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Antitrust Concerns of Patent Acquisition

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I. INTRODUCTION

Recent events demonstrate that patents increasingly are being purchased and used for anticompetitive means. For example, patent assertion entities (also known as "patent trolls" or "PAEs") collect patents to extract high licensing fees; competitors acquire patents to create blocking positions that serve to exclude other competitors from competing in downstream markets; and firms acquire patents to create "patent thickets," which are patent collections on such a scale to make it difficult for smaller competitors to evaluate potential infringement with regard to their product development and innovation. The problem is particularly pronounced in the mobile marketplace, where intellectual property litigation is rampant, as market participants jockey for the dominant position in this hundreds-of-billions of dollars market.

A recent example involving the highly publicized patent dispute between Apple and Samsung highlights the potential for anticompetitive application of a high tech patent portfolio. In its trial brief, Samsung accused Apple of using patent enforcement to "stifle legitimate competition and limit consumer choice to maintain its historically exorbitant profits."[2] Although Apple ultimately prevailed in its litigation, securing a potential multi-billion dollar settlement from Samsung, as well as a potential injunction that would prohibit Samsung from selling many of its mobile products in the United States, that case and others demonstrate the potential exclusionary effect of IP in these highly competitive mobile markets.

Indeed, under current marketplace dynamics, a company competing in high-tech industries must amass a large patent portfolio to defend itself against the inevitable lawsuits that competitors or non-practicing entities (or "patent trolls") bring either to impose high rents on necessary technology components or prevent new competing products from entering the market. It is for this reason that antitrust authorities around the world have taken a heightened interest in IP market dynamics, and have conducted a number of very high profile investigations, and announced several significant consent decrees.

Indeed, the current patent environment's stress on competition and innovation has caused several detrimental market effects:

- small startups are sued for patent infringement before bringing their products to market and, as a result: (1) cannot bring their products to market, (2) are delayed in bringing their products to market, (3) can only bring their products to market at higher prices, or (4) must be acquired by a larger competitor with a significant patent portfolio that can be asserted defensively or contain pre-existing licenses to relevant patents;

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[2] Defendant's Trial Brief, Apple Inc. v. Samsung Electronics Co. Ltd., 11-cv-01846, 2012 WL3627731 (N.D. Cal. 2012).

- open-source offerings and adoption are stifled because companies implementing open-source alternatives fear patent claims;
- large companies spend billions of dollars on patent acquisition and litigation rather than on developing new products; and
- consumers are faced with higher prices and fewer choices because new products either never make it to market or only arrive after significant delay and additional costs.

Antitrust regulators are concerned about this mobile patent warfare and its effects on consumer welfare. In a report published in March 2010, the Federal Trade Commission ("FTC") recognized that competition is distorted when existing patents are valued based on the ability to extract rents from companies that have already implemented technology.[3] More pointedly, current acting Assistant Attorney General Joseph Wayland recently noted:

> [T]he division has continued closely to monitor the use of RAND-encumbered standard-essential patents in the wireless device industry, particularly as they relate to smartphones and computer tablets, to ensure that they do not stifle competition and innovation in this important industry.
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> Some have raised concerns about business entities that do not develop patented technologies or incorporate them into their products, but purchase and assert patents, through licensing or litigation, against firms who manufacture products using the patented technologies and thus may be locked into that technology.
>
> These firms often accumulate a large number of patents, making an assessment of validity and infringement difficult for an alleged infringer that may enhance the patent acquirer's bargaining leverage in licensing negotiations. Patent acquisitions by these types of companies are not uncommon in the wireless device industry.
>
> While being respectful of the benefits of business models that facilitate the transfer of patent rights, we continue to monitor these activities and their effects on innovation and competition.[4]

A trend that is equally troubling for antitrust regulators is the rise of competitors' joint purchasing of patent portfolios. While combining to purchase portfolios may allow companies to cross-license the patents among themselves and prevent costly patent litigation, companies left out of the consortium are deprived of any means of defending themselves against the assertion of the group's patents. Antitrust agencies must carefully consider the competition and policy concerns raised by these patent purchases, and should appropriately apply Section 7 of the Clayton Act and, where multiple competitors jointly purchase the patents, Section 1 of the Sherman Act, to analyze whether a patent acquisition will result in anticompetitive market power.

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[3] Fed'l Trade Comm'n, *The Evolving IP Marketplace, Aligning Patent Notice and Remedies with Competition* (2011), *available at* www.justice.gov/atr/public/speeches/282515.pdf.

[4] Joseph Wayland, Acting Ass't Atty. Gen., Antitrust Division, Dep't of Justice, *Antitrust Policy in the Information Age: Protecting Innovation and Competition*, Remarks as Prepared for the Fordham Competition Law Institute, New York, NY (Sept. 21, 2012), *available at* http://www.justice.gov/atr/public/speeches/287215.pdf.

II. ANTITRUST LEGAL FRAMEWORK AND POTENTIAL FOR UNILATERAL EFFECTS WITH PATENT ACQUISITIONS

The Antitrust Division of the U.S. Department of Justice ("DOJ") and the FTC have expressly stated that "[t]he Agencies apply the same general antitrust principles to conduct involving intellectual property that they apply to conduct involving any other form of tangible or intangible property."[5] While patents confer a statutory right to exclude others from the use of a given technology, patents are not free from application of the antitrust laws:

> An intellectual property owner's rights to exclude are similar to the rights enjoyed by owners of other forms of private property. As with other forms of private property, certain types of conduct with respect to intellectual property may have anticompetitive effects against which the antitrust laws can and do protect. Intellectual property is thus neither particularly free from scrutiny under the antitrust laws, nor particularly suspect under them.[6]

Thus the purchase of intellectual property rights (including patents), where such acquisition would tend to enhance or entrench the purchaser's market power in the properly defined relevant market, is anticompetitive conduct involving intellectual property that justifies enforcement activity. There are four main factual scenarios that may implicate the antitrust laws: (1) collaborative patent collection by competitors; (2) a patent acquisition that creates a blocking position; (3) a patent acquisition that creates a patent thicket; and (4) an acquisition by a patent troll.

Specifically, an acquisition or transfer of existing patents is subject to review under Section 7 of the Clayton Act and will be evaluated to determine if the acquisition confers market power on the acquirer(s) and if there is a likelihood of substantial lessening of competition as a result. Not only is collaborative patent collection by competitors subject to Section 7 scrutiny, but such conduct is also subject to review under Section 1 of the Sherman Act and evaluated to determine whether the combination was formed in an effort to exclude a party that did not participate in a consortium.[7]

Indeed, the theory of unilateral effects is an important consideration when evaluating patent acquisitions. For many years, the FTC and DOJ have applied the principle that a merger violates Section 7 of the Clayton Act where "merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output." In the wake of the DOJ's 2011 victory in *United States v. H&R Block,*[8] in which the court accepted the DOJ's unilateral effects analysis, practitioners must be mindful of unilateral effects in technology transactions. *H&R Block* demonstrated that unilateral effects need to be examined even in cases involving lower market shares and even where the two products are not the closest substitutes.[9] Further, the court suggested that an appropriate market definition is not even a prerequisite in

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[5] *US Dep't of Justice & Fed'l Trade Com'n Antitrust Guidelines for the Licensing of Intellectual Property*, Section 2.1 (Apr. 6, 2011), *available at* www.justice.gov/atr/public/press_releases/2001/8810.htm.

[6] *Id.*

[7] *See* United States v. Singer Manufacturing Co., 374 U.S. 174 (1963) (holding that it is unlawful for competitors concertedly to use patents to hinder or exclude a competitor from the market).

[8] 832 F. Supp. 2d 36 (D.D.C. 2011).

[9] *Id.* at 40 (citations omitted).

this analysis, as "a merger between two close competitors can sometimes raise antitrust concerns due to unilateral effects in highly differentiated markets."[10]

This analysis presents important considerations for technology markets, as market shares are often not an indication of market power or lack thereof, and are often not a reliable measure of whether the merging firm would have the incentive and ability to raise prices or slow the decline of innovation. For example, a merger could result in a small combined market share, but could create significant market power if the parties hold competing patent portfolios that, as a combined entity, would create a blocking position or patent thicket where none previously existed.[11] Similarly, the acquisition of patents by non-practicing entities (*i.e.,* patent trolls) also raises significant competitive concerns that must be evaluated by enforcers. Acquisition of a patent by an entity that does not practice the technology may increase market power because the patent troll can increase royalties, deny licenses, or otherwise increase enforcement without fear of countersuit for infringement.

Thus, in determining potential anticompetitive effects in patent acquisitions, enforcers consider whether: (1) the acquisition creates a blocking position in a technology market that would enable the acquirer to exclude competitors or raise the costs of rivals;[12] (2) the acquisition contributes to a *patent thicket* that makes it impractical for competitors to determine whether their activity infringes the acquiring party's large patent portfolio, thereby deterring potential market entrants and increasing market power;[13] or (3) the acquiring party has different incentives with regard to the patents than the selling party, thereby potentially increasing enforcement of the patent rights if the acquirer is a competitor in the relevant industry seeking to quash competition or a *patent troll* that may increase enforcement without fear of a countersuit for infringement.

Once the agencies determine that a patent acquisition has anticompetitive effects, remedies must be specifically tailored to the potential anticompetitive outcome and strong enough to alleviate the identified issues. The DOJ's updated policy guide to merger remedies issued on June 17, 2011 states, "the key is finding a remedy that works, thereby effectively preserving competition in order to promote innovation and consumer welfare."[14] The remedies guide further states that the central goal "is preserving competition, not determining outcomes or picking winners and losers."[15]

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[10] *Id.*

[11] See, *e.g.*, United States v. 3D Systems Corp. No: 1:01CV01237 (D.D.C. 2002).

[12] *See* Press Release, Dep't of Justice, Antitrust Div., *Department of Justice Requires 3D Systems Corporation and DTM Corporation To Lift Patent Entry Barriers* (Aug. 16, 2001), *available at* www.justice.gov/atr/public/guidelines/272350.pdf.

[13] For example, Apple, Microsoft, Facebook, and others have recently acquired thousands of technology patents.

[14] US Dep't of Justice, Antitrust Division, *Antitrust Division Policy to Merger Remedies* (2011), *available at* www.justice.gov/atr/public/guidelines/272350.pdf.

[15] *Id.*

III. RECENT ENFORCEMENT ACTIVITY

Along with increased demand for smartphones and tablets, there has been a focus on a demand for the patents involved in producing these items. Google, Apple, Microsoft, and RIM, among others, have each developed mobile operating systems—Apple and RIM manufacturing and selling their own devices, Google providing its Android OS under an open-source license free of charge, and Microsoft licensing its OS for a fee to wireless handset original equipment manufacturers. At the beginning of 2010, Microsoft and Apple began asserting their extensive patent portfolios against OEMs that used Android OS in order to block the sale of Android products. At the time, Google only had approximately 1,000 patents, the majority of which covered search technologies, and was in no position to bring counterclaims on the same scale and thereby deter these suits.

Thus, when three significant patent portfolios with potential implications to the smartphone industry became available in 2010 and 2011, technology companies had a great deal of interest in acquiring the portfolios. In the first sale, CPTN, a holding company owned by Microsoft, Oracle, Apple, and EMC Corp, agreed to acquire approximately 450 patents from Novell. These patents relate to Linux, the open-source platform that underlies many consumer electronics and products and forms the technological basis of the Android operating system.

This acquisition raised antitrust concerns in part due to the history of consortium partners' attacking open-source software projects through patent litigation. As open-source projects had been instrumental in promoting competition in technology markets, the DOJ (and, separately, the German Cartel Office) opened an investigation of the acquisition. Ultimately, in order to proceed with the acquisition, CPTN agreed to several changes to the acquisition to address competitive concerns, including (1) divesting the Novell patents to be held by Microsoft and stipulating that all the patents would remain subject to the GNU General Public License and a Open Invention Network ("OIN") license (OIN is an organization that holds a conglomeration of patents which it licenses to members to allow them to defend the Linux ecosystem), as well as (2) stipulating that the CPTN could not take any action to influence or encourage Novell to modify which of the patents are available under the OIN license. The DOJ recognized these changes as improvements, but announced that it would continue to investigate the distribution of patents to ensure continued competition.[16]

In the second transaction, the trustee of the Nortel Networks Bankruptcy estate auctioned off 6,000 patents, which have potentially far reaching application on mobile devices. In the winter of 2011, Google had been selected as the "stalking horse" purchaser of these assets and obtained pre-merger clearances to proceed with the purchase. At the auction, however, while Google continued to pursue this acquisition and increased its initial $900 million bid to $4 billion, Apple and Rockstar Bidco (consisting of Microsoft, RIM, Sony, and Ericsson) jointly outbid Google and acquired the patents.[17] Finally, on August 15, 2011, Google proposed purchasing Motorola

[16] Press Release, Dept' of Justice, Antitrust Div, *CPTN Holdings LLC and Novell Inc. Change Deal in Order to Address Department of Justice's Open Source Concerns* (Apr. 20, 2011), *available at* www.justice.gov/opa/pr/201/April/11-at-491.html.

[17] Press Release, Nortel, *Nortel Announces the Winning Bidder of its Patent Portfolio for a Purchase Price of US$4.5 Billion* (Jun. 30, 2011), *available at* www2.nortel.com/go/news_detail.jsp?cat_id=-8055&oid=100272428.

Mobility Holdings, Inc., a manufacturer of Android OS handsets. Google's primary interest was in acquiring the company's extensive patent portfolio to defend the Android ecosystem from patent attacks by aggressors seeking to raise the costs of the Android OS to OEMs and, in turn, the cost to Android consumers.

In a closing statement issued on February 13, 2012, the DOJ disclosed the analysis that it undertook in connection with Microsoft's purchase of some of the Novell patents, the Apple/Rockstar purchase of Nortel's patents, and Google's acquisition of Motorola Mobility.[18] The DOJ acknowledged that a patent gives the owner the right to exclude infringing devices from the market and/or charge royalties, but went on to outline competitive concerns that can also materialize.

The DOJ was particularly focused on the acquisition of patents necessary to implement a recognized industry standard (standard essential patents ("SEPs")), due to their inclusion by standard setting organizations ("SSOs") in technical standards for essential components of wireless technology. Although most SSOs require the owners of SEPs to make disclosures and commit to license SEPs on reasonable and nondiscriminatory ("RAND") terms, in practice such RAND requirements have not always prevented significant disputes from arising in connection with the licensing of SEPs. The primary concern expressed by the DOJ's closing statement was how the proposed transactions might change the incentive and the ability of acquiring firms to use SEPs in anticompetitive ways.

Ultimately, the DOJ concluded that each of the transactions were unlikely to substantially lessen competition for wireless devices. The DOJ found that RIM's and Microsoft's low market shares in the mobile platforms made them unlikely to use successfully the patents anticompetitively. Conversely, the DOJ concluded that Apple and Google had substantial market share, but that the specific transactions were unlikely to substantially lessen competition.

IV. DISTINCTION BETWEEN SEP AND ESSENTIAL, NON-STANDARDS BASED PATENTS AND THE TRANSFER OF PATENTS TO NON-PRACTICE ENTITIES

Under Section 7 of the Clayton Act, the antitrust agencies ask whether a transaction is likely to result in a substantial lessening of competition. The important element in that inquiry is whether the acquisition gives the acquiring firm the ability and incentive to exercise market power. In the review of the patent acquisitions discussed above, the DOJ posited that the acquisition of SEPs gives a firm a greater ability to exercise market power than essential but non-standards based patents.

However, that conclusion may be both over- and under-inclusive, capturing transactions that do not confer market power, yet missing transactions that do confer market power. Furthermore, this overlooks the equally important incentive to exercise market power. For example, this also overlooks the potential that the transfer of SEPs (and essential non-standards

[18] Press Release, Dep't of Justice, Antitrust Div., *Statement of the Department of Justice's Antitrust Division on its Decision to Close its Investigations of Google Inc.'s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp., and Research in Motion Ltd.* (Feb. 13, 2012), *available at* www.justice.gov/atr/public/press_releases/2012/280190.htm.

based patents) to patent trolls could confer both the incentive and ability to the non-practicing entity to exercise market power.

It is curious that the DOJ limited its concerns to patents that the companies had agreed to license through SSOs, since there is generally no guarantee that firms will submit any or all of their patents that might be necessary to implement a standard. Additionally, complex consumer products such as smartphones often incorporate patents that do not read on an officially recognized standard, but are nonetheless essential as a practical matter. Indeed, both Microsoft and Apple's patent portfolios appear to contain a number of these *de facto* essential patents.

Patents that are essential, whether or not they are officially incorporated into an established standard, can give patentees considerable market power. And, consequently, both SSO members and third-party patentees are capable of abusing the investments that other firms make in adopting a standard. Therefore, the agencies should not limit their inquiry to SEPs when considering the competitive impact of patent acquisitions.

V. CONCLUSION

Despite the agencies' framework under Section 7 of the Clayton Act, it is difficult to predict how antitrust enforcers and courts will handle antitrust enforcement of competitive concerns raised by patent acquisitions. However, it is clear that the agencies believe there is potential for anticompetitive effects in patent acquisitions, and intend to scrutinize these transactions. Thus, it is important for antitrust counsel advising on these transactions to be mindful of the recent legal developments that may impact the agency analysis and enforcement.