Antitrust Update

VERONICA WEBER

Antitrust issues took center stage before the U.S. Supreme Court this past term. The court decided three cases and made a noteworthy refusal to hear a fourth. The cases highlight the peculiar estrangement between the FTC and the Department of Justice Antitrust Division. We've invited six noted practitioners to sort the future of some of these important antitrust issues. They are George Cumming, a partner with Morgan Lewis & Bockius in San Francisco; Robert Freitas, a partner with Orrick, Herrington & Sutcliffe in Silicon Valley; Chad Hummel, a partner with Manatt, Phelps & Phillips in Los Angeles; Gil Ohana, Director of Antitrust and Competition with Cisco Systems in San Jose; Steve Smith, a partner with Morrison & Foerster in Washington, D.C.; and Julie Wood, counsel with O'Melveny & Myers in San Francisco. This panel was moderated by Susan Kostal, a freelance legal affairs journalist, and reported by Cherie L. Lubash for Jan Brown & Associates.

MODERATOR: Let's start with the Texaco case.

CUMMING: In 1998, Shell and Texaco, competitors in the gasoline business formed two joint ventures, one in the West, one in the East. These joint ventures took over the marketing of gasoline produced previously by the companies independently. The parties filed Hart-Scott-Rodino notifications, and the ventures were reviewed by the Federal Trade Commission, as well as several states. The deal was approved, in the sense that regulators chose not to challenge it, subject to certain divestitures. Shell and Texaco dealers now buying gasoline from Equilon, the Western States venture, sued. They didn't challenge the legality of the joint venture; instead they argued the arrangement was illegal because the joint venture was fixing prices. The District Court granted summary judgment. The Ninth Circuit reinstated the

action, and was reversed by the U.S. Supreme Court. The Court held that as long as this joint venture was lawful, it had the right to set its own prices. The significance of this case is two-fold. No. 1, it gets rid of concerns that joint ventures formed by previous competitors can be attacked as price fixing, without either federal or state regulators or private antitrust plaintiffs ever having to prove that the joint venture itself is unlawful under conventional merger law. Second, the case is significant as part of a continuum of Supreme Court decisions that began with *Sylvania* in 1977, and continued in decisions such as *Jefferson Parish, Copperweld, State Oil v. Khan*

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and Spectrum Sports. The Court has been purging antitrust law of some bad virus, in which labels substituted for economic analysis. Justice Powell's opinion in *Sylvania* stressed the need to look at the realities of markets, and not take shortcuts in one's analysis. That same theme pervades the other two cases that were decided by the court this term.

SMITH: One of the things we've seen in this trend of cases is a continuing constriction of the *per se* rule, and the court's unwillingness to find that circumstances the Court once thought were appropriate circumstances in which to apply the per se rule continue to be so. The other important development is the court's discussion of whether conduct that is regarded as being within the core activities of the venture can even be subject to antitrust challenge.

CUMMING: I think that's right. You either attack the joint venture as unlawful under conventional merger analysis, or it's permitted to do those things for which it was formed.

FREITAS: There clearly is a long-term trend that shows the court getting away from labels and working much harder with economic concepts.

HUMMEL: It's going to be far more expensive to pursue these cases from a plaintiff's perspective. You're going to have to define and prove a market, and then prove market power in the market. We are moving away from presumptions of market power. So antitrust cases are going to be even more expensive to discover, and will be very expensive in motion practice. Courts are going to have to grapple with these very difficult economic issues in the summary judgment context. And juries, as difficult as that may sound, will have to do exactly the same. The trend is toward realistic economic analysis.

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SMITH: Another question is what *Dagher* indicates about the future of federal agency enforcement. The FTC and the Justice Department came out in support of the defendants, and as a general proposition apply rule of reason analysis not only to joint ventures, but also to most other activities. That said, there are occasions where the agencies either take the formal position, or suggest, that *per se* analysis is appropriate even though the venture or alliance at issue is not a sham. Will *Dagher* alter the agency's approach going forward? From my view, the answer is, at the margin, it will. I think it will be more difficult for the agencies to pursue cases like *MathWorks* or to pursue *per se* theories in cases like *Three Tenors* in light of the joint venture analysis in the decision.

OHANA: One of the challenges in counseling in this area is that agreements not to compete have not fallen neatly into either a per se bucket or rule of reason bucket. If you look at the history of the Antitrust Division's settlements in this area, for example, the *IBM/StorageTek* case in the late 1990s, the

division very much emphasized that they were going under a rule of reason theory. Fast forward to the *MathWorks* case, where the Division adopted a *per se* theory on facts that were fairly similar. To the extent that Dagher counsels that rule of reason is a better approach, I think that's good news.

WOOD: As one of the vice chairs of the Antitrust Section's Trade Associations Committee, those of us who counsel trade associations breathed a sigh of relief after Dagher, because the court's language was very strong that they are going to presumptively apply the rule of reason. That's going to be the increasing norm going forward.

MODERATOR: Let's move on to this case on tying. Chad, tell us about Illinois Tool Works.

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Chad S. Hummel
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HUMMEL: Illinois Tool Works is a patent tying case. Trident, whose parent was Illinois Tool Works, had a patent on the printhead but not on the ink used with it. The company said if you want our patented printhead, you've got to use our ink. Very simple, classic tying paradigm. The Supreme Court, in what I consider to be a landmark decision, eliminated its decades-old presumption that market power arises from the ownership of intellectual property rights. In a unanimous opinion authored by Justice Stevens, the court held that the plaintiff must prove that the defendant has market power in the tying product. The Court reasoned that the market power presumption in Loew's and International Salt finds no support in modern economic theory or antitrust enforcement policy, does not accord with the Court's modern tying jurisprudence, which is moving away from a per se analysis for tying cases, and lacks support in the Court's earlier patent cases. When Congress in 1988 amended the patent misuse doctrine within the Patent Act, it forced infringers to prove that the patent owner had market power in the patented product. In Illinois Tool Works, the Court adopted Congress' conclusion. The court has firmly established that tying arrangements will be analyzed under a rule of reason. It has also essentially said that there are numerous potential pro-competitive benefits from tying arrangements, particularly if products are integrated. Finally,

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the Court acknowledged that a patent does not necessarily automatically confer market power. With this decision, it will be legitimate in some circumstances to extend the scope of that power by requiring purchases of other products.

FREITAS: Chad is right that the Court relied on section 271(d)(5) in arriving at the conclusion that the presumption would no longer be applied. I was a little surprised that the Court chose to rely so much on the statute.

SMITH: One interesting question that arises out of the Court's invocation of the statute, that is, the amendment to the Patent Act in Section 271(d)(5), is the following question: Did the Court implicitly decide the issue which it declined to decide explicitly as to whether a unilateral refusal to license a patent can be an antitrust violation? The Federal Circuit held in the Xerox case that a unilateral refusal to license could not violate the antitrust laws. There's certainly room for strong argument that the First Circuit reached a different conclusion in Data General, and that there was a conflict there that the Supreme Court declined to consider at the time. Think about the reasoning that you just laid out with respect to 271(d)(5). Justice Stevens says conduct that isn't patent misuse can't be an antitrust violation. Now move up one paragraph in the amendments to the Patent Act. Section 271(d)(4)

says it is not patent misuse for a patent holder to unilaterally refuse to license. If Justice Stevens' analysis is correct, then doesn't that also mean that a unilateral refusal to license a patent is not an antitrust violation?

OHANA: The Supreme Court clearly was laying out its view that those two should be pretty consistent, which is a point the Federal Circuit has also made. And I think that's a good thing, because it avoids a kind of claim arbitrage among defendants responding to infringement litigation as to whether they bring the patent misuse defense or the antitrust counter claim.

FREITAS: I think the issues are often different. The focus under Section 1 is whether there's an unreasonable restraint of trade. In a patent misuse context, the issue is whether the patent owner has unlawfully extended the scope of the patent grant. There's a long history in the case law that says you don't need an antitrust violation. And at least in some cases, it makes sense to say that we don't require a violation of the antitrust laws to have patent misuse.

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OHANA: If you look at the history of patent misuse cases, you can almost always find a corresponding antitrust case. So you're left in litigation dealing with two slightly different litigation theories with separate discoveries, separate experts, et cetera.

SMITH: Judge Richard Posner said, and I think he's right, that it's too late in the day to look at patent misuse and say that it can be informed by any principles other than antitrust. The courts do us a disservice when they try to divorce those two doctrines. I see an overall trend toward convergence. Conduct that the Supreme Court has said constitutes misuse will remain so, until the Court or Congress changes the law. But with respect to the rest of the law, I think we're going to see the lower courts bringing antitrust and misuse doctrine together.

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CUMMING: I agree. What the court recognized here is what lower court commentators have been saying for a long time, which is simply that patents or copyrights confer legal monopolies, but not necessarily economic monopolies.

HUMMEL: As a trial lawyer, I found it more difficult prior to this decision to prove a patent misuse defense. Proving a tying counterclaim was easier. So from a practical perspective, companies can take some comfort that patent holders can now sue clear infringers on strong patents, and not fear the inevitable counterclaim for tying. Litigation is going to be much more focused and consistent.

CUMMING: How does this impact copyrights? All of the old cases said if you have a patent or a copyright you presumptively have market power. I think this decision by its very nature implicates that presumption in a copyright situation, or at least puts the burden on the plaintiff to show that a distinction between patents and copyrights can and should be drawn, and that one should presume market power in the case of a copyright but not in the case of a patent.

WOOD: The Supreme Court relied heavily on the antitrust guidelines for the licensing of intellectual property. The guidelines apply equally to patents and copyrights—there's no presumption.

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MODERATOR: Gil, how does the Volvo case fit in with these other two cases that we've been discussing?

OHANA: I think it's consistent with what George said earlier about moving away from labels. The case is a pretty straightforward Robinson-Patman case. A truck dealer feels discriminated against by Volvo because it did not receive the same pricing that other truck dealers had received, but those truck dealers received better pricing in deals in which the plaintiff didn't compete. Nevertheless, it brought a Robinson-Patman case and, it won in the Eighth Circuit. The Supreme Court said the plaintiff in this case hasn't proven that it was discriminated against in specific sales opportunities where it was provided worse pricing than the other Volvo dealers and therefore it shouldn't win its Robinson-Patman claim.

SMITH: The other interesting question about Volvo is: why did the Court include Part Four of the opinion? Part Four was unnecessary to the narrow holding on the facts. What Part Four says is that the Robinson-Patman Act ought to be read to serve the broader purposes of the antitrust laws. That is, it ought to be read to ensure competition, not individual competitors, are protected.

FREITAS: I look at Volvo as a reaffirmation of Morton Salt.

OHANA: Which is unfortunate.

MODERATOR: Let's move on to a case the Supreme Court did not hear, *Schering-Plough v. FTC.* Steve, lay this one out for us.

SMITH: *Schering-Plough* involved FTC challenges to patent settlement agreements between Schering, a manufacturer of a patented prescription drug, and two manufacturers of generic versions of that drug, resolving patent infringement litigation brought by Schering against the generics. In the settlements, the generic manufacturers agreed to delay the date on which they would begin selling generic versions of Schering's drug. Schering agreed to make substantial payments to each generic, although there was a dispute between the FTC and the parties as to whether those payments were to compensate those generics for delay of entry, or whether they were related to other elements of the settlement. The FTC staff challenged the settlements on the ground that the so-called "reverse payments" from Schering to the generics were unlawful payments stay out of the market. An FTC Administrative Law Judge found no violation of the antitrust laws, but the full Commission reversed. The Eleventh Circuit, in turn, reversed the Commission, finding that the settlements were lawful because the compromise that was struck was within the potential exclusionary scope of the patent. The Federal

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Trade Commission then exercised its authority to represent itself before the Supreme Court and petitioned for certiorari. The court invited the Solicitor General to file an amicus brief in the case, which the Solicitor General did, and recommended that the court decline to take the case. In June, the Court denied certiorari.

WOOD: The case has not changed how I am counseling clients. Before the denial of cert, FTC Commissioner Jon Leibowitz stated that the FTC plans to take additional cases in the hope of creating a split in the circuits, or to encourage Congress to act. So there's still that potential threat of an enforcement action.

SMITH: The FTC has made it clear that the subjective intent of the parties in striking the settlement is a critical element in their judgment as to whether there is a quid pro quo, and whether the settlement is anticompetitive. That means clients have to start thinking from the moment that the potential infringement action arises, and they're evaluating patent validity, the infringement action, and the likelihood that they'll prevail, about how they are going to address those questions internally, what sort of documents they're going to produce, what sort of exchanges they're going to have within and outside the company. All of that becomes evidence that's relevant to at least the FTC's view as to how the lawfulness of the settlement ought to be assessed. Clients also might want to consider whether, once they settle the suit, they want to take that settlement to court and ask the judge to review and approve it rather than doing it strictly as a private matter. Court approval would give you a very strong if not dispositive measure of Noerr-Pennington immunity from subsequent challenge.

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CUMMING: You have an obligation to make sure your clients are up to some good instead of no good, more so than in most cases. If there is no *quid pro quo,* you need to help clients establish that clearly in the settlement documents. I agree with Steve, if you can get judicial assistance in that endeavor, it would be of value down the road.

FREITAS: It appears that counsel did that. There was expert testimony about the settlement range, the quality of the patent and the defenses. With a record like that, it becomes far more difficult to simplify it as a quid pro quo, or to say it's anticompetitive, when there is a specific record that this is a real settlement or there is a real cross-license.

HUMMEL: This is a perfect example of where you need both antitrust advice and patent advice very early on. The Eleventh Circuit got it exactly right; the focus is on the strength of the patent.

SMITH: The FTC is wrong to go down the path of trying to assess the subjective views of parties in litigation. Companies often have a variety of views as to the strengths of specific patents or their intellectual property positions.

OHANA: I think that's exactly right. And it goes to the point of what's wrong with the FTC's position. It also tends to recommend the approach that the Solicitor General recommended in its brief about the form that merits adjudication as to the patent can take, where they say it can be kind of a mini-trial. In its brief and in the positions FTC staff took during the Part Three administrative process, the FTC tried very hard to avoid that. And I'm

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not sure why, but they seemed very afraid to go down that route.

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WOOD: I query whether the courts are going to be willing to make those assessments. What's the legitimate case or controversy, and what are the guidelines? Unlike the FTC, the courts don't have economists that they can use to facilitate the process. It's a fantastic idea in theory, but I'm wondering whether or not a court would legitimately accept it.

OHANA: And if you hold an open hearing and invite affected parties to participate, what if the FTC shows up?

FREITAS: I think it would be difficult to get a court to make meaningful findings about the subjective intent of the parties, to the extent that is going to be important in the analysis. If I was a judge and litigants came to me with a settlement and asked for findings about what their intent was in entering into it, I'd say you've got to be kidding. Courts might be willing to look at objective factors, and presumably would be expert in assessing things like patent quality, defense quality, arm's length nature of the litigation. There's a role the court might be willing to fill. But in most cases, judges would stay very far away from that.

SMITH: You'd be asking the court to make some fundamental findings that would then enable you to say, given those factual findings, this settlement is within the scope of the patent's exclusionary scope and within the range of reasonable compromise. Under the Eleventh Circuit and Second Circuit precedents, if you're able to establish those two points, you're likely to prevail on the merits. And then you have the additional layer of protection that this is a judgment entered by the court, so if it has alleged anticompetitive effects, it's the court's action, it's not the action of the private parties that's giving rise to those effects. And that of course is the core of the Noerr-Pennington immunity.

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