Federal Trade Commission

DISTINGUISHING UNILATERAL CONDUCT FROM AGGRESSIVE COMPETITION

REMARKS

of

CHAIRMAN DEBORAH PLATT MAJORAS[1]
FEDERAL TRADE COMMISSION

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I am delighted to be in Tokyo and here with you at the Tokyo America Center. Currently, thousands of visitors are in Washington, D.C. enjoying the blooming of the beautiful cherry blossoms. Those cherry trees, of course, were a gift from the Mayor of Tokyo, to enhance the growing friendship between Japan and the United States and to celebrate the continued close relationship between our two nations – a relationship that has continued to blossom. Likewise, the relationship between the Japan Fair Trade Commission and the U.S. Federal Trade Commission, as well as our sister agency, the United States Department of Justice Antitrust Division, is strong, as we work bilaterally and through international organizations to meet the challenges of modern competition enforcement. I appreciate the opportunity to appear before

[1]The views stated here are my own and do not necessarily reflect the views of the Commission or any other Commissioner.

you today and to offer some thoughts on some of the most challenging issues facing the FTC, as well as the JFTC and other competition agencies around the globe, today.

Drawing the Line Between Monopolization and Aggressive Competition

There is perhaps no more challenging issue for a competition enforcer – as well as for courts, the antitrust bar, and the business community – than determining the bounds of lawful conduct for a single firm that has, or is attempting to gain, market power. And the challenge may only increase when intellectual property issues are present. Enforcers around the globe are nearly uniform in their desire to improve capabilities in this area, and the FTC is no exception.

Section 2 of our Sherman Act outlaws monopolization or attempts to monopolize, proscribing exclusionary or predatory conduct that likely will create or maintain monopoly power. Determining what is "exclusionary" or "predatory" is not always easy, though, because conduct that might be labeled exclusionary looks a lot like aggressive competitive conduct, which we want to encourage. As described by one court, distinguishing between legitimate business practices and unlawful monopolization conduct requires "the must subtle of economic judgments about particular business practices."[2] Fortunately, though, our courts have provided some principles and guidance for enforcers in this area. As the U.S. Supreme Court recently reaffirmed, the offense of monopolization requires not only the possession of monopoly power in the relevant market, but also "'the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business

[2]*Goldwasser v. Ameritech Corp*., 222 F.3d 390, 397 (7th Cir. 2000).

acumen, or historic accident.'"[3] In the words of our great American jurist Learned Hand, who delivered a significant antitrust opinion in 1945, "size alone does not determine guilt; . . . there must be some 'exclusion' of competitors."[4] The company that, "by virtue of [its] superior skill, foresight and industry," prevails over its competitors should not be condemned as having violated antitrust laws.[5] Put more simply, "[t]he successful competitor, having been urged to compete, must not be turned upon when he wins."[6]

Our Supreme Court explained why that principle is so important in a significant decision handed down just two years ago: "The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices – at least for a short period – is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth. To safeguard the incentive to innovate, the possession of monopoly power will not be found unlawful unless it is accompanied by an element of anticompetitive *conduct.*"[7]

In a recent FTC example, in *In re Unocal*, the FTC alleged that the anticompetitive conduct in which Unocal engaged was a deceptive "hold up" in the standard-setting context. The California Air Resources Board ("CARB") was developing mandatory standards for certain

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[3]*Verizon v. Trinko*, 540 U.S. 398, 407 (2004) (quoting *United States v. Grinnell*, 384 U.S. 563, 571 (1966)).

[4]*United States v. Alcoa*, 148 F.2d 416, 429 (2d Cir. 1945).

[5]*Id.* at 430.

[6]*Id.*

[7]*Trinko*, 540 U.S. at 407 (emphasis in original).

low-emission gasoline products.[8] The FTC charged in an administrative complaint that Unocal had misrepresented to CARB that certain gasoline research was non-proprietary and in the public domain.[9] Yet, Unocal was allegedly secretly pursuing patent rights at the same time – rights that would allow it to charge companies producing CARB-mandated gasoline substantial royalties if its intellectual property became part of CARB's standards. Unbeknownst to CARB, the standards it adopted did in fact incorporate Unocal's intellectual property, and the resulting high royalties to Unocal would likely be passed on to consumers, resulting in up to $500 million in additional consumer costs, the Commission's complaint alleged. Thus, the anticompetitive conduct alleged was that Unocal misrepresented the status of its intellectual property in order to ensure that it would become part of the standard and enable Unocal to charge royalties. This could be distinguished from gaining the ability to charge royalties based on a superior product, business acumen, or historic accident.

Unocal settled the case with the Commission last summer, entering into two consent decrees that resolved those hold-up allegations as well as the issues surrounding Chevron's proposed $18 billion acquisition of Unocal. Under the consent agreement, Chevron agreed not to enforce the Unocal patents.[10]

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[8]Specifically, it was alleged that CARB was engaged in rulemaking proceedings to determine "cost-effective" regulations and standards governing the composition of low emissions, reformulated gasoline ("RFG").

[9]Complaint *In re Unocal and In re Chevron and Unocal* (Mar. 4, 2003), *available at* http://www.ftc.gov/os/2003/03/unocalcmp.htm.

[10]*See* Statement of Federal Trade Commission, *In re Unocal and In re Chevron and Unocal* (Aug. 2, 2005), *available at* http://www.ftc.gov/os/adjpro/d9305/050802statement.pdf.

Despite guidance from cases like these, this is an area that still creates substantial uncertainty for companies, as they endeavor to incorporate legal principles into business practices. Global firms, in particular, are concerned about such uncertainty multiplied by the numerous jurisdictions in which they operate, as well as the costs of adapting their conduct to the differing rules of various jurisdictions. At the FTC, our job is not limited to identifying antitrust violations and challenging them. We also were established by Congress to do competition policy "research and development," searching for better antitrust policies and standards that enhance competition and benefit consumers. The FTC has long recognized the public interest in advancing knowledge in the area of the most challenging legal issues concerning antitrust and consumer protection. Indeed, in recent years, the FTC, together with the DOJ, has conducted a number of public hearings designed to inform decision-makers on vital issues affecting consumers and the economy. For example, we have held hearings and workshops on issues such as competition in health care, on competition policy in the real estate industry, and on the interface between antitrust and intellectual property law.

Later this year, the Agencies will continue these efforts by holding a series of public hearings designed to examine single-firm conduct. The hearing participants will include business officials, lawyers, economists, academics, and other interested parties. These experts will discuss the standards used in recent Section 2 cases and consider what economic learning contributes to the analysis with respect to exclusionary or predatory conduct. The primary goal of the hearings will be to identify the best thinking on the boundaries under Section 2 between unilateral conduct that is legitimate, pro-competitive, or benign, and unilateral conduct that is anticompetitive and harmful to consumers. In a recently published Federal Register notice, we

solicited public comment on the specific types of conduct reviewable under Section 2 that may raise antitrust concerns in a variety of industries.

It is important to get this right. Under-enforcement of the monopolization laws risks permitting firms to continue to engage in unlawful, exclusionary conduct that harms consumers. But when we over-enforce the monopolization laws, we risk chilling pro-competitive business conduct that benefits consumers. That can lead to serious problems, both within the United States and, beyond our borders. At home, challenging procompetitive conduct can undermine healthy business practices that spur competition to serve consumers better, offering them lower prices or enhanced innovation. Abroad, inconsistent antitrust enforcement can put international firms in the impossible position of having their business conduct reviewed under different standards that lead to conflicting results around the globe. As we seek to promote convergence worldwide, we hope that our hearings will bring some clarity to the issue of the enforcement of the monopolization laws.

In addition to our own hearings, the FTC (and DOJ) will work through these important issues with our non-U.S. counterparts on a multilateral basis, particularly through the International Competition Network ("ICN"). The ICN will convene a new working group on unilateral conduct by dominant firms, the main area of competition law that it has thus far not addressed. Given the importance that we attach to the ICN's work, the FTC has offered to co-chair this new working group. We expect the Unilateral Conduct Working Group to be launched at the ICN's annual conference this May, and we look forward to working with agencies and private sector representatives around the world to bring greater understanding and convergence to this crucial area.

Intellectual Property and Antitrust

Increasingly, the business conduct we examine occurs in industries heavily characterized by intellectual property ("IP"), and patents in particular, sometimes adding an additional layer of complexity to our antitrust analysis. At their core, patent law and competition law share a common goal: to promote innovation. Patents, as property rights, provide protection against copying and thereby offer incentives to innovate. Patents also promote the public disclosure of knowledge that otherwise might be held as trade secrets. Competition, too, drives innovation, as fear that a rival is getting ahead provides a powerful incentive to innovate. The intersection of patents and competition law presents new issues in enforcement and in policy-making.

Accordingly, in this area too, the FTC has turned to research to inform our own actions, as well as those of other policy-makers, and the public. In 2002, for example, we launched a series of intellectual property hearings, co-hosted with DOJ. The hearings, which lasted 24 days and included presentations by more than 300 panelists and numerous written submissions, led to a major report in October 2003: *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*. The FTC's Report, while strongly endorsing a properly functioning patent system, also states that competition can be harmed when the system grants a patent that should not have been granted. If that "wrongfully granted" patent confers market power, it can raise price in the short run and hinder follow-on innovation in the long run – without promoting any of the laudable objectives of a well-functioning patent system. In light of these findings, our Report recommended measures to promote better patent quality at the U.S. Patent and Trademark Office ("PTO").

After we issued that 2003 report, the National Academy of Science's STEP Board and the American Intellectual Property Law Association ("AIPLA") produced their own reports and suggestions, many of which overlapped with the FTC. All three organizations – the FTC, the National Academies' STEP Board, and the AIPLA – then co-sponsored a series of Patent Reform public meetings around the country to solicit the views of practitioners, inventors, and the general public on proposals for patent reform.

Last spring, Congress pursued many of the ideas generated in the reports, holding hearings on the key issues. The FTC's recommendations are reflected in a bill, currently pending in the House of Representatives, designed to improve the quality of patents that the government issues and reduce unnecessary litigation. We are hopeful that further progress can be made on patent reform legislation introduced by Rep. Lamar Smith (R-Tex.) that addresses post-grant review, as well as other important patent reform issues.

In addition, the FTC and DOJ's Antitrust Division are working on a second report based on the 2002 intellectual property hearings, which will address competition issues raised by transactions involving intellectual property, particularly patents. The report will build on the solid foundation provided by the two agencies' joint Antitrust Guidelines for the Licensing of Intellectual Property.

Applying Monopolization Principles and Learning In Practice

We also engage in substantial research to better inform our investigations and case selection and to assist policy-makers with competition issues. In several recent cases before the United States Supreme Court, we have relied on our knowledge to advise the Court on significant issues.

In *Verizon v. Trinko,* a key recent decision in the single-firm conduct area, the FTC and the DOJ jointly filed an *amicus* brief with the Supreme Court arguing that the antitrust laws did not condemn the conduct in question, and the Court agreed. The backdrop for the case was the Telecommunications Act of 1996, which required incumbent local phone companies, such as Verizon, to share their networks with new entrants to the local phone market such as AT&T. A New York City law firm that was an AT&T local telephone service customer alleged that Verizon had not complied with its statutory obligations to provide unbundled access to AT&T, and that this was part of an anticompetitive scheme that violated the antitrust laws.

The Supreme Court disagreed. The Court held that a Section 2 violation requires both monopoly power and anticompetitive conduct, and stressed that, in general, a party can decide with whom it chooses to deal, with this case presenting no exception. The court analyzed the costs of forced sharing, a point that the antitrust enforcement agencies had emphasized in the *amicus* brief. Compelling firms:

> to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities. Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing – a role for which they are ill-suited. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion.[11]

The Court explained that the fact that conduct may violate the 1996 Telecommunication Act did not inform the analysis under Section 2 because the Telecommunication Act did not alter the antitrust laws.

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[11] *Trinko*, 540 U.S. at 407-08.

The most recent and notable judicial development regarding the antitrust and intellectual property interface is the Supreme Court's holding in *Illinois Tool Works Inc., et al. v. Independent Ink, Inc.*[12] Again, the FTC, together with the DOJ, submitted a joint *amicus* brief. In this case, which involved the sale of an unpatented product that was tied to the sale of a patented product, we urged the Supreme Court to rule that market power is not presumed from the presence of a patent. In sum, we argued that such a presumption of market power is contrary to modern tying law and current economic learning. Justice Stevens, writing for a unanimous Court, agreed.

The case was brought by a supplier of printer ink that manufactures ink usable in a patented ink jet printhead system manufactured by the defendant. The defendant licenses its products to printing equipment manufacturers. The supplier objected that the defendant had required the printing equipment manufacturers to use only ink supplied by defendant (which is not patented) in single-use containers and prohibited manufacturers and end users from refilling these ink containers.

The plaintiff alleged that the defendant's actions amounted to unlawful tying in violation of Section 1 of the Sherman Act. The plaintiff relied on a *per se* theory of liability and asserted that the patents gave rise to a presumption that the defendant had market power in the printhead system. The United States Court of Appeals for the Federal Circuit held that Supreme Court precedent required it to recognize a presumption of market power in these circumstances, even as it acknowledged that the presumption had attracted substantial criticism from academics and antitrust enforcement agencies.

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[12] 126 S. Ct. 1281 (2006).

The Supreme Court reversed the Federal Circuit and overruled its old precedent that established the presumption in the first place, concluding that the legal and economic foundations for that precedent had been eroded. After outlining the historical roots of the presumption, the Court's decision showed that those historical underpinnings are no longer valid. It noted that Congress has signaled its displeasure with the presumption in a related area of law; that economists almost uniformly believe that the presumption is inappropriate; and that the antitrust agencies have expressly disavowed the presumption.

What I find most exciting and encouraging about the case is that it shows the Court being influenced by "extensive scholarly comment and a change in position by the administrative agencies charged with enforcement of the antitrust laws."[13] Whatever our views on the presumption in the past, the agencies have made clear for at least the past ten years that we do not "presume that a patent, copyright, or trade secret necessarily confers market power upon its owner."[14] The Court cited that view in support of its decision to jettison the presumption, holding that "a patent does not necessarily confer market power upon the patentee."[15] Old assumptions that patents convey market power – like assumptions that patents amount to essential facilities per se – are outdated, with the evidence amassed over time suggesting a more varied picture. Some patents may convey market power; many do not. We have to look at the evidence to tell which is which.

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[13] *Id.*, slip op. at 3.

[14] U.S. Dep't of Justice & FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* § 2.2 (1995).

[15] *Independent Ink*, slip op. at 16.

The Supreme Court currently has another important intellectual property case on its docket: *eBay v. MercExchange.* The question presented in this case is whether the U.S. Court of Appeals for the Federal Circuit erred when it announced a "general rule" favoring injunctive relief after a finding of patent infringement. Because the grant or denial of patent injunctions may directly affect competition and innovation in the marketplace, this case implicates questions of core concern to the FTC and DOJ, and the United States government as a whole.

On March 10, the United States filed an amicus brief supporting the respondent, MercExchange, and urging the Court to consider the broader implications of this case. The United States reasoned that the Patent Act's provision that injunctions shall issue "in accordance with the principles of equity" directs the district courts to consider the risk of irreparable injury, the adequacy of legal remedies, the balance of hardships, and the public interest before granting an injunction. Because a patent confers a statutory right to exclude others from using a patented invention, continuing infringement normally will result in irreparable injury. This will not always be the case, however, and the decision of whether injunctive relief is appropriate necessarily must turn on the facts of each case. Although the FTC was not a signatory to the United States' brief, our staff provided comments that were influential to the government's position in this case.

The FTC now has asked the Supreme Court to review one of our recent intellectual property cases: *In re Schering-Plough.* In that case, the FTC challenged, agreements that Schering, a manufacturer of patented drugs, made with two generic drug manufacturers pursuant to which Schering paid the generics to delay the sale of their products. The Commission sustained the challenge, but on appeal, the U.S. Court of Appeals for the Eleventh Circuit ruled

that the agreements were proper means of settling patent litigation and that Schering's paying the generics to delay entry was not an antitrust violation because Schering's patents constrained the generics from entering in the first place. We are seeking *certiorari* in the Supreme Court now because we believe that the court of appeals essentially imposed a rule that a patentee is presumptively entitled to buy protection from all generic competition for the full patent term, even if such payments effectively augment the patent's actual power.

In Schering, we are not making any broad pronouncements about the enforceability of intellectual property generally, or even about the enforceability of pharmaceutical patents. Indeed, as we recently reported, legitimate patent settlements – using means other than reverse payments – still occur today, undeterred by our actions in *Schering.* In *Schering*, we are simply taking the position that antitrust enforcement can be warranted when generic entry before the end of a patent term is relatively certain, especially since Congress has spoken on the issue through our Hatch-Waxman amendments, and because we know from our study of the industry that would-be generic entrants have prevailed in almost 75 percent of patent litigation initiated under Hatch-Waxman.

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Refining and clarifying the standards governing single-firm conduct, and understanding the proper interaction between antitrust policy and intellectual property, are two of the most exciting and cutting-edge challenges in competition policy today. The FTC will continue its work in both of these areas, and will work with our counterparts around the world in identifying best practices. I appreciate the opportunity to discuss these important issues with you today. Thank you.