Santa Clara University School of Law

Santa Clara High Technology Law Journal

Volume 14 | Issue 2 Article 6

January 1998

Losing the Presumption of Market Power for Antitrust Purposes, and Its Affect on the Software Industry

Regina A. DeMeo

ESSAYS

LOSING THE PRESUMPTION OF MARKET POWER FOR ANTITRUST PURPOSES, AND ITS AFFECT ON THE SOFTWARE INDUSTRY*

Regina A. DeMeo†

I. INTRODUCTION

Until recently, antitrust laws and intellectual property rights were thought to be antagonistic. It is now readily recognized, however, that both are vital to an efficient economy: intellectual property rights protect innovation, and antitrust laws ensure that markets will remain open to all interested competitors. Nevertheless, as antitrust law currently stands, market power is defined as the power to control prices, or to exclude competition. Relying on this definition of market power, courts developed an automatic **presumption** of market power for cases involving the intellectual property rights of an individual or entity.[1] This presumption that intellectual property rights automatically confer market power, however, is based on false assumptions[2] and thus unduly punishes holders of intellectual property rights.

† J.D. 1998, at The George Washington University Law School. All errors and omissions remain those of the author. The author would like to thank her fellow AIPLA Quarterly Journal publication staff members for their helpful advice and criticism and Benjamin DeMeo for his insightful comments and encouragement.

1. *See, e.g.*, Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 15-16 (1984) (holding that market power may be presumed in a tying agreement involving intellectual property rights).

2. *Id.* at 37 n.7 (O'Connor, J., concurring) (arguing that "a common misconception has been that a patent or copyright...suffices to demonstrate market power..., [however] it is also possible that a seller in these situations will have no market power: for example, a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.").

Recognizing the importance of the software industry in the U.S. economy and the notoriety of our judicial system for lagging behind technology, Representative Henry Hyde has proposed a bill to eliminate the court-created presumption of market power: The Intellectual Property Antitrust Protection Act of 1997. The bill's predecessor (The Intellectual Property Antitrust Protection Act of 1995) stirred some controversy within the software industry, and remained under review in the Judiciary Committee. Thus, in 1997, the bill was reintroduced as H.R. 401. This essay intends to clarify the issues surrounding the bill, and hopefully through greater understanding, to promote support for it.

II. THE PRESUMPTION OF MARKET POWER

While a number of courts have abandoned the presumption of market power, the Ninth Circuit, for example, has decided to uphold the presumption of market power.[3] One would think that the holder of an intellectual property right should have absolute control over its property, and furthermore, that the manufacturer of several products that are designed to function together should have the right to sell the products as a unit, in order to preserve the integrity of its total product, but alas the Ninth Circuit found this should not be the case. Indeed, what is most remarkable about the Ninth Circuit's decision in *Digidyne Corp.* is its discussion of the irrelevance of a detailed market analysis.[4]

These issues have not yet been addressed by the Supreme Court, and so the continued vitality of the presumption doctrine remains uncertain in our judicial system, meanwhile, the Department of Justice and Federal Trade Commission have decided to abandon the presumption of market power in favor of an economic analysis method; which determines whether actual market power exists, rather than presuming it.[5] Now, Congress is attempting to eliminate current judicial reliance on the presumption of market power through enactment of H.R. 401.

---

3. *See* Digidyne v. Data General Corp., 734 F.2d 1336 (9th Cir. 1984).

4. *See id.* at 1340, n.4.

5. *See* Department of Justice and Federal Trade Commission Antitrust Guidelines for the Licensing of Intellectual Property (1995), reprinted in 4 Trade Reg. Rep. (CCH) ¶13,132, at 20,735.

III. THE ANTITRUST INTELLECTUAL PROPERTY PROTECTION ACT OF 1997

H.R. 401 states, in relevant part, that: "[I]n any action in which the conduct of [the holder] of an intellectual property right is alleged to be in violation of the antirust laws in connection with the marketing or distribution of a product or service protected by such a right," that "such right shall not be presumed to define a market, to establish market power, or to establish monopoly power."[6]

Opponents[7] to the elimination of the presumption market power argue that the bill would upset the balance of competition that has propelled the high-tech industry of this country into world-wide leadership. In contrast, the supporters[8] of the bill believe the presumption discriminates against intellectual property rights, and may be adversely affecting our economy.

IV. IMPLICATIONS FOR THE COMPUTER SOFTWARE INDUSTRY

A. Rule of Reason v. Per Se Illegal Standard

With the bill in effect, companies will be able to interact and make arrangements more freely, without fear of a presumption of market power simply based on possession of intellectual property rights on a certain product. The rule of reason will require courts to look at the actual market situation to determine if there is actual market power. Furthermore, courts must verify that there are actual anticompetitive effects without adequate business justifications. This is particularly critical for the software industry, which primarily relies on intellectual property rights to protect its products, which have a tendency to be inter-related or inter-dependent. In order to protect the integrity of their products, and also to adequately profit from their inventions, software developers need to sell their products in packages.

The rationale for per se rules is mainly to avoid the difficult task of analyzing and predicting market conditions. But, a per se condemnation of tying arrangements, particularly if applied to the software industry, fails to recognize today's economic realities. First, a

---

6. H.R. 401, 105th Cong., 1st Sess. § 2 (1997).

7. The most visible opponent is the CCIA (Computer and Communications Industry Association, which enjoys the support of Amdahl Corporation, Sun Microsystems, AT&T, NYNEX, Bell Atlantic, and the National Association of Independent Television Stations, among others.

8. Among those supporting the bill (excluding its sponsors) are Data General Corporation, Coca-Cola, the Licensing Executives Society, and the American Bar Association.

per se rule ignores whether a seller actually has leverage; substitutes and the relative market shares of competitors are not considered. Second, a per se rule does not take into consideration that a purchasing consumer may view two products that are meant to work together as a single product. Third, the actual fairness of the pricing is not considered in a per se rule. Fourth, the rule ignores sellers' justifying arguments, such as technological interdependence, goodwill, economic efficiency, or the need to market a package deal in order to overcome barriers to entry into a certain market.[9]

Ultimately, a per se prohibition against tie-in arrangements is unreasonable. Given that the very reason for prohibiting tie-ins was the concern that they would have a negative impact on consumers, it seems unreasonable to ignore actual economic conditions when determining if a tie-in arrangement should be condemned. To illustrate this point, consider the following hypothetical.

B. RAD Corp. — A Hypothetical Case

Imagine RAD Corp., a startup software company, which provides an electron document delivery service (EDDS). To enhance this product, it develops an encryption program to guarantee security when it is used on the Internet. No one else has been able to develop such a program, so if RAD was able to obtain a copyright on its encryption program, it would in essence have market domination for encryption software. But, until the EDDS subscriber base constitutes a significant share of the total EDDS market, RAD does not actually have market dominance.

Now, if Microsoft approaches RAD and requests a licensing arrangement, so that it may use the encryption software in connection with Microsoft's EDDS, RAD might be inclined to refuse. From an economic standpoint, RAD might be much better off exploiting the fruits of its labor by exclusively providing the encryption software to users of its EDDS. However, under the Ninth Circuit's theory in *Digidyne*, RAD's refusal to license its encryption software, and insistence on providing it exclusively to users of its own EDDS, would constitute an illegal tying arrangement.

If RAD is forced to license its encryption software, however, it may essentially lose control over its intellectual property, as licensing will allow their competitors to profit from RAD's research and de-

9. *See* Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957) for an in-depth analysis of tying justifications.

velopment. The potential profits RAD would have received from the increase in subscribers to its own EDDS might not be matched by the amount of royalty or licensing fees it would receive, and eventually RAD's competitors will be able to alter the encryption program sufficiently to obtain a new copyright in their own right, thereby terminating the need to continue using RAD's program. Meanwhile, robbed of a sufficient profit to cover its research and development costs, RAD is likely to be forced out of business.

If a court were required instead to apply the rule of reason, the outcome would be much different, because the court would have to conduct a market analysis before condemning RAD's tie-in. Consequently, the reviewing court would consider whether RAD has actual leverage in the EDDS market. Ultimately, then a rule of reason would allow the court to decide, in light of all existing factors, whether the tie-in is anti-competitive and therefore illegal, or simply provides RAD's EDDS a competitive advantage.

V. CONCLUSION

The court-created presumption of market power ignores actual market conditions, and unduly burdens holders of intellectual property rights, since defendants are required to produce evidence to rebut the presumption. The Antitrust Intellectual Property Protection Act of 1997 will eliminate the assumption that intellectual property rights automatically confer market power, and replace it with a rule of reason based on economic realities.

In order to remove any uncertainties in the law actually applied — particularly in light of the Ninth Circuit's continued use of the presumption — it is essential that Congress enact H.R. 401.

The proposed bill is not intended to ease bundling of software, hardware and other products in aggregate packages that consumers have come to expect. Rather, it is meant to benefit the computer industry as well as the consumer market by creating certainty in the law and removing the current prejudice against holders of intellectual property rights. Losing the presumption of market power, therefore, should not be feared, but instead wholeheartedly endorsed.