DOJ And FTC Issue Joint Report On Antitrust And Intellectual Property

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On April 17, 2007, the Department of Justice and the Federal Trade Commission (the "Agencies") issued a joint report titled "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition" (the "Report"). Based on a series of hearings held by the Agencies starting in February 2002, the Report focuses on antitrust issues that arise out of the exercise of intellectual property rights and how the Agencies should enforce the antitrust laws with respect to such conduct in order to achieve the dual goals of promoting innovation and enhancing consumer welfare. The Report follows up on an earlier report issued by the Federal Trade Commission in October 2003, which made a series of recommendations for reform of the patent system. The Report reached several conclusions on some key issues at the intersection of antitrust and intellectual property law, few of which represent a departure from what we believe is current antitrust enforcement policy:

• ***Unilateral refusals to license patents.*** The Agencies found that Supreme Court case law supports the principle that a core part of a patent grant is the right to exclude, *i.e.*, the ability of the patent holder unilaterally to refuse to license others. Imposing a duty to license could compel patent holders to affirmatively assist their rivals by sharing their innovations, a position in conflict with underlying antitrust principles. Hence, the Agencies concluded that "[a]ntitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections." Conditional refusals to license patents causing competitive harm, however, are subject to antitrust scrutiny.

• ***Incorporation of patents into collaboratively set standards.*** The Agencies recognized that many efficiencies may result when firms collaborate to establish industry standards through standard-setting organizations ("SSOs"). Such cooperation can raise antitrust concerns, though, particularly when the standard involves intellectual property rights. Where the standard chosen by the SSO includes a patented technology without an effective substitute, the patent holder may be able to hold up implementation of the standard by exacting higher royalties or less favorable licensing terms than it could have if the standard had not included its patented technology, and the Report assumes that such hold up power will exist where notification of the existence of patents is lacking. Notification of intellectual property rights during the standard-setting process can mitigate hold up. In light of this procompetitive benefit, the Report notes that, without more, an intellectual property owner's unilateral announcement of its price or licensing terms to the SSO, would not be construed as a violation of either section 1 or 2 of the Sherman Act.

• ***Collective negotiation of royalty rates by SSOs.*** The Report concluded that the Agencies will apply the rule of reason in evaluating joint *ex ante* collaboration on licensing terms by SSO participants; the joint negotiation can mitigate the hold up described above. This may be construed as a departure from the general rule that collective action in the context of a price negotiation cannot be justified on the ground that it is mitigating the market power of a monopolistic seller or buyer. However, the approach taken by the Agencies in the specific context of the SSO can also be seen as consistent with generally more liberal *(i.e.,* rule of reason) antitrust approaches to joint purchasing.

• ***Patent pools and portfolio cross licensing agreements.*** The Agencies observed that patent pools and portfolio cross licenses may be efficient ways to license complementary patent rights that are controlled by multiple rights holders, avoiding the transactional costs of multiple negotiation, royalty stacking and hold up. Because such arrangements can also create anticompetitive effects, including price fixing (where, for example, the technologies are not complementary but substitutes), the Agencies typically will employ, as they have in the past, a rule of reason approach when evaluating the competitive effects of both types of agreements. Notably, however, the Agencies have taken the position that including substitute patents in a pool does not make the pool *per se* or presumptively anticompetitive; the fact that there may be competing patents in the pool is simply a factor to consider under the rule of reason.

• ***Specific intellectual property licensing practices.*** Firms may include various provisions when licensing intellectual property rights, including non-assertion clauses, grantbacks and reach-through royalty agreements. The Agencies will continue to evaluate the competitive effects of such transactions under the rule of reason.

• ***Tying and bundling of intellectual property rights.*** The Agencies observed that, when products involving intellectual property rights are tied or bundled together, economic theory can identify both procompetitive and anticompetitive effects. The Agencies will continue to evaluate both the anticompetitive effects and the efficiencies attributable to a tying arrangement involving intellectual property under the rule of reason. The Agencies will likely challenge a tying arrangement if: "(1) the seller has market power over the tying product, (2) the arrangement has an adverse effect on competition in the relevant market for the tied product, and (3) efficiency justifications for the arrangement do not outweigh the anticompetitive effects." These rules will be applied in light of the recent Supreme Court precedent that, in a tying case, the fact that the tying product is patented does not create a presumption of market power. *See Illinois Tool Works, Inc. v. Independent Ink, Inc.,* 547 U.S. 28(2006).

• ***Extensions of market power conferred by a patent beyond its statutory term.*** Firms may seek to extend the reach of their patents beyond the expiration of the patent's statutory term, either by collecting post-expiration royalties, using exclusive contracts, or bundling trade secrets with patents. In such instances, the Agencies' initial consideration is whether the patent confers market power upon its holder. If it does so, the Agencies will then inquire whether the patent holder's conduct unreasonably extends the market power beyond the patent's statutory term. Factors to be considered in this inquiry are whether the extension of market power beyond the statutory expiration of the patent is designed to prevent expansion by those already in the market or deter entry of substitute products or processes. This approach is somewhat inconsistent with the long-standing Supreme Court precedent holding that post-expiration royalties are *a per se* form of patent misuse. *See Brulotte v. Thys Co*., 379 U.S. 29 (1964); *Scheiber v. Dolby Labs., Inc*., 293 F.3d 1014 (7th Cir. 2002), *cert. denied,* 537 U.S. 1109 (2003).

The Report, of course, provides some insight into the enforcement intentions of the Agencies, but Justice will not deter private parties from asserting antitrust claims even in circumstances that would go unchallenged by the Agencies. Moreover, while the Report may be cited in an effort to defend a particular practice in a private litigation, it has no binding effect on the courts.

Supreme Court Holds That Antitrust Conspiracy Complaint Must Be Based On Factual Allegations Beyond Mere Speculation

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In a decision important to the business community, the Supreme Court has made it more difficult for antitrust (and perhaps other) plaintiffs to avoid dismissal of conspiracy claims based on conclusory allegations. On May 21, the Court, by a 7-2 vote, reversed a decision by the Second Circuit Court of Appeals, and declared that a conspiracy complaint under § 1 of the Sherman Act should be dismissed under Federal Rule 12(b)(6) when it alleges only parallel conduct, absent "factual context suggesting agreement." *Bell Atlantic Corp. v. Twombly*, No. 05-1126, slip op. at 1 (May 21, 2007). In an opinion by Justice Souter, the Court held that a complaint states a § 1 claim only when there is enough "factual matter" to suggest than an agreement, rather than independent action, caused the purportedly anti-competitive effects alleged by a plaintiff. *Id*. at 9-10. The *Twombly* decision may also have consequences beyond antitrust, as it also "retired" an oft-cited phrase from a 50-year-old Supreme Court decision that many had read to require that claims must be allowed to proceed unless there was "no set of facts in support" of the claim that would entitle the plaintiff to relief. *See id*. at 14-17, *clarifying Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

At issue in *Twombly* were the actions of the "Incumbent Local Exchange Carriers," or "ILECs," which arose after the breakup of AT&T's monopoly on local telephone service in 1984. *Id*. at 1. Between 1984 and 1996, the ILECs had monopolies on local telephone service within their respective regions. However, after the Telecommunications Act of 1996, the ILECs were required to share their respective networks with competitors ("CLECs") who wished to provide local telephone service. *Id*. at 1-2.

The plaintiffs represented a putative class consisting of all subscribers of local telephone and/or high speed Internet services since February 1996. *Id*. at 2. The plaintiffs alleged that the ILECs conspired to restrain trade and inflate prices on their services by (a) agreeing to engage in similar anticompetitive conduct in their respective service areas to inhibit the growth of upstart CLECs and (b) refraining from competition with one another within their respective regions. *Id*. at 3-4.

The Supreme Court held that to survive the defendants' motion to dismiss, the plaintiff's factual allegations must raise "above the speculative level" the expectation that discovery will reveal evidence of illegal agreement, thus moving a claim "across the line from conceivable to plausible." *Id*. at 24. The Court emphasized that this standard could help avoid the "potentially enormous expense of discovery" associated with groundless antitrust cases, observing that liberal discovery practice in federal courts rendered it unlikely that abuses could be effectively solved by measures during the discovery phase. *Id*. at 12-14. The foregoing implies that discovery on such claims should not proceed while a motion to dismiss is pending.

In holding that plaintiffs' allegations in the case before it should be dismissed under these principles, the Court stressed that there were independent reasons that ILECs might want to maintain their local dominance and not invest large sums of time and resources on a competitor's turf, especially in a concentrated market where interdependent conduct is consistent with rational and competitive business strategy. *Id*. at 18-22. Thus, the Court concluded, "[w]hen we look for plausibility in this complaint, we agree with the District Court that plaintiffs' claim of conspiracy in restraint of trade comes up short." *Id*. at 18.

Despite this antitrust-specific discussion, the Court's rejection of the "no set of facts" standard adopted in *Conley* may impact the *de facto* pleading requirements in federal suits in non-antitrust federal cases. It is this possibility that apparently provoked the passionate dissent of Justice Stevens, writing also on behalf of Justice Ginsburg. Much of the dissent consisted of a detailed discussion of the pleading standards under the Federal Rules of Civil Procedure, and the continued relevance of the *Conley* "no set of facts" standard. *See Bell Atlantic Corp. v. Twombly*, dissenting slip op. at 4-19 (May 21, 2007) (Stevens, J.). It seems clear that Justice Stevens believes the pleading model contemplated in the majority opinion may "inure to the benefit of all civil defendants." *Id*. at 27.

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