The Role of Antitrust Enforcers in Dynamic High-Tech Markets

Skadden Arps / Compass Lexecon Symposium: Antitrust in the Technology Sector
Palo Alto, CA
Keynote Remarks of Commissioner Terrell McSweeney
As Prepared for Delivery
January 27, 2015

Good afternoon. Thank you, Steve, for the kind introduction. I would also like to thank Skadden Arps and Compass Lexecon for inviting me to speak at this event. It is terrific to be here at the heart of the technology sector.

Today I’m going to talk about the 21st century role competition enforcers play in dynamic high-tech markets. In the last year, we’ve celebrated the 100th anniversaries of both the FTC and the Clayton Act – which represent important 20th century innovations in antitrust law. The Sherman Act – America’s first significant antitrust law – is now 125 years old. It is sometimes said that antitrust and competition enforcers can’t keep pace with the change in high-tech markets, that our time-tested tools and doctrines developed to deal with trusts and monopolies in “traditional” markets are ineffective at addressing the dynamic economy of the 21st century.

I disagree. Modern antitrust law and enforcers are not only up to the challenge – they play a vital role in promoting innovative, open and competitive markets in three ways, by: (1) protecting competition and innovation through merger enforcement; (2) advocating for the competition introduced by innovators; and (3) working to keep the balance between competition and IP policy right.

Protecting Competition & Innovation in High-Tech Markets

First, well-designed merger enforcement that is grounded in economics permits mergers that are benign – or that, on balance, make consumers better off – while preventing mergers that substantially reduce competition and may harm innovation. The Horizontal Merger Guidelines are designed to be a flexible tool that can be applied regardless of industry. And the 2010 Horizontal Merger Guidelines include a new section that specifically addresses innovation effects, emphasizing the important role innovation plays in the agencies’ merger analysis.2

The FTC routinely challenges or obtains divestitures in mergers in the pharmaceutical space where there is evidence that the merger would harm competition in research and development for the treatment of various diseases. Section 7 of the Clayton Act calls for a forward-looking approach to mergers, and the FTC embraces that role. In Teva/IVAX, for example, the Commission required the merging parties to divest a pipeline generic product even

---

1 The views expressed in this speech are my own and do not necessarily reflect those of the Commission or any other Commissioner.

though both companies’ products were still in the development stage.³ Similarly, the Commission required a divestiture of competitive assets in Nielsen/Arbitron because the merging parties were the best-positioned firms to develop a cross-platform audience measurement product increasingly sought by media companies and advertisers – even though that product had “yet to be developed and marketed.”⁴

Last month the Commission challenged Verisk Analytics’ proposed acquisition of EagleView Technology. The challenge focused on rooftop aerial measurement, which is a relatively new product offering that uses aerial images to calculate the dimensions of rooftops, primarily for insurance purposes – such as when replacement is necessary after a tornado or other major storm. EagleView is the leading provider of rooftop aerial measurement products in the United States. Verisk is the leading provider of downstream software platforms, but it had also recently entered into rooftop aerial measurement and had begun investing in capturing higher-resolution aerial images to win insurance carriers away from EagleView. One of the things the FTC looked at was the likelihood of continued competition between EagleView and Verisk in offering customers more innovative products.⁵ There was strong evidence that Verisk was uniquely well positioned to compete against EagleView and that there were significant barriers to entry or expansion by other firms. While I don’t think there was anything particularly novel about the analysis in Verisk, it is nonetheless a reminder that the Commission takes innovation and quality competition seriously and is focused on the future effects of transactions.

They key lesson is that anticompetitive effects and harm to innovation must be offset by efficiencies – even in high-tech markets that are rapidly evolving and subject to potential disruption. As Judge Orrick wrote in upholding DOJ’s challenge of Bazaarvoice’s acquisition of PowerReviews, “while Bazaarvoice indisputably operates in a dynamic and evolving field, it did not present evidence that the evolving nature of the market itself precludes the merger’s likely anticompetitive effects.”⁶ The court in Bazaarvoice applied the Horizontal Merger Guidelines rigorously, focusing in particular on internal party documents, which described an anticompetitive rationale for the merger.

Advocating for Innovation & Disruption

Competition enforcers also play an important role in promoting innovation by advocating for disruptive entrants. The FTC has a relatively long history of advocating for competition at the state and local level. For example, in the last few years, the FTC has submitted comments to multiple cities and taxicab authorities urging that regulations be limited to legitimate safety and consumer protection issues, and not impede competition from new ride-sharing platforms such as


those offered by Uber and Lyft. Last year, FTC officials publicly criticized as “bad policy” state laws designed to protect the automobile dealership model from competition from Tesla’s direct-to-consumer sales strategy.\(^7\)

I also believe that competition plays a vital role in promoting better, faster Internet service, which is why I have been urging states to be cautious in overly restricting experimentation in broadband delivery at the local level.\(^8\)

These examples demonstrate that – far from playing catch-up when it comes to innovative products and services – the antitrust agencies are frequently out in front, using the principles of competition law to help ensure that new and exciting ideas have the opportunity to succeed on their merits.

Promoting Innovation: The Intersection of Competition and Intellectual Property

Finally, competition enforcers promote innovation by ensuring courts and policy makers balance competition principles and intellectual property protections. In particular, there are three areas at the intersection of IP and competition where the FTC is playing an active role: addressing reverse payment settlements in the pharmaceutical industry; studying the conduct of patent assertion entities (PAEs); and identifying the problem of standard essential patent “hold up.”

As an initial matter, I think it is important to recognize that the aims of competition law and intellectual property law are largely harmonious from a public policy perspective – both are intended to promote more and better products at lower prices. As an overarching principle, competition is the best method for achieving those ends – so in most cases, we trust the market to allocate resources efficiently.

Intellectual property rights are, in essence, a response to what would otherwise be a rather substantial market failure. Creating intellectual property can require a significant investment of time and resources. If competitors could simply appropriate intellectual property as soon as it was developed, the original creator might well fail to recoup her costs or benefit from her investment. Without some form of legal protection for intellectual property, we’d have a lot less of it.

From a competition perspective, intellectual property protections represent a valuable market correction that increases the output of intellectual property. Of course, the optimal level of protection varies by the type of intellectual property and the underlying industry.\(^9\) There is


\(^9\) Patents generally offer protection for 20 years, although extensions of that term are granted in certain circumstances. Hatch Waxman, for example, provides for patent extensions to account for the time necessary to obtain FDA approval for pharmaceuticals. The Orphan Drug Act provides for seven years of exclusivity for specific
thus the possibility that intellectual property protections may not go far enough in some situations and may go too far in others. What we are left with is a sort of high-wire balancing act. As Judge Posner has explained, “[t]he patent and copyright laws try to strike the output-maximizing balance by giving the creator of intellectual property some but not complete protection from competition.”

In this sense, I think the fundamental question at the heart of the intersection of competition and IP is how much of an adjustment we need to make to the market to correct for the failure that would otherwise occur. What level of intellectual property protection will maximize output? It is a difficult balancing act, but an important one, and the FTC (and the DOJ) are currently at the forefront of several important issues at this intersection of competition and IP.

Reverse Payments

The Commission is probably most well-known for its work related to reverse payment settlements (or “pay-for-delay” agreements). The settlement of a Hatch-Waxman patent infringement suit has the potential to cause competitive harm if the generic manufacturer agrees to delay its entry into the market in exchange for some sort of compensation from the brand name manufacturer that the generic could not have obtained even if it prevailed in the infringement litigation. In this situation, the brand and generic each make more money by sharing in the brand’s monopoly profits instead of competing – reducing output and harming consumers who pay higher prices for prescription drugs.

In the last year, the Commission actively engaged in both enforcement and in helping lower courts interpret the Supreme Court’s ruling in Actavis, which confirmed the harm to competition from reverse payment agreements. The issue of what constitutes a payment subject to antitrust scrutiny is currently playing out in a number of private actions across many different jurisdictions. The Actavis opinion only refers to “payments” and “money” but, in my view, nothing in the opinion suggests that the Supreme Court meant to limit its ruling to strictly cash, as opposed to in-kind compensation. From a competition perspective, of course, the form that a particular payment takes is irrelevant. The competitive harm results from the delayed entry of the lower-priced competitor, regardless of the form of compensation the incumbent chooses to use in order to secure that delay.

Last year, the Commission filed an amicus brief and participated in argument in the Lamictal direct purchaser litigation pending before the Third Circuit, explaining that a “no-authorized generic” commitment – whereby a brand refrains from marketing its own authorized generic in return for delayed generic entry – is a type of reverse payment subject to scrutiny following FDA approval, regardless of the drug’s patent status. Copyright law generally protects the work of authors for life plus 70 years.


11 Reverse payments are so-named because they involve the unusual circumstance of a plaintiff (the incumbent patent-holder) paying a defendant (the potential entrant) to settle litigation. The payment thus flows in the “reverse” direction of what one would commonly expect in a patent settlement.
under the Supreme Court’s analysis in *Actavis*. And in September, the Commission brought its first post-*Actavis* lawsuit, charging pharmaceutical companies with filing sham patent litigation suits against potential generic competitors to delay the introduction of lower-priced versions of the blockbuster testosterone replacement drug Androgel. The Commission also charged that those same pharmaceutical companies subsequently entered into an anticompetitive reverse payment agreement in the form of an authorized generic deal on an unrelated drug to delay generic competition with Androgel further.

**Patent Assertion Entities**

Another area in which the FTC is working to get the balance right between competition policy and IP is the conduct of patent assertion entities (PAEs). PAEs raise a number of significant questions from a competition policy perspective. Proponents of PAEs argue that they foster a valuable secondary market for patents, enabling inventors to capitalize on their ideas and encouraging venture capital firms to fund new projects. On the other hand, critics argue that PAEs divert resources away from manufacturing firms’ productive research and development efforts, take advantage of an imbalance in litigation costs between PAEs and defendants, and act as a drag on innovation. Fundamentally, this is a debate about whether PAEs enhance or reduce output.

The Commission believes that it is important to understand how PAEs do business and how they affect innovation and competition. The Commission hosted a workshop with the Department of Justice on the subject of patent assertion entities in 2012, and received approval this summer to use our 6(b) authority – which allows the FTC to compel production of information from market participants – to conduct a study on PAEs. Last year we issued information requests to approximately 25 patent assertion entities in connection with our PAE 6(b) study, as well as to approximately 15 non-practicing entities and manufacturing firms in the wireless chipset sector. The FTC intends to publish a descriptive report that will allow industry participants, policymakers, and academics to gain a better understanding of the PAE business model.

At the same time, the FTC is also using its authority to address the deceptive use of patent demand letters, and other potentially abusive tactics, by PAEs. For example, last year the FTC challenged MPHJ for sending tens of thousands of deceptive demand letters falsely threatening patent suits. MPHJ’s letters alleged that the companies were illegally sending emails of scanned documents from a networked copier – something I think most of us have done – without paying a licensing fee to do so. In its letters, MPHJ claimed that “many other


businesses” have paid for a license, and that failure to pay would result in legal action. Neither of those claims was true, and the deceptive letters led to FTC action.15

While I hope that the FTC’s 6(b) study will contribute meaningfully to our understanding of the PAE business model, the work on the report should not be seen as an obstacle to Congressional patent reform efforts. For example, the 6(b) study results aren’t needed to conclude that greater transparency in demand letters and lawsuits would be helpful. And we should be able to agree, without waiting for the 6(b) study, that it makes sense to protect individual consumers and small businesses from liability for using off-the-shelf products in the intended manner. Congress has indicated a desire to move forward with patent reform efforts. I know that House Judiciary Chairman Bob Goodlatte said earlier this month that he hopes to get patent reform enacted “as quickly as possible.”16 And so, without weighing in on any particular bills, I would just say that I certainly hope that important patent reform is able to move forward while our 6(b) study is ongoing.

Standard Essential Patents

I’ll conclude my remarks by noting some encouraging developments regarding standard essential patents (SEPs) – another area at the intersection of IP and antitrust in which the FTC has been actively engaged.17 Last month the Federal Circuit held in Ericsson v. D-Link that any royalty award for infringement of an SEP must be based on the incremental value of the invention, not the value of the standard as a whole or any increased value the patented feature gained from inclusion in the standard.18 And I am pleased that some standard-setting organizations are continuing to seek to clarify the meaning of FRAND commitments in their IP policies.


Conclusion

The task of 21st century competition enforcers is to protect competition and innovation – to make sure that hi-tech markets remain dynamic, fertile grounds for new products and ideas. As I have discussed today, I think we’re up to the challenge.

Thank you again for the invitation to speak to you this afternoon.