



EFFECTIVE POLICING OF AFTERMARKET RESTRAINTS INVOLVING INTELLECTUAL PROPERTY

9th Seoul International Competition Forum, Session 1, Competition Issues in Aftermarket *Panel remarks of Randy M. Stutz, Associate General Counsel, American Antitrust Institute (15 minutes)*

Thank you very much to Chairman Jeong and the KFTC for inviting me to speak at this conference. It is truly an honor to share this stage with so many respected and influential leaders in our field.

I am here on behalf of the American Antitrust Institute, or “AAI.” AAI is a public interest organization in the United States that is devoted to education, research, and advocacy involving competition law and policy. It is a non-profit, non-governmental organization founded in 1998, which has a small staff and a large Board of volunteer advisors that includes many leading competition experts from around the world. We submit briefs and papers to courts and government agencies, write articles for publications, take positions on pending cases, work with other national and international public interest groups, host conferences and symposia, testify before Congress and state legislatures, talk to the media and to the antitrust authorities, and publish handbooks and other large volumes on competition law and policy.

Introduction

I want to talk in more depth about something that has already been raised this morning, which is the involvement of intellectual property, and intellectual property policy, in aftermarket business strategies.

Often the challenge in aftermarket cases is *how* to think about competition, including in primary and secondary markets, and system-wide. But when intellectual property enters the picture, we sometimes have to ask *whether* to think about competition, or to what extent. A key question often becomes: What is the role for competition policy in aftermarkets when a patent owner chooses to exclude others from using its patented product?

I’m going to discuss three examples of aftermarket behavior by patent owners that will hopefully bring this question into sharper focus. I want to discuss, first, refusals to sell patented repair parts; second, seeking design patents on repair parts; and third, patent owners seeking to control the use of a patented product after it is sold.

In the United States, the Constitution gives Congress the power to “promote the progress of science and useful arts” by giving patent owners the exclusive right to their inventions.¹ Congress did so in passing the Patent Act, but as U.S. courts have long recognized, patent rights are not limitless, and they are susceptible to misuse and abuse.² Implicit in this recognition is an acknowledgment that deference to a patent owner’s right to exclude does not *always* promote the progress of science and useful arts. Indeed, *competition* also promotes the progress of science and useful arts.

Let me say at the outset that I don’t believe there is a single correct answer to the question I have posed. There may be some instances where competition policy should yield to patent policy if the two are in conflict, but other instances where it should not. I suspect there are no reliable rules, normatively speaking, that can tell everyone, everywhere, when and how often. The answer may be different for different countries and cultures, which may have different commitments to competition values and intellectual property values, and the weighing of these values against one another when that difficult task is necessary.

Rather than attempt to determine the proper role for competition policy when it comes into conflict with patent policy in aftermarket cases, I have a more modest goal this morning. I hope only to suggest a helpful perspective in thinking about this problem, using the three examples I just noted.

Refusals to Sell Patented Repair Parts

A reasonable place to begin is the much-discussed *Kodak* and *Xerox* cases in the United States, which each involved patent owners’ refusal to sell patented repair parts. These cases present starkly different approaches to thinking about the interplay between competition and patent policy in aftermarkets.

In the 1997 *Kodak* case, which was decided on remand by the U.S. Ninth Circuit Court of Appeals, the plaintiffs were independent service organizations (“ISOs”) that competed with Kodak to repair Kodak’s copying machines.³ To compete effectively, the ISOs needed access to Kodak’s replacement parts, but some of these replacement parts were patented. For years, Kodak had profitably sold its replacement parts – both patented and unpatented – to ISOs voluntarily. But when competition from ISOs grew significant, Kodak changed its policy and began refusing to sell these parts.

¹ U.S. CONST. art. I, § 8, cl.8. (giving Congress the power “[t]o promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries”).

² See *infra* note 17.

³ *Image Technical Services, Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997), *cert. denied*, 523 U.S. 1094 (1998); see *Eastman Kodak Co. v. Image Technical Servs.*, 504 U.S. 451 (1992).

The ISOs sued Kodak alleging that this refusal to deal amounted to illegal monopolization under U.S. antitrust law. But one of Kodak's counter arguments was that it had an absolute right as a patent owner to decide who it would or would not sell to. The Ninth Circuit sided with the ISOs. It ruled, on the one hand, that a patent owner's right to exclude is a "presumptively legitimate business justification" for refusing to deal with a competitor.⁴ But it also ruled that this presumption is rebuttable if a plaintiff can show that the purported business justification "does not legitimately promote competition or that the justification is pretextual."⁵ Here, the court found that Kodak's assertion of its patent rights was just a pretext for eliminating competition. The important point for my purposes this morning is that the court was willing to consider competitive effects in the presence of patent rights. In other words, the patent right was not absolute.

Three years later, in the *Xerox* case, a different U.S. court of appeals reached a contrary result.⁶ The facts were very similar. Xerox, over time, had begun refusing to sell patented repair parts to independent service organizations that competed with Xerox to repair Xerox's copying machines.

The parties' arguments were also very similar, with the ISOs alleging monopolization by refusal to deal and Xerox countering that it had an absolute right not to sell patented products. The Federal Circuit split with the Ninth Circuit. It determined that the patent owner's right to refuse to sell to others was indeed absolute. It held that a plaintiff could only challenge a patent owner's refusal to deal if it could show that the patent was illegally obtained.

Note the fundamental underlying policy questions that both of these courts had to answer in deciding these cases: To what extent does society's interest in protecting patent rights take priority over society's interest in promoting competition? The *Xerox* court answered that, under the circumstances, patent protection deserves unqualified priority. The *Kodak* court believed that patent rights ordinarily deserve deference, but it tried to preserve a role for competition considerations, although the feasibility of its approach has been questioned.⁷

Abusive Design Patents

Let me shift gears and discuss the use of design patents. Sometimes it is not the decision to enforce an existing patent, but rather the strategic motivation to seek a patent in the first place that raises tensions between patent policy and competition policy in aftermarkets. The automobile repair parts market is a good example.

⁴ *Image Technical Svcs.*, 125 F.3d at 1219.

⁵ *Id.* at 1212.

⁶ *In re Independent Service Organizations Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied*, 531 U.S. 1143 (2001). *See also* Joseph P. Bauer, *Refusals to Deal with Competitors by Owners of Patents and Copyrights: Reflections on the Image Technical and Xerox Decisions*, 55 DEPAUL L. REV. 1211 (2006).

⁷ *See, e.g.*, U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 17-18 (2007) (criticizing Kodak's "subjective intent standard" for being unworkable in practice, lacking a limiting principle, and increasing the costs of IP enforcement).

In the United States, there has long been aftermarket competition between original and non-original equipment manufacturers of automobile repair parts. Recently, however, many automobile manufacturers have begun seeking design patents on these parts, and specifically the exterior parts that are most likely to be replaced after a car accident.⁸ This trend has marked an industry shift, as historically manufacturers sought design patents only on entire vehicles, to protect the overall look of the vehicle.⁹

When individual car parts are design patented, independent manufacturers of aftermarket replacement parts obviously infringe the patent if they follow the design. The problem, however, is that exterior replacement parts, like fenders, bumpers, and grills, usually have no value to a consumer if they are not identical in appearance to the original. Even if an exterior replacement part is less expensive or made from higher quality materials, consumers likely will not use it if it does not restore the car to its original appearance after an accident. This poses an existential threat to aftermarket competition, because third party manufacturers either have to risk infringement litigation or obtain a license from the manufacturer, who is their competitor in the aftermarket.

In one view, there is nothing unlawful about seeking and obtaining a legitimate design patent, and that fact alone should foreclose any competition policy considerations. After all, some competition is always eliminated when a patent is conferred, but it is assumed that the additional profits from the aftermarket patent monopoly will promote investments in innovation, and promote interbrand competition in the primary market by ensuring quality and protecting the brand's reputation.

In another view, however, there is a question whether seeking design patents on crash parts simply eliminates competition without serving any legitimate purpose. For the vast majority of their history, auto manufacturers never deemed individual crash parts to be "ornamental" and worthy of a design patent. And the industry's reversal of its longstanding policy of not seeking design patents on crash parts has reportedly led to the raising of rivals' costs and harm to competition in the aftermarket.

It is hard to imagine an antitrust or competition law case challenging an automobile manufacturer's decision to seek a legitimate design patent. But Congress recently introduced federal legislation that would shorten the period of exclusivity for design patents on automobile parts from 14 years to 30 months, in an effort to promote aftermarket competition.¹⁰

⁸ Property Casualty Insurers Association of America, *The Promoting Automotive Repair, Trade, and Sales (PARTS) Act of 2015*, available at <http://www.pciaa.net/docs/default-source/industry-issues/parts-act-final-1st-part.pdf?sfvrsn=2> (depicting Quality Parts Coalition data showing that the number of design patents sought by automanufacturers has doubled since 2009).

⁹ See Norman Hawker, *The Automobile Aftermarket: Crash Parts, Design Patents, and the Escape from Competition*, AM. ANTITRUST INST. (Mar. 22, 2010), http://antitrustinstitute.org/sites/default/files/aai%20collision%20repair%20parts%20commentary_032220101350.pdf.

¹⁰ See S. 560, 114th Cong. (2015).

Note that the policy question facing Congress is very similar to the question facing the courts in the *Kodak* and *Xerox* refusal to deal cases: To what extent does patent protection take priority over competition?

Conditional Sales of Products Embodying Patented Technology

Now I want to turn to yet another type of behavior, which is a patent holder's attempt to control the use of a patented product after it is sold. Two legal doctrines governing this behavior have developed in the United States, and if they are not in direct conflict, they are in strong tension with one another. The U.S. Supreme Court, over many years, has developed and continued to endorse the patent exhaustion doctrine, which holds that the first authorized sale of a patented product terminates the patent owner's rights in that product.¹¹ The exhaustion doctrine is rooted in promoting healthy secondary markets for the sale of used items, and also preventing unfair enforcement of patent rights against downstream purchasers, who may not have notice of the patent owner's restrictions when they come into possession of a used product.

Meanwhile, the U.S. Federal Circuit Court of Appeals has developed and continued to endorse the conditional sale doctrine.¹² Under this doctrine, on the other hand, a downstream purchaser of a patented product can be liable for infringement if it violates a condition that the patent owner places on the sale of a patented product. The Federal Circuit reasons that because a patent confers a collection of rights to the patentee to make, use, and sell the invention, patent owners can sell patented products with conditions that place restrictions on any of these rights, so long as the restrictions do not violate other laws.

A good example of the tension in these two doctrines can be found in the *Static Control v. Lexmark* case, which is still pending in a U.S. district court in Kentucky.¹³ Lexmark sells proprietary printers and toner cartridges, while Static Control helps third parties refurbish and resell used Lexmark toner cartridges to compete with Lexmark in the toner cartridge aftermarket. Lexmark instituted a new sales program where it offered patented toner cartridges at a discount, but it included a so-called "shrinkwrap license" on the box, which told consumers that Lexmark was offering a discounted price for its toner cartridges on condition that its customer use the cartridge only once and then return it only to Lexmark, so that it couldn't be refurbished. It also warned that failing to comply with the shrinkwrap license would infringe Lexmark's patents. Among other things, Static Control argued that this patent infringement warning was false advertising, because

¹¹ See *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008).

¹² See *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992); *Lexmark Int'l, Inc. v. Impression Products, Inc.*, 816 F.3d 721 (Fed. Cir. 2016).

¹³ *Static Control Components, Inc. v. Lexmark Int'l, Inc.*, No. 5:04-CV-00084-GFVT-REW (E.D. Ky. filed Feb. 24, 2004); see *Static Control Components, Inc. v. Lexmark Int'l, Inc.*, 697 F.3d 387 (6th Cir. 2012); *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 134 S.Ct. 1377 (2014).

Lexmark's patent rights were exhausted under the patent exhaustion doctrine when it sold the patented product.¹⁴

Note the implications for aftermarket competition in the *Static Control* case if the court decides Lexmark's patent rights were exhausted, or if it decides instead that Lexmark made a valid conditional sale. If Lexmark's patents are enforceable and the shrinkwrap license remains on the box, aftermarket competition for replacement Lexmark cartridges likely will be significantly reduced or eliminated. In a petition for review in a different case, the U.S. Supreme Court has been asked to overrule the conditional sale doctrine.¹⁵ The judge in the *Static Control* case is holding his opinion pending that decision.¹⁶

The underlying policy question here is again very similar to the one I have been emphasizing. The conditional sale doctrine prioritizes the patent right, whereas the patent exhaustion doctrine is more accommodating to competition. And once again, the policymaker must weigh and balance these values.

Conclusions

What does all of this tell us about how to effectively police aftermarket restraints that involve intellectual property?

One observation is that the question of how to balance patent policy and competition policy in aftermarkets doesn't only come up in antitrust and competition law cases. As some of the examples I've discussed illustrate, it can come up in legislative proposals before Congress and in consumer protection cases involving allegedly deceptive practices. Sometimes it may be helpful for competition policy experts to share their perspective with courts and policymakers in these other contexts.

Another important takeaway is that patent policy and competition policy are often intertwined, or perhaps even inseparable. Policy makers should be conscious of the fact that giving excessive deference to patent policy can have negative consequences for competition policy, although the reverse is surely also true. In recent years, the U.S. Supreme Court seems to have become increasingly cognizant of the trade-off between the consequences of intervention and the

¹⁴ *Static Control*, 697 F.3d at 409 (“*Static Control* [“SCC”] alleges that Lexmark ‘falsely informed customers that SCC’s products infringe Lexmark’s purported intellectual property,’ and ‘misled ... customers of SCC’s products that license agreements prohibit remanufacturing Lexmark toner cartridges, when no license agreements actually exist,’ causing *Static Control*’s customers to believe that *Static Control* is engaging in illegal conduct and thereby damaging *Static Control*’s business and reputation.”).

¹⁵ *Lexmark Int’l*, 816 F.3d 721, petition for cert. filed, 4 U.S.L.W. 3563 (U.S. Mar 21, 2016) (No. 15-1189).

¹⁶ *Static Control*, No. 5:04-CV-00084-GFVT-REW (E.D. Ky. Mar. 29, 2016) (order maintaining stay pending Supreme Court decision on cert. petition in *Impression Products*).

consequences of inaction in other kinds of cases where competition policy and intellectual property policy intersect.¹⁷ This awareness should translate to aftermarket cases as well.

Finally, it is worth noting that striking the right balance between patent and competition policy has important consequences for consumers, who are intended to be the ultimate beneficiaries under both policies. In many aftermarket cases like the ones I've discussed, the decision whether to give patent protection priority over competition, and to what degree, will determine whether consumer welfare in aftermarkets is served by the promise of manufacturers reinvesting their monopoly profits, or served instead by the promise of competition.

Thank you.

¹⁷ See, e.g., *Fed. Trade Comm'n v. Actavis, Inc.*, 133 S.Ct. 2223, 2231 (2013) (“patent and antitrust policies are both relevant in determining the ‘scope of the patent monopoly’—and consequently antitrust law immunity—that is conferred by a patent”); *Mayo Collaborative Services v. Prometheus Laboratories, Inc.*, 132 S.Ct. 1289, 1293 (2012) (“monopolization of [the basic tools of scientific and technological work] through the grant of a patent might tend to impede innovation more than it would tend to promote it”); *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989) (“The Patent Clause itself reflects a balance between the need to encourage innovation and the avoidance of monopolies which stifle competition without any concomitant advance in the ‘Progress of Science and useful Arts.’); *id.* at 150 (“the stringent . . . novelty and nonobviousness requirements express a congressional determination that the purposes behind the Patent Clause are best served by free competition and exploitation of either that which is already available to the public or that which may be readily discerned from publicly available material”); see also Rudolph J.R. Peritz, *The Competition Question Unasked in Actavis: What is the Scope of the Patent Right to Exclude?*, 28 ANTITRUST 45 (Fall 2013) (describing “patent law’s indigenous competition policy” as resting on “a baseline of free competition”).