



IP-related refusals to deal

Part 2: Pretext and misconduct as standards

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..... In the last issue of *IEEE Micro* (Jan.-Feb. 2000, pp. 9-12), *Micro Law* addressed the *Kodak*, *Intel*, and *Xerox* cases, largely from the vantage point of tactics. All of these cases involved a powerful manufacturer's refusal to sell patented parts, or to license its intellectual property rights, to a rival.

Kodak was unsuccessful in the San Francisco federal court of appeals and the US Supreme Court, while Intel succeeded in overturning an unfavorable district court "home town" decision on its appeal to the federal court of appeals. Xerox pre-

vailed in the district court, and its appeal has been argued. The appeal is pending before the same court of appeals before which Intel prevailed. Intel and Xerox had the advantage of a court of appeals (the Federal Circuit in Washington, D.C.). That court tends to be favorable to the rights of intellectual property owners, and tactical decisions of the parties' attorneys helped to steer the appeals to that court. (Their tactical decision was to make sure that the case had some kind of patent infringement claim in it. Kodak did not follow the same path.)

Tactics are important and surely help determine an outcome. But the legal merits count also. Therefore, let's explore in greater depth the legal theories on which a court might resolve this kind of controversy. When should a powerful manufacturer's refusal to sell patented parts, or to license its intellectual property rights, to a rival be held to be an antitrust violation?

Presumption of legitimacy

Intel and Xerox both argued that, absent a background of conspiracy to fix prices or the like, they enjoy an "absolute and inviolable" right to refuse to sell or license to others the subject matter of their intellectual property rights. Kodak's position was pretty much the same. In other words, absent a very narrow conspiracy exception, the intellectual property owners say that they enjoy an irrebuttable presumption that they never are obliged to allow access to what their intellectual property controls.

The *Kodak* court finessed this argument by finding Kodak's reliance on intellectual property rights a mere pretext, on the ground that only a minute percentage of its parts were covered by intellectual property. Yet, Kodak engaged in the same conduct as for all products, and in some cases behaved in a very heavy-handed manner (such as telling parts suppliers that they better agree not to sell to Kodak's independent service organization, or ISO, rivals).



I'll put aside the "pretext" theory at the outset for several reasons. It won't work in a case where the intellectual property owner can put in a claim of patent infringement. (A well-advised intellectual property owner can very often do that.) That action sends the case to the Federal Circuit, which simply won't consider a refusal to deal pretextual if a real patent infringement claim occurs. In addition, there are serious conceptual problems with the pretext theory. Its foundation is the conclusion that an intellectual property owner doesn't *really* care about its intellectual property rights but instead just wants to exclude its rival from competing. But that is the purpose of any patent or other intellectual property right. It is even the purpose of the patent laws, which seek to promote industrial progress by granting the incentive of a limited-time right to exclude others from the subject matter of a patent. If this legal theory were accepted, virtually any invocation of a patent against an infringing competitor would be held pretextual.

The *Intel* court perhaps inclined toward the irrebuttable presumption theory, but it did not determine the case on that ground. Its main ground was a) that Intel lacked monopoly power in markets such as graphics subsystems, where Intel and rival Intergraph were head-to-head competitors, while b) where Intel did have monopoly power, such as in X86 microprocessor chips, Intergraph was not a competitor. Furthermore, the court insisted that disclosing bug fixes, new interrupts, and other technical information constituted "special benefits," and that even a monopolist has no duty to provide special benefits to somebody suing it (as Intergraph sued Intel) for patent infringement.

These theories, particularly special benefits, are not generally available in cases of this type. For example, in the *Xerox* case, the plaintiff ISOs did not bring infringement suits against Intel—nor did the ISOs in the *Kodak* case. It is therefore essential to consider other legal theories to develop a general approach in intellectual property refusal-to-deal cases, and the presumption theory is of central importance.

Should the presumption be irrebuttable, rebuttable, or nonexistent?

Antitrust plaintiffs do not accept the "absolute and inviolable" right theory. Thus, the ISOs in the *Xerox* case argued that an owner of intellectual property rights can be held liable for monopolization or attempted monopolization for refusing to sell or license the subject matter of the intellectual property rights to an antitrust claimant. The ISOs said that antitrust liability should attach if the result of the refusal to deal is anticompetitive. For example, it could make the intellectual property owner dominant in the business of performing services that require use of parts and other products subject to the intellectual property rights.

These two theories probably represent the polar extremes of what anybody argues in these cases. Each polar theory has difficulties, which I will explore. To rescue you from undue pain and anxiety of suspense, I disclose now that I propose an intermediate theory. This is that an intellectual property owner enjoys a rebuttable presumption that a refusal to deal is legitimate, privileged, and lawful. This presumption can be overcome (rebutted) only by showing that the intellectual property owner engaged in improper conduct that dissipated its privilege of refusing to deal. Some examples of improper conduct that overcome the presumption of legality are

- conspiratorial action, such as organization of a group boycott or using refusal to deal to coerce the antitrust claimant's acquiescence in a price-fix;
- a dominant firm's acquisition of intellectual property covering competing technologies to solidify or acquire monopoly power; and
- deception of a standardization body about the intellectual property, causing the body unknowingly to embed patented or copyrighted technology into a standard.

A major problem with the absolute-right theory is that too many exceptions are already recognized for the theory of

absolute rights to withstand scrutiny. One recognized exception to the privilege of refusing to grant licenses is a concerted refusal to deal (a group boycott). Courts find a group boycott exists if a patentee agrees with several of its licensees that they may veto the grant of licenses to competitors. Similarly, a threat to refuse to deal may violate the Sherman Act. A violation occurs if it is used to coerce customers not to deal with a third-party victim (this was claimed to occur in the *Kodak* case) or coerce them to join a price-fix. (The Supreme Court said that "Kodak forced OEMs, equipment owners, and parts brokers not to sell parts to ISOs.") However, the record in the *Intel* and *Xerox* cases did not suggest any such conspiracy or agreement with others.

Another recognized exception involves acquiring patents from others to insulate against the competition of substitute technologies or to acquire monopoly power. Indeed, in a different case involving *Xerox SCM* sued it over xerography patents. There, the federal court of appeals in New York stated that surely a violation of section 2 of the Sherman Act's antimonopolization provisions occurs when a

dominant competitor in a market acquires a patent covering a substantial share of the same market that he knows when added to his existing share will afford him monopoly power.

When patents are pooled or purchased to create market control, courts do not recognize any absolute right to refuse to deal or grant licenses.

Probably another exception to any allegedly absolute right will be found when a preexisting course of dealing between the parties is terminated. This suddenly deprives the plaintiff of an important and unique market facility ("essential facility") that it had previously enjoyed and depended upon. That is what happened in the well-known suit between two ski-lift companies in Aspen.

Still another exception appears to be

recognized in some technical standards cases. For example, suppose that ANSI or the IEEE adopts a technical standard embodying patented technology. But (hypothetically) the patent owner has misled ANSI or IEEE by failing to disclose the existence of its patent. In such a case, courts will probably strip the patentee of its right to refuse to grant licenses. The standards exception may be even broader than that—for example, where the government has required use of the standard.

The theory of an absolute right to refuse to deal has poor support in legal theory or philosophy as well. Absolute rights are rare in society, if they exist at all. The law of easements (privilege to go on other people's land) and nuisance (prohibition against using your land in a way that persistently harms a nearby landowner) provide illustrations of how even real property rights have limits. An absolute right as to intellectual property would be a legal anomaly.

So, the right of an intellectual property owner to refuse to deal or license is not absolute. Does it exist at all?

Existence of some presumption

No doubt, patent owners enjoy some amount of right to refuse to deal. Arguably, the right is inherent in the idea of granting a patent. A patent is a government grant of the right to exclude others from making, using, or selling a given invention once certain government formalities have first been satisfied.

Perhaps more to the point, the US Congress has spoken explicitly. The presumption of legality follows directly from section 271(d)(4) of the patent law. This section in terms creates a qualified immunity from misuse liability for patent-related refusals to deal.

No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of patent rights by reason of having ... refused to license or use any rights to the patent.

Enactment of this 1988 law reflected a congressional judgment as to the proper balance of the right of patentees to exercise and enforce lawfully obtained patents and the right of the public to competition. Congress considered the policies and purposes of the patent laws on the one hand and the public interest in competition on the other hand. Then, it decided that patentees were entitled to exercise their exclusionary rights to prevent others from competing with them in the exploitation of their inventions. An exception would be a showing of the presence of one or more recognized exceptions that dissipate the privilege of refusing to deal.

Concluding that a patentee enjoys a presumptive right to refuse to share the right to use its invention with others is also consistent with case law preceding and following the enactment of this law. The Supreme Court in several important cases carefully distinguished its holdings that patentees were not entitled to control unpatented components or other products or services from the law applicable to a situation in which "the separate elements of the combination" were individually patented. The Court held only the former illegal in these cases.

The argument has been made at times that section 271(d)'s exemptions apply only to misuse of patent rights, not to antitrust cases based on abusive use of patents. On this theory Congress never exempted patents from more general antitrust prohibitions, which may be less tolerant toward refusals to deal that have anticompetitive effects. But the argument makes no sense.

Misuse is, in effect, a lesser included offense (a subset) in regard to antitrust. The Supreme Court has made it clear that before a court can base a conclusion of antitrust violation on conduct constituting patent misuse, a showing of additional elements over and beyond those of misuse must be made. For example, claimants must show anticompetitive effects in a well-defined market. It would turn the rationale of misuse and antitrust upside down to hold that section 271(d) created a defense or limited immunity to misuse claims but not to antitrust claims. It would

be as irrational as if a statute provided that negligent vehicular homicide shall not be punishable as manslaughter, and a court then interpreted the statute as permitting a prosecution for such conduct as murder in the first degree.

So, a legitimacy presumption of some kind exists, even though it is not absolute. I've already summarized some of the fact patterns that, if shown, rebut the presumption. Are there additional exceptions?

Thus far, one or two main candidates have been argued as further exceptions. One, as stated earlier, appears to be at or near one polar extreme of what has been argued. This is the theory of the *Xerox* plaintiffs: an antitrust violation occurs if the result of the intellectual property owner's refusal to deal is to make the intellectual property owner dominant in a business (say, the repair and service business of the ISOs) that requires use of parts and other products subject to the intellectual property rights.

Another legal theory, or perhaps just another name for the same theory, is that of leverage. Leverage is the use of significant power (such as possession of dominating patents) in one market to gain significant power in a second market. Possibly, to be significant in this sense, the power must be monopoly power. Finally, another possible legal theory is that of essential facility, developed thus far entirely apart from patent cases. Under this theory, the owner of a facility essential to competition has no right of refusal to deal when a certain pattern of factual conditions has occurred.

Leverage

Early leverage cases often had nothing to do with patents. For example, a defendant might own dominant retail outlets (such as movie theaters) in one group of cities. It would tell a supplier that if it wanted to distribute in the markets that the defendant controlled, it would have to give preferences to, or deal exclusively with, the defendant in other cities where the defendant's outlets were not yet dominant. By such tactics, the defendant could use its market power in the first market as

a lever to gain a second monopoly—use one monopoly to beget a second monopoly.

Other early leverage cases involved a defendant having control over a desired product, with or without patents. The defendant would require customers who wanted to buy the desired product to agree to buy something else from the defendant (a tie-in). A mimeograph machine monopoly was used to make customers buy ink or paper. A motion picture projector monopoly tied in the lease of particular movies. A salt injector machine monopoly tied in the sale of salt. A railroad company conditioned sale of land it owned on use of the railroad as a carrier. A hospital made surgery patients use its staff anesthesiologist.

In the *Xerox* case (and in the *Kodak* case), the defendant and ISOs are both in the business of servicing the equipment that the defendant sells. Some of this work involves only labor (services). Some of this work involves replacing parts, some of which are patented. (In addition, some servicing involves use of copyrighted diagnostic software.)

The so-called leverage involved the defendant's refusal to sell or license its patented parts (and copyrighted software) to ISOs. The effect of the refusal was that ISOs couldn't effectively compete in the portion of the service business (maybe all or most of it) requiring access to and use of the patented (or copyrighted) material. The ISOs contended that the defendant extended (leveraged) its first statutory and lawful intellectual property monopoly to a second nonstatutory and unlawful monopoly in the servicing business.

The leverage cases based on tie-ins reflect an earlier stage of tie-in law that is no longer recognized. The case law now confines the tie-in doctrine to cases involving substantial market power and significant anticompetitive impact on the tied-product market. (In addition, case law now requires a tie-in plaintiff to show 1) existence of separate tied and tying products with distinct demands, 2) coercion of customers (for example, take-it-or-leave-it tactics), and 3) market power in a

properly defined relevant market.)

A 1988 amendment to the patent law similarly raised the legal requirements for plaintiffs in patent tie-in cases. Much or most of the time, an antitrust plaintiff in an intellectual property refusal-to-deal case cannot prevail under a tie-in theory because of its inability to meet these legal requirements.

The non-tying leverage cases, such as those involving theater chains, may also not apply to refusals to deal that involved intellectual property. Many of those cases involved conspiratorial action, or at least a pattern of multiple restrictive contracts. By hypothesis, the kind of leverage addressed here is not conspiratorial, for if it were, the conspiracy exception described earlier would arguably apply. The proponent of a unilateral leverage theory would now be obliged to meet general legal standards under section 2 of the Sherman Act. Among other things, that would entail proof that successful monopolization by the defendant is "dangerously probable." That means that as a result of the challenged leverage conduct the defendant is likely to gain dominant market power over sales in a properly defined relevant market. The plaintiff would also need to prove that the defendant specifically intended to gain such power. The plaintiff would need to show that it suffered so-called "antitrust injury," which is a kind of injury resulting from damage to the general competitive process. All of these elements are part of a general raising of barriers to antitrust claims since about 1970.

Proving attempted monopolization under a leverage theory must be based on more than simply *any* conduct that can be labeled leverage. The reason must be that because a monopoly in a first market, when exploited on an exclusive basis, results in a monopoly in a second market. The reported cases prohibiting extension of monopoly between markets all (with the possible exception discussed later of essential facilities cases) involve affirmative acts going beyond a passive refusal to deal. Moreover, they usually involve conduct independently unlawful or at least not ordinarily privileged, such as

sham litigation, false advertising, and other predatory or oppressive conduct.

In short, with a possible exception of the so-called essential facilities doctrine, discussed next, courts probably will not hold that unilaterally leveraging market power from one relevant market to another, without engaging in some related abusive or oppressive conduct, can violate section 2 of the Sherman Act.

Essential facilities

As now understood, the essential facilities doctrine holds that a defendant (an owner of a facility essential to the ability to compete in a market) is not privileged to refuse to deal if the following factual conditions exist:

- the defendant has a monopoly over an essential facility,
- competitors are unable practically to duplicate the essential facility,
- the defendant denies use or access to the facility to the plaintiff competitor, and
- it would be feasible, technically, for the defendant to provide the facility to the plaintiff.

The ski lifts in the Aspen ski-lift case satisfied this standard, although at least one additional factor was present that the Court found important (preexistent dealings suddenly terminated). In a dispute between AT&T and MCI, these conditions were satisfied when AT&T refused to allow MCI to interconnect with AT&T's nationwide long-distance lines. In a case involving a refusal to allow a would-be Chicago Bulls purchaser to use Chicago Stadium, the court held the stadium to be a nonduplicable essential facility for a would-be NBA franchisee, even if perhaps duplicable by another.

So far, no appellate court has held the essential-facility doctrine applicable to patents. The plaintiff ISOs in the *Xerox* case did not attempt to argue that Xerox's patents or copyrights invoked the essential-facilities doctrine. Therefore, the Federal Circuit will presumably find it

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unnecessary to address the doctrine. This failure may have been a tactical error, since an argument could be made that Xerox's diagnostic software meets all of the requirements of the doctrine. That in turn could have precipitated a decision on the applicability of the doctrine to intellectual property. (Probably, however, a majority of the judges of the Federal Circuit would hold that intellectual property is outside the doctrine.)

Is copyright different?

The discussion so far has centered on patents. Do different technical or legal considerations also apply to copyrights?

Different technical considerations can apply. But that is usually simply a matter of a particular case's fact pattern. It may well be that diagnostic software is difficult to duplicate. Among other things, an ISO competitor may lack the necessary technical knowledge of the engineering of the system, so that the cost of developing diagnostic software is prohibitive. (The *Chicago Bulls* case recognized that as a legitimate consideration.) In the *Lotus v. Borland* case, it was impossible to provide a spreadsheet file conversion utility for Lotus 1-2-3 without embodying in the computer program Lotus' command structure. The court of appeals sidestepped the copyright infringement issue by holding such subject matter uncopyrightable, on what appeared to be antitrust policy grounds.

In other cases, a copyright may be easier to avoid than a patent, particularly because copyright law has a fair-use defense and patent law does not. In addition, software patents and business method patents protect their owners at a higher level of generality or abstraction than software copyrights do.

At the policy level, however, different considerations don't apply. Refusal to deal in or license copyrighted subject matter should be neither more nor less privileged than in the case of patents. Arguably, the

antitrust status of a refusal to sell or license copyrighted software is more problematic because the copyright law lacks an explicit counterpart to the patent law's section 271(d). Indeed, when Congress enacted section §271(d)(4), it failed to adopt proposals for more pervasive patent *and* copyright immunities. Nonetheless, analysis of the total structure of the copyright laws better supports treating copyright-related refusals to deal on a par with patent-related refusals to deal than would according them disparate treatment.

In the *Data General* case such considerations led the federal appeals court in Boston to conclude that copyright owners were entitled to a presumption of entitlement to refuse to deal absent a showing of privilege-dissipating conduct. The copyright law gives copyright owners comparable exclusionary rights as to reproduction and distribution of software to what patentees have for manufacture, sale, and use. The existence of such rights implies a corollary right not to relinquish these exclusionary rights—in other words, a limited right to refuse to deal—unless the copyright owner is willing voluntarily to do so. The incentives that the copyright system offers would be significantly diminished if copyright owners had no right at all to refuse to deal. That in turn implies such a right. (This conclusion does not compel, for its recognition, any resort to a theory of an absolute right to refuse to deal, for the same reasons discussed earlier regarding patents.)

For all these reasons, the better view is that patent and copyright owners alike have a qualified right not to sell patented or copyrighted products, or license the use of patented or copyrighted material. The right is not absolute. Rather, there is a presumption favoring an intellectual property owner's right not to deal. The presumption is overcome by a showing of appropriate facts. Such facts are use or acquisition of the intellectual property in a manner otherwise unlawful because the use falls within one or more of several categories of condemned behavior: conspiracy, coercion to commit unlawful acts, and purchase of market control. Perhaps (but

this is very, very iffy) another exception exists in which intellectual property ownership invokes the essential facilities doctrine.

These comments end this two-part series on IP-related refusals to deal. However, as I mentioned in Part 1, we may very well see this controversy reach the US Supreme Court because of the conflicting decisions in different appeal courts.

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see is your name on the screen, you know you have work to do. Steve Gibson leads you through some simple steps that will greatly reduce your vulnerability.

One of Gibson's recommendations is to use the Zone Alarm 2.0 personal firewall, which you can obtain for free from Zonelabs.com of San Francisco. I downloaded this product and have been using it more or less successfully. Zonelabs does not certify the product for the configuration I'm running, and so I don't blame them completely for the occasional blue screens of death that occur when the program fails to handle kernel mode exceptions properly.

Using Zone Alarm has been very revealing. It quite regularly reports probes from unauthorized IP addresses. I'm still tweaking the settings and learning to use it effectively, but I'm happy to have it running, despite the