DOJ's Changing Section 2 Enforcement Policy and High-Technology Industries

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The change in administrations has led to a potentially significant change in the Antitrust Division's enforcement policy concerning single-firm conduct. This area of antitrust enforcement is of great concern for many high-technology industries. Antitrust concerns with single firm conduct generally result when a firm with market power is believed to be engaging in practices that will either entrench that power or extend it into additional markets. High-technology industries often involve emerging markets with few competitors and potentially significant barriers to entry. Firms in such industries often have significant intellectual property (IP). While ownership of IP does not always result in market power, sometimes it does. Market power in high-technology industries may be the lawful result of a firm's innovations. Nonetheless, high-technology firms may find that the authorities are scrutinizing their business practices to determine if that lawful market power is being misused.

Just two years ago the Division issued a report, the "Section 2 Report," that signaled a relatively permissive policy toward single-firm conduct.[1] The report was widely criticized; a majority of FTC Commissioners called it "a blueprint for radically weakened enforcement of Section 2 of the Sherman Act."[2] Soon after taking office, Christine Varney, the Assistant Attorney General now in charge of the Division, withdrew the Report. Ms. Varney suggested

[1] U.S. Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of The Sherman Act,* September 2008 (Section 2 Report).

[2] Statement of Commissioners Harbour, Leibowitz and Rosch on The Issuance of The Section 2 Report by The Department of Justice," September 2008 (FTC statement), p. 1. The Commission stated that "The Department's Report does not consider all of the exclusionary practices that may be used to obtain or maintain monopoly power and cause harm to consumers. . .[footnote omitted]. The Department embraces a series of 'safe harbors' applicable to individual practices, even though each of these practices has substantial potential to lead to anticompetitive foreclosure. . . Even for practices that fall outside the 'safe harbors,' the Department would impose rigorous burdens of proof. . . These burdens of proof will be difficult, if not impossible, for plaintiffs to meet." *op. cit.,* p. 11.

that she did not share the Report's skepticism concerning the ability of enforcers to distinguish lawful acts from anticompetitive conduct. Nor did she share the Report's concern that a more aggressive enforcement policy might deter firms from procompetitive conduct that would benefit consumers. Thus, Ms. Varney promised "[v]igorous antitrust enforcement action under Section 2 of the Sherman Act. . ."[3]. She also stated that the Division would strive "to ensure that when intellectual property is at issue, competition is not thwarted through its misuse or illegal extension."[4]

The Potential for Stricter Treatment of Refusals to Deal

This new policy increases the risk that firms will find that practices putatively adopted for procompetitive reasons are subject to DOJ action because of alleged (or potential) anticompetitive consequences. Among the practices that DOJ may be more likely to challenge are refusals to deal. These include so-called unilateral (or unconditional) refusals to deal with rivals or downstream distributors, as well as conditional refusals, such as exclusive dealing.[5]

Unconditional refusals to deal with rivals are of particular interest in high technology industries because, as the Section 2 Report noted, they often involve a refusal to license IP.[6] Some have argued that firms with market power might refuse to license because of a desire to enhance or extend that power beyond the scope of the patent. Entrants may find product development to be time-consuming. Under such circumstances, an incumbent firm may find it possible to slow entry into its market after patent expiry by refusing to license its proprietary technologies today. Alternatively, the IP holder may refuse to license its technologies in order to foreclose rivals from markets for related products that it plans to sell. Such outcomes could harm the processes of competition and innovation. The Section 2 Report put little weight on those possibilities. Instead, it set forth a policy that unilateral and unconditional refusals to deal with rivals would not be challenged.[7]

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[3] Christine A. Varney, "Vigorous Antitrust Enforcement in this Challenging Era," Remarks as Prepared for the Center for American Progress, May 11, 2009, (Varney Speech), p. 5.

[4] Varney Speech, p. 16.

[5] A unilateral (unconditional) refusal to deal simply involves a firm determining not to deal with rivals/distributors, without more. A conditional refusal to deal, by contrast, involves a refusal to deal except under certain conditions, such as an agreement by the rival/distributor to deal exclusively with the firm in question.

[6] Section 2 Report, p. 124.

[7] Section 2 Report, p. 129. This prescription presumably applied both to refusal to license IP as well as refusals to license "goods and services" inputs. One policy question is whether the same enforcement standard should apply to refusals to deal in an IP setting as opposed to a

The Section 2 Report indicated that requiring firms to license IP to rivals could reduce the incentives to innovate, which was a particular concern given the difficulty of distinguishing anticompetitive from lawful conduct and the potential for "false positives."[8] Moreover, the Report argued that in a case involving a firm's refusal to deal with a rival, it is very difficult to fashion an appropriate remedy. If an antitrust court requires a firm to deal with its rival, then the court will have to regulate the terms of the deal. For example, if the court requires that a patent be licensed, it will have to ensure that the licensor does not set a prohibitively high price for the license while at the same time ensuring that the licensee does not pay a price too low to fairly compensate the licensor for the effort it took to develop the innovation. For these reasons, the Section 2 Report concluded that "antitrust liability for unilateral, unconditional refusals to deal with rivals should not play a meaningful part in Section 2 enforcement."[9] The majority of FTC Commissioners disagreed and contended that a refusal to license IP by a firm with market power could violate the Sherman Act.[10]

The Division likely now will be more willing to challenge refusals to deal with rivals. Ms. Varney twice cites language from Supreme Court decisions stating that firms' right to choose those with whom they deal is subject to some restrictions.[11] Moreover, she indicates that the

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"goods and services" setting. It has been observed that the courts have recently applied a less enforcement-oriented standard to IP refusals to deal (e.g., *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*) than had traditionally been the case with other non-IP property (e.g., *Aspen Skiing Co. v. Aspen Highland Skiing Corp.*). This may be in deference to ostensible loss of incentives to innovate/invest from over-enforcement in an IP setting. See, e.g., Howard A. Shelanski, Unilateral Refusals to Deal in Intellectual Property and Other Property, 76 Antitrust L.J. 369-378 (2009).

8 The potential for false positives (DOJ enforcement when arrangement is efficiency-enhancing) may not be as high as some might expect if one judges from previous case law. There have been relatively few successful claims for refusal-to-deal liability from 1980-2008, despite a rule of reason regime. (See Howard A. Shelanski, *Unilateral Refusals to Deal in Intellectual and Other Property*, 76 Antitrust L.J. 393-94 (2009). Note, however, that being the target of an investigation that is later closed may also impose costs on a firm and could impede efficiency-enhancing conduct, as discussed below.

9 Section 2 Report, p. 129.

10 "If a patent does confer monopoly power, however, then denial of access to the patented technology may not be a 'mere' unilateral refusal to license intellectual property. A firm with monopoly power or near-monopoly power may violate Section 2 if it refuses to license to, or otherwise refuses to deal with, a rival." FTC Statement, p. 9.

11 Varney Speech, pp. 10, 12. The two cases in question *are Lorain Journal v. United States* and *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.* While the latter involved a unilateral refusal to deal, the former concerned a conditional refusal to deal (i.e., a newspaper publisher

effect of stricter Section 2 enforcement on incentives to innovate is unlikely to be significant. Her speech does not address the difficulties inherent in fashioning relief in a case involving refusals to deal with rivals.

The Division's move towards stricter Section 2 enforcement appears likely to close some of the perceived gap between US and European Union (EU) enforcement regimes with regard to exclusionary conduct in general.[12] In particular, the US and EU approaches to unilateral refusals to deal have grown further apart. Most notably, in IMS Health v. NDC in 2004, the European Court of Justice (ECJ) ordered compulsory licensing of IMS's copyrighted market research collection system. The court found that IMS's pharmaceutical market segmentation tool, which formed the basis of the market research product it offered to pharmacies and doctors, had become the preferred industry standard and thus constituted an "essential facility." As such, IMS was found to have abused its dominant position by refusing to license NDC, a significant competitor that wanted to offer a similar product. A compulsory license was ordered. Generally, the position of EU law has been that leveraging of a dominant position in one market (e.g., through refusals to deal regarding a necessary input) to gain commercial advantage in another market, can constitute abuse of dominance. However, a key aspect of proof is that the IP must be "indispensable" to the competitive initiative in question.[13] In addition, the European Commission generally will pursue a case against a refusal to deal only if it believes that the harm to consumers from the refusal to deal exceeds the harm from "imposing an obligation to supply."[14]

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refused to sell advertising space to any parties that also used a new radio station for local advertising).

[12] As a general matter, the European Commission's stance in recent years with regard to exclusionary conduct has been more aggressive than that of the US Agencies. For example, the EC recently (May 2009) imposed a record fine on Intel Corporation, finding that Intel had impeded competition in the computer chip market through practices such as making payments to exclude rival products from retail outlets. [12] The EC had previously (2004) imposed a fine on Microsoft for alleged exclusionary practices in markets for server computers and media software.

[13] See IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, Case C-418/01, [2004] E.C.R., p. 22. An "input is indispensable where there is no actual or potential substitute on which competitors in the downstream market could rely so as to counter—at least in the long-term—the negative consequences of the refusal." [footnote omitted] "Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings," February 2, 2009, available at eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:045:0007:0020:EN:PDF, ¶ 83 (EC Guidance).

[14] EC Guidance, ¶ 86.

Implications for US Competition Policy

The US policy towards unilateral refusals to deal is unlikely to move all the way to the IMS standard based on "essential facilities," even with the policy change announced by Ms. Varney. The IMS court applied the essential facilities doctrine when it determined that NDC's new product could not compete without the "indispensable" input of IMS's market segmentation tool, and therefore was entitled to compulsory licensure. Many U.S. scholars and courts, by contrast, have argued that the essential facilities doctrine cannot properly be applied simply because firms cannot compete with a product incorporating IP without a license to that IP.[15] Such a sweeping use of the essential facilities doctrine would force innovators to share too much of the benefits of their IP with their competitors, which would hurt incentives to innovate.

Nonetheless, the change in policy indicated by Ms. Varney will trouble those who believe that refusals to deal with rivals are usually valid and pro-competitive. In those cases, the rival will have strategic reasons to encourage the DOJ to challenge the refusal. For example, a firm may refuse to license a patent for the simple reason that the proffered fee is not sufficient to reward it for its innovation. In that case, its rival may complain to the DOJ as a method of getting a license at a lower price. Under the new policy, such a ploy is more likely to succeed. Even if DOJ does not take any action, the threat of a complaint that might lead to a protracted and costly investigation could lead a firm to reduce its licensing fee. With the change in policy, such a threat becomes more credible.

The implications of the change in policy for IP holders, however, should not be overstated. While the DOJ now might challenge a firm's refusal to license IP to a competitor, such challenges are likely to be very rare, if indeed there are any. Ms. Varney did not withdraw a 2007 report concerning IP that the DOJ issued jointly with the FTC, the IP Report.[16] The IP Report states that, "antitrust liability for refusal to assist competitors—whether by licensing patents or otherwise—is a rare exception to the ordinary rules of antitrust."[17] Moreover, Ms. Varney appointed as her chief economist Carl Shapiro, who has written "that compulsory

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[15] See, e.g., Paul D. Marquardt & Mark Leddy, The Essential Facilities Doctrine and Intellectual Property Rights: A Response to Pitofsky, Patterson, and Hooks, 70 Antitrust L.J. 847, 848 (2003).

[16] U.S. Department of Justice and Federal Trade Commission. "Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition," November 2007 (IP Report).

[17] IP Report, p. 27.

licensing should be limited to extraordinary circumstances."[18] Finally, the *Trinko* decision is likely to make it difficult to bring such a case.[19] In fact, since the Section 2 Report was withdrawn, DOJ has not filed any cases challenging a refusal to deal. Thus, the change in policy may be from "never" to "almost never" challenging refusals to license. The practical effects of that change could be limited.

A dramatic change in policy is even more unlikely because of the continuing controversy as to whether there should be virtual antitrust immunity for unilateral refusals to deal (license) involving IP.[20] The arguments for preserving incentives to innovate by limiting the duty to share clearly apply to the IP area.[21] On the other hand, stronger rights to exclude can sometimes reduce innovation, since when one firm gains exclusive rights to crucial technology, other firms can be discouraged from innovative effort in related areas or there could be less follow-on innovation.[22] How the trade-off is weighed is inconclusive, since there is no clear consensus among economists about the relationship between monopoly and innovation.[23]

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[18] Richard J. Gilbert and Carl Shapiro, "Unilateral Refusals To License Intellectual Property And International Competition Policy," in Einar Hope and Per Maeleng (eds.) Competition and Trade Policies. Routledge, London and New York, 1998.

[19] In the view of one commentator, that decision "mandates dismissal of most refusal-to-deal cases under Section 2 of the Sherman Act." Eleanor M. Fox, "A Tale Of Two Jurisdictions And An Orphan Case: Antitrust, Intellectual Property, And Refusals To Deal," *28 Fordham Int'l L.J. at 952.*

[20] Compare Robert Pitofsky, Donna Patterson, and Jonathan Hooks, *The Essential Facilities Doctrine Under US Antitrust Law* 70 ANTITRUST LAW JOURNAL 443, 444-445 (2002) and Paul D. Marquardt and Mark Leddy, *The Essential Facilities Doctrine and Intellectual Property Rights: A Response to Pitofsky, Patterson, and Hooks*, 70 ANTITRUST LAW JOURNAL 847, 856, (2003). See also, Howard A. Shelanski, *Unilateral Refusals to Deal in Intellectual and Other Property*, 76 ANTITRUST LAW JOURNAL 369 (2009).

[21] For example, this is one of the objectives of patent law. See DENNIS W. CARLTON AND JEFFREY M. PERLOFF, MOD. INDUS. ORG. 505-511 (3d ed. 2000).

[22] Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698 (1998); Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting, in* INNOVATION POLICY AND THE ECONOMY, (Adam Jaffe, Joshua Lerner, and Scott Stern, eds., MIT Press, 2001); and Howard A. Shelanski, *Unilateral Refusals to Deal in Intellectual and Other Property*, 76 Antitrust L.J. 394 (2009)

[23] This tradeoff is made even more complex because of the potential implementation of separate reforms of the IP system that make patenting harder or reduce the consequences of

One possible direction for DOJ enforcement policy would be to move towards an approach advocated by some Department of Justice economists and attorneys—evaluating a wide variety of potentially monopolizing conduct (including refusals to deal) through one test such as the "no economic sense" test.[24] The no economic sense test asks whether or not the challenged conduct would have made economic sense even if it didn't reduce or eliminate competition. In other words, "but for" the elimination of competition, would the firm have been likely to adopt the challenged conduct? If not, then the conduct would be condemned since its anticompetitive objective would be considered unambiguous.[25] The DOJ has argued for this test in a number of past cases, including *Microsoft*, *Dentsply*, and *Trinko,* but no court has specifically adopted it. [26] The Section 2 Report called this test "useful" but stated that it should not be a "necessary condition for liability" under Section 2 because a trivial procompetitive benefit should not outweigh significant anticompetitive harms.[27]

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patentability. If IP reform reduces firms' abilities to use IP protections to block competitive supply and innovation, then the antitrust authorities potentially may evaluate refusals to deal more leniently. See Howard A. Shelanski, IP Reform, Antitrust Reform, and Unilateral Duties to Deal, Universite of Paris-sud, May 2008, Lecture 3 at 4, 12-15.

[24] Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, 73 ANTITRUST L.J. 413, 414-433 (2006). This test is similar to the "sacrifice" test or the "business sense" test. Under these tests, conduct is anticompetitive only if it makes no business sense or is unprofitable for the defendant "but for" the exclusion of rivals and/or supra-competitive recoupment. See A. Douglas Melamed, *Exclusive Dealing Agreements and Other Exclusionary Conduct—Are There Unifying Principles?* 73 ANTITRUST L.J. 389-395 (2006)

[25] For example, in the context of an exclusive dealing arrangement between a manufacturer and a distributor, the agreement would be considered anticompetitive according to the "no economic sense" test if the distributor would not have agreed to the restraint absent the ability to share in the monopoly profits the manufacturer arguably expects to gain by excluding its rivals—i.e., any efficiencies alone of the arrangement would not have been sufficient to induce the restraint.

[26] Antitrust Modernization Commission Report and Recommendations, April 2007 at 91-92, 103-104. While the *Trinko* decision doesn't specifically address the no economic sense test, the court often used reasoning that appeared to endorse it. For example, the court rejected the plaintiff's (Trinko's) "refusal to deal" claim on the grounds that the defendant's (Verizon's) prior course of conduct did not provide evidence that its current conduct was motivated by elimination of competitors. One could interpret that as a statement that the court saw no evidence that Verizon's current conduct would only make economic sense if it eliminated competitors.

[27] Section 2 Report, p. 43.

The Section 2 Report did advocate a somewhat more aggressive policy towards exclusive dealing than towards refusals to deal with rivals. The report suggested that exclusive dealing might be challenged, if it forecloses 30% or more of customers or efficient distribution.[28] But exclusive dealing would be challenged only if it resulted in harms that could be shown to be "substantially disproportionate" to its procompetitive benefits.[29]

The requirement that exclusive dealing only be challenged if its harms are *substantially* disproportionate to its benefits is called the "disproportionality test." The Section 2 Report argues for the use of this test in cases of exclusive dealing, and also possibly in judging other forms of conduct.[30] The advocacy of this test was one of the reasons that a majority of FTC Commissioners was critical of the Report when it was issued.[31] Ms. Varney explicitly rejected the disproportionality test.[32] She did not propose a specific test to replace it. Instead Ms. Varney said that the Division will weigh pro- and anticompetitive effects to determine "whether on balance the net effect of this conduct harms competition and consumers."[33] Thus, it seems that an IP holder will face a greater burden if it tries to justify to the DOJ a policy of exclusive dealing that has increased its market power.

Just how aggressive the new DOJ policy is will remain uncertain until the Division has dealt with a number of actual practices and determined whether or not to challenge them. The IP Report recognizes that exclusive dealing by IP owners often does not extend market power and may result in significant efficiencies.[34] For example, exclusive contracts may be used to give a licensee incentives to improve the licensed technology.[35] Thus, the fact that the IP Report (as opposed to the Section 2 Report) was not withdrawn suggests the policy towards exclusive dealing (at least in an IP context) may not be very aggressive.

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28 Section 2 Report, p. 141.

29 Such conduct also would be challenged if it had absolutely no procompetitive benefits. Section 2 Report, p. 140.

30 Section 2 Report, p. 46.

31 FTC Statement, p. 5.

32 Varney Speech, p. 8.

33 Varney Speech, p. 13.

34 The IP Report, p. 116.

35 The IP Report, p. 122.

The DOJ so far has not filed any cases under Section 2 under the new administration. The closest that it has come is its "Statement of Interest" in the Google Books settlement.[36] In that matter, DOJ expressed concerns similar to those often found in Section 2 cases, in particular the fear that the settlement might entrench Google's alleged dominant position in online search.[37] Much of DOJ's concern in that matter, however, focused on the settlement as an agreement between competitors rather than on single-firm conduct. The lack of cases may simply reflect the lack of time since the Section 2 Report was withdrawn. The DOJ did initiate seven Section 2 investigations in 2009.[38] As has been noted, however, that number is not much different from the annual average number of Section 2 investigations begun during the previous administration.[39]

Even under the new policy, with either unconditional refusals to deal or exclusive dealing, DOJ will only act against a firm if it believes that the firm has significant market power, which will not be true of all owners of IP. Moreover, DOJ will not act against a firm with market power unless DOJ believes that the firm is engaging in a particular practice that will enhance or extend that power and that the anticompetitive effects of that practice outweigh its procompetitive effects. Those conditions, however, are in the eye of the beholder. One reason that the Section 2 Report advocated such a cautious policy was the fear that enforcement authorities might mistakenly attack practices that in fact were largely procompetitive ("false positives"). The DOJ now seems to be confidently minimizing that possibility.

DOJ may also be more aggressive in the area of the "duty to deal" in "reasonable and non-discriminatory" (RAND) manner in a standard setting context when licensing IP that is necessary to practice the standard. There has been considerable concern, particularly at the FTC, about potential hold-up that may arise after patented technologies are incorporated into a standard. This concern underlay the FTC's actions in *Dell* and *Rambus* (where the FTC challenged under Section 2 and Section 5 of the FTC Act the alleged misuse of a standard setting

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[36] Statement of Interest of The United States Of America Regarding Proposed Amended Settlement Agreement, The Authors Guild, Inc. et al., Plaintiffs, v. Google Inc., (United States District Court Southern District Of New York), 05 Civ. 8136 (DC), February 4, 2010.

[37] Id., at 22. For an argument that the DOJ's position in the Google Books settlement reflects a more aggressive Section 2 policy, see Gregory K. Leonard, "The Proposed Google Books Settlement: Copyright, Rule 23, and DOJ Section 2 Enforcement," 24 Antitrust 26 (Summer 2010).

[38] "Antitrust Division Workload Statistics," FY 2000-2009, available at www.justice.gov/atr/public/workstats.pdf.

[39] John D. Harkrider, "Obama: The First Year," 24 Antitrust 8 (Summer 2010).

organization (SSO) by patent holders to gain monopoly power over an industry standard).[40] Ms. Varney participated in the *Dell* case as an FTC Commissioner. Moreover, Carl Shapiro, currently head of the Economic Analysis Group at the Department of Justice, has championed this particular area, noting that the "hold up" problem becomes more severe in the case of standards, where potential licensees have already made sunk cost investments to comply with the standard, "locking-in" the licensee to the patented technology.[41] For these reasons, Shapiro and others have advocated ex ante licensing negotiations that take place before lock-in occurs. Alternatively, they have expressed the importance of patent holders' agreeing to license on RAND terms, meaning the royalties that would have been negotiated ex ante between patent holder and patentees. They also favor measures that encourage early disclosure of patents to the SSO.[42] In a recent speech, Ms. Varney also expressed concern about the potential for "hold-up" problems in standard setting.[43] These positions may portend strong DOJ (or FTC) Section 2 enforcement in the standard setting/IP arena.

Conclusion

One should not overreact to the first policy statements of a new administration. How aggressive the new policy towards single-firm conduct will be remains unclear. As indicated, since the Section 2 Report was withdrawn over a year ago, the Antitrust Division has not filed any cases under Section 2. Such cases, however, likely would take a long time to find and investigate. Thus, it seems that firms in high-technology industries should be more cautious in adopting practices that could be seen as anticompetitive. Moreover they should be ready to make a stronger case for the procompetitive benefits of those practices, in case they have to defend them to the Government.[44]

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[40] For a discussion of the issues in the Rambus case, see Stanley M. Besen and Robert J. Levinson, "Lessons from *FTC v. Rambus,*" *Icarus,* Summer 2010, pp. 17-27.

[41] Joseph Farrell, John Hayes, Carl Shapiro, & Theresa Sullivan, *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603 (2007). As one co-author of this article, Joseph Farrell, is now Director of the FTC's Bureau of Economics, there is also likely to be continued rigorous enforcement in this area by the FTC, even after the loss in Rambus.

[42] Farrell et al., supra at 637; 641.

[43] Christine A. Varney, "Promoting Innovation Through Patent and Antitrust Law and Policy," May 26, 2010.

[44] It is not clear how any DOJ policy changes will affect FTC policies towards single-firm conduct. It is possible that the policies of the two entities could now become more similar, or that changes in DOJ policy will embolden the FTC.