Federal Trade Commission/Department of Justice Hearings on Antitrust and Intellectual Property Law and Policy

Statement of
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Thank you for the opportunity to speak to you today about the intersection of antitrust and intellectual property law and policy, and in particular to address the important topic of refusals to deal or refusals to license intellectual property. My name is Mark Whitener, and I am Antitrust Counsel for General Electric Company. Before joining GE, I served as Deputy Director of the FTC's Bureau of Competition where I supervised the FTC's non-merger enforcement in matters involving intellectual property and other issues. While at the FTC I worked on the *Intellectual Property Guidelines,* which I believe continue to provide highly useful and sensible guidance in this area. Today I will attempt to provide the perspective of someone who believes strongly in the role of antitrust in the global economy, and who counsels a company that has long been an important contributor of innovation and technology development. I should emphasize that the views I state today are my own and not necessarily those of GE.

I will begin by describing some of the difficulties that the uncertain state of the law governing refusals to deal creates for those who counsel intellectual property owners. Then I will offer my views on the proper role of antitrust in this area, including suggestions as to how the U.S. antitrust agencies might address this issue in a manner that is consistent with both the fundamental mission of the antitrust laws and with the interests of innovators and the consumers who benefit from investments in innovation.

The Ninth Circuit's decision in *Image Technical Services v. Eastman Kodak Co.*[1] is largely responsible for introducing uncertainty into what was previously a fairly well-settled area of the law – the right of intellectual property owners unilaterally to refuse to license their IP rights to others. As my colleague Ron Myrick pointed out in his testimony before these hearings, the Federal Circuit's rejection in *Xerox*[2] of the Ninth Circuit's analysis, while a positive development, does not eliminate this uncertainty, since patent holders that may face litigation in the Ninth Circuit must still heed that court's analysis in exercising their patent rights.[3] This is not merely a regional issue, of course; any firm operating nationally or globally is likely to be subject to the law of the Ninth Circuit, and therefore the *Kodak* decision remains a major factor in the antitrust analysis of refusals to license patent rights.

Many commentators, including participants in today's panel, have discussed the implications of the Ninth Circuit's *Kodak* decision. As I will make clear later in my remarks, I do not believe it is the proper role of antitrust enforcers, or courts applying the antitrust laws, to regulate the circumstances (much less the terms and conditions) under

1 125 F.3d 1195 (1997).

2 *In re Independent Service Organization Antitrust Litigation*, 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied sub nom, CSU LLC v. Xerox Corp., 531* U.S. 1143 (2001).

3 Testimony of Ronald Myrick before the FTC/DOJ Hearings on IP and Antitrust at 13-16 (March 19, 2002) ("*Myrick statement")*, *available online at* <
http://www.ftc.gov/opp/intellect/020319ronmyrickpreparedtestimony.pdf>.

which owners of intellectual property must share that property with others. Instead, the role of antitrust is properly understood as law enforcement, not regulation, applying legal standards that focus on prohibiting conduct that is exclusionary or collusive, and that can reasonably be understood and applied by businesses. Indeed, the very confusion engendered by the Ninth Circuit's ill-conceived analysis in *Kodak* makes this point fairly eloquently, because one of the many problems with trying to apply antitrust to refusals to deal lies in the inherent difficulty of coming up with sensible analytical standards on which to base such intervention. I will focus on two aspects of the confusion – and resulting difficulties in antitrust counseling – that arise from the Ninth Circuit's *Kodak* decision: the artificial subdivision of intellectual property rights into multiple "markets" for purposes of determining whether a refusal to license improperly extends those rights from one market to another; and the misplaced analysis of subjective intent and "pretextual" motivations for a refusal to license.[4]

First, despite its inability to find any reported decision where a patent or copyright holder's unilateral refusal to license had been the basis for antitrust liability, the Ninth Circuit (in erroneous reliance on a footnote in the Supreme Court's 1992 *Kodak* decision)[5] concluded that Kodak's parts policies had improperly extended its monopoly in the market for parts for its equipment into the market for copier service. The fundamental error here was the conclusion that antitrust theories relating to the improper

[4] I will not address here some other, perhaps equally important, areas where the antitrust analysis of IP rights has at times gone awry, including the arbitrary equation of IP rights with market power by some courts and commentators, and the failure properly to define relevant markets in some cases (particularly those cases involving parts, services and software that are related to a primary equipment market).

[5] *Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451, 480 n.29 (1992).

extension of intellectual property rights from one market to another are applicable to a unilateral refusal to deal in patented property, where the patent rights at issue can be said to encompass multiple antitrust markets. The court was not deterred by the fact that any power allegedly possessed by the patent owner stemmed from the same intellectual property regardless of which "market" was said to be affected, and that any alleged extension of that power resulted from the refusal to share that same common core of intellectual property. If the Ninth Circuit's approach were accepted as the correct standard for refusals to license, then virtually any time the subject matter of a patent is applicable in more than one end-use in which the patent owner is active – which will often be the case – then (at least where monopoly power is found or inferred in one market) a simple refusal to license arguably can be viewed as an unlawful extension or leveraging of that position from the "primary" market encompassed by the patent into separate "markets."

This theory of liability not only reflects a fundamental legal and analytical error, it poses an enormous problem for counseling, risk assessment and business planning. Important business decisions become subject to *post hoc* assessments of how many "markets" are encompassed by a single IP grant. Not only should that question be irrelevant to the antitrust analysis of a refusal to deal, but the answer usually will be unknowable at the time the initial innovation is taking place.[6] This makes it very difficult to assess up front – when crucial investment decisions are being made – how a court

[6] *See, e.g.*, *In re ISO Antitrust Litig.*, 989 F. Supp. 1131, 1136 (D. Kan. 1997) (under the Ninth Circuit's standard, "[i]nventors rarely could refuse to license without fear that they had not properly defined the relevant antitrust market or considered how the relevant markets may be defined in the future.").

ultimately would evaluate key business issues such as whether a firm will be able to capture the full value of the technology it is developing, whether it will be forced to share the technology with others, and what sort of arrangements it can implement in developing and marketing products based on that technology. We can debate the precise extent to which these uncertainties chill procompetitive investments in innovation, but it must be the case that aggregate investment in innovation is less when innovators face greater uncertainty about their ability to capture returns on that investment and greater restrictions in how they go about doing so.[7]

A second problem with the Ninth Circuit's analysis in *Kodak* that raises serious problems in antitrust counseling is the court's conclusion that where patent rights relating to one market are allegedly being used to obtain a monopoly in another market, the patent holder must demonstrate a legitimate business justification for exercising its right under the patent to exclude others. The court compounded the problem by concluding that, while the desire to profit from the protection of IP rights is presumed to be a legitimate justification, that presumption may be rebutted by evidence that such a motivation is a "pretext" for some other, "anticompetitive" motivation such as a "hostility to competition." The court found evidence that Kodak's asserted IP justification was pretextual, including the fact that Kodak's parts manager testified that patents "did not

[7] *See, e.g.*, *SCM v. Xerox Corp*., 645 F.2d 1195, 1206 (2d Cir. 1981) ("If the threat of treble damage liability for refusing to license were imbedded in the minds of potential patent holders as a likely prospect incident to every successful commercial exploitation of a patented invention, the efficacy of the economic incentives afforded by our patent system might be severely diminished.").

cross [his] mind" when Kodak began its policy of selling parts only to end-users and not to competing service providers.[8]

Many commentators – including some who believe that unilateral refusals to license should be unlawful in certain instances – have pointed out the absurdity of this distinction-without-a-difference between a subjective desire to "protect intellectual property rights" (legitimate) and a desire to "eliminate competition" (improper). Of course, both characterizations describe the same fundamental business objective – to extract the full value of one's IP rights by, among other things, preventing others from using those rights. Legally and analytically, an inquiry into the subjective intent behind a refusal to license is unsound, since exclusion of competitors from using one's patents "may be said to have been of the very essence of the right conferred by the patent, . . . without question of motive."[9] Antitrust liability should not turn on how IP owners express their lawful intention to exercise their right to exclude. From a counseling standpoint, the Ninth Circuit's distinction between legitimate and "pretextual" assertions of patent rights is both unworkable in practice and very difficult to explain to business people who want to know how to ensure that their activities are lawful. As the district court noted in *Xerox*, under the Ninth Circuit's standard in *Kodak*, liability can turn on the existence or absence of "a self-serving memorandum in the files of a corporate

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[8] 125 F.3d at 1219.

[9] *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405, 429 (1908).

executive, which states that the company is refusing to license its products because they are patented . . . ."[10]

It always makes sense for business people to avoid creating documents suggesting a desire to harm any competitor or the competitive process, and to make clear in documents and discussions the positive, procompetitive benefits of business activities. But it is not at all clear whether business people can ever confidently stay on the right side of the *Kodak* "pretext" analysis when precisely the same motivation, and even the identical language, could be found to fall on either side of the line. When the analysis of such motivations is treated as a question of fact for the jury in an antitrust case, IP owners are exposed to real-world risks of treble damages in situations where they have done nothing more than attempt to keep what they created. And, perversely, the magnitude of that risk increases as the value of the intellectual property increases. All else being equal, a more important innovation may be more likely to be portrayed as creating market power, as encompassing multiple end-use markets, and as something that competitors "need" in order to compete with the innovator. This creates a situation where it is precisely those innovations offering the greatest benefits to society that are the most likely to be chilled.

The Federal Circuit's decision in *Xerox* refuted the Ninth Circuit's analysis in *Kodak.* Most commentators agree that the Federal Circuit reached the right result in that

[10] 989 F. Supp. at 1141. *See also, e.g.,* Carl Shapiro, *Competition Policy and Innovation,* OECD STI Working Papers 2002/11, at 13 ("The *Kodak* case is a good example of legal formalisms triumphing over economics and common sense").

case, and many agree that the antitrust analysis of refusals to deal in IP rights was better off before the Ninth Circuit's *Kodak* decision. At the same time, the *Xerox* decision has not been received with uniform approval, so it is useful to examine the various categories into which much of the criticism of *Xerox* falls.

First, of course, there are those who support a broad-based duty to share IP rights in various circumstances and who fundamentally disagree with the analysis in *Xerox*. Second, some object to the idea that a category of conduct such as refusals to license patent rights should be given "immunity" from antitrust liability. They point to the principle espoused in the *Intellectual Property Guidelines*[11] that the same basic antitrust principles apply to various forms of property rights and argue that any particular conduct should be analyzed on its own facts without the benefit of any "special protection" for intellectual property. Third, some do not quarrel with the outcome in *Xerox* but take issue with the Federal Circuit's dictum describing purported exceptions (tying, fraud on the patent office and sham litigation) to the right of an intellectual property owner to unilaterally refuse to deal,[12] and point to other situations involving refusals to deal where they believe antitrust liability should be imposed.[13]

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[11] U.S. Department of Justice and Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* (1995).

[12] 203 F.3d at 1327.

[13] *See, e.g.,* Robert Pitofsky, *Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy* (March 2, 2001). In his article *Antitrust Liability for Unilateral Refusals to License Intellectual Property: Xerox and its Critics*, INTELL. PROP. NEWS. (A.B.A. Antitrust Section, Intell. Prop. Committee), Spring, 2001, Jon Gleklen responds to many of these points, provides a strong defense (as counsel to Xerox in the ISO litigation) for the fundamental soundness of the result in that case, notes that the dictum about "exceptions" to the right to refuse to deal is in various respects superfluous or flawed, and comments on former Chairman Pitofsky's suggestions that there are other possible exceptions that the Federal Circuit did not address.

As noted above, I disagree with the critics of *Xerox* in the first camp. As for the third, I think it is fair to point out that the Federal Circuit's dictum was not especially insightful, accurate or complete. But if the concern about that dictum is that it meant to describe the full range of IP-related activities *other than* unilateral refusals to deal that might run afoul of the antitrust laws in certain circumstances, this concern seems to me overblown, since the court's language did no such thing.

It is the second category of criticism of *Xerox* noted above that I want to address: that antitrust and intellectual property policies are not fundamentally in opposition; property is property; and as a policy matter it is preferable to avoid categorical rules of legality or immunity, but rather to consider on a case by case basis whether particular conduct runs afoul of some legitimate theory of competitive harm. This sounds like a flexible approach and therefore might seem reasonable at first blush, but as applied to unilateral refusals to deal in intellectual property, I think it is wrong, for several reasons.

First, the legal and statutory arguments that were advanced in *Xerox*, and that are addressed in other statements at these hearings, establish in my view that Congress has indeed afforded special protection to intellectual property, so that antitrust analysis is not writing on a clean slate at least where patents are concerned.[14] Second, critics of categorical legality for unilateral refusals to deal in IP point to situations where they

[14] *See, e.g., Gleklen,* n.10 *supra; Myrick statement* at 13-16. The *Xerox* decision itself is not a model of clarity, and the arguments in support of its holding may have been better stated by others than by the court itself.

believe liability should be imposed, but the situations they describe often involve conduct other than a pure refusal to deal that readily would be analyzed under a traditional antitrust theories relating to tying, exclusivity, or other competition-limiting conditions.

Third, many of the critics of a broad right to refuse to deal fail, in my view, to offer a coherent analytical framework under which refusals to deal or refusals to license should be analyzed. It is not enough to say that refusals to deal can be analyzed under the general Section 2 framework of "exclusionary" conduct. This begs all sorts of questions. For example, it is widely accepted (in the United States at least) that it is not unlawful merely to possess monopoly power, or to exercise it by (for example) charging monopoly prices. And it was fairly clear before the Ninth Circuit's *Kodak* decision that unilateral refusals to deal in intellectual property (and indeed in other forms of property) were ordinarily not viewed as unlawful exclusionary conduct. When, and why, should a unilateral decision not to share intellectual property be viewed as an "exclusionary" act rather than the mere "exercise" of monopoly power (if that) in the same category as supracompetitive pricing? Moreover, critics of a broad right to refuse to deal seldom address a very important issue: if an IP owner is required to share its IP rights, then on what terms and at what price, and who decides? Neither courts nor, for that matter, antitrust authorities are particularly well-equipped to act as price regulators.[15] Finally, a

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[15] Note that in *Kodak* the Ninth Circuit overturned an injunction requiring Kodak to sell at "reasonable" prices and permitted Kodak to charge "any nondiscriminatory price the market will bear." 125 F.3d at 1225-26. The problems with having the courts or enforcement authorities seek to determine "reasonable" prices have been widely noted. The alternative of mandating "nondiscriminatory" pricing raises other, equally serious concerns. What is the proper benchmark against which a discrimination is to be measured? What if the IP owner charges everyone equally high, profit-maximizing prices? And how to deal with the fact that, as even some proponents of liability for certain unilateral refusals to deal acknowledge, "there is no antitrust prohibition against a patent owner's using price discrimination to maximize his income from the patent"? *USM Corp. v. SPS Technologies*, 694 F.2d 505, 512-13 (7th Cir. 1982), *cited in* A. Douglas

rule of reason analysis requires a consideration of the justifications for the conduct in question. How is the innovator's legitimate (indeed, statutory) interest in capturing the full return on its investment in innovation taken into account, and when (and why) would it ever be trumped by other interests?

When antitrust is properly understood as a system of law enforcement against specific anticompetitive conduct, and enforced according to well-established analytical principles, then antitrust creates no tension with the policies of the intellectual property laws, because fundamentally it does not call into question the right of an owner of intellectual (or other) property to share or refrain from sharing that property with others and thereby to capture the full economic value of that property. If there is ever to be a policy decision that certain intellectual (or other) property must be shared with others, I do not believe antitrust law is the proper vehicle for such a decision, regardless of whether it is wielded by antitrust enforcers or by the courts at the behest of private litigants.

When they are founded on sound economic principles, and enforced consistently with those principles, the antitrust laws play an important role in preventing activities that harm competition and undermine efficiency. But there is a critical element to what constitutes sound antitrust policy that is sometimes overlooked or ignored, and that is relevant to today's discussion of refusals to deal or refusals to license intellectual property. In this area in particular, it is essential to keep in mind that antitrust is

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Melamed and Ali M. Stoeppelwerth, *The CSU Case: Facts, Formalism and the Intersection of Antitrust and Intellectual Property Law*, 10:3 Geo. Mason L. Rev. 1, 10 n.42 (2002).

fundamentally about law enforcement – the application of laws to specific activities that are found to violate the law, in light of consistent and transparent standards, and therefore need to be prohibited – and not a system of economic regulation in which activities are judged for consistency with whatever policy preferences may prevail at the time.

The stated topic of today's panel is "The Strategic Use of Licensing: Is There Cause for Concern About Unilateral Refusals to Deal?" Let me respectfully suggest that the relevant question where antitrust policy and enforcement is concerned is not whether some may have "concerns" over refusals to deal that may reflect policy preferences for broader diffusion of certain technologies than the IP laws afford. Instead, the question is whether a refusal to share intellectual property should be viewed as an actionable offense under the antitrust laws. If we leave aside hard cases that might raise line-drawing issues as to what constitutes a simple or "pure" refusal to share intellectual property as opposed to "conditional" licensing or some other conduct that might be analyzed under a different analytical rubric, then it seems to me that the answer is, simply, no.

The 1995 *Intellectual Property Guidelines* are, in my view, among the most successful guidelines the antitrust agencies have issued – not as groundbreaking, perhaps, as the Bill Baxter's 1982 Horizontal Merger Guidelines, but important nonetheless. Government guidelines should seek to state the agencies' enforcement policy in a manner that is clear and concise; should provide guidance to the business and legal communities by addressing situations that they confront in the real world; and should reflect a synthesis of current law while also helping to clarify the law in an economically sensible manner when the law is uncertain or in a state of flux. I believe the *Intellectual Property Guidelines* succeeded on all fronts, and they have received considerable, bipartisan praise. Equally importantly, in my experience they are actually *used* by lawyers and business people who are engaged in the development and usage of IP rights. Among other things, the *Guidelines* clearly and practically address how the antitrust laws apply in various situations that businesses frequently confront.

In particular, the *Guidelines* embody – both expressly and implicitly – the view that while there are various activities relating to intellectual property that can violate the antitrust laws, unilateral refusals to license are not among them. Expressly, they point out that even if, in fact, a grant of intellectual property rights does confer market power on the IP owner, the possession of market power is not itself an offense under the antitrust laws, "nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others" (Section 2.2). The *Guidelines* also make clear that although certain restrictive licensing arrangements (like other types of agreements) can harm competition among competitors, "[t]he Agencies will not require the owner of intellectual property to create competition in its own technology" (Section 3.1). Implicitly, the *Guidelines* treat unilateral refusals to license as outside the prohibitions of the antitrust laws because in enumerating the various ways in which IP arrangements can be unlawful, nowhere do the *Guidelines* suggest that a unilateral refusal to deal is potentially actionable, much less articulate an analytical framework under which such a refusal would be examined and possibly challenged.

Some have suggested that the *Guidelines* could be clearer in rejecting refusal to deal theories. It has also been pointed out that the *Guidelines* could be read to imply that the language in Section 271(d) the Patent Act – which the Federal Circuit found in *Xerox* bars both misuse and antitrust claims founded on a refusal to license – only applies to the misuse defense.[16] In addition, since the *Guidelines* were issued the Justice Department in the Clinton Administration opposed categorical protection for refusals to deal in its brief to the Supreme Court opposing certiorari in *Xerox*.[17]

I can understand why the agencies might have wanted at that time to be careful not to undermine their enforcement prerogatives, or cases that were in litigation, by endorsing a seemingly broad "immunity" to the antitrust laws. But special protection for certain activities or types of property is not the issue here. Instead, the issue is the proper role of antitrust itself. Enforcers will have plenty to do, and can have a substantial and beneficial impact on competition and consumers, if they investigate and challenge on conduct that is anticompetitive under well-accepted antitrust theories. No meritorious case or legal theory would be undermined if the agencies were to clarify that "pure" unilateral refusals to deal in intellectual property do not violate the antitrust laws.

Private litigants are another matter. They serve, by definition, private rather than public interests. The agencies, however, can play a vital role in shaping the law and encouraging courts to move in the right direction. Many positive developments in

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[16] See *IP Guidelines*, Section 5.3 n.36.

[17] *CSU, L.L.C. v. Xerox Corp., Brief for the United States as Amicus Curiae* (Jan. 2001).

antitrust law have been promoted by advocacy from the federal antitrust agencies in the form of guidelines, litigation, amicus briefs and other policy statements. And the agencies can be a positive influence not only with domestic courts but also with antitrust authorities and courts in other countries. Antitrust has become a truly global issue, with more countries enacting laws, establishing and funding enforcement agencies and challenging business conduct. Decisions in the European Union and elsewhere have dealt with refusals to deal in ways that may be no more persuasive than the Ninth Circuit's analysis in *Kodak*.[18]

I urge the FTC and the Department of Justice to finish the job that the *Intellectual Property Guidelines* started. Make it clear, in the *Guidelines* and any other appropriate forums, that unilateral refusals to license intellectual property do not violate the antitrust laws and will not be challenged. Confront other issues as needed, such as distinctions between "pure" and "conditional" refusals to deal. And, of course, continue to enforce the law in areas relating to intellectual property and other forms of property as well, where there is a sound legal and economic basis to do so. These hearings are an ideal way for the agencies to gather needed input and then to formulate policy statements that will restore coherence to this critical area of antitrust law while promoting innovation and competition.

Thank you for the opportunity to discuss these issues with you today.

[18] *See, e.g., RTE and IPC v. Commission ("Magill"),* Joined Cases C-241/P and C-242/91 P (European Court of Justice 1995).