The third proposition is that the Justice Department in a 2008 Report not only contended that the combination of complementary factors of production by intellectual property licensing is "generally procompetitive," but that a unilateral, unconditional refusal to license to a rival is generally per se legal.[7] The Justice Department subsequently withdrew the Report, including its statement on unilateral refusals to deal, in 2009.[8] Since the withdrawal, neither the courts nor the antitrust agencies have reached a consensus on how to evaluate that conduct if more than a *mere* refusal to deal is involved.

I. INTELLECTUAL PROPERTY IS NOT JUST PROPERTY

The 1995 Intellectual Property Guidelines asserted that the legality of the acquisition of intellectual property should be tested like the acquisition of any other property—that it should be considered illegal if the acquisition would further concentrate an already highly concentrated market and that it should be considered legal if it did not.[9] Such a consolidation could occur in a traditional goods market, or alternatively, in markets for technology or for research and development (the latter being referred to as an innovation market).[10] However, in the nearly

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[7] U.S. Dep't. of Justice, Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act 129 (2008) [hereinafter, Single Firm Conduct Report] (disavowed by the Federal Trade Commission in 2008 and withdrawn by the Department of Justice in 2009), *available at* http://www.justice.gov/atr/public/reports/236681.htm.

[8] Press Release, U.S. Dep't of Justice, Justice Department Withdraws Report on Antitrust Monopoly Law (May 11, 2009), *available at* http://www.justice.gov/atr/public/press_releases/2009/245710.htm.

[9] Of course, the Intellectual Property Guidelines, as their full title implies, are specifically directed at acquisitions of intellectual property rights through licensing arrangements.

[10] According to Section 3.2.1 of the Intellectual Property Guidelines, goods markets are determined by using the market definition methodology in the Horizontal Merger Guidelines. If the competitive effects of the transaction or business arrangement cannot be adequately assessed from the standpoint of the affected goods market(s), then the Guidelines prescribe the delineation of technology markets, which Section 3.2.2 defines as "the intellectual property that is licensed . . . and its close substitutes—that is, the technologies or goods that are close enough substitutes

120-year history of antitrust law, the concept of an "innovation market" is relatively new. Indeed, the question of whether the antitrust laws should even be in the business of regulating competition in innovation appears to have first arisen, to my knowledge, in the mid-1970s when a merger was challenged, among other grounds, on the theory that the consolidation would harm competition in an innovation market following the merger of Xerox and Rank-Xerox.

In *Xerox*, the Commission alleged that Xerox violated Section 5 of the FTC Act by creating and preserving a noncompetitive market structure in the market for office copiers and the submarket for plain paper copiers.[11] Xerox's challenged conduct included, among other things, its development of an extensive patent portfolio through acquisition of control over Rank Xerox, a joint venture in which Xerox had previously held a non-majority stake.[12] Because Xerox had acquired patents to all of the technologies needed to practice xerography, the Commission alleged that Xerox was eliminating competition in the development and creation of plain office copiers.[13] The Commission settled the *Xerox* suit in 1975 with a consent decree that

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significantly to constrain the exercise of market power with respect to the intellectual property that is licensed[,]" and innovation markets, which Section 3.2.3 defines as "the research and development directed to particular new or improved goods or processes, and the close substitutes for that research and development."

[11] Complaint ¶ 16, Xerox Corp., FTC Docket No. 8909, *reprinted in Xerox Corp.*, 86 F.T.C. 364, 368 (1975). The *Xerox* case is discussed in detail in Willard K. Tom, *The 1975 Xerox Consent Decree: Ancient Artifacts and Current Tensions*, 68 Antitrust L.J. 967 (2001).

[12] *Id.* ¶¶ 14(a)-(c), 15, Xerox Corp., FTC Docket No. 8909, *reprinted in Xerox Corp.*, 86 F.T.C. at 367-68.

[13] *Id.* ¶ 14(j), Xerox Corp., FTC Docket No. 8909 ("Xerox has engaged in acts, practices

required Xerox to permit the use of any three of its dry paper copier patents on a royalty-free basis and to desist in pursuing certain of its infringement suits.[14]

Following *Xerox*, the agencies went for nearly two decades without any significant challenges to transactions and conduct affecting innovation markets. Beginning with Anne Bingaman's tenure as Assistant Attorney General for the Antitrust Division in 1993, however, the agencies began to chart a different course.[15] In *United States v. General Motors Corp.*, Bingaman and the Justice Department challenged the proposed acquisition of General Motors' Allison Transmission Division by ZF Friedrichshafen AG, a German company, on innovation market grounds.[16] Although the transaction would have resulted in very high levels of concentration in a few application-specific bus and truck transmission markets, as Bingaman later noted, the Justice Department's concern was "not limited to these narrow product markets where the two firms presently were alternative sources of supply."[17] Instead, it alleged that the acquisition would stifle competition in "worldwide technological innovation in the design and production of automatic transmissions for medium and heavy duty commercial and military vehicles" because ZF would not engage in the same vigorous research and development after the

[14] Order, §§ G0 Td[(sg 12 DC ygag ÞBDC d(a01 Tm(14)tpd0 TdS3an)]TJ-0.002 0.0011ssssss

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There are at least three *practical* issues that underlie any attempt to regulate innovation markets.

First, the most fundamental practical consideration is whether, from a policy standpoint, the application of antitrust laws to innovation markets provides consumers with better products or products that are developed more quickly. Critics of applying antitrust laws to regulate "innovation markets" assert that although it is generally accepted that increases in concentration of markets composed of "property" do tend to detrimentally affect *property prices*, the relationship between concentration and *innovation* is far more ambiguous.[21] Put another way, while there is generally agreement about what type of market structure fosters competition in product markets, "[t]here is not yet a universally accepted consensus as to the kind of market structure that best facilitates innovation."[22]

Is it better to lock scientists from competing firms in a room and let intellectual fermentation occur? Will that result in more innovation or at least quicker innovation than challenging such collaboration as an antitrust violation under Section 1 or Section 7?[23] Or, conversely, are consumers better off when the agencies use antitrust laws to increase

[21] *See* M. Howard Morse, *The Limits of Innovation Markets*, Antitrust & Intellectual Property, Spring 2001; Richard Rapp, *The Misapplication of the Innovation Market Approach to Merger Analysis*, 64 Antitrust L.J. 19 (1995).

[22] Ronald W. Davis, *Innovation Markets and Merger Enforcement: Current Practice in Perspective*, 71 Antitrust L.J. 677, 681 (2003).

[23] The agencies' jointly issued Antitrust Guidelines for Collaboration Among Competitors contemplate this very question: "For example, two firms may be able to combine their research or marketing activities to lower their cost of bringing their products to market, or reduce the time needed to develop and begin commercial sales of new products." U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidelines for Collaborations Among Competitors § 2.1 (2000) [hereinafter, Collaboration Guidelines], *available at* http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf.

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and development and the level of innovation.[26] He stated that "neither economic theory nor empirical research supports an inference regarding the merger's likely effect on innovation (and hence patient welfare) based simply on observing that the merger changed the number of R&D programs."[27]

A third practical consideration is whether, notwithstanding the Intellectual Property Guidelines, it is accurate to view *all* intellectual property (i.e. patents, copyrights, trade secrets, know-how and trademarks) as akin to other species of property for purposes of antitrust analysis. Are there any limiting principles and if so, what are they? For example, one limiting principle might be that we should confine our conception of property to *patented* intellectual property rights. This would have the effect of focusing antitrust analysis on pre-existing, publicly recognized, property rights that may be clearly and directly linked to a relevant goods market (based on the nature and scope of the claims) and hence may potentially provide the owner with some measure of exclusionary power over that market.

Even patent rights may not provide a clear enough basis for antitrust analysis, however, when the relevant market of interest is not a goods market but an innovation market. This problem can be seen in the *Genzyme-Novazyme* merger I've just discussed, and also in the *SCM Corp. v. Xerox Corp.* case, which I will discuss next. It suggests another limiting principle, which is that in the context of regulating an innovation market, patent rights may be most

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[26] *See* Statement of Chairman Timothy J. Muris in the Matter of Genzyme Corporation/Novazyme Pharmaceuticals, *available at* http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf .

[27] *Id.* at 5-6. In reaching that conclusion, Muris relied heavily on a 1996 report prepared by the Commission's staff, which he observe

relevant, when they, like other specialized assets such as laboratories, are clearly associated with the capabilities of a firm to engage in particular research and development.[28] For example, if a patent covers a necessary input to research and development, such as an analytical procedure needed to see if a concept will work as intended, then securing the rights to practice that patent will obviously be crucial to competing in a relevant innovation market.

There are also at least two *legal* considerations that bear on when antitrust challenges to transactions affecting innovation markets are appropriate.

First, it cannot be ignored that, in the 35 years since the Commission first challenged a merger under an innovation market theory when it contested the Rank-Xerox merger in 1974, there still has not been a successful antitrust challenge (public or private) based on the theory that a defendant stifled or threatened competition in a pure innovation market (i.e., when there is no product market at the time that the patent is acquired).[29]

As I've stated, Rank-Xerox itself resulted in a consent decree that required compulsory licensing of Xerox's patents. The Second Circuit's 1981 decision in *SCM Corp. v. Xerox Corp.* followed, and as the main federal court decision to have considered whether and how antitrust laws should regulate innovation markets, *SCM* has arguably made future challenges more difficult.[30] Relying on the same facts that the FTC pleaded in its *Xerox* challenge, SCM alleged that by 1969, Xerox had willfully acquired monopoly power in a relevant product market that

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[28] *See* Collaboration Guidelines, *supra* note 23, § 3.32(c) ("The Agencies define an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms.").

[29] ABA Section of Antitrust Law, *Antitrust Law Developments* 587 (6th ed. 2007) ("To date, no court has invalidated a transaction solely because it reduced competition in an innovation market.").

[30] *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195 (2d Cir. 1981).

should be dictated by the extent of the power already possessed by that party in the relevant market into which the products embodying the patented art enter."[34] Because no product market as yet existed in 1956, Xerox was not liable under the antitrust laws for acquiring patents in a pure innovation market.[35]

Thus, while the FTC and DOJ's appetite for challenging mergers under an innovation market theory demonstrably increased during the 1990s,[36] the agencies have yet to litigate to conclusion a case that involved an innovation market.

A second legal consideration as to whether antitrust challenges to innovation markets are appropriate is the one that Chairman Muris raised in conjunction with the Commission's closing of its investigation into the Genzyme-Novazyme merger. In merger cases, the courts typically require upfront market definition. And they certainly require such market definition if the plaintiff wishes to rely on the

lessen competition.[40] While upfront market definition may be very helpful in determining the presence or likelihood of market power, I don't believe that it should be a threshold requirement in every instance. Courts, economists, and scholars have emphasized that market definition is merely an indirect means to assist in determining the presence or likelihood of market power.[41] And in cases brought under the Sherman Act, courts have increasingly focused on direct evidence of competitive effects to determine the lawfulness of completed or ongoing conduct.[42] Collaboration arrangements involving innovation markets illustrate another area in which an

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[40] J. Thomas Rosch, *Litigating Merger Challenges: Lessons Learned,* Remarks Presented at the Bates White Fifth Annual Antitrust Conference (June 2, 2008), *available at* http://www.ftc.gov/speeches/rosch/080602litigatingmerger.pdf. *See also* Concurring opinion of J. Thomas Rosch In the Matter of Evanston Northwestern Healthcare Corp., FTC Docket No. 9315 at 8, *available at* http://www.ftc.gov/os/adjpro/d9315/070806rosch.pdf (discussing, in the consummated merger context, the value in examining the merger's anticompetitive effects to determine whether there is a Section 7 violation and noting that "[m]arket definition is a tool for analyzing market power, but it is not the only tool, either as a matter of law or economics").

[41] *See Toys "R" Us, Inc. v. FTC*, 221 F.3d 928, 937 (7th Cir. 2000) ("The share a firm has in a properly defined relevant market is only a way of estimating market power, which is the ultimate consideration."); 2A Phillip E. Areeda & Herbert Hovenkamp,

patented products must present “proof of power in the relevant market” rather than rely on a “mere presumption”.

considered that Apple had unique advantages due to its control of the iPhone platform and its ability to regulate access of third party developers (like Admob) to information generated by using its platform.[52] Under these circumstances, it arguably made no sense to challenge Google's acquisition of Admob, where Admob's viability as a competitor was largely based on its access to the Apple platform. Thus, the theory underlying the Commission's enforcement decision was based on Apple's unique ability to hobble or eliminate competition with its own mobile advertising service.

III. REFUSALS TO LICENSE INTELLECTUAL PROPERTY SHOULD NOT BE CONSIDERED LEGAL PER SE

As I've said, in 2008 the Justice Department issued a report on single firm conduct, which went further than the Rule of Reason case law and essentially gave refusals to license intellectual property a free pass.

Let me begin with some background on the Justice Department's Report. From June 2006 to May 2007, the Justice Department and the Commission held a series of joint hearings to explore the antitrust treatment of single-firm conduct. The agencies' goal was "to explore how best to identify anticompetitive exclusionary conduct for purposes of antitrust enforcement under Section 2 of the Sherman Act."[53]

On September 8, 2008, the Justice Department issued a 213-page Report purportedly based on the hearings. Several things stood out about the Report. First, it included several safe harbors for actions by firms with monopoly or near monopoly power, which, by definition, are

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[52] *Id*. ("Apple's ownership of the iPhone software development tools, and its control over the developers' license agreement, gives Apple the unique ability to define how competition among ad networks on the iPhone will occur and evolve.").

[53] Consumer Benefits and Harms: How Best to Distinguish Aggressive, Pro-Consumer Competition from Business Conduct To Attain or Maintain a Monopoly, 71 Fed. Reg. 17872 (Apr. 7, 2006).

the firms covered by Section 2. And second, the Report expressed great concern with harm caused by over-enforcement of Section 2, which is often called Type I error.

With respect to intellectual property issues, the Report stated that a monopolist's refusal to deal with rivals, including licensing intellectual property rights, "should not play a meaningful role in section 2 enforcement" in part because "judges and enforcement agencies are ill-equipped to set and supervise the terms on which" intellectual property rights are licensed.[54] The Report also described a variety of other problems with remedies involving mandatory sharing or licensing of intellectual property, including spillover effects on other economies.[55]

The Commission declined to join the Justice Department's Report. Three of the four Commissioners, including myself, issued a statement criticizing the Report as a "blueprint for radically weakened enforcement of Section 2 of the Sherman Act."[56] We explained that under the Report, firms with monopoly power or near monopoly power would be able to engage in a variety of exclusionary practices "with impunity, regardless of potential foreclosure effects and impact on consumers."[57] It is not hard to see how the Report's safe harbors could have crippled antitrust enforcement with respect to other aspects of patent licensing, such as tying or bundling the sale of patents or patented products.

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[54] Single Firm Conduct Report, *supra* note 7, at xi. *See also id*. at 124-27.

[55] *Id*. at 152-53, 170, 180.

[56] Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice 1 (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmt.pdf. Then-Chairman Kovacic issued a separate statement. *See* Statement of Federal Trade Commission Chairman William E. Kovacic, Modern U.S. Competition Law and the Treatment of Dominant Firms: Comments on the Department of Justice and Federal Trade Commission Proceedings Relating to Section 2 of the Sherman Act (Sept. 8, 2008), *available at* http://www.ftc.gov/os/2008/09/080908section2stmtkovacic.pdf.

[57] Statement of Commissioners Harbour, Leibowitz and Rosch, *supra* note 56, at 10.

The Report was Justice Department policy for only eight months. On May 11, 2009, the new Assistant Attorney General for Antitrust Christine Varney withdrew it, declaring that it "no longer represents the policy of the Department of Justice with regard to antitrust enforcement under Section 2 of the Sherman Act."[58] She took particular exception to what she characterized as "an excessive concern with the risks of over-deterrence and a resulting preference for an overly lenient approach to enforcement."[59] The withdrawal of the Report made front-page headlines in the *New York Times* and *Washington Post*, notwithstanding the fact that the action had been widely expected based on comments made at Varney's confirmation hearing.

I had a number of objections to the Report, which I've described on a number of other occasions.[60]

could reduce the incentives for innovation both by the original inventors, as well as by rivals seeking their own alternatives to the monopolist's patents. Thus, the Commission stated in its 1980 *DuPont* case that the "imposition of a duty to license might serve to chill the very kind of innovative process that led to duPont's cost advantage."[62] Likewise, the Supreme Court has asserted that compelling firms to assist their rivals "may lessen the incentive for the monopolist, the rival, or both to invest in . . . economically beneficial facilities."[63]

Nevertheless, the Ninth Circuit in *Image Technical Services v. Eastman Kodak Company* held that a unilateral refusal to license intellectual property by a monopolist could violate Section 2 of the Sherman Act if it is not supported by a valid business justification.[64] In that case, the court found that Kodak's reliance on intellectual property rights as a justification for refusing to

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("[A patent's] strength is in the restraint, the right to exclude others from the use of the invention . . . . Its exertion within the field . . . is not an offense against the Anti-Trust Act.");

license was largely pretextual. This may have been the first time a federal court imposed antitrust liability for the refusal to license a patent.

When confronted with a similar issue a few years later in the *Xerox*/*ISO* case, the Federal

before an FTC ALJ.

Toshiba would offer a package license to patents held by six different companies that were essential to manufacturing products in compliance with certain DVD standards.[78] The Department concluded that "the proposed arrangement is likely to combine complementary patent rights, thereby lowering the costs of manufacturers that need access to them in order to produce [DVD] discs, players and decoders."[79] These are just two of many instances where the agencies have helped facilitate a potentially pro-competitive patent policy, patent pool, or licensing practice.

V. CONCLUSION

We are now two years into the new administration and have a new FTC Chairman and a new Assistant Attorney General for the DOJ's Antitrust Division. So far neither agency has brought a merger enforcement case alleging harm to an innovation market or brought a case involving a refusal to license intellectual property. But that isn't to say that the agencies have been silent in these areas. Last year, the two agencies issued updated Horizontal Merger Guidelines. Under Section 6.4 of the Guidelines, the agencies may challenge a merger that results in "a reduced incentive to continue with an existing product-development effort or reduced incentive to initiate development of new products."[80] In contrast, the prior iteration of the Horizontal Merger Guidelines said little about innovation markets.[81] The other significant

[78] Business Review Letter from Joel I. Klein, Assistant Attorney Gen., U.S. Dep't. of

development, as I have already mentioned, is the Justice Department's withdrawal of its Section 2 Report. As a result, the Department is no longer bound by the prior Administration's claim that a monopolist's refusal to license intellectual property does not raise any Section 2 concerns. Both of these are positive developments which, I hope, will portend greater enforcement activity that will help resolve the policy and legal questions still waiting to be answered in both of these areas.

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be the result of anticompetitive output reductions."), *available at* http://www.ftc.gov/bc/docs/horizmer.shtm.