COMMENTARY

Patents and the Presumption of Market Power: The Latest Twist in Tying Law

By [redacted] *

In the wacky world of tying law, nothing is a safe bet. While the principal elements of proving a tying violation remain clear — market power, distinct products, market foreclosure and an actual tie — the exact nature and scope of these elements remain very much a crapshoot.

Courts and commentators seem to be all over the place on whether tying is still a per se offense which, like price fixing and allocating markets, is anticompetitive on its face. There is even a confusion over the degree of competition that must be foreclosed to support a tying challenge.

Even the seemingly transparent question of what constitutes two distinct products has become muddled in this age of technological innovation and integration. Then there's the ultimate challenge of what actually qualifies as a tying arrangement — when is a purchase actually "forced" upon a consumer.

Amidst this sea of legal uncertainty, businesses and their counsel could at least find some comfort in the relatively straightforward question of market power. There is little disagreement as to what market power is and how it can be proven. It is the ability to profitably raise prices, decrease output, reduce quality or exclude competition. It can be proven directly with evidence of such adverse effects on price, output, quality or competition. It can also be proven indirectly through market share — 40 percent or more will usually suffice.

In the context of tying, market power also can be shown by forcing a customer to make an unwanted purchase. Regardless of the mystery surrounding the other elements of a tying offense, without market power, a company could rest assured that it was virtually immune from a tying attack. Not anymore.

With its recent decision in *Independent Ink, Inc. v. Illinois Tool Works Inc.*, 396 F.3d 1342 (Fed. Cir. 2005), the Federal Circuit has thrown into disarray what it means to have market power for companies with patents. There, the court found that the mere possession of a patent — without any analysis of the relevant market or the traditional indicia of power in that market — creates a presumption of market power in a tying case.

In other words, plaintiffs now have a need pass an easily [redacted] claim. No need to show relevant market. No need to show power over price, output, quality or competition. No need to show anything. It's all presumed. The burden is up to the defendant patent holder to refute. That is a tough, if not unlikely, task. The ramifications for the immediate future stakes are considerably high for companies with patents products involving patents.

The Decision

Independent Ink involved a manufacturer of a patented ink-jet printhead ink jet printer-based system that used [redacted] suggested buyers of the ink-jet to also purchase the company's ink. A competing manufacturer brought suit under the Sherman Act, claiming this requirement was an illegal tying arrangement.

The District Court threw out the case, finding that the plaintiffs failed to produce any evidence of the defendants' market power. The plaintiffs did not even attempt to define the relevant market or analyze whether substitutes existed in that market for the defendant's ink jet.

The Federal Circuit reversed, finding a presumption of market power from the defendant's patent. According to the circuit court, the plaintiff did not have to show anything more to support its tying claim. It was the defendant's burden to rebut the presumption. The court's decision was not based on any economic rationale for presuming market power from a patent. Indeed, the court seemed to go out of its way to show its way to acknowledge that there was none.

It pointed to the prior rejection of such a presumption by several Supreme Court justices, including the late Chief Justice [redacted] and the Federal Trade Commission, to apply such a presumption in the prosecution of tying cases. And, it pointed to the heavy criticism of the presumption by some of the country's leading antitrust scholars. The court essentially only conceded that support for the presumption was weak and the time had come to abandon it. But the court refused to take that step.

The Federal Circuit demurred because it did not want to upset the line of Supreme Court decisions establishing the tying law presumption. According to the court, that prerogative belongs only to the high court or Congress. Was the Federal Circuit correct in its unwillingness to overrule the Supreme Court? Absolutely. The stability and consistency of the United States legal system would be lost if lower courts were free to flout the precedents of higher courts.

But the Federal Circuit here did not have to defy the Supreme Court to reach what it apparently recognized was the right result. Both the Supreme Court and Congress have already cleared the way for dumping the presumption.

The original rationale for equating patents with market power grew out of a general uneasiness with patents, and in particular, any effort that might extend the reach of a patent to nonpatented products. The presumption also developed at a time when the Supreme Court was more willing to condemn tying arrangements without any detailed analysis of [illegible] market power. All that has changed.

Patents are no longer viewed so suspiciously and the Supreme Court now demands real proof of market power in tying cases. It must be based on economic reality and not formalistic distinctions. Twenty-year-old Supreme Court dicta — which has been flatly rejected by at least four of the justices that decided the case — is all that remains of the presumption's wobbly foundation.

Congress has also weighed in on the subject. Under the Patent Misuse Reform Act, proof of actual market power is required to establish a patent misuse defense based on patent tying. This congressional mandate of proving market power when a patent-tying claim is used defensively cannot be reconciled with a presumption that no such proof is required when such a claim is used offensively. If anything, one would expect that a higher burden be satisfied, not a lower one, before exposing a party to treble damages under the antitrust laws.

Patent Holders Beware

For whatever reason, the Federal Circuit decided to stay the course. Maybe it was out of due deference to the Supreme Court. Maybe it was a clever gambit to force the high court to revisit its earlier decisions and set the record straight on this issue once and for all. Regardless of the reason, the decision has at least for the moment reinvigorated a dying doctrine.

Fortunately, the Supreme Court has recently granted *certiorari* over this case and will therefore have an opportunity to review it in the coming months. A decision is not likely until next year. Until then, the Federal Circuit's decision must be viewed as the latest word on patent tying law.

What it means for patent holders is that their risk of antitrust exposure — and the treble damage penalties that go with it — has increased considerably. The Federal Circuit has seriously diluted the market-power requirement for proving a patent-tying claim. On a motion to dismiss, there is no requirement at all. Market power is presumed as a matter of law. The presumption cannot be rebutted.

On summary judgment, the defendant has the opportunity to rebut the presumption, but as the *Independent Ink* court made clear — this is no easy task. There must be no issue of material fact on the question. The existence of competing substitutes for the patented product will not be enough. Unless the patent holder comes up with undisputed economic evidence that it lacks market power, the presumption will stand.

Defeating the presumption at trial may be equally problematic. It is difficult enough for a jury to grasp the concepts of relevant markets and market power. Juries often rely more on common experience and perception than on any kind of real economic analysis. Throwing into the mix a court-endorsed presumption of a defendant's market power may be all that is necessary to tip the scale of a confused or equivocating jury toward the plaintiff.

So patent holders beware. The peril of tying may just got a lot more menacing. Until the Supreme Court intervenes, the absence of real market power will no longer provide a guaranteed escape hatch from liability. Companies offering integrated products with patented components will be vulnerable to tying liability even if there is no real threat to competition. Hopefully, the Supreme Court will do the right thing and correct this deviation from principled antitrust analysis. Until it does, however, patent holders are best advised to think through very carefully how they package their products. The cost of not doing so may be dear.

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