraint horizontal or vertical?
2. Is there market power at the licensor or licensee level?
   - Without market power, no anticompetitive effect
   - Check the safety zones (see below)
3. How will the restraint harm competition?
4. How will the license increase output (efficiency)?
5. Is (3) reasonably necessary to achieve (4)?
   - If so, ROR

The normative premise: Compete horizontally, cooperate vertically



- The antitrust laws treat horizontal restraints with much greater suspicion than vertical restraints
  - Is the restraint, on a stand-alone basis, per se illegal?
  - Is the restraint naked? i.e., is there no underlying, efficient agreement?
- A restraint in a license agreement is horizontal, if there would have been actual or likely potential competition in the absence of the restraint
- Examples of vertical agreements
  - Upstream pure-play R&D licenses to downstream manufacturer
  - Upstream component manufacturer grants license to downstream manufacturer
  - Upstream manufacturer/licensor grants license to downstream distributor/marketer.

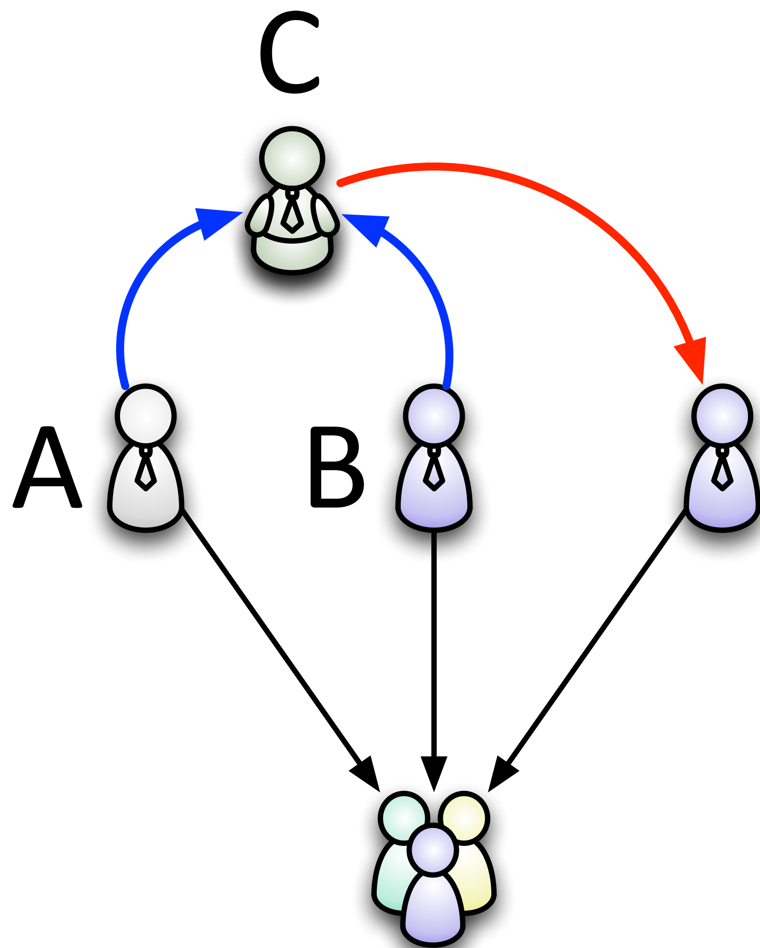
Example 1:
Vertical v. horizontal agreements



See 1995 Guidelines, Examples 5, 6

- A and B are competing farm equipment manufacturers. A grants B a patent license to A's new emission control technology. B grants A a license to its valve technology.
- The emission license is vertical
  - B's technology does not constrain the price of A's much superior technology. Since B's technology is no substitute, A and B are not current competitors.
  - A's patent claim is broad such that B's likely improvements to its own technology would infringe A's patents. B is thus not a likely future competitor.
- The valve license is horizontal
  - A's valve technology constrains the price of B's comparable technology. A and B are actual competitors.
  - B's patent claims do not stand in the way of A's likely improvements. A is thus a likely future competitor.
  - This does not mean that the license poses a problem.

Example 2:
Vertical v. horizontal: patent pooling

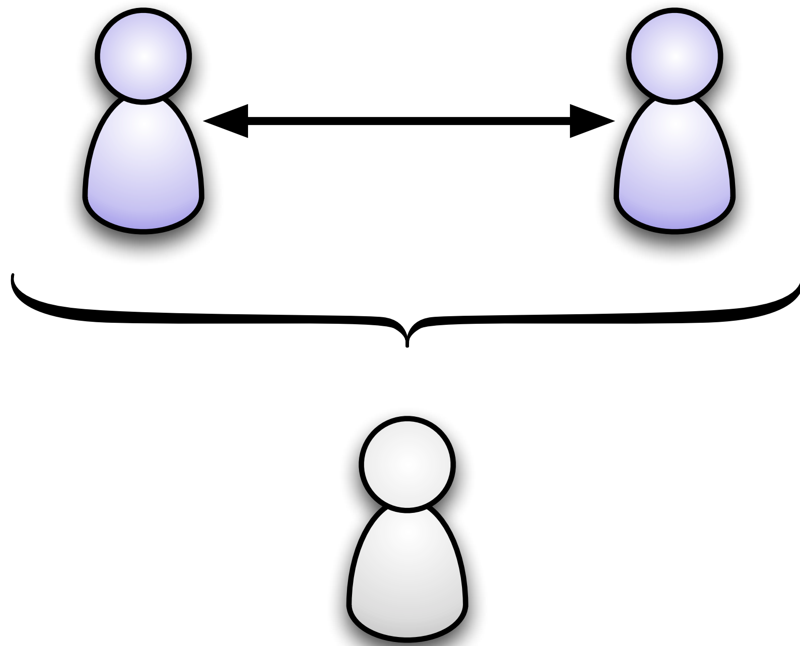


See 1995 Guidelines, Examples 9, 10

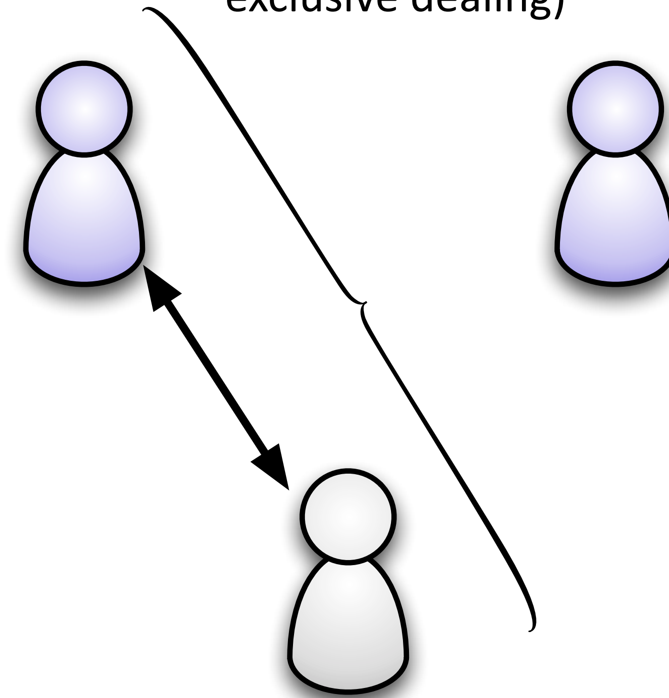
- A and B sell competing patented widgets. They also license their widget patents to third party widget manufacturers. A and B create C as a 50/50 JV and assign all widget patents for licensing to C. C sets the price, revenues are split between A and B.
- Hypo 1: Patents assigned to C are non-blocking
  - The JV eliminates competition for widget IP licensing between A and B. If no production or licensing efficiencies, per se illegal price fixing agreement. If efficiency-enhancing integration, then ROR analysis
- Hypo 2: Patents are blocking
  - A and B are not in a horizontal relationship with respect to these patents, because neither could practice the technology. No antitrust concerns.

How will the restraint harm competition? Collusion or exclusion

The agreement limits competition between the parties.
(Direct, collusive effect, e.g., price fixing)



The agreement limits competition from third parties.
(Indirect, exclusionary effect, e.g., exclusive dealing)

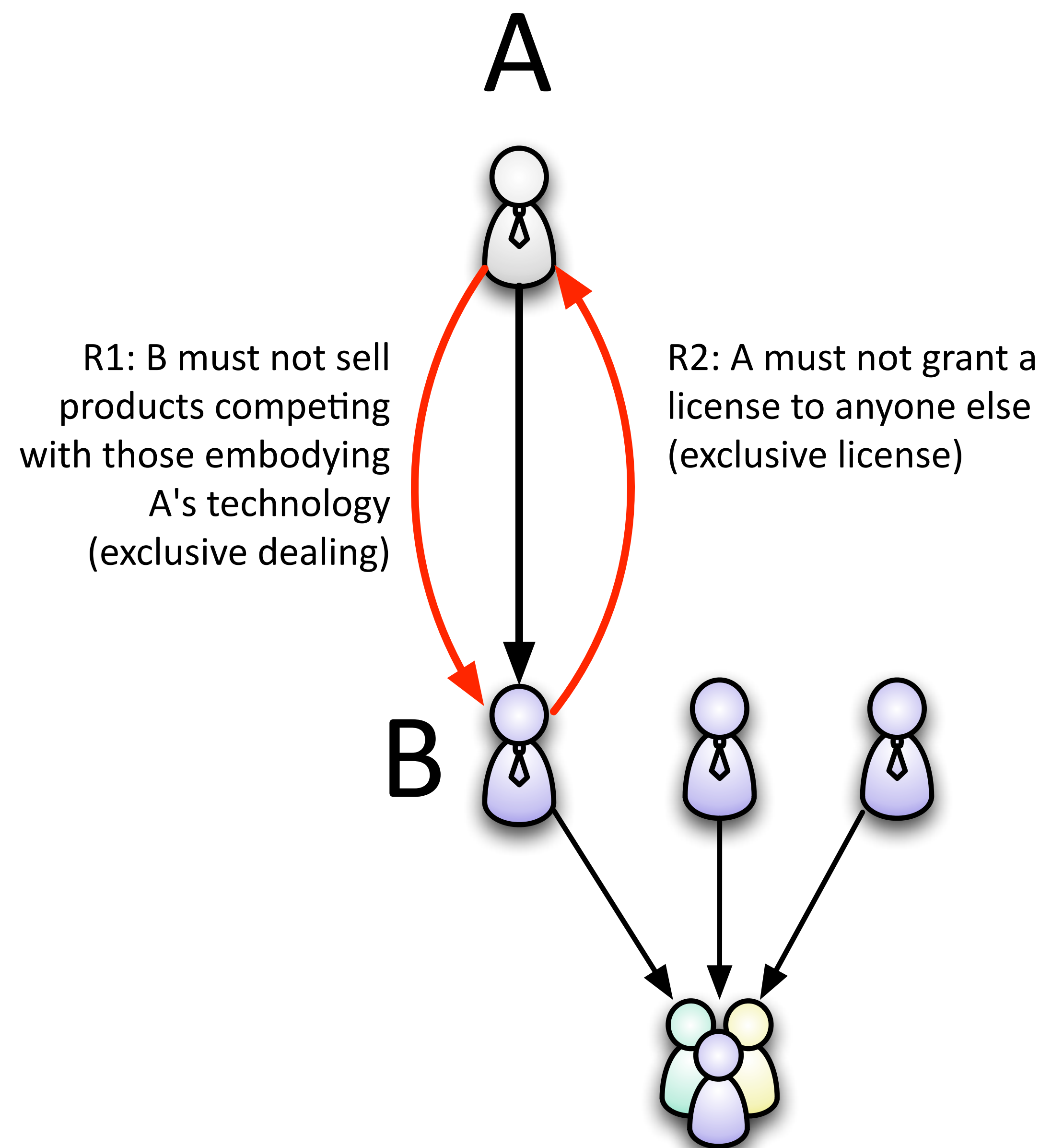


No power, no harm (unless there's a per se violation)

Share	§1	§2
0-33%	no	no
33-66%	yes	maybe
66-100%	yes	yes

- In the antitrust context, market power is a symptom of insufficient competition
- No more "patent = market power" presumption (*Independent Ink*)
- Market definition requires identifying firms that are actual and potential competitive constraints ("in or out")
- In the EU the market share triggers are generally lower

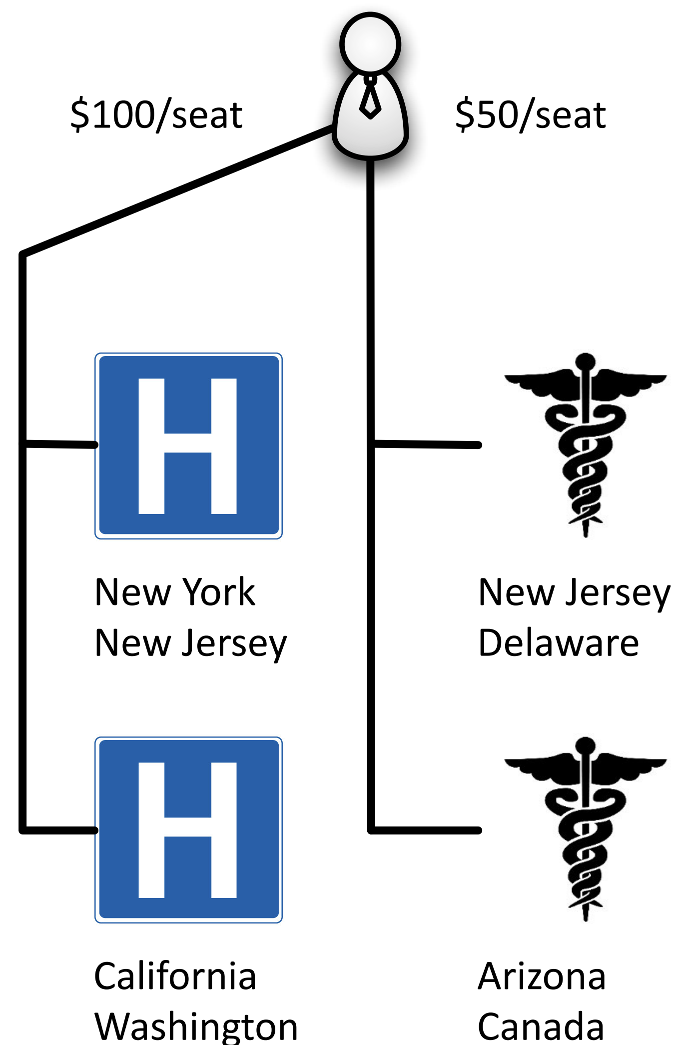
Example 3: Exclusive licenses and exclusive dealing



See 1995 Guidelines, Example 8

- A is the inventor and vendor of new flat panel technology. To commercialize the product, A licenses the product to B. B is not developing technology similar to A's.
- The license contains two restraints
  - A must not grant a license to anyone else (exclusive license, restraint on the licensor)
  - B must not sell products competing with those embodying A's technology (exclusive dealing, restraint on the licensee)
- The restraints are analyzed differently
  - Exclusive licenses in a vertical setting are almost always procompetitive
  - Exclusive dealing may restrict competition from others, depending on the level of foreclosure
- HSR notification may be required
  - Fully exclusive license = asset. Value > $63 million.

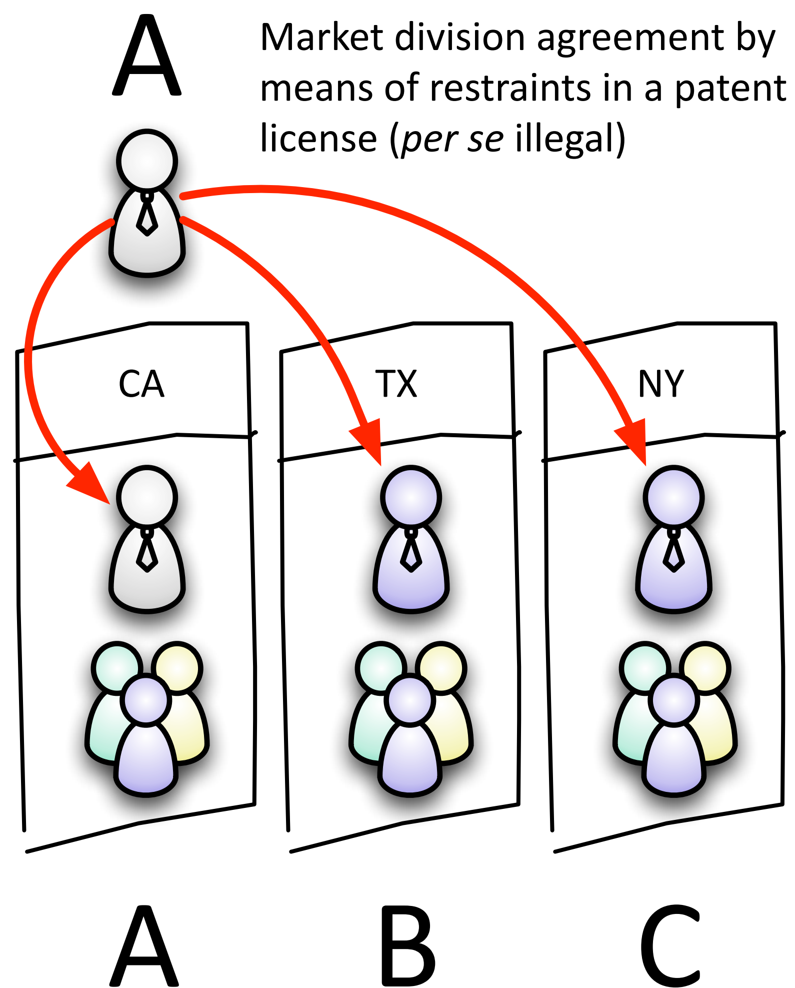
Example 4:
Field of use and territorial restraints



See 1995 Guidelines, Example 1

- Software vendor licenses inventory management program to hospitals and doctors' offices
  - Field of use restrictions
  - Territorial restrictions
  - Different royalties (hospitals pay more)
- No competitive concerns
  - Hospitals and doctors are neither present nor likely future competitors in the market for inventory management software (vertical)
  - Intra-brand restraint. Nothing prevents hospitals or doctors from using a competing product (no exclusivity, no possibility of foreclosure)
  - Nothing keeps hospitals or doctors from developing their own competing products
  - Cost of license is so small that it cannot facilitate coordination in the downstream (healthcare) market among hospitals or doctors

Example 5: Sham restraints, per se illegal agreements



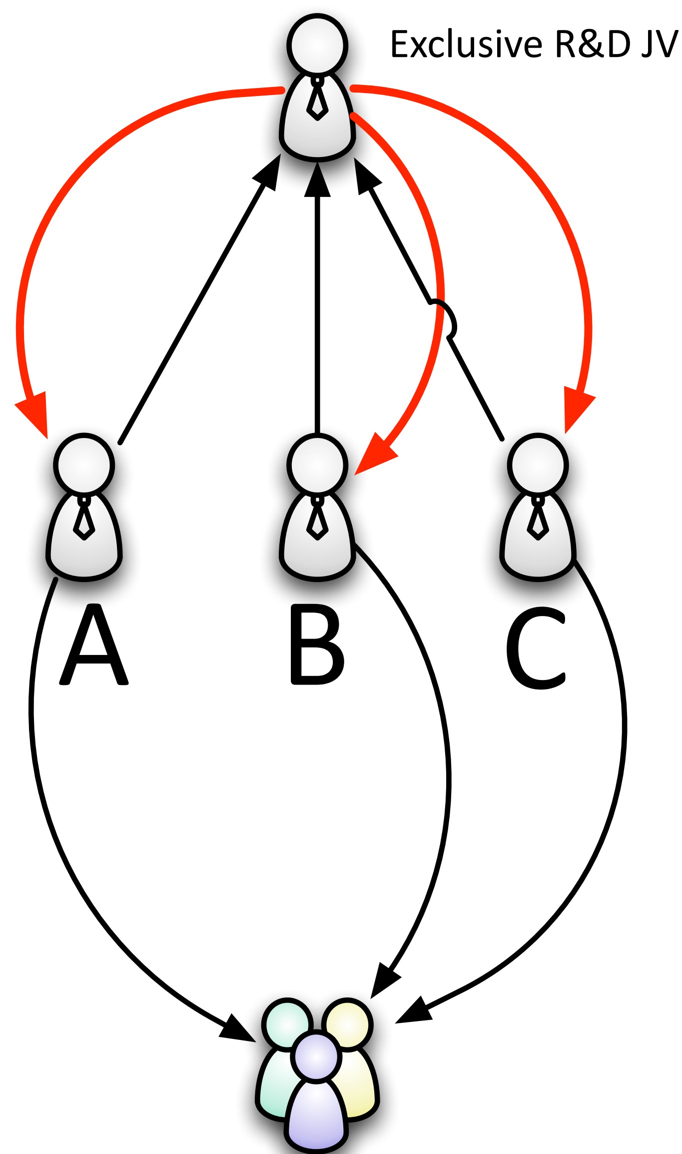
See 1995 Guidelines, Example 7

- A sells widgets using a patented process in competition with other vendors. A licenses its process to every other widget vendor, assigning exclusive territories. The licensees do not use A's process, but they abide by the license restrictions.
- Per se illegal territorial allocation
  - A and the other vendors are competitors in the widget market
  - The "licensees" do not care about A's technologies. They care about the restrictions that come with it.
  - The agreement is horizontal, because the licensees would be competitors in the absence of the (restrictions that come with the) license
- If A's technology was demonstrably superior, the ROR would apply
  - Using A's technology would be efficiency enhancing

Goods, technology, and innovation markets

Market	Example	Antitrust safety zone
Present goods market	DVD player	The parties to the agreement control no more than 20% of any relevant market.
Present technology market (IP & goods)	Essential patents for practicing the DVD technology	There are four or more additional, independent, competing technologies.
Innovation market (future technology)	New form of media storage, the "next big thing."	There are four or more additional, independent players in the same R&D space

Example 7:
Exclusive R&D JV, innovation markets



See 1995 Guidelines, Example 4

- A, B, and C set up a R&D JV for the development of a new product technology. The JV will license all patents and know how exclusively to A, B, and C.
- A, B, C are current R&D competitors
  - No per se issues here. The agreement does not implicate price fixing or direct output reduction
- Competitive effects depend on:
  - Number of other R&D competitors. Safe haven if 4 or more, i.e., a 6-5 “merger” is OK.
  - Efficiencies from the JV, such as greater likelihood of successful R&D and more rapid development, cost savings.
  - Absence of restraints on competition in the goods market, i.e., A, B, and C are free to compete in downstream sales of the product.

Unilateral conduct – "With great power comes great responsibility" (§2)

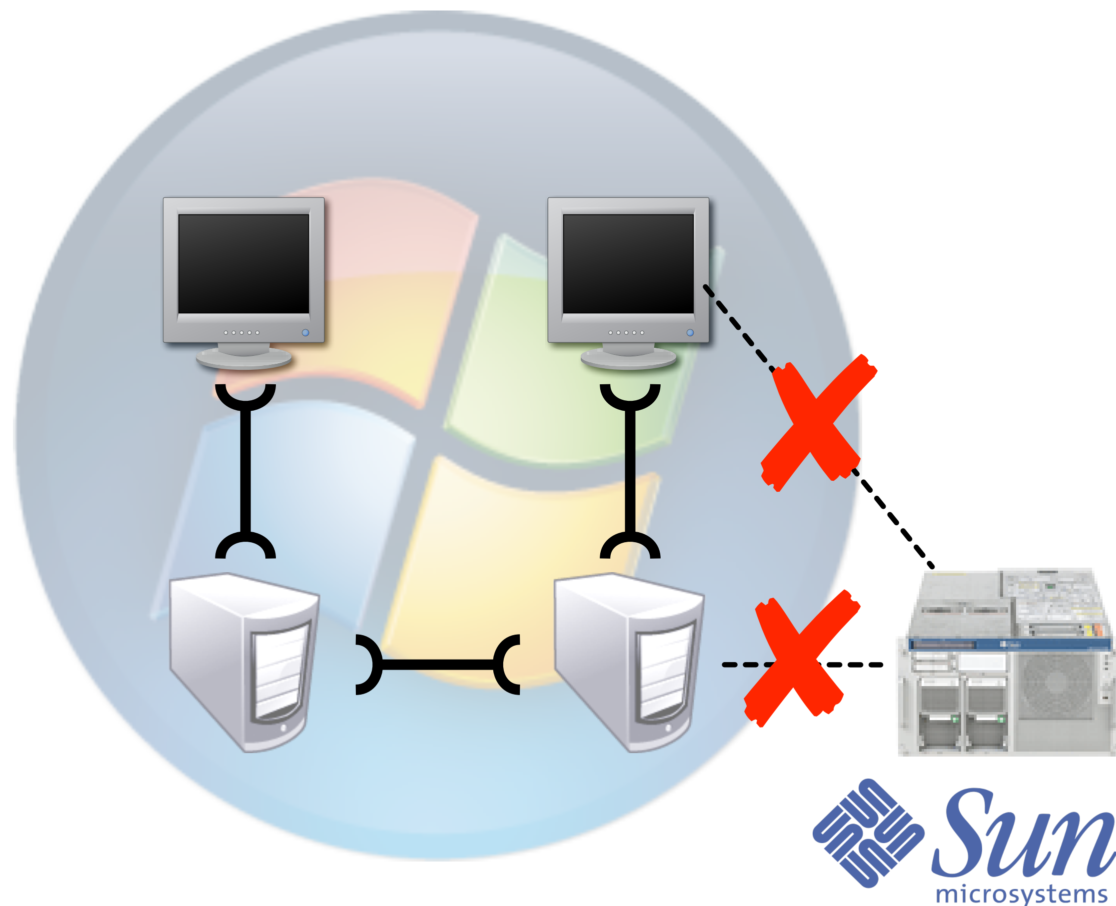
Big	Bad	
no	yes	OK
yes	no	OK
yes	yes	AT

Nasty dwarf

- Dominant position ("big")
  - U.S. ~ 66%, could be less; EU ~ 40% (!)
- Exclusionary conduct ("bad")
  1. Harms rivals
  2. Does not benefit consumers
  3. Reinforces the dominant position

Gentle giant

Compulsory *de novo* licensing obligations *Commission v. MSFT* (2007)



- MSFT failed to disclose server-to-server interoperability protocols, making it impossible for Sun and others to build workgroup servers to fully replace Windows 2003 servers in a Windows domain
  - The Commission ordered MSFT to license all required protocols. On appeal, the CFI upheld the decision.

1. **Dominant position?**

- Yes, MSFT had a dominant position in server OS

2. **Exclusionary conduct?**

- A refusal to license is not in itself abusive or exclusionary, unless the product is

(a) indispensable (can't be duplicated),

(b) refusal to license would eliminate downstream competition;

(c) prevent the emergence of new products; and

(d) is not justified by efficiencies

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