

# Antitrust issues of particular relevance to high-technology industries

Tyler A Baker and Mark S Ostrau

Fenwick & West LLP

Not that long ago, there was a relatively widespread belief among executives in high-technology companies that, because of the unique characteristics of high-technology industries, the antitrust laws had little, if any, application to them or their businesses. While certain features of high-technology industries set them apart from others for the purposes of antitrust analysis, there has never been any basis for the idea that high-technology companies have a ‘free pass’ from the antitrust laws, as confirmed in *United States v Microsoft Corp.*<sup>1</sup> Moreover, recent high visibility filings by Advanced Micro Devices against Intel and both Novell and RealNetworks against Microsoft demonstrate that high-technology companies are increasingly willing to invoke the antitrust laws themselves.

The growing consolidation in many high-technology markets, as predicted (and in part directly facilitated) by Larry Ellison of Oracle, means that serious antitrust issues are likely to become more common in both merger and non-merger situations. Also, many companies currently rely on cooperative or collaborative relationships with industry giants like Microsoft, Intel, IBM and Oracle in order to interoperate effectively with those companies’ products, and can be at grave risk if the giants decide to move into adjacent markets in search of additional growth. Thus, the question today is not whether antitrust law is relevant to high-technology companies, but rather how such companies both large and small can compete vigorously and effectively, consonant with its proscriptions.

Here is a selection of several antitrust issues that are likely to be important to counsel for high-technology companies in the years ahead.

## Market definition

Over the last 30 years, the introduction of more rigorous economic standards to antitrust analysis has reduced the number of business practices that raise serious antitrust concerns. But as *Microsoft* shows, antitrust enforcement and litigation have not been eliminated, but rather redirected to, and refocused on, new situations that present a genuine potential for harm to competition. Increasingly, the courts separate potentially harmful practices from the innocuous ones by asking whether the defendant has market power. The economic logic is that in the absence of market power, competition will act as a sufficient check on many business practices. This logic holds true in high-technology markets.<sup>2</sup>

In most cases, market power is inferred from the presence of high market shares in a relevant market with significant barriers to entry. Thus, defining the relevant market is often a threshold issue in many antitrust cases today.<sup>3</sup> In every type of industry including high-technology, market definition is intensely fact-specific. But high-technology markets present added challenges in market definition for a variety of reasons, including but not limited to the fact that the technology underlying the relevant product or service may be complex and unfamiliar to most judges, juries and government enforcers.

In our practice, we regularly deal with market definition issues relating to high technology in the context of merger investigations by the US Department of Justice or the Federal Trade Commission. Relatively few of these investigations result in reported cases. The

most visible recent case in this area is, of course, *United States v Oracle*,<sup>4</sup> in which the district court rejected the Antitrust Division’s challenge to the merger. While the Division’s proposed market definition admittedly presented some particularly difficult hurdles, it would be a mistake to conclude that high-technology mergers will be immune from challenge after *Oracle*. While Judge Walker wrote a detailed opinion supporting his decision, another court could have concluded that the merger was anti-competitive on the same record. In addition, the enforcement agencies are continuing to apply the same market definition analysis that prompted them to challenge the Oracle/PeopleSoft deal, and few companies have the time, money, or strategic incentive to engage in protracted litigation as Oracle did.

One reason why market definition for software and other high-technology markets presents an added challenge is that the products are often highly differentiated and are distributed and priced in multiple ways. In addition, in many situations the enforcement agencies and the courts may identify substitutes in the form of outsourcing or home-grown/do-it-yourself solutions. These considerations have figured prominently in merger cases such as *Oracle*<sup>5</sup> and *SunGard*<sup>6</sup>, as well as in several merger investigations that did not result in a challenge.

## Anti-competitive effects in high-technology mergers

The traditional focus of merger analysis is on the effect of the proposed merger on overall market concentration and the resulting potential for tacit coordination of pricing and output-restricting behaviour. Although the enforcement agencies continue to evaluate mergers on this basis, they have increasingly focused on an economic doctrine known as ‘unilateral effects’ in markets where the products are highly differentiated, as is the case in most high-technology markets. The economic logic is that tacit coordination of prices is difficult and unlikely where the products are highly differentiated. But economists believe that a merger in such a market may nevertheless cause prices to rise where the merging parties have products that are the first and second choices of a significant number of consumers and other sellers cannot easily reposition their products to meet those preferences. In an important sense, a unilateral effects analysis does not depend on defining the overall market but rather focuses on the closeness of the products of the merging parties and the differences between their products and the next best substitutes.

Because there is often no clear break in the continuum of alternatives available to buyers, the current mode of analysis in recent investigations of high-technology mergers is to evaluate whether narrower ‘price discrimination’ markets exist within the larger market.<sup>7</sup> Finding such a narrower market first requires there to be a definable group of customers whose requirements are sufficiently distinct from the overall customer base so that only a subset of suppliers are reasonable substitutes. This involves evaluating both the characteristics of customers (eg, size, industry, and because of the special requirement of interoperability found in high-technology markets, installed IT infrastructure) and the intended use of the relevant product. In general, any such market segmentation must be based on a product feature or characteristic that is recognised by industry participants<sup>8</sup>

and be susceptible to clear articulation.<sup>9</sup> Moreover, suppliers must be able to identify whether a particular prospective customer is a member of the narrower group in advance of sale in order to be able to treat the customer less favourably than those who have a broader range of available alternatives. This sort of calculated discrimination may be difficult to do given what is often an ‘alphabet soup’ (OEM, VAD, VAR, etc) of distribution channels in many high-technology markets, and may be impossible if the distinction among customers is based on internal preferences rather than external factors.

Certain attributes of high-technology industries also can affect the determination of whether a supplier (or merged entity) has the requisite market power within a narrow or price discrimination market sufficient to raise concerns in a merger or non-merger case.<sup>10</sup> For example, many types of software products can be repositioned to address specific customer segments much more quickly and economically than physical products that require intensive prototyping and manufacturing. On the other hand, significant technological barriers to repositioning, such as interoperability requirements, technical expertise, or intellectual property issues, may be more prevalent in high-technology markets. Recognition of such barriers is evident in a number of consent orders or agreements resolving agency concerns with recent transactions, which often contain provisions designed to lower or remove these barriers.<sup>11</sup>

### Unilateral refusals to deal

Another antitrust issue that is particularly pertinent to high-technology industries involves whether a putative monopolist may lawfully refuse to deal with a competitor. The law is clear that simply possessing monopoly power does not violate the antitrust laws. However, the law is equally clear that a monopolist is held to a different and higher standard than companies in competitive markets. In other words, conduct that would not be illegal if done by a company in a competitive market may be illegal if done by a monopolist.<sup>12</sup> While merely possessing monopoly power is not illegal, a monopolist cannot obtain or maintain such power by means other than competition on the merits. The basic rule thus can be succinctly stated as follows: the Sherman Act proscribes any unilateral conduct by a monopolist, including a refusal to deal with its competitors, if that conduct harms competition and lacks a legitimate business justification.<sup>13</sup>

In high-technology industries, an antitrust claim premised on a unilateral refusal to deal is likely to see more and more use in litigation because the ‘dealing’ in question may take any one of a myriad of forms: eg, provision of technical assistance and advance information about new products,<sup>14</sup> access to replacement parts for repairing photocopiers,<sup>15</sup> access to application programming interfaces for ensuring interoperability,<sup>16</sup> and sale of DSL services to the customers of a rival.<sup>17</sup> Notwithstanding the fact that dealing may encompass all manner of business relationships between a putative monopolist and a rival company, however, the Sherman Act was not designed to convert all “harsh commercial actions” that “adversely affect another’s business situation” into antitrust violations.<sup>18</sup>

The United States Supreme Court’s decision in *Verizon Communications v Trinko* confirmed the narrowness of the prohibition against unilateral refusals to deal.<sup>19</sup> In rejecting an antitrust claim premised on Verizon’s alleged insufficient assistance in providing interconnection services to rivals, the court held that “traditional antitrust principles [do not] justify adding the present case to the few existing exceptions from the proposition that there is no duty to aid competitors.”<sup>20</sup> “We have been very cautious in recognizing such exceptions, because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm.”<sup>21</sup> Significantly, however, the court did not repudiate any of the previous cases. Moreover, the decision actually turned on

the specific regulatory framework of the Telecommunications Act of 1996, which provided a mechanism for resolving the type of complaint on which Trinko’s antitrust claim was based.

The Court in *Trinko* stated that *Aspen Skiing* was at the outer reaches of a Section 2 duty to deal, but it did not overrule or limit the decision. There, the defendant was willing to terminate a voluntary and presumably profitable business relationship with the plaintiff in the hope of driving out its smaller competitor and thereby realising a monopoly in the relevant market. If a high-technology company can articulate how a monopolist’s refusal to deal or share is inconsistent with rational, competitive business behaviour (as was the case with the defendant’s profit sacrifice in *Aspen Skiing*), it should be able to present a claim that at least withstands a motion to dismiss.<sup>22</sup>

*Aspen Skiing* thus can still be particularly instructive where a monopolist refuses to continue an existing and profitable relationship. In technology markets, it is not uncommon for a monopolist to encourage other companies to provide solutions using the monopoly product. Doing so increases the use and acceptance of the monopolist’s product and may create network effects protecting it from competitors. Once the monopoly product is solidly entrenched, however, the monopolist may attempt to take over the adjacent markets. Although antitrust cases should not be undertaken lightly, a refusal to deal case is possible under the right set of circumstances.

Closely associated with a unilateral refusal to deal and often asserted by plaintiffs as the cornerstone of such a claim is the essential facilities doctrine. The Supreme Court has never recognised such a doctrine but some lower courts have, so high-technology companies should consider whether they might plead it as an additional or alternative basis for a monopolisation claim.<sup>23</sup> Invoking the doctrine requires identifying a ‘facility’ that is essential to effective competition, is exclusively controlled by one company, and is being used by that company to create or maintain monopoly power in a relevant market through the denial of access by its rivals.<sup>24</sup> The antitrust plaintiff must prove that “the defendant controls an essential facility that cannot be practically or economically duplicated” and that access to this facility is unavailable.<sup>25</sup>

This doctrine has intuitive appeal in the context of high-technology industries because technology firms “may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers”.<sup>26</sup> A good example would be a platform for computer games or an operating system. Smaller companies then innovate along the periphery of this infrastructure, creating products (eg, game software, desktop applications) that compete with the products created by the putative monopolist that controls the infrastructure. If the monopolist later decides to block access to information necessary for products to interoperate with the infrastructure, there could be a refusal to deal claim based upon the infrastructure as an essential facility.

Another layer of complexity in the antitrust analysis of unilateral refusals to deal relates to the existence of intellectual property rights (eg, patents and copyrights) that protect the putative monopolist’s products, services, technology and know-how. Generally speaking, high-technology firms are more likely to have a web of intellectual property protection covering various aspects of their businesses. That complicates the refusal to deal analysis because several appellate courts have held that a monopolist’s refusal to deal is backed by a valid business justification if it is premised upon a refusal to license an intellectual property right.<sup>27</sup> The Ninth Circuit has added, however, that the business justification is only presumptively valid and may be rebutted by “evidence of pretext”.<sup>28</sup> In contrast, the Federal Circuit has disagreed with the addition of this proviso on the ground that a patentee’s subjective motivation for refusing to sell or license its patented products is irrelevant and therefore no

inquiry into the issue of pretext is proper in the absence of fraud on the Patent Office.<sup>29</sup> These conflicting views between the Ninth Circuit and the Federal Circuit have not as of yet been resolved by the Supreme Court or by statute.<sup>30</sup>

## Notes

- 1 253 F.3d 34, 50 (D.C. Cir. 2001) (en banc).
- 2 Moreover, in many high-technology markets, network effects may naturally tend to create a dominant company at any point in time, and, for that reason, first mover advantages sometimes may be more important than truly superior technology.
- 3 The exceptions are those practices that are considered to be per se illegal. Even in that limited category of practices, the Supreme Court has increasingly interjected a requirement of market definition. Specifically, the per se rules against tying and group boycotts require proof of some market power and, therefore, market definition.
- 4 *United States v Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).
- 5 *Id* at 1121 (characterising market definition in differentiated product markets as a difficult task due to competition among many non-price dimensions).
- 6 *United States v SunGard Data Systems Inc*, 172 F. Supp. 2d 172, 186 (D.D.C. 2001) (discussing customer replacement of an external product with an internally created system).
- 7 For example, in its challenge to the acquisition of Hyprotech Ltd by Aspen Technology Inc, which was resolved by a consent decree in 2004, the FTC alleged an overall market of “software used to simulate continuous process engineering applications”, as well as four narrower markets within the overall market defined by end-user application. *In the Matter of Aspen Technology, Inc*, FTC Dkt. No. 9310 (Dec. 21, 2004).
- 8 See, eg, *Lantec Inc v Novell Inc*, 146 F. Supp. 2d 1140, 1148 (D. Utah 2001), quoting *Brown Shoe Co v United States*, 370 U.S. 294, 325 (1962).
- 9 For example, the government’s ill-fated definition of ‘large complex enterprises’ needing ‘high function software’ in *Oracle* failed to meet either test.
- 10 In what may be a narrow view of the test in a merger context, the court in *Oracle* took the position that “[t]o prevail on a differentiated products unilateral effects claim, a plaintiff must prove a relevant market in which the merging parties would have essentially a monopoly or dominant position.” 331 F.Supp. 2d at 1123. As normally understood, the doctrine recognises the potential for harm to competition from a combination of companies whose products are very close substitutes even though the merger would not necessarily be objectionable in light of the overall concentration of the broader relevant market.
- 11 See, eg, *In the Matter of Aspen Technology Inc*, FTC Dkt. No. 9310 (Dec. 21, 2004); *In the Matter of Itron*, FTC File No. 031-0201 (Aug. 10, 2004).
- 12 *Image Tech Servs, Inc v Eastman Kodak Co*, 125 F.3d 1195, 1207 (9th Cir. 1997).
- 13 *Eastman Kodak Co v Image Technical Servs, Inc*, 504 U.S. 451, 483 n.32 (1992); *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 U.S. 585, 602-05 (1985).
- 14 *Intergraph Corp v Intel Corp*, 195 F.3d 1346, 1354 (Fed. Cir. 1999).
- 15 *Image Technical*, 125 F.3d at 1201.
- 16 *Microsoft*, 253 F.3d at 53.
- 17 *Covad Communs Corp v Bell Atlantic Corp*, 398 F.3d 666, 675 (D.C. Cir. 2005).
- 18 *Intergraph*, 195 F.3d at 1354.
- 19 *Verizon Communs Inc v Trinko*, 540 U.S. 398 (2004).
- 20 *Id* at 411 (emphasis added).
- 21 *Id* at 408.
- 22 See, eg, *Covad Communications*, 398 F.3d at 676.
- 23 *Trinko*, 540 U.S. at 411.
- 24 *Morris Communs Corp v PGA Tour Inc*, 364 F.3d 1288, 1294 (11th Cir. 2004).
- 25 *Id*.
- 26 *Trinko*, 540 U.S. at 407.
- 27 *CSU LLC v Xerox Corp*, 203 F.3d 1322, 1327-28 (Fed. Cir. 2000); *Image Technical*, 125 F.3d at 1218; *Data General Corp v Grumman Sys Support Corp*, 36 F.3d 1147, 1186 (1st Cir. 1994).
- 28 *Image Technical*, 125 F.3d at 1218.
- 29 *CSU*, 203 F.3d at 1327.
- 30 See *Telecom Tech Servs Inc v Rolm Co*, 388 F.3d 820, 828 n.8 (11th Cir. 2004).

## Fenwick & West LLP

**Mountain View, California Office**  
**Silicon Valley Center**  
**801 California St**  
**Mountain View, California 94041**  
**Tel: 650 988 8500**  
**Fax: 650 938 5200**

**San Francisco, California Office**  
**Embarcadero Center West**  
**275 Battery Street**  
**San Francisco, CA 94111**  
**Tel: 415 875 2300**  
**Fax: 415 281 1350**

**Contact: Tyler A Baker**  
**e-mail: [tbaker@fenwick.com](mailto:tbaker@fenwick.com)**

**Mark S Ostrau**  
**e-mail: [mostrau@fenwick.com](mailto:mostrau@fenwick.com)**

Antitrust and unfair competition cases are often costly because of attorneys' fees and potential fines and damages. Even more importantly, however, such claims often strike at the core of a company's business strategy and demand the attention of key management. To be effective in representing clients in this challenging and complex area of the law, attorneys must combine a deep understanding of the client's business, the substantive laws, and the litigation and administrative processes through which the laws are enforced. The antitrust and unfair competition group at Fenwick & West LLP is well positioned to represent clients aggressively, efficiently, and effectively in this difficult and constantly changing area of the law. Our practice includes both highly sophisticated counseling and complex litigation, and our experience in each area complements and enhances our abilities in the other.