FENWICK & WEST LLP

Antitrust Update

Supreme Court Eliminates Presumption of Market Power in Patent Tying Cases

MARCH 6, 2006

On March 1, 2006, the Supreme Court issued its decision in *Illinois Tool Works, Inc. v. Independent Ink*, which considered the long-standing presumption of market power in patent tying cases. As was widely expected, the Court eliminated this presumption, holding that the use of a patented product as the "tying product" in a tying arrangement does not obviate a plaintiff's need to prove market power. The case is an obvious boon to defendants facing allegations that they have tied a patented product, as overcoming the presumption was often a heavy and expensive burden that required economic analysis, but it also raises significant issues regarding the applicable standard for product ties generally.

Petitioner Illinois Tool Works manufactures ink jet printheads and inks, which typically are incorporated into larger printing machinery and used for printing bar codes and product labels. Sales of the patented printheads are made on the condition that they will be used exclusively in conjunction with Illinois Tool Works ink, which is unpatented. Respondent Independent Ink, which manufactures ink compatible with the printheads, challenged this practice as a *per se* illegal tying arrangement in violation of Sherman Act § 1.

For many years, a *per se* rule of illegality has applied to *certain* tying arrangements. But, tying arrangements that did not satisfy all the elements of that *per se* rule have also been subject to review under the so-called "rule of reason." If a *per se* rule applies, the practice is deemed to be an unreasonable restraint on trade, and therefore illegal, without any further inquiry into its actual competitive effect or the defendant's justifications for its actions. In contrast, under the rule of reason, the practice is evaluated in its total market context, and both positive and negative effects are considered in determining whether, on balance, it is unreasonable, and therefore illegal.

The elements of the *per se* rule against tying are: two separate products, the defendant's conditioning the sale of the tying product on the purchase of the tied product, the involvement of a not insubstantial amount of commerce, and some degree of market power over the tying product. Since the Supreme Court's 1984 decision in *Jefferson Parish Hospital District No. 2 v. Hyde*, a plaintiff asserting a *per se* theory of tying must affirmatively prove the defendant has market power in the tying product market, and most courts require evidence of at least (and often substantially more than) a 30% share in a properly defined economic market to meet this test.

Where the defendant holds a patent for this product, however, earlier case law had held that market power is presumed, and the defendant must bear the often-heavy burden of establishing that market power does not exist. Because the presence or absence of market power is a fact question, the presumption made it difficult to obtain summary judgment in all but the most extreme cases. Commentators have often questioned this aspect of tying law, noting that there is no necessary relationship between the "patent monopoly" and the actual power to raise market prices above their competitive levels, the "monopoly" of concern to the antitrust laws. The patent provides a "legal monopoly" over products meeting the specific claims set forth in the patent, but many patents fall far short of an "economic monopoly" because of available substitutes.

In *Illinois Tool Works*, the Federal Circuit, while noting the presumption had been the subject of heavy academic criticism, ultimately concluded it was bound by Supreme Court precedent on the issue. Probably because of the questions raised by the Federal Circuit, the Supreme Court granted review to reconsider the continuing validity of the presumption. In a unanimous opinion (Justice Alito not participating), Justice Stevens reviewed the long history of Supreme Court cases dealing with tie-ins between patented and unpatented products. That history began with cases holding that such tie-ins constituted a "misuse" of the patent based on the view that patentee was improperly extending the scope of its patent. A finding of misuse resulted in the patentee being denied the right to enforce the patent until the misuse was purged. Over time, however, the misuse doctrine's approach to tying migrated into the antitrust area and became the basis for affirmative claims rather than merely a defense to an infringement action.

In eliminating the presumption, Justice Stevens noted that, "Congress, the antitrust enforcement agencies, and most economists have all reached the conclusion that a patent does not necessarily confer market power upon the patentee." Although the presumption originated in early patent misuse doctrine, Congress subsequently amended the Patent Act in 1988, providing for a finding of patent misuse through tying only where the defendant had market power in the tying product. The Court relied heavily on the disjunction created by this amendment between patent misuse and antitrust. "It would be absurd to assume that the use of a patent that merited punishment as a felony would not constitute misuse." (Although the disjunction was real and unjustifiable, Justice Stevens' argument is questionable because the Department of Justice has for many years limited its criminal enforcement to cartel activity such as price-fixing and market allocation agreements among competitors.)

The opinion raises a significant question regarding the availability of the rule of reason to challenge a product tie should a plaintiff fail to meet the elements of a *per se* case. *Jefferson Parish* left open the theoretical possibility that a plaintiff that failed to prove market power could still challenge a tie based on the rule of reason. Such a possibility remained primarily theoretical, however, as absent market power the likelihood that a tie has an actual adverse affect on competition—and that a plaintiff can prove such an effect as required by the rule of reason—is extremely low. Lower courts after *Jefferson Parish* varied in their recognition of this fact, with some making out an explicit market power requirement for any tying case and others engaging in a full rule of reason analysis even when market power could not be shown. While as a practical matter they usually led to the same result, *Illinois Tool Works* seems to foreclose the latter approach, going so far as to say: "[We] hold that, in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product." (Emphasis added.) This result is consistent with the increasing tendency of courts to hold that some proof of market power is necessary in a rule of reason case.

Illinois Tool Works also casts some doubt on the continued validity of the *per se* rule itself. Throughout the opinion, Justice Stevens rejects the assumption that tying arrangements are almost always anticompetitive and serve no legitimate purpose. The validity of such an assumption has been a stated requirement for the existence of *per se* rules in antitrust for many years. While the market power requirement certainly limits the extent to which competitively beneficial or neutral practices are prohibited, it is a very imperfect screen. The proper economic concern of tying law is that the market power over the tying product will be used to harm competition in the market for the *tied product*. Without some market power, a company would lack the ability to force a tie on unwilling buyers. However, it does not follow that competitive harm is likely in the tied product market whenever market power exists in the tying product market. Indeed, in *Jefferson Parish*, four Justices would have eliminated the *per se* rule for tying altogether.

In the absence of a *per se* rule, the inquiry would naturally focus on the market where the competitive harm might occur—the tied product market. Under the existing *per se* rule as explained in *Illinois Tool Works*, a plaintiff must demonstrate market power in the tying product market, requiring expensive economic analysis of that market. This *per se* rule for tie-ins is thus a very different kind of *per se* rule than the one forbidding price-fixing among direct competitors, which merely requires proof of the agreement and does not include a market power element. Assuming that economic analysis is necessary, it should be focused directly on the actual competitive effect in the tied product market, rather than approaching that issue indirectly through the tying product market. In many cases, the likelihood of competitive harm in the tied product market will be so low that one would never need to analyze the tying product market at all. *Illinois Tool Works* may eventually be seen as one more step along the road to the elimination of the *per se* rule against tying altogether.

If you have questions please contact:

Tyler A. Baker, Co-Chair, Antitrust and
Unfair Competition Group
tbaker@fenwick.com, 650-335-7624

Mark S. Ostrau, Co-Chair, Antitrust and
Unfair Competition Group
mostrau@fenwick.com, 650-335-7269