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10-21-2013

### Innovation, IP Rights, and Anticompetitive Exclusion

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**INNOVATION AND COMPETITION POLICY, Ch. 8 (2d):  
INNOVATION, IP RIGHTS, AND ANTICOMPETITIVE  
EXCLUSION**

**Herbert Hovenkamp**

This book of CASES AND MATERIALS ON INNOVATION AND COMPETITION POLICY is intended for educational use. The book is free for all to use subject to an open source license agreement. It differs from IP/antitrust casebooks in that it considers numerous sources of competition policy in addition to antitrust, including those that emanate from the intellectual property laws themselves, and also related issues such as the relationship between market structure and innovation, the competitive consequences of regulatory rules governing technology competition such as net neutrality and interconnection, misuse, the first sale doctrine, and the Digital Millennium Copyright Act (DMCA). Chapters will be updated frequently. The author uses this casebook for a three-unit class in *Innovation and Competition Policy* taught at the University of Iowa College of Law and available to first year law students as an elective. The table of contents is as follows (click on chapter title to retrieve it):

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**INNOVATION AND COMPETITION POLICY:  
CASES AND MATERIALS  
HERBERT HOVENKAMP**

**CHAPTER 8 (2d ed)**

**INNOVATION, IP RIGHTS, AND ANTICOMPETITIVE  
EXCLUSION**

**CONTINENTAL PAPER BAG COMPANY v. EASTERN PAPER  
BAG COMPANY  
210 U.S. 405 (1908)**

*[Justice McKenna gave this statement of the case:]*

This is a bill in equity to restrain the infringement of letters patent No. 558,969, issued to William Liddell for an improvement in paper bag machines, for making what are designated in the trade as self-opening square bags. The claims in suit do not include mechanism for making a complete bag, but only mechanism for distending one end of a tucked or bellows-folded paper tube made by other mechanism, and folding it down into a form known in the art as the 'diamond fold.' This fold is flattened and pasted by other mechanism and forms a square bottom to the bag.

The allegation of the answer as to the jurisdiction of the court is as follows:

'The defendant says, on information, advice, and belief, that a court of equity has no jurisdiction to grant any prayer of the bill of complaint, even if the said Liddell patent, No. 558,969, were valid, and even if the defendant's paper bag machines were to be held to infringe that patent; because the said patent, No. 558,969, is a mere paper proposition which the complainant has never put into effect or use, and because it is contrary to equity to suppress a useful and established business, like that which the defendant is prosecuting with its paper bag machines, at the request of a complainant which simply owns one paper bag machine patent that has never been employed by that complainant in any way in any paper bag machinery, and because the complainant in this case has a plain, adequate, and complete remedy at law for any infringement which may have been done upon Liddell letters patent, No. 558,969.'

Mr. Justice McKenna delivered the opinion of the court:

The defense of want of invention in the Liddell machine is not urged here, because it is said that the decision of that question depends upon mechanical comparisons, too numerous and complicated to be conveniently made by a bench of judges, and because, though the Liddell patent approaches closely the prior art, it 'perhaps covers a margin of differentiation sufficient, though barely sufficient, to constitute invention.'

Th[e] point of law, it is further said, has been formulated in a decision of this court as follows: 'Where the patent does not embody a primary invention, but only an improvement on the prior art, and defendant's machines can be differentiated, the charge of infringement is not sustained.' Counsel for respondent do not contend that the Liddell invention is primary within the definition given of that term by petitioner. Their concession is that it is 'not basic, in the sense of covering the first machine ever produced to make self-opening square bags by machinery.' They do contend, however, that it is one of high rank, and, if it be given a 'fair construction and scope, no matter whether we call it basic, primary, or broad, or even merely entitled to be construed as covering obvious mechanical equivalents, the question of infringement of the claims in suit by petitioner's machine becomes mechanically, and from a patent-law standpoint, a simple one, in spite of slight differences of operation, and of reversal of some of the moving parts.' The lower courts did not designate the invention as either primary or secondary. They did, however, as we shall presently see, decide that it was one of high rank and entitled to a broad range of equivalents. It becomes necessary, therefore, to consider the point of law upon which petitioner contends the question of infringement depends.....

If the invention is broad or primary in its character, the range of equivalents will be correspondingly broad, under the liberal construction which the courts give to such inventions.' And this was what was decided in *Kokomo Fence Mach. Co. v. Kitselman*, 189 U.S. 8 (1903), *Cimiotti Unhairing Co. v. American Fur Ref. Co.*, 198 U.S. 399 (1905), and *Computing Scale Co. v. Automatic Scale Co.* 204 U. S. 609 (1907). It is from the second of those cases, as we have seen, that the citation is made which petitioner contends the point of law upon which infringement depends is formulated; but it was said in that case: 'It is well settled that a greater degree of liberality and a wider range of equivalents are permitted where the patent is of a pioneer character than when the invention is simply an improvement, maybe the last and successful step, in the art theretofore partially developed by other inventors in the same field.'

It is manifest, therefore, that it was not meant to decide that only pioneer

patents are entitled to invoke the doctrine of equivalents, but that it was decided that the range of equivalents depends upon and varies with the degree of invention.... We start, then, with the proposition that the Eastern Company may invoke for the Liddell patent the doctrine of equivalents; but, without deciding now how broadly, we proceed to the consideration of the question of infringement. Invention is conceded to the Liddell machine, as we have seen, by the Continental Company. The concession, however, is qualified by the assertion that it covers only a 'margin of differentiation' from the prior art. The circuit court and the circuit court of appeals had a higher estimate of it. The circuit court said that the nature of its invention was 'clear . . . [was] disconnected from what precedes it by such a hiatus that, if the claims are as extensive as the invention, there is no difficulty so far as concerns the application to the case of the rules with reference to equivalents.' And answering the contention that it was the twentieth in the line of patents in its branch of the arts, and that it should be limited to the details described in its specifications, it was said that there was 'such hiatus between them and what appears on the face of the Liddell patent that they have no effect either in narrowing or broadening the alleged Liddell invention.' The circuit court of appeals affirmed the decree of the circuit court. It was less circumstantial than the circuit court in describing the invention. It said, however, after stating the claims, that their breadth 'would imperil the patent, were the real invention less broad; but the defendant [the Continental Company] has not pointed out, and we have been unable to find, any operative combination of a rotary cylinder and a forming plate oscillating thereon earlier than the patent in suit. If, therefore, the patent is valid, it has a wide scope, and the mechanical arrangement used by the defendant is fairly within its terms.' The lower courts, therefore, found that the invention was a broad one, and that the machine used by the Continental Company was an infringement. To decide the question of invention an examination of the prior art was necessary, and a consideration of what step in advance of that art, if any, the Liddell patent was. To decide the question of infringement a comparison of the Liddell machine with the machine used by the Continental Company was necessary and a determination of their similarity or difference.

The bill alleges the infringement of claims 1, 2, and 7.... Claim 1 is as follows: 'In a paper bag machine, the combination of a rotating cylinder provided with one or more pairs of side-folding fingers adapted to be moved toward or from each other, a forming plate also provided with side-forming fingers adapted to be moved toward of from each other, means for operating said fingers at definite times during the formative action upon the bag tube, operating means for the forming plate adapted to cause the said

plate to oscillate about its rear edge upon the surface of the cylinder during the rotary movement of said cylinder, the whole operating for the purpose of opening and forming the bottom of the bag tube, and means to move the bag tube with the cylinder.’

‘The pith of . . . [the] invention,’ the circuit court said, ‘is the combination of a rotating cylinder with means for operating the forming plate in connection therewith, limited, however, to means which cause the plate to oscillate about its rear edge.’ The court expressed the opinion that the invention extended to every means by which that result could be attained, and rejected the contention of the Continental Company, that the invention was no broader than the details described in the specification. The court said that it was unable to see upon what the proposition could be based. And further said that there was nothing in the prior art which either broadened or narrowed the Liddell invention. ‘If any of . . . [the nineteen patents which had been put in evidence]’ the court added, ‘pointed out any form of combining the forming plate with a rotating cylinder, they would, of course, narrow what Liddell could claim; but they have nothing of that kind.’ And, speaking of the claims and their limitation by the description, it was said: ‘Nothing in the manner in which the claims are expressed adopts as an element the detailed description contained in the specification. So far as the details of that description are concerned, they come within the ordinary rule of the preferable method.’...

The discussion thus far brings us to two propositions: That infringement is not averted merely because the machine alleged to infringe may be differentiated from the patented machine, even though the invention embodied in the latter be not primary; and, second, that the description does not necessarily limit the claims....

It may be well before considering these contentions to refer again to the view which the circuit court and the circuit court of appeals had of Liddell’s patent. The circuit court said that the ‘pith’ of the invention ‘is the combination of a rotating cylinder with means for operating the forming plate in connection therewith, limited, however, to means which cause the plate to oscillate about its rear edge on the surface thereof,’ and distinguished the invention from the prior art, as follows: ‘Aside from the cylinder and the forming plate oscillating about its rear edge, everything in these claims [the claims of the patent] is necessarily old in the arts.’ It was this peculiar feature of novelty, it was said, which clearly distinguished it from all that went before it. This conclusion was in effect affirmed by the circuit court of appeals. The latter court said that the folding of the bottoms of S. O. S. paper bags had been accomplished in the prior art ‘both by a

folding plate reciprocating upon a plane, and by the operation of fingers upon a cylinder. The folding plate and the cylinder had never been combined. The complainant urges with much probability that the reason why they had not been combined lay in the difficulty of operating a pivoted folding from upon the surface of a cylinder. Two circles external to each can be in contact at but one point, while, in order that the folding plate may operate, its end, as it moves upon a pivot, must remain for some distance in contact with the surface of the revolving cylinder. The problem may be solved by causing the pivot or axis of the folding plate to yield away from the cylinder, or by causing the surface of the cylinder to be depressed away from the folding plate. The patent in suit adopts the first device, the defendant's machine the second, and the crucial question before the court is this: Under all the circumstances of the case, is the second method, as compared with the first, within the doctrine of equivalents?'

The court, as we have seen, concluded, from the character of the Liddell patent, that 'the second method,' that is, the method of the Continental Company's machine, was 'within the doctrine of equivalents.' ...

The next contention of the petitioner is that a court of equity has no jurisdiction to restrain the 'infringement of letters patent the invention covered by which has long and always and unreasonably been held in nonuse . . . instead of being made beneficial to the art to which it belongs.' It will be observed that it is not urged that nonuse merely of the patent takes jurisdiction from equity, but an unreasonable nonuse. ....

Judge Aldrich, in his dissenting opinion in the court of appeals, excluded the cases as authoritative for a different reason than counsel expresses. The learned judge said:

'Simple nonuse is one thing. Standing alone, nonuse is no efficient reason for withholding injunction. There are many reasons for nonuse which, upon explanation, are cogent; but when acquiring, holding, and nonuse are only explainable upon the hypothesis of a purpose to abnormally force trade into unnatural channels,-a hypothesis involving an attitude which offends public policy, the conscience of equity, and the very spirit and intention of the law upon which the legal right is founded,-it is quite another thing. This is an aspect which has not been considered in a case like the one here.'

Respondent attacks the conclusion of Judge Aldrich and that of petitioner, and insists that there is nothing in the record to show that the nonuse of the patent was either unreasonable or sinister. A very strong argument is presented by respondent. Its counsel pointedly say that 'there is

no record evidence at all on the subject or character of complainants' [respondents'] use or nonuse,' and points out that neither the assignments of error on appeal to the circuit court of appeals nor the petition for rehearing in that court presented the question that the injunction should be denied on the ground of mere nonuse or unreasonable nonuse. Let us see what the courts say and what petitioner says. The circuit court says:

'We have stated that no machine for practical manufacturing purposes was ever constructed under the Liddell patent. The record also shows that the complainant, so to speak, locked up its patent. It has never attempted to make any practical use of it, either itself or through licenses, and, apparently, its proposed policy has been to avoid this. In this respect it has not the common excuse of a lack of means, as it is unquestioned that the complainant is a powerful and wealthy corporation. We have no doubt that the complainant stands in the common class of manufacturers who accumulate patents merely for the purpose of protecting their general industries and shutting out competitors.'

... But petitioner has given its explanation of the purpose of respondent. Quoting Judge Aldrich, that the patent in suit has been 'deliberately held in nonuse for a wrongful purpose,' petitioner asks, 'What was that wrongful purpose? It was the purpose to make more money with the existing old reciprocating Lorenz & Honiss machines and the existing old complicated Stilwell machines than could be made with new Liddell machines, when the cost of building the latter was taken into account. And this purpose was effective to cause the long and invariable nonuse of the Liddell invention, notwithstanding that new Liddell machines might have produced better paper bags than the old Lorenz & Honiss machines or the old Stilwell machines were producing.'

But, granting all this, it is certainly disputable that the nonuse was unreasonable, or that the rights of the public were involved. There was no question of a diminished supply or of increase of prices, and can it be said, as a matter of law, that a nonuse was unreasonable which had for its motive the saving of the expense that would have been involved by changing the equipment of a factory from one set of machines to another? And even if the old machines could have been altered, the expense would have been considerable. As to the suggestion that competitors were excluded from the use of the new patent, we answer that such exclusion may be said to have been of the very essence of the right conferred by the patent, as it is the privilege of any owner of property to use or not use it, without question of motive....

The right which a patentee receives does not need much further

explanation. We have seen that it has been the judgment of Congress from the beginning that the sciences and the useful arts could be best advanced by giving an exclusive right to an inventor. The only qualification ever made was against aliens, in the act of 1832. That act extended the privilege of the patent law to aliens, but required them 'to introduce into public use in the United States the invention or improvement within one year from the issuing thereof,' and indulged no intermission of the public use for any period longer than six months. A violation of the law rendered the patent void. The act was repealed in 1836. It is manifest, as is said in Walker on Patents, § 106, that Congress has not 'overlooked the subject of nonuser of patented inventions.' And another fact may be mentioned. In some foreign countries the right granted to an inventor is affected by nonuse. This policy, we must assume, Congress has not been ignorant of nor of its effects. It has, nevertheless, selected another policy; it has continued that policy through many years. We may assume that experience has demonstrated its wisdom and beneficial effect upon the arts and sciences.

From the character of the right of the patentee we may judge of his remedies. It hardly needs to be pointed out that the right can only retain its attribute of exclusiveness by a prevention of its violation. Anything but prevention takes away the privilege which the law confers upon the patentee. If the conception of the law that a judgment in an action at law is reparation for the trespass, it is only for the particular trespass that is the ground of the action. There may be other trespasses and continuing wrongs and the vexation of many actions. These are well-recognized grounds of equity jurisdiction, especially in patent cases, and a citation of cases is unnecessary. Whether, however, as case cannot arise where, regarding the situation of the parties in view of the public interest, a court of equity might be justified in withholding relief by injunction, we do not decide.

Decree affirmed.

### NOTES AND QUESTIONS

1. If the doctrine of equivalents should have a broad application to pioneer patents, as the court suggests, shouldn't a corollary be that it ought to have a very narrow application to a narrow patent or, particularly in this case, a patent that is not even being practiced? On the doctrine of equivalents and patent scope, see Chapter 1.
2. The *Paper Bag* Court held that a holder of a valid patent is not obligated to license its right to a competitor, even if the right is not being used. Further, whether the patent creates a market monopoly is irrelevant. And

finally, in this case the patentee did not develop the enforced patent internally, but acquired it from another for the purpose of taking the alternative technology out of the market altogether. Is that consistent with the purpose of the Patent Act?

Congress apparently supported the *Paper Bag* principle when it enacted the Patent Misuse Reform Act in 1988. The statute provides:

(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having ... (4) refused to license or use any rights to the patent...

35 U.S.C. §271 (d)(4). Note that the statute does not distinguish between used and unused patents, or between internally developed patents and those acquired from others. Does this provision create an antitrust immunity as well? Antitrust law does not impose an obligation to use or license intellectual property either. See *Hartford-Empire Co. v. United States*, 323 U.S. 386, 432-33 (1945) (“a patent owner is not in the position of a quasi-trustee for the public . . . [it] has no obligation to use it or grant it to others”). But see the *Kodak* decision, *infra*. See also CHRISTINA BOHANNAN & HERBERT HOVENKAMP, *CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION*, Ch. 11 (2011), which argues that if a monopolist acquires a patent from an outside source the acquisition should be limited to a nonexclusive license. That would give the monopolist the opportunity to keep its technology up to date by practicing the patent, but it would not permit the monopolist to shut the technology down by denying access to others.

4, For additional commentary on the Paper Bag case, see Eduwardo M. Penalver & Oskar Livak, *The Right Not to Use in Property and Patent Law* (Cornell Legal Studies Res. P. # 12-62, Oct. 16, 2012, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2162667](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2162667)).

**WALLACE v. IBM Corp.**  
**467 F.3d 1104 (7<sup>th</sup> Cir. 2006)**

EASTERBROOK, Circuit Judge.

Does the provision of copyrighted software under the GNU General Public License (“GPL”) violate the federal antitrust laws? Authors who

distribute their works under this license, devised by the Free Software Foundation, Inc., authorize not only copying but also the creation of derivative works-and the license prohibits charging for the derivative work. People may make and distribute derivative works if and only if they come under the same license terms as the original work. Thus the GPL propagates from user to user and revision to revision: neither the original author, nor any creator of a revised or improved version, may charge for the software or allow any successor to charge

One prominent example of free, open-source software is the Linux operating system, a derivative of the Unix operating system written by AT&T in the 1960s and now available without cost. (UNIX® is a trademark of The Open Group, but the source code to many variants of AT & T's work is freely available.) Linux is one of many modern derivatives of Unix-which is not itself under the GPL. Thus Apple Computer, which uses the Berkeley Software Distribution variant of Unix as the foundation for the Mac OS X operating system, is entitled to charge for its software. Linux, initially the work of Linus Torvalds, is maintained by a large open-source community. International Business Machines offers Linux with many of its servers, or customers can install it themselves. IBM has contributed code to the Linux project and furnishes this derivative work to anyone else with an interest. Red Hat, Inc., sells media (such as DVDs), manuals, and support for the installation and maintenance of Linux. The GPL covers only the software; people are free to charge for the physical media on which it comes and for assistance in making it work. Paper manuals, and the time of knowledgeable people who service and support an installation, thus are the most expensive part of using Linux.

Daniel Wallace would like to compete with Linux-either by offering a derivative work or by writing an operating system from scratch-but maintains that this is impossible as long as Linux and its derivatives are available for free. He contends that IBM, Red Hat, and Novell have conspired among themselves and with others (including the Free Software Foundation) to eliminate competition in the operating system market by making Linux available at an unbeatable price. Under the GPL, which passes from user to improver to user, Linux and all software that incorporates any of its source code will be free forever, and nothing could be a more effective deterrent to competition, Wallace maintains. ...

Although antitrust law serves the interests of consumers rather than producers, the Supreme Court has permitted producers to initiate predatory-pricing litigation. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Matsushita Electric Industrial Co. v. Zenith*

Radio Corp., 475 U.S. 574 (1986). This does not assist Wallace, however, because his legal theory is faulty substantively.

Predatory pricing is a three-stage process: Low prices, followed by the exit of producers who can no longer make a profit, followed by monopoly prices. The law's worry is the final period in which the survivor (or cartel of survivors) recoups losses incurred during the low-price period. When exit does not occur, or recoupment is improbable even if some producers give up the market, there is no antitrust problem. So the Court held in both *Brooke Group* and *Matsushita*. ... Either prices will stay low (reflecting efficient production and enduring benefits to consumers) or the practice will be self-detering (because the predator loses more during the low-price period than it gains later, and consumers are net beneficiaries). When monopoly does not ensue, low prices remain-and the goal of antitrust law is to use rivalry to keep prices low for consumers' benefit. Employing antitrust law to drive prices up would turn the Sherman Act on its head.

Wallace does not contend that software available for free under the GPL will lead to monopoly prices in the future. How could it, when the GPL keeps price low forever and precludes the reduction of output that is essential to monopoly? ...

Software that is not maintained and improved eventually becomes obsolete, and the lack of reward may reduce the resources devoted to maintenance and improvement of Linux and other open-source projects. If that occurs, however, then proprietary software will enter or gain market share. People willingly pay for quality software even when they can get free (but imperfect) substitutes. Open Office is a free, open-source suite of word processor, spreadsheet and presentation software, but the proprietary Microsoft Office has many more users. Gimp is a free, open-source image editor, but the proprietary Adobe Photoshop enjoys the lion's share of the market. Likewise there is a flourishing market in legal treatises and other materials, plus reference databases such as LEXIS and Westlaw, even though courts give away their work (this opinion, for example, is not covered by copyright and may be downloaded from the court's web site and copied without charge). And so it is with operating systems. Many more people use Microsoft Windows, Apple OS X, or Sun Solaris than use Linux. IBM, which includes Linux with servers, sells mainframes and supercomputers that run proprietary operating systems. The number of proprietary operating systems is growing, not shrinking, so competition in this market continues quite apart from the fact that the GPL ensures the future availability of Linux and other Unix offshoots.

It does not help to characterize people who accept the GPL as

“conspirators.” Although the antitrust laws forbid conspiracies “in restraint of trade,” 15 U.S.C. § 1, § 26, the GPL does not restrain trade. It is a cooperative agreement that facilitates production of new derivative works, and agreements that yield new products that would not arise through unilateral action are lawful.

Nor does it help to call the GPL “price fixing.” Although it sets a price of zero, agreements to set maximum prices usually assist consumers and therefore are evaluated under the Rule of Reason. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997). Intellectual property can be used without being used up; the marginal cost of an additional user is zero (costs of media and paper to one side), so once a piece of intellectual property exists the efficient price of an extra copy is zero, for that is where price equals marginal cost. Copyright and patent laws give authors a right to charge more, so that they can recover their fixed costs (and thus promote innovation), but they do not require authors to charge more. No more does antitrust law require higher prices. Linux and other open-source projects have been able to cover their fixed costs through donations of time; as long as that remains true, it would reduce efficiency and consumers’ welfare to force the authors to levy a charge on each new user.

Wallace does not contend that Linux has such a large market share, or poses such a threat to consumers’ welfare in the long run, that evaluation under the Rule of Reason could lead to condemnation. A “quick look” is all that’s needed to reject Wallace’s claim. *See, e.g., California Dental Association v. FTC*, 526 U.S. 756 (1999); *National Collegiate Athletic Ass’n v. University of Oklahoma*, 468 U.S. 85 (1984); *Ball Memorial Hospital, Inc. v. Mutual Hospital Insurance, Inc.*, 784 F.2d 1325 (7<sup>th</sup> Cir. 1986) (unless a firm with market power can increase its profits by curtailing output, the practice is lawful under the Rule of Reason). The GPL and open-source software have nothing to fear from the antitrust laws.

*AFFIRMED.*

### NOTES AND QUESTIONS

1. How can a software company make a profit when it offers a product for free? Software is typically expensive to develop but very inexpensive to distribute once it has been developed.

A great deal of free software, such as that in *Wallace*, is sold in “two-sided” markets in which the seller earns its revenue from a different product that is bundled with the software. That was the point missed in his complaint: IBM was not “giving away” software: it was providing the open

source software at no additional charge to users of its computer systems. See CHRISTINA BOHANNAN & HERBERT HOVENKAMP, CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION, Chs. 11 & 12 (2011).

The business model adopted by free software is based on a product that offers a very low price, a large installed base, and adaptability. A customer of free software is able to modify and adapt the software to its individual needs. Additionally, a business also assumes that by offering the software for free, it will be able to increase the sales of complementary products and services that it already charges its customers.

For example, Symbian and Android are operating systems for cellphones that are bundled with the phones themselves. Symbian was developed for more traditional phones, although its features have expanded over time. Android, which was developed by Google, is used in “smartphones.” The software license allows each manufacturer to design a mobile phone device of its choosing. Additionally, the manufacturers are able to update the devices with new features or applications.

2. The law of predatory pricing generally requires a plaintiff to show that a price is “below cost” and that the predatory could reasonably anticipate that its investment in below cost pricing would be followed by a “recoupment” period after the rival has been excluded. Further, this anticipated recoupment must be sufficiently large to pay off the investment in predation after being discounted for the time value of money and the likelihood that the scheme will fail. See *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); and *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*, 549 U.S. 312 (2007) (predatory buying). See also HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE §§ 8.2-8.7 (4<sup>th</sup> ed. 2011). As Judge Easterbrook observes, there can be no post-predation “recoupment” if the price of the product can never rise above zero; nothing will ever be recouped.

What about the price, however? Was it “below cost,” given that IBM was not simply giving away software. Rather it was bundling the software with a computer hardware system? It was additionally required by the license agreement to make its variation of the software available to others. How does one measure the “price” of the software in these circumstances?

What if IBM's overall profits from making computers and open source software to run them were positive?

2. Some patent licensing agreements contain provisions known as “grantbacks.” This provision stipulates that the licensee is required to convey back to the licensor the right to use those improvements. Could this provision produce an anticompetitive effect? According to the Justice Department and the Federal Trade Commission, which have issued antitrust Guidelines for intellectual property licensing, grantbacks can be anticompetitive “if they substantially reduce the licensee’s incentives to engage in research and development and thereby limit rivalry in innovation markets.” *Antitrust Guidelines for the Licensing of Intellectual Property* § 5.6 (1995).<sup>1</sup> But grantbacks can be competitively harmless if they are nonexclusive. *See Binks Mfg. c. Ransburg Electro-Coating Corp.*, 281 F.2d 252, 259 (7th Cir. 1960). Courts evaluate grantbacks under antitrust’s rule of reason, which requires proof of market power and competitive harm. *See Transparent-Wrap Mach. Corp. v. Stokes & Smith Co.*, 329 U.S. 637, 646-48 (1947). The Antitrust-IP Guidelines provide that factors considered in the rule of reason analysis are “the likely effects [of grantbacks] in light of the overall structure of the licensing arrangement and conditions in the relevant markets.” *Id.* at §5.6. Other factors include: (1) relevant market power and relevant market’s competition in the technology, (2) scope and duration of the grantbacks, (3) whether the grantback is royalty free and whether improvements are sublicensed free, and (4) the extent to which an pooling arranging in conjunction with grantbacks impede competition and innovation.

**IMAGE TECHNICAL SERVICES, INC. v. EASTMAN  
KODAK CO.**  
**125 F.3d 1195 (9<sup>th</sup> Cir. 1997), cert. denied, 523 U.S. 1094 (1998)**

BEEZER, Circuit Judge:

Plaintiffs-Appellees Image Technical Services, and ten other independent service organizations (“ISOs”) that service Kodak photocopiers and micrographic equipment sued the Eastman Kodak Co. (“Kodak”) for violations of the Sherman Act. The ISOs alleged that Kodak used its monopoly in the market for Kodak photocopier and micrographic parts to create a second monopoly in the equipment service markets. A jury verdict awarded treble damages totaling \$71.8 million....

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<sup>1</sup> Available at <http://www.justice.gov/atr/public/guidelines/0558.htm>.

This appeal raises questions relating to the application of antitrust principles upon a finding that a monopolist unilaterally refused to deal with competitors. We also address overlapping patent and copyright issues and their significance in the antitrust context.

Kodak manufactures, sells and services high volume photocopiers and micrographic (or microfilm) equipment. Competition in these markets is strong. In the copier market Kodak's competitors include Xerox, IBM and Canon. Kodak's competitors in the micrographics market include Minolta, Bell & Howell and 3M. Despite comparable products in these markets, Kodak's equipment is distinctive. Although Kodak equipment may perform similar functions to that of its competitors, Kodak's parts are not interchangeable with parts used in other manufacturers' equipment.

Kodak sells and installs replacement parts for its equipment. Kodak competes with ISOs in these markets. Kodak has ready access to all parts necessary for repair services because it manufactures many of the parts used in its equipment and purchases the remaining necessary parts from independent original-equipment manufacturers. In the service market, Kodak repairs at least 80% of the machines it manufactures. ISOs began servicing Kodak equipment in the early 1980's, and have provided cheaper and better service at times, according to some customers. ISOs obtain parts for repair service from a variety of sources, including, at one time, Kodak.

As ISOs grew more competitive, Kodak began restricting access to its copier and micrographic parts. In 1985, Kodak stopped selling copier parts to ISOs, and in 1986, Kodak halted sales of micrographic parts to ISOs. Additionally, Kodak secured agreements from their contracted original-equipment manufacturers not to sell parts to ISOs. These parts restrictions limited the ISOs' ability to compete in the service market for Kodak machines. Competition in the service market requires that service providers have ready access to all parts.

Kodak offers annual or multi-year service contracts to its customers. Service providers generally contract with equipment owners through multi-year service contracts. ISOs claim that they were unable to provide similar contracts because they lack a reliable supply of parts. Some ISOs contend that the parts shortage forced them out of business.

In 1987, the ISOs filed this action against Kodak, seeking damages and injunctive relief for violations of the Sherman Act. The ISOs claimed that Kodak both: (1) unlawfully tied the sale of service for Kodak machines with the sale of parts in violation of § 1 of the Sherman Act, and (2) monopolized or attempted to monopolize the sale of service for Kodak

machines in violation of § 2 of the Sherman Act.

... Before closing arguments, the ISOs withdrew their § 1 tying and conspiracy claims. The remaining § 2 attempted monopolization and monopolization claims were submitted to the jury. A unanimous verdict awarded damages to the ISO's totaling \$71.8 million after trebling....

After accepting the verdict, the district court crafted a ten year injunction requiring Kodak to sell all parts to ISOs on "reasonable and nondiscriminatory terms and prices." The injunction required Kodak to sell: (1) all parts for Kodak equipment; (2) all parts described in Kodak's Parts Lists; (3) all parts of supply items that are field replaceable by Kodak technicians; (4) all service manuals and price lists; and (5) all tools or devices "essential to servicing Kodak equipment."

Section 2 of the Sherman Act prohibits monopolies, attempts to form monopolies, as well as combinations and conspiracies to do so. 15 U.S.C. § 2. The ISOs presented evidence in support of two § 2 theories: attempted monopolization and monopolization. They alleged, and the jury concluded, that Kodak used its monopoly over Kodak photocopier and micrographic parts to attempt to create and actually create a second monopoly over the service markets.

To prevail on a § 2 attempt claim, the ISOs were required to establish: "(1) a specific intent to control prices or destroy competition; (2) predatory or anticompetitive conduct directed at accomplishing that purpose; (3) a dangerous probability of achieving 'monopoly power,' and (4) causal antitrust injury." ... The requirements of a § 2 monopolization claim are similar, differing primarily in the requisite intent and the necessary level of monopoly power. ...

To demonstrate market power by circumstantial evidence, a plaintiff must: "(1) define the relevant market, (2) show that the defendant owns a dominant share of that market, and (3) show that there are significant barriers to entry and show that existing competitors lack the capacity to increase their output in the short run."

We begin with the relevant market determination. The relevant market is the field in which meaningful competition is said to exist....

[Kodak] argues that because no two parts are interchangeable, the relevant markets for parts consist of the market for each individual part for Kodak photocopiers and each single part for Kodak micrographics equipment. Under Kodak's theory there are not two relevant parts markets, but thousands of individual "part" markets. Kodak contends that the ISOs

should have been required to demonstrate that they could not obtain particular nonpatented parts and that the failure to obtain that particular part resulted in a Kodak monopoly over service. We reject Kodak's market definition.

Kodak's market definition focuses exclusively on the interchangeability of the parts although ignoring the "commercial realities" faced by ISOs and end users. ...

The "commercial reality" faced by service providers and equipment owners is that a service provider must have ready access to all parts to compete in the service market. As the relevant market for service "from the Kodak equipment owner's perspective is composed of only those companies that service Kodak machines," *id.*, the relevant market for parts from the equipment owners' and service providers' perspective is composed of "all parts" that are designed to meet Kodak photocopier and micrographics equipment specifications. The makers of these parts "if unified by a monopolist or a hypothetical cartel, would have market power in dealing with" ISOs and end users. *Rebel Oil*, 51 F.3d at 1436 (quoting *Areeda & Hovenkamp*, Antitrust Law, ¶ 518.1b, at 534 (Supp.1993)) (defining relevant "market")....

.... The second element of a § 2 monopoly claim, the "conduct" element, is the use of monopoly power "to foreclose competition, to gain a competitive advantage, or to destroy a competitor." ...

Kodak's chief complaint with the monopoly power jury instructions lies with Jury Instruction No. 29. That Instruction, entitled "Monopolization-Monopoly Conduct," states in relevant part:

[a] company with monopoly power in a relevant market has no general duty to cooperate with its business rivals and may refuse to deal with them or with their customers if valid business reasons exist for such refusal. It is unlawful, however, for a monopolist to engage in conduct, including refusals to deal, that unnecessarily excludes or handicaps competitors in order to maintain a monopoly.

(emphasis added). Kodak argues that this instruction lacks objective standards and improperly includes within the prohibited activities a lawful monopolist's "aggressive" competition.

Specifically, Kodak challenges Instruction No. 29's "unnecessarily excludes or handicaps competitors" language. Kodak says that this language is based on a form of "monopoly leveraging" that we previously rejected in *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 543 (9th

Cir.1991). In *Alaska Airlines* we did reject the Second Circuit's holding in *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2nd Cir. 1979). *Berkey Photo* recognized liability under § 2 of the Sherman Act on a theory of monopoly leveraging involving a firm which used "its monopoly power in one market to gain a competitive advantage in another, albeit without an attempt to monopolize the second market." 603 F.2d at 275. In *Alaska Airlines*, we held that "monopoly leveraging" could not exist as a basis for § 2 liability in the absence of the defendant using its monopoly in one market to monopolize or attempt to monopolize the downstream market. 948 F.2d at 547. We characterized *Berkey Photo*'s downstream monopoly requirement "to gain a competitive advantage" as too "loose." *Alaska Airlines*, 948 F.2d at 546.

Kodak accuses the district court of incorporating *Berkey Photo*'s repudiated language into the court's instructions. We disagree. Instruction No. 29 required the jury to find that Kodak's monopoly conduct be undertaken "in order to maintain a monopoly" in the downstream market. *Berkey Photo*'s watered-down standard does not go this far. Instruction No. 29 makes clear that the monopolies at issue are Kodak's alleged service monopolies and the Instruction required the jury to find that Kodak acted in furtherance of maintaining its service monopolies. Instruction No. 29's "unnecessarily excludes or handicaps competitors" language does not come from *Berkey Photo*, but from the jury instruction endorsed by the Supreme Court in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 597 (1985)....

Section 2 of the Sherman Act prohibits a monopolist's unilateral action, like Kodak's refusal to deal, if that conduct harms the competitive process in the absence of a legitimate business justification....

The Supreme Court began its analysis in *Aspen Skiing* with a discussion of the "right to refuse to deal," a right the Court characterized as highly valued but not "unqualified." *Id.* at 601. The Court, quoting extensively from *Lorain Journal Co. v. United States*, 342 U.S. 143, 155 (1951), held that the right to refuse to deal was "neither absolute nor exempt from regulation" and when used "as a purposeful means of monopolizing interstate commerce" the exercise of that right violates the Sherman Act. *Aspen Skiing*, 472 U.S. at 602. Thus "the long recognized right ... [to] freely [ ] exercise [one's] own independent discretion as to parties with whom he will deal" does not violate the Sherman Act "[i]n the absence of any purpose to create or maintain a monopoly." *Id.* (quoting *Lorain Journal*, 342 U.S. at 155) (emphasis in the original) (citations omitted). In *Aspen Skiing*, the Court noted that a defendant's refusal to deal was evidence of

its' intent "relevant to the question whether the challenged conduct is fairly characterized as 'exclusionary' or 'anticompetitive'-to use the words in the trial court's instructions-or 'predatory,' to use a word that scholars seem to favor."

Next, the Court reasoned that a monopolist's refusal to deal was not limited to the specific facts of *Lorain Journal*, but also covered the Aspen Skiing defendant-monopolist's election "to make an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years."....

Jury Instructions Nos. 28 and 29 here covered the requirements set forth in *Aspen Skiing*. Like the Supreme Court in *Aspen Skiing*, we are faced with a situation in which a monopolist made a conscious choice to change an established pattern of distribution to the detriment of competitors. *Id.* at 603. Although the service market prior to Kodak's parts policy had not "originated in a competitive market and persisted for several years," *id.*, the ISO service market had existed for three years and was growing rapidly before Kodak implemented its parts policy. Our case is factually distinguishable from *Aspen Skiing* in several respects: here there are no readily comparable competitive markets; ISO profits were not halved after the imposition of the anticompetitive policies; and there are two markets at issue, rather than only one. Further, unlike most essential facilities cases and this case, *Aspen Skiing* did not involve the effects of a supplier's refusal to deal with its customers in order to control a downstream market.... [W]e believe the Supreme Court, in *Aspen Skiing*, endorsed a more general application of § 2 principles to refusal to deal cases. *See Data General*, 36 F.3d at 1183-84 (plaintiff alleging § 2 refusal to deal claim "need not tailor its argument to a preexisting 'category' of unilateral refusals to deal."). The district court's Jury Instruction No. 29 was proper.....

Our conclusion that the ISOs have shown that Kodak has both attained monopoly power and exercised exclusionary conduct does not end our inquiry. Kodak's conduct may not be actionable if supported by a legitimate business justification. When a legitimate business justification supports a monopolist's exclusionary conduct, that conduct does not violate § 2 of the Sherman Act. A plaintiff may rebut an asserted business justification by demonstrating either that the justification does not legitimately promote competition or that the justification is pretextual. *See Kodak*, 504 U.S. at 483-84 (citing *Kodak*, 903 F.2d at 618). Kodak asserts that the protection of its patented and copyrighted parts is a valid business justification for its anticompetitive conduct and argues that the district court's erroneous jury instructions made it impossible for the jury to properly consider this

justification....

The ISOs' evidence suffices to support the jury's rejection of Kodak's business justifications, as the record reflects evidence of pretext. The ISOs presented evidence that: (1) Kodak adopted its parts policy only after an ISO won a contract with the State of California; (2) Kodak allowed its own customers to service their machines; (3) Kodak customers could distinguish breakdowns due to poor service from breakdowns due to parts; and (4) many customers preferred ISO service. Kodak also attacks the district court's business justifications instructions for their failure to properly detail Kodak's intellectual property rights. Kodak argues that the court failed to instruct the jury that Kodak's numerous patents and copyrights provide a legitimate business justification for Kodak's alleged exclusionary conduct. Kodak holds 220 valid United States patents covering 65 parts for its high volume photocopiers and micrographics equipment, and all Kodak diagnostic software and service software are copyrighted. The jury instructions do not afford Kodak any "rights" or "privileges" based on its patents and copyrights: all parts are treated the same. In Jury Instruction No. 37, the court told the jury:

[i]f you find that Kodak engaged in monopolization or attempted monopolization by misuse of its alleged parts monopoly ... then the fact that some of the replacement parts are patented or copyrighted does not provide Kodak with a defense against any of those antitrust claims.

In Jury Instruction No. 28, the court stated, over Kodak's objection, that:

[s]uch [exclusionary] conduct does not refer to ordinary means of competition, like offering better products or services, exercising superior skill or business judgment, utilizing more efficient technology, or exercising natural competitive advantages.

Kodak proposed to include "exercising lawful patents and copyrights" amongst the list of non-exclusionary conduct in Instruction No. 28, but the district court rejected that language.

Kodak's challenge raises unresolved questions concerning the relationship between federal antitrust, copyright and patent laws. In particular we must determine the significance of a monopolist's unilateral refusal to sell or license a patented or copyrighted product in the context of a § 2 monopolization claim based upon monopoly leveraging. This is a question of first impression.

We first identify the general principles of antitrust, copyright and patent law as we must ultimately harmonize these statutory schemes in responding

to Kodak's challenge.

Antitrust law seeks to promote and protect a competitive marketplace for the benefit of the public. *See Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911); *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1203 (2d Cir. 1981). The Sherman Act, the relevant antitrust law here, prohibits efforts both to restrain trade by combination or conspiracy and the acquisition or maintenance of a monopoly by exclusionary conduct. 15 U.S.C. §§ 1, 2.

Patent law seeks to protect inventions, while inducing their introduction into the market for public benefit. *SCM Corp.*, 645 F.2d at 1203. Patent laws “reward the inventor with the power to exclude others from making, using or selling [a patented] invention throughout the United States.” *Id.* Meanwhile, the public benefits both from the faster introduction of inventions, and the resulting increase in market competition. Legally, a patent amounts to a permissible monopoly over the protected work. *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 135 (1969). Patent laws “are in pari materia with the antitrust laws and modify them pro tanto (as far as the patent laws go).” *Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964).

Federal copyright law “secure[s] a fair return for an author’s creative labor” in the short run, while ultimately seeking “to stimulate artistic creativity for the general public good.” *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156 (1975) (internal quotations omitted). The Copyright Act grants to the copyright owner the exclusive right to distribute the protected work. 17 U.S.C. § 106. This right encompasses the right to “refrain from vending or licensing,” as the owner may “content [itself] with simply exercising the right to exclude others from using [its] property.” *Data General*, 36 F.3d at 1186 (quoting *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932)); *see Stewart v. Abend*, 495 U.S. 207, 228-29 (1990) (“nothing in the copyright statutes would prevent an author from hoarding all of his works during the term of the copyright.”)

Clearly the antitrust, copyright and patent laws both overlap and, in certain situations, seem to conflict. This is not a new revelation. We have previously noted the “obvious tension” between the patent and antitrust laws: “[o]ne body of law creates and protects monopoly power while the other seeks to proscribe it.” *United States v. Westinghouse Electric Corp.*, 648 F.2d 642, 646 (9th Cir. 1981) (citations omitted). Similarly, tension exists between the antitrust and copyright laws. *See Data General*, 36 F.3d at 1187.

Two principles have emerged regarding the interplay between these

laws: (1) neither patent nor copyright holders are immune from antitrust liability, and (2) patent and copyright holders may refuse to sell or license protected work. First, as to antitrust liability, case law supports the proposition that a holder of a patent or copyright violates the antitrust laws by “concerted and contractual behavior that threatens competition.”...

Case law also supports the right of a patent or copyright holder to refuse to sell or license protected work. .... We find no reported case in which a court has imposed antitrust liability for a unilateral refusal to sell or license a patent or copyright. Courts do not generally view a monopolist’s unilateral refusal to license a patent as “exclusionary conduct.” See *Data General*, 36 F.3d at 1186 (citing *Miller Insituform, Inc. v. Insituform of North America*, 830 F.2d 606, 609 (6th Cir. 1987)) (“A patent holder who lawfully acquires a patent cannot be held liable under Section 2 of the Sherman Act for maintaining the monopoly power he lawfully acquired by refusing to license the patent to others.”).....

This basic right of exclusion does have limits. For example, a patent offers no protection if it was unlawfully acquired. *Data General*, 36 F.3d at 1186 (citing *SCM Corp.*, 645 F.2d at 1208-09). Nor does the right of exclusion protect an attempt to extend a lawful monopoly beyond the grant of a patent. See *Mercoïd*, 320 U.S. at 665. Section 2 of the Sherman Act condemns exclusionary conduct that extends natural monopolies into separate markets. Much depends, therefore, on the definition of the patent grant and the relevant market.

The relevant market for determining the patent or copyright grant is determined under patent or copyright law. See, e.g., *id.* at 666 (the patent’s grant “is limited to the invention which it defines.”). The relevant markets for antitrust purposes are determined by examining economic conditions. ...

Parts and service here have been proven separate markets in the antitrust context, but this does not resolve the question whether the service market falls “reasonably within the patent [or copyright] grant” for the purpose of determining the extent of the exclusive rights conveyed....

... [W]e adopt a modified version of the rebuttable presumption created by the First Circuit in *Data General*, and hold that “while exclusionary conduct can include a monopolist’s unilateral refusal to license a [patent or] copyright,” or to sell its patented or copyrighted work, a monopolist’s “desire to exclude others from its [protected] work is a presumptively valid business justification for any immediate harm to consumers.” *Data General*, 36 F.3d at 1187.

... Given the interplay of the antitrust and intellectual property laws

discussed above, Kodak's contention that its refusal to sell its parts to ISOs was based on its reluctance to sell its patented or copyrighted parts was a presumptively legitimate business justification. *See Data General*, 36 F.3d. at 1187. Kodak may assert that its desire to profit from its intellectual property rights justifies its conduct, and the jury should presume that this justification is legitimately procompetitive.

Nonetheless, this presumption is rebuttable.... The *Data General* court noted that the presumption of legitimacy can be rebutted by evidence that the monopolist acquired the protection of the intellectual property laws in an unlawful manner. *See* 36 F.3d at 1188 (citation omitted). The presumption may also be rebutted by evidence of pretext. Neither the aims of intellectual property law, nor the antitrust laws justify allowing a monopolist to rely upon a pretextual business justification to mask anticompetitive conduct....

Kodak photocopy and micrographics equipment requires thousands of parts, of which only 65 were patented. Unlike the other cases involving refusals to license patents, this case concerns a blanket refusal that included protected and unprotected products.... From this evidence, it is more probable than not that the jury would have found Kodak's presumptively valid business justification rebutted on the grounds of pretext.

Kodak argues that the existence of some patented and copyrighted products undermines ISOs "all parts" theory. To the contrary, as discussed above, the "all parts" market reflects the "commercial realities" of the marketplace and the lack of identifiable separate markets for individual parts. The fact that Kodak did not differentiate between patented and nonpatented parts lends further support to the existence of these commercial realities. The jury accepted the "all parts" theory and found a scheme to monopolize the service market through Kodak's conduct. We hold that the district court's failure to instruct on Kodak's intellectual property rights was harmless.

Last, Kodak challenges the district court's ten-year permanent injunction requiring Kodak to sell all parts to all ISOs at reasonable prices....

[T]he injunction requires Kodak to sell all parts for Kodak equipment, whether or not Kodak manufactures those parts, and forbids Kodak from interfering with sales to ISOs by original-equipment manufacturers. Through these two provisions, the injunction allows the ISOs to choose between purchasing from Kodak, which must warehouse parts, or from individual suppliers. Because the ISOs have an alternative source for these

parts, the “no interference with [original-equipment manufacturers]” requirement is unnecessary and anticompetitive. It promotes free-riding by requiring Kodak to pay for keeping a massive inventory of parts for the ISOs.....

Next, Kodak contends that the injunction imposes utility-like regulation of prices and deprives Kodak of its right to earn monopoly profits on its patented and copyrighted products. This requirement involves the court in a matter generally considered beyond our function, namely, direct price administration.

.... Dropping the reasonableness element and requiring nondiscriminatory pricing will both end Kodak’s service monopoly and protect Kodak’s intellectual property rights. Kodak should be permitted to charge all of its customers, including end users (both self-servicers and those under service contracts with Kodak), service companies contracting with Kodak and ISOs, any nondiscriminatory price that the market will bear. We direct the district court to modify the injunction by deleting the requirement that prices “in any event, be reasonable.”....

AFFIRMED in part, REVERSED in part, and REMANDED for further proceedings.

### NOTES AND QUESTIONS

1. The Ninth Circuit’s *Kodak* opinion was on remand from the Supreme Court’s important and controversial decision five years earlier in *Eastman Kodak Co. v. Image Tech. Svces.*, 504 U.S. 451 (1992). The Supreme Court held that although Kodak controlled only some 23% of the market for high speed photocopiers there could nevertheless be a relevant market for “Kodak” parts and service. The Court reasoned that once Kodak’s customers had purchased their unit they were “locked in” and faced high “switching costs,” thus permitting them to be charged a monopoly price. As a result a relevant market limited to a single brand could be appropriate. Since a firm controls 100% of its own brand this could entail monopoly. See HERBERT HOVENKAMP, *FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE* §3.3a (4<sup>th</sup> Cir. 2011). As the discussion there notes, while *Kodak* has never been overruled its recognition of single-brand markets by nondominant firms has proven to be very controversial and courts often bend over backwards to avoid it.

2. Subsequent to the Ninth Circuit’s *Kodak* decision, the Federal Circuit also confronted the issue of a patent owner’s refusal to license its patent rights to others. *In re Independent Service Organizations Antitrust*

*Litigation*, 203 F.3d 1322 (Fed. Cir. 2000) (“Xerox”). The Federal Circuit rejected the claim brought by an independent service organization (“ISO”) that Xerox’s refusal to sell patented replacement parts and copyrighted service manuals for its copiers violated the antitrust laws:

[The plaintiff] relies on the Ninth Circuit’s holding ... in *Image Technical Services* [*Kodak*] that “while exclusionary conduct can include a monopolist’s unilateral refusal to license a [patent] or to sell its patented ... work, a monopolist’s desire to exclude others from its [protected] work is a presumptively valid business justification for any immediate harm to consumers. 125 F.3d at 1218 (citing *Data General Corp. v. Grumman Sys. Support Corp.*, 36 F.3d 1147, 1187 (1st Cir.1994)). By that case, the Ninth Circuit adopted a rebuttable presumption that the exercise of the statutory right to exclude provides a valid business justification for consumer harm, but then excused as harmless the district court’s error in failing to give any instruction on the effect of intellectual property rights on the application of the antitrust laws. It concluded that the jury must have rejected the presumptively valid business justification as pretextual. This logic requires an evaluation of the patentee’s subjective motivation for refusing to sell or license its patented products for pretext. We decline to follow *Image Technical Services*.

We have held that if a [patent infringement] suit is not objectively baseless, an antitrust defendant’s subjective motivation is immaterial. *Nobelpharma*, 141 F.3d at 1072. We see no more reason to inquire into the subjective motivation of Xerox in refusing to sell or license its patented works than we found in evaluating the subjective motivation of a patentee in bringing suit To enforce that same right. In the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws. We therefore will not inquire into his subjective motivation for exerting his statutory rights, even though his refusal to sell or license his patented invention may have an anticompetitive effect, so long as that anticompetitive effect is not illegally extended beyond the statutory patent grant. It is the infringement defendant and not the patentee that bears the burden to show that one of these exceptional situations exists and, in the absence of such proof, we will not inquire into the patentee’s

motivations for asserting his statutory right to exclude....

The court further held that a patent owner's subjective motivation for refusing to license its patents is irrelevant, except in three narrow instances: (1) where the patent owner procures the patent by fraud on the Patent and Trademark Office, (2) where the patent owner engages in "sham" patent litigation (that is, sues to enforce a patent knowing that the patent is invalid, or (3) where the patent owner engages in unlawful "tying." *Id.* at 1326-27. Rather, the court must determine whether the patent holder was acting "within the scope of the statutory patent grant" regardless of whether those actions fall in multiplex antitrust markets.

3. Suppose Alpha patents a device or technology that works exclusively with Beta's patented technology. That may place the firms in a bilateral monopoly relationship. But should that give Beta an antitrust duty to deal with Alpha? In *Eatoni Ergonomics, Inc. v. Research in Motion Corp.*, 2012 WL 2348443 (2d Cir. June 21, 2012), the Second Circuit held that Research in Motion (RIM), the maker of the Blackberry smartphone, did not act unlawfully when it refused to incorporate the plaintiff's patented "reduced QWERTY" keyboard technology into its devices. The parties had initially agreed to engage in joint development that might result in incorporation of Eatoni's technology, but RIM abandoned the efforts after making "a legitimate business judgment that the parties' proposed reduce QWERTY model was not viable." The court observed:

To the extent Eatoni argues that RIM's mobile phones offer the only platform compatible with its patented reduced QWERTY keyboard technology, we agree with the district court that [§ 2](#) does not obligate RIM to share its patented platform technology, from which RIM derives the lawful power to exclude others' use. Further, Eatoni's contention is belied by the amended complaint, which states that Eatoni has successfully applied its patent to a mobile phone platform other than RIM's.

### **MICROSOFT CORP. V COMMISSION OF THE EUROPEAN COMMUNITIES**

**(Case T-201/04 European Court of First Instance , Sep. 2007)**

*[Microsoft was charged with abuse of a dominant position under European Competition law (Article 82, now Article 102 of the Treaty on the*

*Functioning of the European Union). It allegedly failed to provide the operators of email or internet servers who used non-Microsoft operating systems satisfactory interconnection protocols, or instructions so that they could be fully compatible with networks that ran the Microsoft Windows operating system. Microsoft had also developed a proprietary Microsoft server operating system in competition with these rivals. – ed.]*

*Summary of the Judgment*

Article 82 EC deals with the conduct of one or more economic operators involving the abuse of a position of economic strength which enables the operator concerned to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors, its customers and, ultimately, consumers.

Furthermore, whilst the finding of a dominant position does not in itself imply any criticism of the undertaking concerned, that undertaking has a special responsibility, irrespective of the causes of that position, not to allow its conduct to impair genuine undistorted competition on the common market....

4 In proceedings brought on the basis of Article 82 EC, the Commission may define the concept of ‘interoperability’ as the capacity for two software products to exchange information and to use that information mutually in order to allow each of those software products to function in all the ways envisaged, without being bound by the definition given by Directive 91/250 on the legal protection of computer programs, from which it does not depart.

In that context, the Commission may determine the ‘degree of interoperability’ of software products by reference to what, in its view, is necessary, in the light of Article 82 EC, in order to enable developers of work group server operating systems competing with the dominant developer to remain viably on the market. Should it be established that the existing degree of interoperability does not enable those developers to remain viably on the market, it follows that the maintenance of effective competition on that market is being hindered.

In requiring, by way of remedy, that an undertaking in a dominant position disclose the interoperability information, the Commission refers to a detailed technical description of certain rules of interconnection and interaction that can be used within the work group networks to deliver work group services. That description does not extend to the way in which the undertaking implements those rules, in particular, to the internal structure or to the source code of its products.

The degree of interoperability thus required by the Commission enables competing operating systems to interoperate with the dominant undertaking's domain architecture on an equal footing in order to be able to compete viably with the latter's operating systems. It does not entail making competitors' products work in exactly the same way as its own and does not enable its competitors to clone or reproduce its products or certain features of those products.

5 In a decision penalising the refusal by a dominant undertaking to provide competing undertakings with interoperability information of software products, the Commission may refrain from making a finding on the issue whether the dominant undertaking's communication protocols or the specifications of those protocols are covered by intellectual property rights and assume that the undertaking is able to rely on such rights. Thus the Commission may proceed on the premise that the refusal to supply interoperability information might not be a mere refusal to supply a product or a service indispensable to the exercise of a specific activity but a refusal to license intellectual property rights. The Commission thus chooses the strictest legal test and therefore the one most favourable to the accused dominant undertaking. In such a situation, it is therefore necessary to ascertain whether the criteria which determine when an undertaking in a dominant position can be required to grant a licence relating to intellectual property rights are satisfied.

6 Although undertakings are, as a rule, free to choose their business partners, in certain circumstances a refusal to supply on the part of a dominant undertaking may constitute an abuse of a dominant position within the meaning of Article 82 EC unless it is objectively justified.

The refusal by an undertaking holding a dominant position to license a third party to use a product covered by an intellectual property right cannot in itself constitute an abuse of a dominant position within the meaning of Article 82 EC.

It is only in exceptional circumstances that the exercise of the exclusive right by the owner of the intellectual property right may give rise to such an abuse and that, accordingly, it is permissible, in the public interest in maintaining effective competition on the market, to encroach upon the exclusive right of the holder of the intellectual property right by requiring him to grant licences to third parties seeking to enter or remain on that market.

The following circumstances, in particular, must be considered to be exceptional: in the first place, the refusal relates to a product or service

indispensable to the exercise of a particular activity on a neighbouring market; in the second place, the refusal is of such a kind as to exclude any effective competition on that neighbouring market; in the third place, the refusal prevents the appearance of a new product for which there is potential consumer demand.

Once it is established that such circumstances are present, the refusal by the holder of a dominant position to grant a licence may infringe Article 82 EC unless the refusal is objectively justified.

Finally, in order that a refusal to give access to a product or service indispensable to the exercise of a particular activity may be considered abusive, it is necessary to distinguish two markets, namely, a market constituted by that product or service and on which the undertaking refusing to supply holds a dominant position and a neighbouring market on which the product or service is used in the manufacture of another product or for the supply of another service. The fact that the indispensable product or service is not marketed separately does not exclude from the outset the possibility of identifying a separate market. It is sufficient that a potential market or even a hypothetical market can be identified. Such is the case where the products or services are indispensable to the conduct of a particular business activity and where there is an actual demand for them on the part of undertakings which seek to carry on that business. It is decisive that two different stages of production are identified and that they are interconnected in that the upstream product is indispensable for supply of the downstream product.

7 For the purposes of application of Article 82 EC to the refusal of a dominant undertaking to grant a licence in the market for work group server operating systems, the ‘interoperability information’ must be regarded as being ‘indispensable’, inter alia because the interoperability is of significant competitive importance in that market, even if their lack of availability leads to competition being eliminated only gradually and not immediately.

8 As stated in the Commission Notice on the definition of the relevant market for the purposes of Community competition law, ‘[a] relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products’ characteristics, their prices and their intended use’. Supply-side substitutability may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. That means that suppliers are able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks

in response to small and permanent changes in relative prices.

With respect to operating systems, the Commission may correctly find that there is a market for work group server operating systems which is separate from the market for client PC operating systems.....

12 Although the burden of proof of the existence of the circumstances that constitute an infringement of Article 82 EC is borne by the Commission, it is for the dominant undertaking concerned, and not for the Commission, before the end of the administrative procedure, to raise any plea of objective justification and to support it with arguments and evidence. It then falls to the Commission, where it proposes to make a finding of an abuse of a dominant position, to show that the arguments and evidence relied on by the undertaking cannot prevail and, accordingly, that the justification put forward cannot be accepted.

The mere fact that a product is covered by intellectual property rights cannot constitute objective justification to refuse to grant a licence. If the mere fact of holding intellectual property rights could in itself constitute objective justification for such a refusal, the exception established by the case-law could never apply.....

15 In order to determine whether the conduct of the dominant undertaking constitutes abusive tying, the Commission is entitled to base its finding on the following factors: first, the tying and tied products are two separate products; second, the undertaking concerned is dominant in the market for the tying product; third, the undertaking concerned does not give customers a choice to obtain the tying product without the tied product; and fourth, the practice in question forecloses competition. The Commission also takes into account the fact that the tying is not objectively justified.

#### 1. The contested decision....

##### I – Relevant product markets and geographic market

24 The first market defined in the contested decision is the market for client PC operating systems. Operating systems are defined as ‘system software’ which controls the basic functions of the computer and enables the user to make use of the computer and run application software on it (recital 37 to the contested decision). Client PCs are defined as general-purpose computers designed for use by one person at a time and capable of being connected to a network (recital 45 to the contested decision).

25 As regards the second market, the contested decision defines

work group server operating systems as operating systems designed and marketed to deliver collectively ‘basic infrastructure services’ to relatively small numbers of client PCs connected to small or medium-sized networks (recitals 53 and 345 to the contested decision)....

30 In the contested decision, the Commission finds that Microsoft has had a dominant position on the client PC operating systems market since at least 1996 and also on the work group server operating systems market since 2002 (recitals 429 to 541 to the contested decision).

31 As regards the client PC operating systems market, the Commission relies essentially on the following factors to arrive at that conclusion:

- Microsoft’s market shares are over 90% (recitals 430 to 435 to the contested decision);
- Microsoft’s market power has ‘enjoyed an enduring stability and continuity’ (recital 436 to the contested decision);
- there are significant barriers to market entry, owing to indirect network effects (recitals 448 to 464 to the contested decision);
- those network effects derive, first, from the fact that users like platforms on which they can use a large number of applications and, second, from the fact that software designers write applications for the client PC operating systems that are the most popular among users (recitals 449 and 450 to the contested decision)....

33 As regards the work group server operating systems market, the Commission relies, in substance, on the following factors:

- Microsoft’s market share is, at a conservative estimate, at least 60% (recitals 473 to 499 to the contested decision);
- the position of Microsoft’s three main competitors on that market is as follows: Novell, with its NetWare software, has 10 to 25%; vendors of Linux products have a market share of 5 to 15%; and vendors of UNIX products have a market share of 5 to 15% (recitals 503, 507 and 512 to the contested decision);
- the work group server operating systems market is characterised by the existence of significant entry barriers, owing in particular to network effects and to Microsoft’s refusal to disclose interoperability information (recitals 515 to 525 to the contested decision);
- there are close commercial and technological links between the latter market and the client PC operating systems market (recitals 526 to 540 to the contested decision).

34 Linux is an ‘open source’ operating system released under the ‘GNU GPL (General Public Licence)’. Strictly speaking, it is only a code base, called the ‘kernel’, which performs a limited number of services specific to an operating system. It may, however, be linked to other layers of software to form a ‘Linux operating system’ (recital 87 to the contested decision). Linux is used in particular as the basis for work group server operating systems (recital 101 to the contested decision) and is thus present on the work group server operating systems market in conjunction with Samba software, which is also released under the ‘GNU GPL’ licence (recitals 506 and 598 to the contested decision).

35 ‘UNIX’ designates a number of operating systems that share certain common features (recital 42 to the contested decision). Sun has developed a UNIX-based work group server operating system called ‘Solaris’ (recital 97 to the contested decision).

### III – Abuse of a dominant position

#### A – Refusal to supply and authorise the use of interoperability information

36 The first abusive conduct in which Microsoft is found to have engaged consists in its refusal to supply its competitors with ‘interoperability information’ and to authorise the use of that information for the purpose of developing and distributing products competing with Microsoft’s own products on the work group server operating systems market, between October 1998 and the date of notification of the contested decision (Article 2(a) of the contested decision). That conduct is described at recitals 546 to 791 to the contested decision....

39 A ‘protocol’ is defined as ‘a set of rules of interconnection and interaction between various instances of Windows work group server operating systems and Windows client PC operating systems running on different computers in a Windows work group network’ (Article 1(2) of the contested decision).

40 In the contested decision, the Commission emphasises that the refusal in question does not relate to Microsoft’s ‘source code’, but only to specifications of the protocols concerned, that is to say, to a detailed description of what the software in question must achieve, in contrast to the implementations, consisting in the implementation of the code on the computer....

569 First, the file shows that initially Microsoft supplied only client PC operating systems and that it was a relatively late entrant to the server operating systems market. It was only in the early 1990s that Microsoft began to develop a server operating system – it marketed its first system, ‘Windows NT 3.5 Server’, in July 1992 – and it was only with ‘Windows NT 4.0’, released in July 1996, that it first encountered real commercial success (see, in particular, paragraph 50 of the response of 17 November 2000 to the first statement of objections and paragraphs 50 and 56 of the application).

570 It is apparent from the IDC data, as reproduced at recital 591 to the contested decision, that Microsoft’s market share, by units shipped, on the market for operating systems for servers costing under USD 25 000 grew from 25.4% (24.5% by turnover) in 1996 to 64.9% (61% by turnover) in 2002, a leap of almost 40% in just six years....

575 Second, it is apparent from the file that, alongside the evolution of Microsoft’s position as described above, Novell experienced a continuous decline on the work group server operating systems market and in just a few years became a secondary player. At the time when Microsoft entered the server operating systems market, the leading product for the supply of work group services was Novell’s NetWare (see paragraph 56 of the application), which had been present on that market since the mid-1980s....

619 The Commission had even more reason to conclude that there was a risk that competition would be eliminated on that market because the market has certain features which are likely to discourage organisations which have already taken up Windows for their work group servers from migrating to competing operating systems in the future. Thus, as the Commission correctly states at recital 523 to the contested decision, it follows from certain results of the third Mercer survey that the fact of having an ‘established record as proven technology’ is seen as a significant factor by the large majority of IT executives questioned. At the time of the adoption of the contested decision, Microsoft, at a conservative estimate, held a market share of at least 60% on the work group server operating systems market (recital 499 to the contested decision). Likewise, certain results of that survey also establish that the factor ‘available skill-sets and cost/availability of support (in-house or external)’ is important for the majority of the IT executives questioned. As the Commission quite correctly states at recital 520 to the contested decision, ‘[that] means that the easier it is to find technicians skilled in using a given work group server operating system, the more customers are inclined to purchase that work group server operating system’ and, ‘[i]n turn, however, the more popular a

work group server operating system is among customers, the easier it is for technicians (and the more willing are technicians) to acquire skills related to that product'. Microsoft's very high market share on the work group server operating system market has the consequence that a very large number of technicians possess skills which are specific to Windows operating systems.

620 The Court therefore concludes that the circumstance that the refusal at issue entailed the risk of elimination of competition is present in this case....

1231 By way of remedy for the abusive refusal to supply the interoperability information, Article 5 of the contested decision orders Microsoft to disclose, within 120 days of notification of that decision, that information to any undertaking having an interest in developing and distributing work group server operating systems and to allow, on reasonable and non-discriminatory terms, those undertakings to use the information in question to develop and distribute work group server operating systems. Microsoft is also required to ensure that the interoperability information disclosed is kept updated on an ongoing basis and in a timely manner. Last, Article 5 of the contested decision orders Microsoft, within 120 days of the date of notification of that decision, to set up an evaluation mechanism that will give interested undertakings a workable possibility of informing themselves about the scope and terms of use of the interoperability information....

1233 Article 7 of the contested decision, moreover, provides for the establishment of a suitable mechanism to assist the Commission in monitoring Microsoft's compliance with the contested decision and including, in particular, the appointment of an independent monitoring trustee. Article 7 provides that that mechanism is to form the subject-matter of a proposal by Microsoft within 30 days of notification of the decision, while in the event that the Commission considers that the proposed mechanism is not suitable, it is to 'retain the right to impose such a mechanism by way of a decision'.

**NOVELL V. MICROSOFT**  
**2013 WL 5303259, \_\_ F.3d \_\_**  
**(10th Cir. Oct. 2, 2013)**

Gorsuch, Circuit Judge

A straggler of a case, this one drags us back twenty years. To a time before the dot-com boom busted and boomed again, a time when Microsoft

was busy amassing a virtual empire—if sometimes in violation of the antitrust laws. Long since found liable for a rich diversity of antitrust misdeeds in the 1990s, this case calls on us to decide whether Microsoft back then committed still another, as-yet undetected antitrust violation—this time at Novell's expense.

Novell's suit against Microsoft finally found its way to trial in 2011 but the jury couldn't manage a verdict. Reviewing the record for itself after trial, the district court decided it could fairly admit of only one conclusion: Microsoft's conduct did not offend section 2 of the Sherman Act. So the district court entered judgment as a matter of law, *see* Fed.R.Civ.P. 50, a decision Novell now asks us to overturn but one we find we cannot. Novell complains that Microsoft refused to share its intellectual property with rivals after first promising to do so. But the antitrust laws rarely impose on firms—even dominant firms—a duty to deal with their rivals. With respect to Novell at least, Microsoft did nothing unlawful.

\* \* \*

. . . .

By the mid-1990s Microsoft had become the leading provider of Intel-compatible personal computer operating systems. An operating system amounts to the computer's core software—software that allows the everyday user to take advantage of a computer's functions. . . .

. . . On one hand, Microsoft had some incentive to cooperate with ISVs. After all, ISVs wrote applications for Microsoft's operating system; increasing the number of applications that could run on Microsoft's operating system meant increasing the utility of the operating system for users; and that meant more sales for Microsoft. On the other hand, Microsoft didn't just supply the operating system—it also competed with ISVs in the development and sale of applications for use on its Windows operating system. So, for example, by the mid-1990s, “office suites” containing applications for word processing, spreadsheets, and other everyday office tasks were all the rage and Microsoft began to offer its Microsoft Office suite (including Microsoft Word and Microsoft Excel) in competition with ISVs. Among the ISVs with whom Microsoft competed during this era was Novell. In the mid-1990s (and well before then), Novell produced WordPerfect—Microsoft Word's leading rival in word processing applications—and the company harbored ambitions to create an office suite of its own to rival Microsoft Office, one it called PerfectOffice.

....

As it was planning to roll out its Windows 95 operating system, the successor to Windows 3.0, Microsoft faced the questions whether and to what degree it should share its intellectual property with ISVs. Should it share a pre-release development version of the new operating system, and perhaps provide access to its internal workings, all to help ISVs develop applications ready for use by the public when the final version of Windows 95 went on sale? The firm was torn. Doing so would help the marketing of Windows 95, allowing the company to boast a robust range of applications users could employ on the new operating system straight away. At the same time, helping ISVs develop and sell applications threatened to hurt Microsoft's own applications business, perhaps most especially its new office suite product, Microsoft Office.

At first, Microsoft opted to share. Anticipating the release of Windows 95 to the public sometime in 1995, in June 1994 it shared a beta, or test, version of the operating system with ISVs. At the same time, Microsoft also gave ISVs access to Windows 95's application programming interfaces (APIs). APIs allow programs to invoke the operating system's built-in abilities to perform certain functions; each API consists of a set of named procedures that automate particular tasks an application might need to perform. By publishing the names of the procedures in an API and providing information about how to invoke each one, Microsoft essentially permitted ISVs a shortcut—they could rely on Microsoft's APIs when writing their own code rather than having to design custom code to perform the same functions.

....

Among the APIs Microsoft chose to share information about were namespace extensions (NSEs). NSEs are a subset of APIs that permit a user to see (and then open) documents affiliated not just with the current application but located in wildly different places on the computer or elsewhere. Familiar namespaces include the “Recycle Bin”—where a user might dispose of an unwanted document—and the “Desktop”—the computer's default screen that displays when the user starts up his computer. If a user wants to open a document on the Desktop, she might click the Desktop namespace icon on the left side of the file open dialog in the application she is currently running, and watch the contents of the Desktop appear on the right side of the window. With a double click, she might then open the document. NSEs thus provide something of a shortcut to places

outside the current application.

Novell thought access to these NSEs particularly key. Not only would access to Microsoft's NSEs allow Novell to ensure users of its programs could access, say, the Desktop and Recycle Bin without having to leave WordPerfect. Access to Microsoft's NSEs would also allow Novell to create custom namespaces of its own. So, for example, Novell had in mind the possibility that someone in its WordPerfect program with the file open dialog screen open could access, say, items in Novell's email application or its ClipArt library, all for use in a WordPerfect document. Novell's hope was to use NSEs to help make its product so useful that users might be able to "live in" WordPerfect (or PerfectOffice) because they could open, modify, and search for their files across the computer all while remaining within the WordPerfect environment.

[A]fter first choosing to share so much of its intellectual property with ISVs in the beta version distributed in June 1994, Microsoft reversed course in October, indicating to ISVs that they could no longer rely on the previously published APIs and that Microsoft would not guarantee the operability of the previously published APIs in the final version of Windows 95. The evidence suggests Microsoft did so because it concluded that—on balance—this move would prove profit maximizing for the firm. Withdrawing access to information about how to invoke APIs generally and NSEs in particular would make it harder for ISVs to produce applications for Windows 95 and in this way would marginally reduce the attractiveness of Microsoft's new operating system. But withdrawing access would also make Microsoft's own applications, including Microsoft Office, more immediately attractive to users. While ISVs could eventually develop work-arounds to give users the same effective experience, without advance access to information about how to invoke Microsoft's APIs and NSEs, it would take them time to do so. All the while, Microsoft's applications would have a competitive advantage, being the first applications usable on Windows 95. In an October 3, 1994 email, Bill Gates, Microsoft's CEO, explained as much: "I have decided that we should not publish these [NSEs]. We should wait until we have a way to do a high level of integration [which] will be harder for the likes of Notes, WordPerfect to achieve, and which will give [Microsoft] Office a real advantage."

When Microsoft withdrew access to its NSEs, Novell contends its business suffered. . . . While Novell was able to achieve the same functionality for consumers, it took until May 1996, nine months after

Windows 95's public release, for it to roll out its own applications for Windows 95. That nine month delay, Novell argues, made all the difference. Where once it had a leading word processing program and hopes of a leading office suite, it contends the nine month delay gave Microsoft Office a huge leg up, one that it alleges was designed to be and proved to be a permanent advantage.

\* \* \*

. . . It was after that trial in Utah Judge Motz entered judgment as a matter of law for Microsoft—and it is that result Novell now asks us to undo.

\* \* \*

At this point, one might wonder: How did Microsoft's withdrawal of the NSEs help it maintain a monopoly in the operating systems market? Wouldn't the withdrawal of NSEs have prevented ISVs from writing applications for Windows 95, at least to some degree? And wouldn't this have hurt rather than helped Microsoft's sales of operating systems? Withdrawing NSEs may have helped Microsoft's competitive position against ISVs in selling applications, but any claim Novell might have involving an applications market was lost long ago. Novell has to show that withdrawing NSEs helped Microsoft maintain its dominant position in operating systems. How could it have done *that*?

Novell offers two theories.

First, Novell argues that—but for Microsoft's withdrawal of the NSEs—it would have released PerfectOffice earlier and acquired a greater following for its products. This larger group of consumers—now freed from dependence on Microsoft office suite applications—would have proven more susceptible to the lure of other operating systems (like Linux) also capable of running Novell's applications. Put simply, Novell alleges that by delaying the release of WordPerfect, Microsoft was able to lock more people into using Microsoft Office, and because Microsoft Office could only run on a Windows operating system those consumers were then locked into using a Windows operating system too.

Second, Novell explains that PerfectOffice was equipped with middleware—PerfectFit and AppWare—that permitted ISVs to write

applications directly for PerfectOffice rather than for the operating system. If PerfectOffice could perform more of the tasks traditionally performed by operating systems, more users would be more inclined to “live in” PerfectOffice rather than Windows. And because PerfectOffice was designed to work on other operating systems, these users too might be more easily enticed away from Windows.

Could a rational trier of fact find Novell was a victim of unlawful monopolization under these theories? To prevail on a section 2 claim, a plaintiff generally must show the defendant possessed sufficient market power to raise prices substantially above a competitive level without losing so much business that the gambit becomes unprofitable. *See United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966). Then the plaintiff must show that the defendant achieved or maintained that market power through the use of anticompetitive conduct. *See Verizon Commc'ns v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004). Finally, a private plaintiff must show that its injuries were caused by the defendant's anticompetitive conduct. *See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977); 3 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 501, at 85 (3d ed.2008). How do Novell's theories stack up against these standards?

\* \* \*

...

Though often the focus of section 2 disputes, questions of market definition and power aren't in play here. Microsoft doesn't dispute that in the 1990s a nationwide product market existed for Intel-compatible personal computer operating systems, as Novell alleges. Neither does Microsoft dispute it possessed market power in that market. . . .

\* \* \*

With issues of market definition and power by the board, our focus turns to the next question in the sequence required to establish liability: Did Microsoft engage in anticompetitive conduct in violation of section 2 when it withdrew access to its NSEs from Novell and other ISVs? Or was this legally permissible competition?

In earlier days, some courts suggested that a monopolist must lend smaller rivals a helping hand. If a monopolist so much as expanded its

facilities to meet anticipated demand, or failed to keep its prices high enough to permit less efficient rivals to stay afloat, it could find itself held liable under section 2. *See, e.g., Alcoa*, 148 F.2d at 430; *Telex Corp. v. Int'l Bus. Machs. Corp.*, 510 F.2d 894, 925 (10th Cir.1975) (rejecting district court's view that monopoly maintenance “need not be evidenced by predatory practices”). The Supreme Court and this one, however, have long and emphatically rejected this approach, realizing that the proper focus of section 2 isn't on protecting competitors but on protecting the process of competition, with the interests of consumers, not competitors, in mind. Forcing monopolists to “hold[ ] an umbrella over inefficient competitors” might make rivals happy but it usually leaves consumers paying more for less. *Olympia*, 797 F.2d at 375; *see also Trinko*, 540 U.S. at 411; 3 Areeda & Hovenkamp, *supra*, ¶ 651, at 107.

So what exactly qualifies as anticompetitive conduct under section 2, properly understood? It's been said that anticompetitive conduct comes in too many forms and shapes to permit a comprehensive taxonomy. *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767–68 (1984). But the question we often find ourselves asking is whether, based on the evidence and experience derived from past cases, the conduct at issue before us has little or no value beyond the capacity to protect the monopolist's market power—bearing in mind the risk of false positives (and negatives) any determination on the question of liability might invite, and the limits on the administrative capacities of courts to police market terms and transactions. *See* 3 Areeda & Hovenkamp, *supra*, § 651 a, at 96–97. With time and a gathering body of experience, courts have been able to adapt this general inquiry to particular circumstances, developing considerably more specific rules for common forms of alleged misconduct—like tying, *Eastman Kodak*, 504 U.S. at 461–62; exclusive dealing, *Microsoft*, 253 F.3d at 69; or efforts to defraud or lie to regulators or consumers, *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768, 783–88 (6th Cir.2002); *Caribbean*, 148 F.3d at 1087.

As these common categories and the rules associated with them suggest, section 2 misconduct usually involves some assay by the monopolist into the marketplace—to limit the abilities of third parties to deal with rivals (exclusive dealing), to require third parties to purchase a bundle of goods rather than just the ones they really want (tying), or to defraud regulators or consumers. By contrast, and “as a general rule ... purely unilateral conduct” does not run afoul of section 2—“businesses are free to choose” whether or not to do business with others and free to assign what prices they hope to

secure for their own products. *See Pac. Bell Tel. Co. v. Linkline Commc'ns*, 555 U.S. 438, 448 (2009). Put simply if perhaps a little too simply, today a monopolist is much more likely to be held liable for failing to leave its rivals alone than for failing to come to their aid. *See id.*: 3 Areeda & Hovenkamp, *supra*, ¶ 658, at 183.

Many antitrust values lie behind the boundary line the law sketches here. If the law were to make a habit of forcing monopolists to help competitors by keeping prices high, sharing their property, or declining to expand their own operations, courts would paradoxically risk encouraging collusion between rivals and dampened price competition—themselves paradigmatic antitrust wrongs, injuries to consumers and the competitive process alike. Forcing firms to help one another would also risk reducing the incentive both sides have to innovate, invest, and expand—again results inconsistent with the goals of antitrust...

Administrability considerations are also at play here. If forced sharing were the order of the day, courts would have to pick and choose the applicable terms and conditions. That would not only risk judicial complicity in collusion and dampened price competition. It would also require us to become “central planners,” a role for which we judges lack many comparative advantages and a role in which we haven't always excelled in the past. *See Trinko*, 540 U.S. at 407–08; 3B Areeda & Hovankamp, *supra*, ¶ 772, at 220.

The bottom line, then, is that antitrust evinces a belief that independent, profit-maximizing firms and competition between them are generally good things for consumers. Just as courts have held particular forms of antitrust conduct *per se* illegal because experience teaches that they are almost always destructive of competition, so too courts have fashioned rules of presumptive legality for certain forms of conduct that experience teaches almost never harm consumers. Experience teaches that independent firms competing against one another is almost always good for the consumer and thus warrants a strong presumption of legality. Acknowledging as much in the form of a general rule gives a degree of predictability to judicial outcomes and permits reliance by all market participants, themselves goods for both the competitive process and the goal of equal treatment under the law. *See Trinko*, 540 U.S. at 407–8.

Of course, most every rule proves over- or under-inclusive in some way. We often accept a degree of over- and under-inclusion as the price that must

be paid for the benefits associated with a clear rule of law. But rarely is the law so unsubtle that it fails to acknowledge and candidly account for at least a rule's most glaring exceptions. And certainly section 2 doctrine isn't so unsubtle. Though “rare,” liability can sometimes be assigned even when the monopolist engages in “purely unilateral” conduct. *Pac. Bell Tel. Co.*, 555 U.S. at 448. Predatory pricing presents a notable and easy example. *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222–23 (1993). Refusals to deal supplies is another if somewhat more controversial example. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 600–01 (1985); *see also* 3B Areeda & Hovenkamp, *supra*, ¶ 772. Essential facilities doctrine offers perhaps an even more controversial example still. *Compare Otter Tail Power Co. v. United States*, 410 U.S. 366, 377–79 (1973) (forebearer of essential facilities doctrine), *with Trinko*, 540 U.S. at 411 (“We have never recognized such a doctrine.”).

Our case revolves around the second of these exceptions to the general rule protecting unilateral conduct. Novell seeks to impose section 2 liability on Microsoft for refusing to deal with its rivals. Initially, Microsoft chose to share its internal NSE protocols with ISVs in an effort to spur them into writing software for Windows 95. Then Microsoft reversed course, choosing to keep its NSEs to itself. Normally, this sort of unilateral behavior—choosing whom to deal with and on what terms—is protected by the antitrust laws. Even a monopolist generally has no duty to share (or continue to share) its intellectual or physical property with a rival. Novell insists, however, that Microsoft had an affirmative duty to continue sharing its intellectual property and that the firm's decision to withdraw that assistance violated section 2. Predatory pricing appears nowhere in the case and Novell disclaims any reliance on essential facilities doctrine. So if a path to recovery lies anywhere for Novell, it lies through the narrow-eyed needle of refusal to deal doctrine.

\* \* \*

Refusal to deal doctrine's high water mark came in *Aspen*. There, this court and the Supreme Court upheld a jury verdict finding liability when a monopolist (Aspen Skiing Company) first voluntarily agreed to a sales and marketing joint venture with a rival (Aspen Highlands) and then later discontinued the venture even when the evidence suggested the arrangement remained a profitable one. This result, however, falls “at or near the outer boundary of § 2 liability.” *Trinko*, 540 U.S. at 409. Since *Aspen*, the Supreme Court has refused to extend liability to various other refusal to

deal scenarios, emphasizing that *Aspen* represents a “limited exception” to the general rule of firm independence. *Trinko*, 540 U.S. at 409. To invoke *Aspen's* limited exception, the Supreme Court and we have explained, at least two features present in *Aspen* must be present in the case at hand.

First, as in *Aspen*, there must be a preexisting voluntary and presumably profitable course of dealing between the monopolist and rival. *Trinko*, 540 U.S. at 409; *Four Corners*, 582 F.3d at 1224–25; *Christy Sports*, 555 F.3d at 1197....

Second, as in *Aspen*, the monopolist's discontinuation of the preexisting course of dealing must “suggest[ ] a willingness to forsake short-term profits to achieve an anti-competitive end.” *Id.* In *Aspen*, the Supreme Court held, the evidence suggested that the parties' joint venture was profitable for all concerned and that Aspen Skiing Company (the monopolist) discontinued the arrangement simply to reduce the value of Aspen Highlands, force Highlands to sell, and in this way allow the monopolist to win control of all four ski mountains in Aspen. Much as in predatory pricing doctrine, the animating concern here is that a dominant firm may be able to forgo short-term profits longer than smaller rivals, and it may have an incentive to take on those losses to drive rivals from the market or to discipline them for having the audacity to try competition on the merits rather than abide as price-takers under the monopolist's umbrella. Giving up short-term profits in these particular circumstances may risk doing less to enhance competition and consumer interests than to entrench a dominant firm and enable it to extract monopoly rents once the competitor is killed off or beaten down. *See Brooke Grp.*, 509 U.S. at 222–23; 3 *Areeda & Hovenkamp*, *supra*, ¶ 651, at 102–03.

Of course, firms routinely sacrifice short-term profits for lots of legitimate reasons that enhance consumer welfare (think promotional discounts). Neither is it unimaginable that a monopolist might wish to withdraw from a prior course of dealing and suffer a short-term profit loss in order to pursue perfectly procompetitive ends—say, to pursue an innovative replacement product of its own. *See* 3 *Areeda & Hovenkamp*, *supra*, ¶ 651, at 102–03. To avoid penalizing normal competitive conduct, then, we require proof not just that the monopolist decided to forsake short-term profits. Just as in predatory pricing cases, we *also* require a showing that the monopolist's refusal to deal was part of a larger anticompetitive enterprise, such as (again) seeking to drive a rival from the market or discipline it for daring to compete on price. Put simply, the monopolist's

conduct must be irrational but for its anticompetitive effect. *See Aspen*, 472 U.S. at 597 (a refusal to deal with a competitor doesn't violate section 2 if "valid business reasons exist for that refusal"); 3B Areeda & Hovenkamp, *supra*, ¶ 772, at 223 (the refusal must be "irrational" but for its anticompetitive tendencies); *see also* Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, 73 Antitrust L.J. 413, 422–25 (2006).

At this point, one might object: refusal to deal doctrine requires the monopolist to sacrifice short-term profits to be held liable, but surely a monopolist can find ways to harm competition while still making money. And that's undoubtedly right. Filing false papers with regulators and misleading consumers or others, for example, don't (necessarily) involve the short-term sacrifice of profits but can at least conceivably harm competition as much as profit-sacrificing maneuvers. As we have already seen, though, a rival is always free to bring a section 2 claim for affirmatively interfering with its business activities in the marketplace. *See, e.g., Caribbean*, 148 F.3d at 1087; 3B Areeda & Hovenkamp, *supra*, ¶ 782 (discussing relationship between antitrust and business torts). Refusal to deal doctrine targets only a discrete category of section 2 cases attacking a firm's unilateral decisions about with whom it will deal and on what terms. It doesn't seek to displace doctrines that address a monopolist's more direct interference with rivals. ...

\* \* \*

There's no question that Novell can satisfy the first essential component of refusal to deal doctrine. A voluntary and profitable relationship clearly existed between Microsoft and Novell. Microsoft doesn't dispute that at first it freely offered its applications rivals, including Novell, access to its NSEs. Neither does Microsoft dispute that doing so was profitable enough, encouraging software companies to write for its new operating system and in that way making Windows more attractive to consumers.

The difficulty is that Novell has presented no evidence from which a reasonable jury could infer that Microsoft's discontinuation of this arrangement suggested a willingness to sacrifice short-term profits, let alone in a manner that was irrational but for its tendency to harm competition. To the contrary, all the evidence suggests that Microsoft's decision came about as a result of a desire to maximize the company's immediate and overall profits. And, as we've seen, refusal to deal doctrine specifically and section

2 generally seek to protect, not penalize, such prosaic profit-maximizing (and presumptively pro-competitive) conduct by independently operating firms, even dominant firms.

Within the operating systems market alone, it's not clear Microsoft lost or expected to lose revenues in the short term—or ever. By withdrawing NSEs, Microsoft may have handicapped the ability of ISVs to write for Windows 95. But as Novell acknowledges, ISVs had a reasonably strong incentive to write for Microsoft's operating system with or without access to Windows' NSEs—given Microsoft's significant presence in the operating systems market (already about a 90 percent share before Windows 95). In fact, the record suggests that Microsoft's market share continued to *grow* even after the introduction of Windows 95 without shared NSEs (to at least 95 percent). To be sure, Novell's CEO testified that Windows 95 would have done even better (to some unspecified degree) had Microsoft continued to provide access to NSEs. But Novell's own expert refused to opine on the question. And Novell's own theory of monopoly maintenance posits that Microsoft's withdrawal of the NSEs *helped* its position in the operating systems market by wedding consumers to Microsoft applications that themselves could run only on its operating system. Perhaps Novell would respond that this strategy *only* helped Microsoft in the *long run* after a period of forgone short-term profits—but here again Novell presents no evidence to support such a theory.

Besides, even assuming Microsoft's conduct *did* suggest a willingness to forgo short-term profits in the operating systems market, that would still account for only part of the story. As we've seen, Microsoft also produced various applications and, by everyone's estimation, its withdrawal of the NSEs *helped* the firm win additional profits in that field. Indeed, Novell's theory in this lawsuit rests on the view that Microsoft's withdrawal of NSEs allowed it to win significant profits in the sale of office suite applications—and to do so immediately. Put differently, even if Microsoft's decision to withdraw the NSEs ultimately made Windows 95 less successful, any losses in that market have to be considered in light of the acknowledged and immediate gains it achieved in the applications arena. Microsoft is an integrated firm with the goal of maximizing overall profits. And viewed overall, there's no evidence that Microsoft took any course other than seeking to maximize the company's net profits in the shortas [sic] well as long-term.

Perhaps Novell might reply that we should disaggregate operating

systems from applications—that proof of a design to forgo short-term profits in one line of business (operating systems) should suffice without consideration of admittedly inevitable short-term gains in another (applications). Novell, however, never attempts the argument for itself—and for good reason. It would be inconsistent with both the formal aspects and the reasoning behind *Aspen* and *Trinko*. In *Aspen*, the Supreme Court found that Aspen Skiing Company's conduct had *no* economic justification *except* its tendency to exclude a rival. *Aspen*, 472 U.S. at 608. Neither did the Court disaggregate profits from different lines of business in *Trinko*: in concluding that Verizon's behavior failed to show a willingness to sacrifice short-term profits, the Court didn't separately consider the wholesale and retail markets at play there. The point of the profit sacrifice test is to isolate conduct that has *no* possible efficiency justification. *See id.* Parsing profits from different product lines would defeat this project, holding firms liable for making moves that enhance their overall efficiency, if at the expense of a particular business line. It would risk as well returning us to a day when larger firms had to forgo immediate overall gains in order to subsidize a less efficient rival that happens to do business only in one particular product line. And it would present a serious administration challenge to say the least. After all, businesses have the ability “to recoup [their] investment[s]” in any number of ways. *Christy Sports*, 555 F.3d at 1194. And selling operating systems surely isn't the only way to recoup the costs of developing a new operating system—a company might just as easily recoup costs through the sale of applications designed for that operating system. All this courts would have to account for and police.

When pressed at oral argument to point to evidence of Microsoft's willingness to sacrifice short-term profits, Novell contended that Mr. Gates's internal October 3, 1994 email did the trick. That email, however, indicates only a desire to keep NSEs from rivals “until we have a way to do a high level of integration [that] will be harder for the likes of Notes, WordPerfect to achieve, and which will give Office a real advantage.” J.A.1967. This may suggest a hard-nosed intent to undo rivals in the applications field, to assure Microsoft a leg up, but it doesn't suggest Microsoft intended to forgo profits. More nearly, it suggests just the opposite—a wish to *increase* the firm's immediate profits—and in this way it tends to show that Microsoft's conduct was hardly irrational but for its exclusionary tendencies. Maybe the e-mail suggests an uncharitable intent toward rivals, maybe even a wish to “hurt” or “destroy” them. But as we've seen, experience teaches that the process of firms investing in their own infrastructure and intellectual property and competing rather than colluding

normally promotes competition and consumer gains—and the intent to undo a competitor in this process should hardly surprise. “Competition,” after all, “is a ruthless process.” *Ball Memorial*, 784 F.2d at 1338. “Most businessmen don't like their competitors” and the antitrust laws aren't designed to be a guide to good manners. *Olympia*, 797 F.2d at 379...

\* \* \*

Still, that is not quite the end of the story. Unable to travel the hard road of refusal to deal doctrine, Novell seeks an escape route, trying to recast Microsoft's conduct as an “affirmative” act of interference with a rival rather than a “unilateral” refusal to deal. Novell says Microsoft “affirmatively” induced reliance on its intellectual property only then to pull the rug out from underneath it, raising Novell's cost of doing business in the process—and that, Novell says, should be enough to state a claim under section 2. Essentially Novell asks us to toy with the act-omission distinction, seeking to have us describe Microsoft's conduct as an “affirmative” act of interference rather than an “omission” of assistance, and to replace the profit sacrifice test with a raising rivals' cost test.

Traditional refusal to deal doctrine is not so easily evaded. One could just as easily recast the monopolists' “withdrawals” of assistance in *Aspen* or *Trinko* as “affirmative” acts of interference with the plaintiff's efforts to win customers, ones that raised the rival's costs of doing business in the process. Indeed, in almost *any* case where a monopolist first shares and then withdraws its property—as in *Aspen* and *Trinko*—the dominant firm might be said to raise the rival's costs of doing business by forcing it to forgo reliance on the monopolist's facilities or intellectual property and compete on its own. That's the whole reason why competitors sue for refusals to deal—because they now have to incur costs associated with doing business another firm previously helped subsidize. Yet neither *Trinko* nor *Aspen Skiing* suggested this is enough to evade their profit sacrifice test, and we refuse to do so either. Whether one chooses to call a monopolist's refusal to deal with a rival an act or omission, interference or withdrawal of assistance, the substance is the same and it must be analyzed under the traditional test we have outlined.

...

Novell seeks to evade refusal to deal doctrine in one final way. It charges Microsoft with acting deceptively when it withdrew the NSEs.

Microsoft gave pretextual technical reasons for withdrawing the NSEs, Novell says, when Microsoft's real reasons were competitive in nature. This act of deception, Novell submits, is actionable under the antitrust laws without regard to traditional refusal to deal doctrine.

Business torts generally, and acts of fraud more particularly, can sometimes give rise to antitrust liability. At least when the defendant's deceptive actions—usually aimed at third parties in the marketplace—are so widespread and longstanding and practically incapable of refutation that they are capable of injuring both consumers and competitors. *See, e.g., Caribbean*, 148 F.3d at 1087; *Conwood*, 290 F.3d at 783; 3B Areeda & Hovenkamp, *supra*, ¶ 782b. Here, however, at least that last element is missing. Whatever other problems exist with Novell's theory, it falters when it comes to the antitrust injury requirement.

Suppose Microsoft had admitted its “real” reasons for withdrawing the NSEs, as Novell says it should have. Novell and consumers *still* would have suffered the same alleged harm—the delayed release of PerfectOffice. *Deception*, then, wasn't the cause of Novell's injury or any possible harm to consumers—Microsoft's *refusal to deal* was. And that refusal to deal must be analyzed under the doctrine we've described. The antitrust laws don't turn private parties into bounty hunters entitled to a windfall anytime they can ferret out anticompetitive conduct lurking somewhere in the marketplace. To prevail, a private party must establish some link between the defendant's alleged anticompetitive conduct, on the one hand, and its injuries and the consumer's, on the other. Here, that essential element is missing: the conduct Novell complains about (deception) is divorced from the conduct that allegedly caused harm to it and to consumers (the refusal to deal). Even if Microsoft had behaved just as Novell says it should have, it would have helped Novell not at all. *See Brunswick Corp.*, 429 U.S. at 489.

\* \* \*

At the end of the day it is clear to us, as it was to the district court, that Microsoft's conduct does not qualify as anticompetitive behavior within the meaning of section 2. The district court offered still other rationales for rejecting Novell's claim—ruling that Microsoft's conduct didn't harm competition in the operating systems market, and that Novell's delay in producing its Windows 95 software was really attributable to its own mismanagement and not Microsoft's withdrawal of the NSEs. We have no need to reach those alternative holdings or tangle with the parties' arguments over them. The district court's first and primary holding is

correct and sufficient to support the judgment. Novell's motion to seal portions of the joint appendix is granted. The judgment is affirmed.

### NOTES AND QUESTIONS

1. The European Competition provision on “Abuse of a Dominant Position” states:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States."

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Contrast this with §2 of the Sherman Act, 15 U.S.C. §2, which condemns everyone “who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize.”

#### **Note: The United States Antitrust Law of Refusal to Deal**

The United States Supreme Court has addressed the issue of whether or not a firm violates antitrust laws by refusing to deal with a competitor in both *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) and *Verizon Commc'ns v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

*Aspen* involved a dispute between two competing ski resorts: Ski Co., which owned three of the four mountains available for skiing in a geographic area, and Highlands Skiing, which owned the other mountain. *Aspen Skiing Co.*, 472 U.S. 585, 589-601. The dispute arose when Ski Co. stopped participating in a joint ski pass that allowed skiers to purchase one pass and have access to all four mountains. The Court held that “the absence of an unqualified duty to cooperate” did not mean this “may not have evidentiary significance” or that it “may not give rise to liability in certain circumstances.” Ski Co. was in violation of section 2 since Ski Co. was not able to provide a valid business justification for discontinuing its participation in the joint program.

In its *Trinko* decision two decades later the Supreme Court severely limited the circumstances under which a defendant can violate §2 of the Sherman Act by refusing to deal. The plaintiffs brought a class action suit alleging that Verizon refused to provide AT&T with access to its systems and support operations in a reasonable manner, thereby impairing AT&T’s ability to provide competitive services. The Court held that the refusal to deal did not violate pre-existing antitrust standards because it did “not believe that traditional antitrust principles justify adding the present case to the few existing exceptions from the proposition that there is no duty to aid competitors.” Additionally, the Court described *Aspen* as “at or near the outer boundary of § 2 liability” and noted the Court was “very cautious” about recognizing exceptions to the general rule against requiring a firm to cooperate with its competitors. The Court further cautioned against antitrust intervention noting that “[u]nder the best of circumstances, applying the requirements of § 2 ‘can be difficult’” and that the “cost of false positives counsels against an undue expansion of § 2 liability.” *Id.* at 414 (quoting *U.S. v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001)).

The European approach declared in the principal case appears to be significantly more interventionist than the United States position. *See also* European Commission, *Guidance on the Commission’s Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings* (2008). The *Guidance* defines “abuse” as “a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking.”

One important qualification on *Trinko*, however, is that the 1996 Telecommunications Act, 47 U.S.C. § 251(c), requires virtually global

interconnection between the market dominating incumbent telephone carriers and the “competitive” carriers that want to hook into the telephone system. As a result the competitive carrier in *Trinko* had already obtained full relief from the Federal Communications Commission and state telecommunications agencies, which held that Verizon was in violation of its interconnection obligations. As a result, what the Supreme Court really decided was that the antitrust laws could not be used as an overlay to a regulatory system that was already in place in order to justify an award of treble damages to the plaintiffs. See the *Talkamerica* case, *infra*. On the antitrust law of refusal to deal in regulated industries, see 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶787 (3d ed. 2007).

**ALLIED ORTHOPEDIC APPLIANCES, INC. V. TYCO HEALTH  
CARE GROUP, LP  
592 F.3d 991 (9<sup>th</sup> Cir. 2010)**

SILVERMAN, Circuit Judge:

Plaintiffs in this antitrust suit are a group of hospitals and other health care providers that purchased pulse oximetry sensors from Tyco Healthcare Group LP after November 2003. They allege that ... by introducing OxiMax, a patented pulse oximetry system that is incompatible with generic sensors, Tyco unlawfully maintained its monopoly over the sensor market in violation of Section 2 of the Sherman Act, 15 U.S.C. § 2.

The district court ... granted Tyco’s motion for summary judgment on the Section 1 and 2 claims... We ... agree that there is no Section 2 violation; the undisputed evidence shows that the patented OxiMax design is an improvement over the previous design. Innovation does not violate the antitrust laws on its own, and there is no evidence that Tyco used its monopoly power to force customers to adopt its new product. Accordingly, we affirm the district court’s judgment on the merits ...

The pulse oximetry products at issue in this litigation include sensors and monitors. Sensors attach to a patient’s body. A monitor receives and interprets the signal from a sensor and then displays the patient’s level of blood oxygenation. Stand-alone monitors measure only blood oxygenation. Multi-parameter monitors measure various patient diagnostics in addition to blood oxygenation. Monitors are more expensive than sensors on a unit basis, but the volume of sensor sales is much larger than the volume of monitor sales.

Tyco was an early entrant in the pulse oximetry market and was able to establish an installed base of monitors greatly exceeding that of its

competitors. Its technology was initially protected by its “R-Cal” patent, which prevented competitors from selling sensors compatible with its installed base of monitors. Tyco anticipated that upon expiration of the R-Cal patent in November 2003, competitors would begin to produce generic sensors compatible with its installed base of monitors. It thus set about creating a new proprietary oximetry technology.

Tyco’s plan matured into what became known as the “OxiMax Strategy.” Tyco created a new patented sensor design that contained a writable memory chip. Moving the digital memory chip from the monitor to the sensor allowed Tyco to add new features to the OxiMax sensors, such as the ability to store the patient’s oxygen saturation history in the sensor itself (the “sensor event reporting” feature) and the ability to inform a physician of possible causes of and solutions for signal interruption (the “sensor messaging” feature).

The digital memory chip also allowed Tyco to move essential calibration coefficients from the monitors into the sensors themselves. Because the new OxiMax monitors do not contain any calibration coefficients, they are incompatible with generic sensors. However, OxiMax monitors are compatible with new types of sensors that Tyco develops. Previously, when Tyco introduced a new sensor, customers either had to buy a new monitor or reprogram their entire installed base of stand-alone and multiparameter monitors with the appropriate calibration coefficients. With the OxiMax system, customers can adopt new types of sensors without affecting their installed base of monitors because the necessary coefficients are contained in the sensors themselves. This reduces costs for customers and frees sensor designers from having to use the predefined coefficients programmed into the installed base of monitors. Moving the calibration coefficients into the sensors therefore facilitates the development and introduction of new types of sensors.

Tyco launched OxiMax in March 2002 and notified equipment manufacturers that all remaining R-Cal boards were being discontinued in February 2003....

... The [district] court held that Tyco’s ... introduction of OxiMax, both alone and in combination with its other business practices, was not unreasonably restrictive of competition under Section 2. The OxiMax design was a “superior and more sophisticated offering than the previous generation R-Cal system” and Tyco “did nothing to force OxiMax monitors on its customers.” Plaintiffs timely appealed the district court’s final judgment. We affirm....

“There are three essential elements to a successful claim of Section 2 monopolization: (a) the possession of monopoly power in the relevant market; (b) the willful acquisition or maintenance of that power; and (c) causal ‘antitrust’ injury.” *Cal. Computer Prods., Inc. v. Int’l Bus. Mach. Corp.*, 613 F.2d 727, 735 (9th Cir. 1979) (“ CalComp ”). For purposes of Tyco’s motion and this appeal, the parties agree that Tyco is a monopolist in the U.S. pulse oximetry sensor market. The focus of the dispute is whether Tyco unlawfully maintained its monopoly power in that market by introducing OxiMax.

Plaintiffs contend that Tyco maintained its monopoly by (1) designing its new patent-protected OxiMax sensors to be compatible with its new OxiMax monitors and the installed base of R-Cal monitors, but designing its new OxiMax monitors to be incompatible with the old R-Cal sensors; and (2) allegedly forcing customers and OEMs to adopt the new OxiMax monitors by discontinuing its R-Cal monitors and implementing other exclusionary business practices. Plaintiffs argue that the district court erred in rejecting these arguments because it did not balance the benefits of Tyco’s alleged product improvement against its anticompetitive effects. They further argue that the district court impermissibly decided disputed issues of material fact regarding the sufficiency of Tyco’s innovation and the competitive effect of its overall OxiMax strategy. We agree with the district court.

“Section 2 of the Sherman Act proscribes ‘monopolization’; it does not render unlawful all monopolies.” *Foremost Pro Color, Inc. v. Eastman Kodak Co.*, 703 F.2d 534, 543 (9th Cir. 1983). “A monopolist, no less than any other competitor, is permitted and indeed encouraged to compete aggressively on the merits, and any success it may achieve solely through ‘the process of invention and innovation’ is necessarily tolerated by the antitrust laws.” *Id.* at 544-45 (quoting *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281 (2nd Cir. 1979)). Accordingly, “[a]s a general rule, courts are properly very skeptical about claims that competition has been harmed by a dominant firm’s product design changes.” *United States v. Microsoft Corp.*, 253 F.3d 34, 65 (D.C.Cir.2001).

However, changes in product design are not immune from antitrust scrutiny and in certain cases may constitute an unlawful means of maintaining a monopoly under Section 2. *Foremost*, 703 F.2d at 545. For example, in *United States v. Microsoft*, the plaintiffs showed that Microsoft harmed competition by integrating its Web browser, Internet Explorer, into the Windows 98 operating system. *Microsoft*, 253 F.3d at 65-66. Microsoft provided no “procompetitive justification,” *id.* at 59, for having integrated

Internet Explorer into Windows. Having failed to show “that its conduct serve[d] a purpose other than protecting its operating system monopoly,” the D.C. Circuit held that Microsoft had violated Section 2 of the Sherman Act.

In contrast, a design change that improves a product by providing a new benefit to consumers does not violate Section 2 absent some associated anticompetitive conduct. *See CalComp*, 613 F.2d at 735-36 (holding that a design change must not be “unreasonably restrictive of competition”). In *CalComp*, a manufacturer of peripheral computer devices argued that “IBM made design changes on certain of its CPUs, disk drives and controllers of no technological advantage and solely for the purpose of frustrating competition” from peripheral device manufacturers. *Id.* at 739. However, there was uncontroverted evidence that IBM’s changes allowed it to reduce manufacturing costs and prices to the consumer and also improved performance of the product. *Id.* at 744.

*CalComp* ... therefore stand[s] for the uncontroversial proposition that product improvement by itself does not violate Section 2, even if it is performed by a monopolist and harms competitors as a result. *See* IIB AREEDA & HOVENKAMP ¶ 776a at 285-86 (3d ed. 2006) (“At the very least, as all courts recognize, product improvement without more is protected and beyond antitrust challenge.”). There is no violation of Section 2 unless plaintiff proves that some conduct of the monopolist associated with its introduction of a new and improved product design “constitutes an anticompetitive abuse or leverage of monopoly power, or a predatory or exclusionary means of attempting to monopolize the relevant market.”

There is no room in this analysis for balancing the benefits or worth of a product improvement against its anticompetitive effects. If a monopolist’s design change is an improvement, it is “necessarily tolerated by the antitrust laws,” unless the monopolist abuses or leverages its monopoly power in some other way when introducing the product. To hold otherwise “would be contrary to the very purpose of the antitrust laws, which is, after all, to foster and ensure competition on the merits.” “Antitrust scholars have long recognized the undesirability of having courts oversee product design, and any dampening of technological innovation would be at cross-purposes with antitrust law.” *United States v. Microsoft Corp.*, 147 F.3d 935, 948 (D.C. Cir. 1998).

To weigh the benefits of an improved product design against the resulting injuries to competitors is not just unwise, it is unadministrable. There are no criteria that courts can use to calculate the “right” amount of innovation, which would maximize social gains and minimize competitive

injury....

In this case, it is undisputed that by placing a digital memory chip in the sensor and moving the calibration coefficients from the monitor to the sensor, Tyco made its new OxiMax system incompatible with generic sensors and harmed generic sensor manufacturers. We must therefore decide whether there remains a genuine issue that the OxiMax sensor design provided some new benefit to consumers and thus constituted an improvement.

First, the United States Patent and Trademark Office found the OxiMax sensor design to be sufficiently innovative over the prior art to deserve a patent.... Although, as the district court properly noted, there is not a per se rule barring Section 2 liability on patented product innovation, the existence of a patent on a new product design is some evidence that the change is an improvement over previous designs. After all, “the proper amount of gains to innovation are left to Congress, who has the authority to vary the terms of patent protections, the point in time from which the protections run, or the scope of patentable innovations.” *IIIB AREEDA & HOVENKAMP* ¶ 777d at 311.

Second, it is undisputed that Tyco’s new sensor design allows it to introduce new types of sensors without requiring its customers to purchase new monitors or reprogram their installed base of monitors. This added flexibility promotes the introduction of new types of sensors, such as Max-Fast, and reduces costs for consumers of pulse oximetry equipment. It also allows new functions, such as sensor event reporting and sensor messaging, to be included in the sensors themselves.

Tyco’s internal documents show that from the very earliest stages of its development of OxiMax, it aimed to produce a new technology that both served as “a new, flexible platform for future oximetry innovation” and added customer value by improving performance. To ensure that the new feature set enabled by OxiMax would help to differentiate its new sensors from generics, Tyco surveyed clinicians and initially received positive feedback. Plaintiffs focus on statements showing that Tyco hoped its new technology would constitute a barrier to entry for generic sensor manufacturers. However, even legitimate product improvement can have the effect of harming or even destroying competitors.

Likewise, Plaintiffs mistakenly focus on documents showing that, sometime in 2001, Tyco began to realize that the sensor messaging and sensor event reporting features were less valuable than it initially believed and worried that the market would perceive its new technology as nothing

more than a way to lock out generics. These documents do not create a genuine issue of material fact about whether OxiMax represented an improvement over previous sensor designs. Since technological innovation “is accompanied by tremendous uncertainty as to cost, technical success, and eventual market success ... ex post realizations are rarely a useful indicator of ex ante expectations.” IIBB AREEDA & HOVENKAMP ¶ 775c at 284. Evidence of an innovator’s initial intent may be helpful to the extent that it shows that the innovator knew all along that the new design was no better than the old design, and thus introduced the design solely to eliminate competition. But the documents here show that Tyco initially believed that clinicians would value the new feature set....

In sum, Plaintiffs have presented no evidence to refute that the patented OxiMax sensor design facilitates the introduction of new types of sensors with added capabilities at less cost to consumers. The district court properly concluded that Plaintiffs had not created a genuine issue of material fact on whether OxiMax was a genuine improvement.

#### **Tyco Did Not Use Its Market Power to Force Adoption of OxiMax**

Although it is undisputed that the OxiMax sensor design is an improvement over previous designs, Tyco may still have violated Section 2 if any of its other conduct “constitutes an anticompetitive abuse or leverage of monopoly power, or a predatory or exclusionary means of attempting to monopolize the relevant market.”

Plaintiffs argue that Tyco forced consumers to adopt OxiMax by discontinuing the older R-Cal technology. A monopolist’s discontinuation of its old technology may violate Section 2 if it effectively forces consumers to adopt its new technology. *Berkey Photo*, 603 F.2d at 287 n. 39. Here, however, there was uncontroverted evidence that [other suppliers of pulse oximetry monitors and sensors effectively competed with Tyco]. Given all these alternatives, Tyco did not force consumers to purchase its OxiMax monitors simply by discontinuing its support of the R-Cal technology.

Plaintiffs’ argument that Tyco could have made its monitors compatible with the old sensors also fails. Our precedents make clear that a monopolist has no duty to help its competitors survive or expand when introducing an improved product design. The evidence shows that the OxiMax monitors’ incompatibility with R-Cal sensors was the necessary consequence of moving the calibration coefficients from the monitor into the sensor. Thus, the product improvement at issue in this case, not some associated conduct by Tyco, caused the incompatibility....

In sum, Plaintiffs have provided no evidence that Tyco used its monopoly power to force consumers of pulse oximetry products to adopt its new OxiMax technology. Absent evidence of such compulsion, the only rational inference that can be drawn from some consumers' adoption of OxiMax is that they regarded it to be a superior product. *Berkey*, 603 F.2d at 287. The district court therefore properly concluded that Plaintiffs had failed to create a genuine issue of material fact regarding Tyco's introduction of OxiMax and properly granted summary judgment on the Section 2 claim.

*AFFIRMED.*

### NOTES AND QUESTIONS

1. How much faith does the Ninth Circuit have in a court's ability to assess whether a design change is anticompetitive? As the court observed:

[Weighing] the benefits of an improved product design against the resulting injuries to competitors is not just unwise, it is unadministrable. There are no criteria that courts can use to calculate the 'right' amount of innovation, which would maximize social gains and minimize competitive injury....The balancing test proposed by plaintiffs would therefore require courts to weigh as-yet-unknown benefits against current competitive injuries. Our precedents and the precedents we have relied upon strongly counsel against such a test.

*Orthopedic Appliances*, 592 F.3d at 1000. Why does this Court come to this conclusion? Does it present any contrary authority that supports a different holding? Is there any instance when an innovation can be held in violation of antitrust law? What if Tyco forced consumers to adopt the new technology? More recently, the Northern District of California granted defendant Apple's motion for summary judgment in a case involving an alleged anticompetitive effect of an innovation. *The Apple iPod iTunes Antitrust Litigation*, 5:05-cv-00037-JW (N.D. Cal. May 5, 2011). In relying on *Orthopedic Appliances*, Judge Ware held that software updates to iTunes 4.7 constituted a "genuine improvement" and could not support an antitrust claim. However, it denied summary judgment with respect to other design changes that appeared to produce incompatibilities with the plaintiff's products but were not shown to be an improvement. See the following note on software redesigns.

By contrast, in *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1371 (Fed.Cir.1998), cert. denied, 526 U.S. 1130 (1999), the Federal Circuit affirmed a jury verdict for the plaintiff in a case where the defendant redesigned its skin graft gun so as to make it incompatible with rivals' generic disposable needles. In this case there was no evidence that the gun represented a genuine product improvement. Should the test be whether the product as measured after the fact ends up not being an improvement, or whether the defendant never intended for it to be an improvement to begin with but only to create an incompatibility with the products of rivals? See CHRISTINA BOHANNAN & HERBERT HOVENKAMP, *CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION*, Ch. 11 (2011). For severe criticism of *Bard*, see Alan Devlin & Michael Jacobs, *Anticompetitive Innovation and the Quality of Invention*, 26 BERKELEY TECH. L.J. (2012).

See also *In re Intel Corp.*, No. 9341, 2010 WL 4542454 (F.T.C. Nov. 2, 2010). Intel is the dominant maker of central processing units (CPUs) for personal computers. Rival firms built CPUs but also graphics processing units (GPUs) for computers that process a great deal of graphics. When the rivals began building GPUs so as to take on some of the functions performed by CPUs, Intel allegedly attempted to limit interoperability between its CPU and its rivals' GPUs, thereby reducing "future competition on both price and innovation" between Intel and its rivals. The parties entered a consent decree which required Intel to support a standard interface between its CPUs and its rivals' GPU. For excellent commentary of the issues raised in both *Intel* and *Microsoft*, see William H. Page & Seldon J. Childers, *Antitrust, Innovation, and Product Design in Platform Markets: Microsoft and Intel* (Aug. 22, 2011), <http://ssrn.com/abstract=1914737>.

2. *Exclusionary Software Redesigns*. One reason for our very considerable tolerance of product redesigns is that they are costly and risky, as the defendant's technology in the principal case almost certainly was. A firm is highly unlikely to invest millions of dollars in a new product for the sole purpose of making a rival's technology incompatible. Suppose, however, that the product design involves nothing more than software code, which can cheaply be rewritten so as to eliminate compatibility with rivals' products. See, e.g., *Apple iPod iTunes Antitrust Litig.*, No. C 05-00037 JW, 2011 WL 2690511 (N.D. Cal. May 19, 2011), in which the plaintiff class action accuse Apple of altering its iPod/iTunes software to prevent a rival's products from playing on Apple's hardware. The plaintiffs alleged that Apple's software redesign served no procompetitive purpose and that Apple had yet to "allege some procompetitive justification other than merely

foreclosing rivals.” A similar issue was raised in *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001). See John M. Newman, *Anticompetitive Product Design in the New Economy*, 38 FLA. ST. U. L. REV. (2012), who argues that our tolerance for anticompetitive design generally should be modified if the product is computer software – most particularly, software operating systems in which compatibility with the hardware, applications, or other products of rivals is essential. Newman observes that (1) software updates are a “uniquely attractive method of foreclosing rivals,” and (2) software redesigns are “more easily analyzed than traditional, physical-product redesigns,” because experts can isolate specific sections of code to separate anticompetitive design elements from procompetitive innovations. An expert was used for this purpose in *Microsoft, supra*. Courts should consider a defendant’s intent only in “ambiguous” cases—though Newman argues that “code-based product redesigns will rarely present a truly ‘ambiguous’ case.”

3. The grandparent of product redesign cases is *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979). Kodak simultaneously introduced a radically redesigned amateur camera, the 110 “Pocket Instamatic,” which used a film cartridge that dropped right into the camera, much easier than older technologies that required film to be strung onto a take up reel. The new camera was a roaring success and significantly upset the market for older technologies, but until the two products could be re-engineered by rivals the camera and film were compatible only with each other. The plaintiff, a rival camera maker, could not reasonably attack the design itself, which was acknowledged to be a great technological improvement. Rather, it argued that Kodak had a duty to “predisclose” its research plans so that rivals would have an opportunity to get on the market earlier with their own compatible products. In rejecting that claim the court observed:

[E]nforced predisclosure would cause undesirable consequences beyond merely encouraging the sluggishness the Sherman Act was designed to prevent. A significant vice of the theory propounded by Berkey lies in the uncertainty of its application. Berkey does not contend, in the colorful phrase of Judge Frankel [author of the district court’s opinion], that “Kodak has to live in a goldfish bowl,” disclosing every innovation to the world at large. However predictable in its application, such an extreme rule would be insupportable. Rather, Berkey postulates that Kodak had a duty to disclose limited types of information to certain competitors under specific circumstances. But it is difficult to comprehend how a major corporation, accustomed though it is to making business decisions with antitrust considerations in mind,

could possess the omniscience to anticipate all the instances in which a jury might one day in the future retrospectively conclude that predisclosure was warranted. And it is equally difficult to discern workable guidelines that a court might set forth to aid the firm's decision. For example, how detailed must the information conveyed be? And how far must research have progressed before it is "ripe" for disclosure? These inherent uncertainties would have an inevitable chilling effect on innovation. They go far, we believe, towards explaining why no court has ever imposed the duty Berkey seeks to create here.

4. In *Static Control Components, Inc. v. Lexmark International, Inc.*, 697 F.3d 387 (6th Cir. 2012), the Sixth Circuit affirmed a district court's dismissal of Plaintiff Static Control Components, Inc.'s ("Static Control") federal antitrust claims because it insufficiently alleged that it had standing to sue for damages. Static Control's antitrust claims arise from conduct by Lexmark International, Inc. ("Lexmark"), a manufacturer of laser printers and toner cartridges, to prevent third parties from refilling used Lexmark toner cartridges and reselling them. To combat remanufacturers' business model, Lexmark added microchips to its toner cartridges and printers such that a Lexmark printer would not work unless the toner cartridge had the microchip. Static Control figured out how to copy the microchips and sold the microchips to remanufacturers that refill and resell Lexmark toner cartridges. Upset with remanufacturers, Lexmark redesigned the microchips and initiated a "Prebate" program. Under the redesign, the new microchips disabled the cartridge once it ran out of toner. To reuse the cartridge, the microchip had to be replaced, but getting replacements was difficult because the company that produced them agreed to sell only to Lexmark. Under the Prebate program:

Lexmark would sell new toner cartridges [to large customers] at an upfront discount of around 20% if the end user agreed to (1) a single-use license and (2) a restriction that the cartridge be returned to Lexmark for remanufacturing or recycling and not to a third-party remanufacturer.

Lexmark eventually obtained several patents for its toner cartridges and sued Static Control for infringement. Static Control counterclaimed under the Sherman Act, alleging that Lexmark's microchip redesign and Prebate program were anticompetitive. The district court granted Lexmark's motion to dismiss, holding that Static Control lacked antitrust standing. The Sixth Circuit affirmed.

When bringing an antitrust claim for damages, a private plaintiff must establish that he has antitrust standing under the following five-factor balancing test:

(1) the causal connection between the antitrust violation and harm to the plaintiff and whether that harm was intended to be caused; (2) the nature of the plaintiff's alleged injury including the status of the plaintiff as consumer or competitor in the relevant market; (3) the directness or indirectness of the injury, and the related inquiry of whether the damages are speculative; (4) the potential for duplicative recovery or complex apportionment of damages; and (5) the existence of more direct victims of the alleged antitrust violation. *Southaven Land Co. v. Malone & Hyde, Inc.*, 715 F.2d 1079, 1085 (6th Cir. 1983) (citing *Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters* (“AGC”), 459 U.S. 519, 537–45 (1983)). No one factor controls.

The Sixth Circuit found that Static Control's allegations did not establish the first AGC factor. “Static Control alleges that Lexmark's anticompetitive chips “exclude competition, restrict output, and increase end-user prices in the relevant markets,” but the counterclaim never identifies any change in competition, output, or prices in the market for component parts or microchips as a result of Lexmark's conduct.” Static Control also lacked standing because Lexmark's Prebate program was not intended to harm Static Control:

As alleged, the Prebate Program targets only the market for remanufactured cartridges. No part of the Prebate Program relates to the market for microchips or components, even though the allegations support the Prebate Program's incidental effects in the other markets. Static Control itself states that “Lexmark specifically launched its Prebate program to intimidate and to exclude competition from remanufacturers.”

The Sixth Circuit also found that Static Control failed to establish standing because it did not satisfy the second AGC factor.

[O]nly claimants who are competitors or consumers within the injured market have standing to sue. *Southaven*, 715 F.2d at 1086. However, claimants who are not direct players in the relevant market may nonetheless have standing if their injury is “inextricably intertwined’

with the injury sought to be inflicted upon the relevant market or participants therein.” Id.

Static Control also failed to establish the last three AGC factors, “which all relate to the directness of Static Control’s injuries relative to potentially more-direct victims.” While Static Control’s injuries are a “byproduct” of Lexmark’s conduct, “The more-direct victims are the end users, who . . . had to pay more for their cartridges, . . . and the remanufacturers, who were unable to compete in the market for Lexmark-compatible toner cartridges after Lexmark’s Prebate program undercut their prices and reduced supply.” If Static Control had standing based on its indirect injuries, then there would be a “danger of duplicative recovery.”

The Sixth Circuit also found insufficient Static Control’s allegations that Lexmark harmed competition by redesigning microchips. Under *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992), Static Control might have had standing to pursue its claims if it had alleged that Lexmark maintained its monopoly on remanufactured cartridges by “making cartridge parts wholly unavailable.”

Static Control does not specifically allege a tying scheme under § 1 of the Sherman Act, as was the case in *Eastman Kodak*, nor does Static Control allege any facts to suggest that the prices for parts increased as a result of being illegally tied to the market for cartridges. Static Control alleges that Lexmark continuously redesigned its microchips “to exclude competitors from the relevant markets, restrict output, and increase end-user prices.”

Additionally, Static Control failed to allege how Lexmark’s redesigns harmed competition or who it competes with in the market for microchips. Absent these allegations, Static Control cannot establish that it has standing to pursue a claim based on Lexmark’s microchip redesign efforts.

## NOTES AND QUESTIONS

1. The United States Court of Appeals for the Federal Circuit has jurisdiction over patent infringement suits in a well pleaded complaint. 28 U.S.C. § 1338(a). However, in *Holmes Grp., Inc. v. Vornado Air Circulation Sys., Inc.*, 535 U.S. 826 (2002), the Supreme Court held that this exclusive jurisdiction extends to original claims but not to counterclaims. In *Static Control*, Lexmark initially filed a copyright

infringement suit. Then *Static* counterclaimed alleging misuse and antitrust violations, and only then did Lexmark file a counterclaim to the counterclaim alleging patent infringement. So under the law that existed when Lexmark filed its lawsuit the appeal went to the regional Circuit, the Sixth. Subsequently, however, the Leahy-Smith America Invents Act provided for exclusive Federal Circuit jurisdiction over “any civil action in which a party has asserted a compulsory counterclaim arising under[ ] any Act of Congress relating to patents.” The amendment was explicitly made prospective only, however, “to any civil action commenced on or after the date of the enactment of this Act.” Pub.L. 112–29, § 19(b), (e), 125 Stat. 333. An action such as this one filed today would be appealed to the Federal Circuit.

2. Why didn’t the court dismiss the counterclaim because there is no relevant market for “Lexmark cartridges,” given that Lexmark is only one of many players in the market for computer printers, with a market share of under 15%?

3. The court observes the challenged practices were intended to increase the sale of cartridges supplied by Lexmark itself by making it much more difficult for consumers to use remanufactured cartridges. So clearly a “target” of the practices was the remanufacturers. But the microchips are used on the cartridges in a one-to-one ratio. Wouldn’t Static Controls have exactly the same injury as the cartridge remanufacturers? If so, why deny standing to Static? Section four of the Clayton Act grants an antitrust suit to “anyone who shall be injured in his business or property” by an antitrust violation. 15 U.S.C. §15.

### **DEALING OBLIGATIONS UNDER THE 1996 TELECOMMUNICATIONS ACT**

#### **TALK AMERICA, INC. V. MICHIGAN BELL TELEPHONE CO. 131 S.Ct. 2254 (2011)**

THOMAS, J., delivered the opinion of the Court,

In these cases, we consider whether an incumbent provider of local telephone service must make certain transmission facilities available to competitors at cost-based rates. The Federal Communications Commission

(FCC or Commission) as *amicus curiae* contends that its regulations require the incumbent provider to do so if the facilities are to be used for interconnection: to link the incumbent provider's telephone network with the competitor's network for the mutual exchange of traffic. We defer to the Commission's views and reverse the judgment below.

The Telecommunications Act of 1996 (1996 Act), 110 Stat. 56, imposed a number of duties on incumbent providers of local telephone service in order to facilitate market entry by competitors. *AT & T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 371 (1999). The incumbent local exchange carriers (LECs) owned the local exchange networks: the physical equipment necessary to receive, properly route, and deliver phone calls among customers. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 490 (2002). Before the 1996 Act, a new, competitive LEC could not compete with an incumbent carrier without basically replicating the incumbent's entire existing network.

The 1996 Act addressed that barrier to market entry by requiring incumbent LECs to share their networks with competitive LECs in several ways, two of which are relevant here. First, 47 U.S.C. § 251(c)(3) requires incumbent LECs to lease "on an unbundled basis"— i.e., a la carte— network elements specified by the Commission. This makes it easier for a competitor to create its own network without having to build every element from scratch. In identifying which network elements must be available for unbundled lease under § 251(c)(3), the Commission is required to consider whether access is "necessary" and whether failing to provide access would "impair" a competitor's provision of service. § 251(d)(2). Second, § 251(c)(2) mandates that incumbent LECs "provide ... interconnection" between their networks and competitive LECs' facilities. This ensures that customers on a competitor's network can call customers on the incumbent's network, and vice versa. The interconnection duty is independent of the unbundling rules and not subject to impairment analysis. It is undisputed that both un-bundled network elements and interconnection must be provided at cost-based rates.

These cases concern incumbent LECs' obligation to share existing "entrance facilities" with competitive LECs. Entrance facilities are the transmission facilities (typically wires or cables) that connect competitive LECs' networks with incumbent LECs' networks. The FCC recently adopted a regulation specifying that entrance facilities are not among the network elements that § 251(c)(3) requires incumbents to lease to competitors on an unbundled basis at cost-based rates. *See* 47 CFR § 51.319(e)(2)(i) (2005).

The specific issue here is whether respondent, Michigan Bell Telephone Company d/b/a AT & T Michigan (“AT&T”), must lease existing entrance facilities to competitive LECs at cost-based rates. The FCC interprets its regulations to require AT & T to do so for the purpose of interconnection. We begin by reviewing the Commission’s recent actions regarding entrance facilities and then explain the particular dispute that is before us today.

...

[In 2003, the FCC revised prior orders by stating that: (1) incumbent LECs are not obligated to provide cost-based unbundled access to entrance facilities under § 251(c)(3), and (2) entrance facilities are not subject to the unbundling requirement because they are not network elements.]

[But in 2005 the D.C. Circuit questioned the Commission’s determination that entrance facilities are not network elements under § 251(c)(3) and] the Commission responded. *See* Triennial Review Remand Order ¶¶ 136–141. The Commission re-treated from its view that entrance facilities are not network elements but adhered to its previous position that cost-based unbundled access to them need not be provided under § 251(c)(3). Treating entrance facilities as network elements, the Commission concluded that competitive LECs are not impaired without access to them. *Ibid.* The Commission again emphasized that it “d[id] not alter the right of competitive LECs to obtain interconnection facilities pursuant to section 251(c)(2).”

In the wake of the Triennial Review Remand Order, AT & T notified competitive LECs that it would no longer provide entrance facilities at cost-based rates for either backhauling or interconnection, but would instead charge higher rates. Competitive LECs complained to the Michigan Public Service Commission (PSC) that AT & T was unlawfully abrogating their right to cost-based interconnection under § 251(c)(2). The Michigan PSC agreed with the competitive LECs and ordered AT & T to continue providing entrance facilities for interconnection at cost-based rates.

AT & T challenged the Michigan PSC’s ruling in the District Court, which, relying on the Triennial Review Remand Order, ruled in AT & T’s favor. The Michigan PSC and several competitive LECs, including petitioner Talk America, Inc., appealed....

Petitioners contend that AT & T must lease its existing entrance facilities for interconnection at cost-based rates. We agree.

No statute or regulation squarely addresses whether an incumbent LEC

must provide access to entrance facilities at cost-based rates as part of its interconnection duty under § 251(c)(2).

AT & T contends that [§ 251(c)(2)] makes clear that an incumbent LEC need not provide access to any facilities—much less entrance facilities—to provide interconnection. The company points out that § 251(c)(2) does not mention incumbent LECs’ facilities, but rather mandates only that incumbent LECs provide interconnection “for the facilities and equipment of any [competing] carrier.” In contrast, AT & T notes, § 251(c)(3) requires that incumbent LECs provide unbundled “access to [their] network elements.”

We do not find the statute so clear. Although § 251(c)(2) does not expressly require that incumbent LECs lease facilities to provide interconnection, it also does not expressly excuse them from doing so. The statute says nothing about what an incumbent LEC must do to “provide ... interconnection.” § 251(c)(2). “[T]he facilities and equipment of any [competing] carrier” identifies the equipment that an incumbent LEC must allow to interconnect, but it does not specify what the incumbent LEC must do to make the interconnection possible.

In the absence of any unambiguous statute or regulation, we turn to the FCC’s interpretation of its regulations in its amicus brief. ...[W]e defer to an agency’s interpretation of its regulations, even in a legal brief, unless the interpretation is “ ‘plainly erroneous or inconsistent with the regulation [s]’ ” or there is any other “ ‘reason to suspect that the interpretation does not reflect the agency’s fair and considered judgment on the matter in question.’ ”

The Commission contends that its regulations require AT & T to provide access at cost-based rates to its existing entrance facilities for the purpose of interconnection. The Commission’s interpretation proceeds in three steps. First, an incumbent LEC must lease “technically feasible” facilities for interconnection. Second, entrance facilities are among the facilities that an incumbent must make available for interconnection, if technically feasible. Third, it is technically feasible to provide access to the particular entrance facilities at issue in these cases.

The Commission first contends that an incumbent LEC must lease, at cost-based rates, any requested facilities for obtaining interconnection with the incumbent LEC’s network, unless it is technically infeasible to do so. Section 251(c)(2) mandates that an incumbent LEC provide interconnection, at cost-based rates, “at any technically feasible point within the carrier’s network.” The FCC has long construed § 251(c)(2) to require

incumbent LECs to provide, at cost-based rates, “any technically feasible method of obtaining interconnection ... at a particular point.” 47 CFR § 51.321(a) (2010).

The requirement in § 51.321(a) to provide a “method of obtaining interconnection,” the Commission argues, encompasses a duty to lease an existing facility to a competing LEC. When the Commission originally promulgated § 51.321(a), it explained that incumbent LECs would be required to “adapt their facilities to interconnection” and to “accept the novel use of, and modification to, [their] network facilities.”...

Next, the Commission contends that existing entrance facilities are among the facilities that an incumbent LEC must lease for interconnection. According to the FCC, the Triennial Review Remand Order adopted a regulatory definition that reestablished that entrance facilities are part of an incumbent LEC’s network....

Finally, the FCC contends that providing access to the entrance facilities here for interconnection purposes is technically feasible. Under the Commission’s regulations, an incumbent LEC bears the burden of showing that a requested method or point of interconnection is technically infeasible. See 47 CFR §§ 51.305(e), 51.321(d); see also §§ 51.305(d), 51.321(c) (previously successful interconnection is “substantial evidence” of technical feasibility). AT & T does not dispute technical feasibility here.

The FCC’s interpretation is not “plainly erroneous or inconsistent with the regulation[s].” ... Indeed, the Commission’s view on this question is more than reasonable; it is certainly not plainly erroneous. The Triennial Review Remand Order responded to the D.C. Circuit’s decision questioning the Commission’s earlier finding that entrance facilities are not network elements. It revised the definition of dedicated transport—a type of network element—to include entrance facilities....

Second, we are not persuaded by AT & T’s argument that the Commission’s views conflict with the definition of interconnection in § 51.5. That regulation provides: “Interconnection is the linking of two networks for the mutual exchange of traffic. This term does not include the transport and termination of traffic.” AT & T focuses on the definition’s exclusion of “transport and termination of traffic.” An entrance facility is a transport facility, AT & T argues, and it makes no sense to require an incumbent LEC to furnish a transport facility for interconnection when the definition of interconnection expressly excludes transport.

We think AT & T reads too much into the exclusion of “transport.” The regulation cannot possibly mean that no transport can occur across an

interconnection facility, as that would directly conflict with the statutory language. See § 251(c)(2) (requiring “interconnection ... for the transmission and routing of [local] telephone exchange service”).

The better reading of the regulation is that it merely reflects that the “transport and termination of traffic” is subject to different regulatory treatment than interconnection. Compensation for transport and termination—that is, for delivering local telephone calls placed by another carrier’s customer—is governed by separate statutory provisions and regulations. See 47 U.S.C. §§ 251(b)(5), 252(d)(2); 47 CFR § 51.701. The Commission explains that a competitive LEC typically pays one fee for interconnection—“just for having the link”—and then an additional fee for the transport and termination of telephone calls. Tr. of Oral Arg. 28; see also Brief for United States as Amicus Curiae 3, n. 1. Entrance facilities, at least when used for the mutual exchange of traffic, seem to us to fall comfortably within the definition of interconnection. See 597 F.3d, at 388 (Sutton, J., dissenting) (noting that entrance facilities are “designed for the very purpose of linking two carriers’ networks” (internal quotation marks omitted)).

In sum, the Commission’s interpretation of its regulations is neither plainly erroneous nor inconsistent with the regulatory text. Contrary to AT & T’s assertion, there is no danger that deferring to the Commission would effectively “permit the agency, under the guise of interpreting a regulation, to create de facto a new regulation.” *Christensen v. Harris County*, 529 U.S. 576, 588 (2000).

It is so ordered.

[a concurring opinion by Justice Scalia is omitted; Justice Kagan did not participate]

### NOTES AND QUESTIONS

1. As discussed earlier, in its *Trinko* decision the Supreme Court held that the antitrust laws compel dealing with a rival only in extreme situations. The Telecommunications Act of 1996, 47 U.S.C. § 251(c), goes much further. Under it an incumbent carrier must provide interconnection to all competitive carriers. The incumbent may charge market-based rates unless the FCC determines that this price would impair the competitor’s ability to offer its service to customers; then it must charge cost-based rates.

Do these provisions create a more efficient and competitive telecommunications market that benefit consumers? If a dominant

incumbent is obligated to license its intercommunication equipment to smaller, local firms at a cost-based price, this will open the market to more firms, creating more “competition.” But will this result in higher output and lower prices? Further, what incentive does a dominant firm have to invest in innovation or more efficient business practices when smaller firms will be able to benefit without contributing to the investment cost? The interpretation of the antitrust laws in *Trinko* and the interconnection requirements in the 1996 Telecommunications Act reflect radically different approaches to this problem, do they not?

**“NET NEUTRALITY” AND RELATED OBLIGATIONS  
IMPOSED  
BY THE FEDERAL COMMUNICATIONS COMMISSION  
COMCAST CABLE COMMUNICATIONS, LLC, V. FCC  
717 F.3d 982 (D.C. Cir. 2013)**

[WILLIAMS](#), Senior Circuit Judge.

Regulations of the Federal Communications Commission, adopted under the mandate of § 616 of the Communications Act of 1934 and virtually duplicating its language, bar a multichannel video programming distributor (“MVPD”) such as a cable company from discriminating against unaffiliated programming networks in decisions about content distribution. More specifically, the regulations bar such conduct when the effect of the discrimination is to “unreasonably restrain the ability of an unaffiliated video programming vendor to compete fairly.” [47 C.F.R. § 76.1301\(c\)](#); see also [47 U.S.C. § 536\(a\)\(3\)](#). Tennis Channel, a sports programming network and intervenor in this suit, filed a complaint against petitioner Comcast Cable, an MVPD, alleging that Comcast violated § 616 and the Commission’s regulations by refusing to broadcast Tennis as widely (i.e., via the same relatively low-priced “tier”) as it did its own affiliated sports programming networks, Golf Channel and Versus. (Versus is now known as NBC Sports Network and was originally called Outdoor Life Network; for consistency with the order under review, we refer to it as “Versus.”) An administrative law judge ruled against Comcast, ordering that it provide Tennis carriage equal to what it affords Golf and Versus, and the Commission affirmed. See [Tennis Channel, Inc. v. Comcast Cable Commc’ns, LLC, Memorandum Opinion and Order, 27 FCC Rcd. 8508 \(July 24, 2012\)](#) (“*Order*”).

Comcast poses a number of issues as to the meaning of § 616, including

an argument that the Commission reads it so broadly as to violate Comcast's free speech rights under the First Amendment. We need not reach those issues, as Comcast prevails with its third set of arguments—that even under the Commission's interpretation of § 616 (the correctness of which we assume for purposes of this decision), the Commission has failed to identify adequate evidence of unlawful discrimination.

Comcast ... argued that the Commission could not lawfully find discrimination because Tennis offered no evidence that its rejected proposal would have afforded Comcast *any* benefit. If this is correct, as we conclude below, the Commission has nothing to refute Comcast's contention that its rejection of Tennis's proposal was simply “a straight up financial analysis,” as one of its executives put it. Joint Appendix (“J.A.”) 300.

\* \* \*

Comcast, the largest MVPD in the United States, offers cable television programming to its subscribers in several different distribution “tiers,” or packages of programming services, at different prices. Since Versus's and Golf's launches in 1995, Comcast—which originally had a minority interest in the two networks, and now has 100% ownership—has generally carried the networks on its most broadly distributed tiers, Expanded Basic or the digital counterpart Digital Starter. [Order ¶ 12](#); J.A. 1223–24.

Tennis Channel, launched in 2003, initially sought distribution of its content on Comcast's less broadly distributed sports tier, a package of 10 to 15 sports networks that Comcast's subscribers can access for an extra \$5 to \$8 per month. In 2005, Tennis entered a carriage contract that gave the Comcast the “right to carry” Tennis “on any ... tier of service,” subject to exclusions irrelevant here. Comcast in fact placed Tennis on the sports tier.

In 2009, however, Tennis approached Comcast with proposals that Comcast reposition Tennis onto a tier with broader distribution. [Order ¶¶ 12, 33](#). Tennis's proposed agreement called for Comcast to pay Tennis for distribution on a per-subscriber basis. Tennis provided a detailed analysis—which is sealed in this proceeding—of what Comcast would likely pay for that broader distribution; even with the discounts that Tennis offered, the amounts are substantial. Neither the analysis provided at the time, nor testimony received in this litigation, made (much less substantiated) projections of any resulting increase in revenue for Comcast, let alone revenue sufficient to offset the increased fees.

Comcast entertained the proposal, checking with “division and system employees to gauge local and subscriber interest.” J.A. 402. After those consultations, and based on previous analyses of interest in Tennis, Comcast rejected the proposal in June 2009. Tennis then filed its complaint with the Commission in January 2010, which led to the order now under review. By way of remedy, the ALJ ordered, and the Commission affirmed, that Comcast must “carry [Tennis] on the same distribution tier, reaching the same number of subscribers, as it does [Golf] and Versus.” [Order ¶ 92](#).

The parties agree that Comcast distributes the content of affiliates Golf and Versus more broadly than it does that of Tennis. The question is whether that difference violates § 616 and the implementing regulations. There is also no dispute that the statute prohibits only discrimination *based on* affiliation. Thus, if the MVPD treats vendors differently based on a reasonable business purpose (obviously excluding any purpose to illegitimately hobble the competition from Tennis), there is no violation. The Commission has so interpreted the statute, [Mid-Atlantic Sports Network v. Time Warner Cable Inc.](#), 25 FCC Rcd. 18099, ¶ 22 (2010), and the Commission's attorney conceded as much at oral argument, see Oral Arg. Tr. at 24–25; see also [TCR Sports Broad. Holding L.L.P. v. FCC](#), 679 F.3d 269, 274–77 (4th Cir.2012) (discussing the legitimate, non-discriminatory reasons for an MVPD's differential treatment of a non-affiliated network).

In contrast with the detailed, concrete explanation of Comcast's additional costs under the proposed tier change, Tennis showed no corresponding benefits that would accrue to Comcast by its accepting the change. Testimony from one of Comcast's executives identifies some of the factors it considers when deciding whether to move a channel to broader distribution:

In deciding whether to carry a network and at what cost, Comcast Cable must balance the costs and benefits associated with a wide range of factors, including: the amount of the licensing fees (which is generally the most important factor); the nature of the programming content involved; the intensity and size of the fan base for that content; the level of service sought by the network; the network's carriage on other MVPDs; the extent of [most favored nation]<sup>2</sup> protection provided; the

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<sup>2</sup> A “most favored nation” provision grants the distributor “the right to be offered any more favorable rates, terms, or conditions subsequently offered or

term of the contract sought; and a variety of other operational issues.

But neither Tennis nor the Commission offers such an analysis on either a qualitative or a quantitative basis. Instead, the best the Commission offers, both in the Order and at oral argument, is that Tennis charges less per “rating point” than does either Golf or Versus. *Order* ¶ 78 n. 243; Oral Arg. Tr. at 25–29. But those differentials are not affirmative evidence that acceptance of Tennis's 2009 proposal could have offered Comcast any net gain. Even if we were to assume *arguendo* that low charges per ratings point are the be-all and the end-all of assigning a network to a broadly accessible tier (and the record does not support such an assumption), the cost-per-ratings-point evidence would at most show that (by this particular criterion) Tennis's gross cost is not as high as that of either Golf or Versus. It does not show any affirmative net benefit. As to the assumption about cost per ratings point, the sealed record suggests (consistent with Comcast's evidence about the factors guiding its tier placement decisions) that a very high price per rating point is by no means an absolute barrier to placement in a broadly available tier. J.A. 51, 1112.

A rather obvious type of proof would have been expert evidence to the effect that X number of subscribers would switch to Comcast if it carried Tennis more broadly, or that Y number would leave Comcast in the absence of broader carriage, or a combination of the two, such that Comcast would recoup the proposed increment in cost. There is no such evidence....

Not only does the record lack affirmative evidence along these lines, there is evidence that no such benefits exist. [Evidence that no benefits for Comcast exist can be seen in a] natural experiment conducted in Comcast's southern division. There Comcast had in 2007 or 2008 acquired a distribution network from another MVPD that had distributed Tennis more broadly than did Comcast. When Comcast repositioned Tennis to the sports tier (a “negative repo” in MVPD lingo), thereby making it available to Comcast's general subscribers only for an additional fee, not one customer complained about the change.

When we asked at oral argument about the absence of evidence of benefit to Comcast from the proposed tier change, Commission counsel

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granted by a network to another distributor.” Of course the record is very strong on the proposed increment in licensing fees, in itself a clear negative. The question is whether the other factors, and perhaps ones unmentioned by Comcast, establish reason to expect a net benefit.

pointed not to any such evidence but to the ALJ's remedy (affirmed by the Commission), which gave Comcast the alternative of narrowing the exposure of Golf and Versus (rather than broadening that of Tennis). Such a change was the Commission's alternative remedy for bringing the three networks to tiering parity. But the discriminatory act alleged by the Commission was Comcast's refusal to broaden its distribution of Tennis, not a refusal to narrow its distribution of Golf and Versus. The latter may make complete sense in terms of providing an evenhanded remedy. But evidence that such a change would have afforded Comcast a net benefit—for example, by generating incremental sports tier fees exceeding incremental losses from the removal of Golf and Versus from lower priced tiers—would in itself have little bearing on the lawfulness of Comcast's rejection of Tennis's actual proposal to extend distribution of the latter's content....

Without showing any benefit for Comcast from incurring the additional fees for assigning Tennis a more advantageous tier, the Commission has not provided evidence that Comcast discriminated against Tennis on the basis of affiliation. And while the Commission describes at length the “substantial evidence” that supports a finding that the discrimination is based on affiliation, Resp'ts' Br. at 25–31, none of that evidence establishes benefits that Comcast would receive if it distributed Tennis more broadly. On this issue the Commission has pointed to no evidence, and therefore obviously not to substantial evidence. See [Guardian Moving & Storage Co., Inc. v. ICC, 952 F.2d 1428, 1433 \(D.C.Cir.1992\)](#).

\* \* \*

The petition is therefore

*Granted.*

[KAVANAUGH](#), Circuit Judge, concurring:

...

As the Court's opinion explains, the FCC erred in concluding that Comcast discriminated against the Tennis Channel on the basis of affiliation. I join the Court's opinion in full. I write separately to point out that the FCC also erred in a more fundamental way. Section 616's use of the phrase “unreasonably restrain”—an antitrust term of art—establishes that the statute applies only to discrimination that amounts to an unreasonable restraint under antitrust law. Vertical integration and vertical contracts—for example, between a video programming distributor and a video

programming network—become potentially problematic under antitrust law only when a company has market power in the relevant market. It follows that Section 616 applies only when a video programming distributor possesses market power. But Comcast does not have market power in the national video programming distribution market, the relevant market analyzed by the FCC in this case. Therefore, as I will explain in Part I of this opinion, Section 616 does not apply here.

Applying Section 616 to a video programming distributor that lacks market power not only contravenes the terms of the statute, but also violates the First Amendment as it has been interpreted by the Supreme Court. As I will explain in Part II of this opinion, the canon of constitutional avoidance thus strongly reinforces the conclusion that Section 616 applies only when a video programming distributor possesses market power.

## I

Section 616 of the Communications Act requires the FCC to:

prevent a multichannel video programming distributor from engaging in conduct the effect of which is to *unreasonably restrain* the ability of an unaffiliated video programming vendor to compete fairly by discriminating in video programming distribution on the basis of affiliation or nonaffiliation of vendors in the selection, terms, or conditions for carriage of video programming provided by such vendors.

[47 U.S.C. § 536\(a\)\(3\)](#) (emphasis added); *see* [47 C.F.R. § 76.1301\(c\)](#). The statutory text establishes that a Section 616 violation has two elements. First, the video programming distributor must have discriminated against an unaffiliated video programming network on the basis of affiliation. Second, the video programming distributor's discrimination must have “unreasonably restrain[ed]” the unaffiliated network's ability “to compete fairly.”

Congress enacted Section 616 (over the veto of President George H.W. Bush) as part of the Cable Television Consumer Protection and Competition Act of 1992, known as the Cable Act. The Cable Act included numerous provisions designed to curb abuses of cable operators' bottleneck monopoly power and to promote competition in the cable television industry. When the Act was passed, however, the video programming market looked quite different than it looks today. At the time, most households subscribed to cable in order to view television programming. And as Congress noted, “most cable television subscribers [had] no opportunity to select between

competing cable systems.” Cable Television Consumer Protection and Competition Act of 1992, [Pub.L. No. 102–385](#), § 2(a)(2), 106 Stat. 1460, 1460 (1992). Congress decided to proactively counteract the bottleneck monopoly power that cable operators possessed in many local markets.

The Cable Act employs a variety of tools to advance competition. Some provisions directly prohibit practices that Congress viewed as anticompetitive in the market at the time. For example, the Act prohibits local franchising authorities from granting exclusive franchises to cable operators. *See id.* § 7(a), 106 Stat. at 1483. Similarly, the Act’s “must-carry” provisions require cable operators to carry a specified number of local broadcast stations. *See id.* § 4, 106 Stat. at 1471.

In other parts of the Act, Congress borrowed from antitrust law, authorizing the FCC to regulate cable operators’ conduct in accordance with antitrust principles. For example, the Act requires the FCC, when prescribing limits on the number of cable subscribers or affiliated channels, to take account of “the nature and market power of the local franchise.” *See id.* § 11(c), 106 Stat. at 1488. Similarly, the Act allows rate regulation only of those cable systems that are not subject to effective competition. *See id.* § 3, 106 Stat. at 1464.

The provision at issue in this case, Section 616, incorporates traditional antitrust principles. Section 616 does not categorically forbid a video programming distributor from extending preferential treatment to affiliated video programming networks or lesser treatment to unaffiliated video programming networks. Rather, to violate Section 616, a video programming distributor must discriminate among video programming networks on the basis of affiliation, *and* the discrimination must “unreasonably restrain” an unaffiliated network’s ability to compete fairly. [47 U.S.C. § 536\(a\)\(3\)](#).

The phrase “unreasonably restrain” is of course a longstanding term of art in antitrust law. *See, e.g., Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007)* (“[T]he Court has repeated time and again that § 1 outlaws only unreasonable restraints.”).....

When a statute uses a term of art from a specific field of law, we presume that Congress adopted “the cluster of ideas that were attached to each borrowed word in the body of learning from which it was taken.” [FAA v. Cooper, 132 S.Ct. 1441, 1449 \(2012\)](#)...; ANTONIN SCALIA &

BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 73 (2012) (where “a word is obviously transplanted from another legal source, ... it brings the old soil with it”) (internal quotation mark omitted); cf. [FTC v. Phoebe Putney Health System, Inc.](#), 133 S.Ct. 1003, 1015(2013) (reading statute “in light of our national policy favoring competition”).

From the “term of art” canon and Section 616's use of the antitrust term of art “unreasonably restrain,” it follows that Section 616 incorporates antitrust principles governing unreasonable restraints.

So what does antitrust law tell us? In antitrust law, certain activities are considered per se anticompetitive. Otherwise, however, conduct generally can be considered unreasonable only if a firm, or multiple firms acting in concert, have market power. See [Leegin Creative Leather Products](#), 551 U.S. at 885–86.

This case involves vertical integration and vertical contracts. Beginning in the 1970s (well before the 1992 Cable Act), the Supreme Court has recognized the legitimacy of vertical integration and vertical contracts by firms without market power..... See Douglas H. Ginsburg, [Vertical Restraints: De Facto Legality Under the Rule of Reason](#), 60 *ANTITRUST L.J.* 67, 76 (1991) (“Antitrust law is a bar to the use of vertical restraints only in markets in which there is no apparent interbrand competition to protect consumers from a potentially welfare-decreasing restraint on intrabrand competition.”); 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 756a, at 9 (3d ed.2008) (vertical integration “is either competitively neutral or affirmatively desirable because it promotes efficiency”)....

Not surprisingly given its procompetitive characteristics, vertical integration and vertical contracts are common and accepted practices in the American economy: Apple's iPhones contain integrated hardware and software, Dunkin' Donuts sells Dunkin' Donuts coffee, Ford produces radiators for its cars, McDonalds sells Big Macs, Nike stores are stocked with Nike shoes, Netflix owns “House of Cards,” and so on. As Professors Areeda and Hovenkamp have explained, vertical integration “is ubiquitous in our economy and virtually never poses a threat to competition when undertaken unilaterally and in competitive markets.” 3B AREEDA & HOVENKAMP, *ANTITRUST LAW* ¶ 755c, at 6.

Following the lead of the Supreme Court and influential academic literature on which the Supreme Court has relied in the antitrust field, this Court's case law has stated that vertical integration and vertical contracts are procompetitive, at least absent market power. See [Cablevision Systems Corp. v. FCC](#), 649 F.3d 695, 721 (D.C.Cir.2011) (vertical integration is “not always pernicious and, depending on market conditions, may actually be procompetitive”); [National Fuel Gas Supply Corp. v. FERC](#), 468 F.3d 831, 840 (D.C.Cir.2006) (“We began by emphasizing that vertical integration creates efficiencies for consumers.”); [Tenneco Gas v. FERC](#), 969 F.2d 1187, 1201 (D.C.Cir.1992) (“[A]dvantages a pipeline gives its affiliate are improper only to the extent that they flow from the pipeline's anti-competitive market power. Otherwise vertical integration produces permissible efficiencies that cannot by themselves be considered uses of monopoly power.”) (internal quotation marks omitted); see also [Cablevision Systems Corp. v. FCC](#), 597 F.3d 1306, 1325 (D.C.Cir.2010) (Kavanaugh, J., dissenting) (“At least unless a company possesses market power in the relevant market, vertical integration and exclusive vertical contracts are not anti-competitive; on the contrary, such arrangements are ‘presumptively procompetitive.’ ”) (quoting 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1803, at 100 (2d ed.2005)).

Now back to Section 616: Because Section 616 incorporates antitrust principles and because antitrust law holds that vertical integration and vertical contracts are potentially problematic only when a firm has market power in the relevant market, it follows that Section 616 applies only when a video programming distributor has market power in the relevant market. Section 616 thus does not bar vertical integration or vertical contracts that favor affiliated video programming networks, absent a showing that the video programming distributor at least has market power in the relevant market. To conclude otherwise would require us to depart from the established meaning of the term of art “unreasonably restrain” that Section 616 uses. Moreover, to conclude otherwise would require us to believe that Congress intended to *thwart* procompetitive practices. It would of course make little sense to attribute that motivation to Congress.

How, then, did the FCC reach the opposite conclusion in this case? The short answer is that the FCC badly misread the statute. Contrary to the plain language of Section 616, the FCC stated that the term “unreasonably” modified “discriminating” not “restrain”—even though Section 616 says it applies only to discriminatory conduct that “unreasonably restrain[s]” the ability of a competitor to compete fairly. See [Order](#) ¶¶ 43, 85–86. Because

the FCC did not read Section 616 as written, it did not recognize the antitrust term of art “unreasonably restrain” that is apparent on the face of the statute. That erroneous reading of the text, in turn, led the FCC to mistakenly focus on the effects of Comcast's conduct on a competitor (the Tennis Channel) rather than on overall competition. *See id.* ¶¶ 83–85. That was a mistake because the goal of antitrust law (and thus of Section 616) is to promote consumer welfare by protecting competition, not by protecting individual competitors. *See, e.g., NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 135 (1998) (Sherman Act plaintiff “must allege and prove harm, not just to a single competitor, but to the competitive process, *i.e.*, to competition itself”); *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993) (“The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market.”); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (“The antitrust laws ... were enacted for the protection of *competition*, not *competitors*.”) (internal quotation marks omitted); *see also* AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 755c, at 6 (“[E]ven competitively harmless vertical integration can injure rivals or vertically related firms, but such injuries are not the concern of the antitrust laws.”).

It is true that Section 616 references discrimination against competitors. But again, the statute does not ban such discrimination outright. It bans discrimination that *unreasonably restrains* a competitor from competing fairly. By using the phrase “unreasonably restrain,” the statute incorporates an antitrust term of art, and that term of art requires that the discrimination in question hinder overall competition, not just competitors.

In sum, Section 616 targets instances of preferential program carriage that are anticompetitive under the antitrust laws. Section 616 thus may apply only when a video programming distributor possesses market power in the relevant market. Comcast has only about a 24% market share in the national video programming distribution market; it does not possess market power in the market considered by the FCC in this case. *See Order* ¶ 87. Therefore, the FCC erred in finding that Comcast violated Section 616.

## II

To the extent there is uncertainty about whether the phrase “unreasonably restrain” in Section 616 means that the statute applies only in cases of market power or instead may have a broader reach, we must construe the statute to avoid “serious constitutional concerns.” *Edward J.*

[DeBartolo Corp. v. Florida Gulf Coast Building & Construction Trades Council](#), 485 U.S. 568, 577 (1988); see also [Solid Waste Agency of Northern Cook County v. Army Corps of Engineers](#), 531 U.S. 159, 172 (2001). That canon strongly supports limiting Section 616 to cases of market power. Applying Section 616 to a video programming distributor that lacks market power would raise serious First Amendment questions under the Supreme Court's case law....

To begin with, the Supreme Court has squarely held that a video programming distributor such as Comcast both engages in and transmits speech, and is therefore protected by the First Amendment. See [Turner Broadcasting System, Inc. v. FCC](#), 512 U.S. 622, 636 (1994). Just as a newspaper exercises editorial discretion over which articles to run, a video programming distributor exercises editorial discretion over which video programming networks to carry and at what level of carriage.

It is true that, under the Supreme Court's precedents, Section 616's impact on a cable operator's editorial control is content-neutral and thus triggers only intermediate scrutiny rather than strict scrutiny. See [id. at 642–43](#). But the Supreme Court's case law applying intermediate scrutiny in this context provides that the Government may interfere with a video programming distributor's editorial discretion only when the video programming distributor possesses market power in the relevant market.

In its 1994 decision in [Turner Broadcasting](#), the Supreme Court ruled that the Cable Act's must-carry provisions might satisfy intermediate First Amendment scrutiny, but the Court rested that conclusion on “special characteristics of the cable medium: the bottleneck monopoly power exercised by cable operators and the dangers this power poses to the viability of broadcast television.” [Id. at 661](#). When a cable operator has bottleneck power, the Court explained, it can “silence the voice of competing speakers with a mere flick of the switch.” [Id. at 656](#). In subsequently upholding the must-carry provisions, the Court reiterated that cable's bottleneck monopoly power was critical to the First Amendment calculus. See [Turner Broadcasting System, Inc. v. FCC](#), 520 U.S. 180, 197–207 (1997) (controlling opinion of Kennedy, J.). The Court stated that “cable operators possess[ed] a local monopoly over cable households,” with only one percent of communities being served by more than one cable operator. [Id. at 197](#).

...

[But since this Court decided *Turner Broadcasting*], the video programming distribution market has changed dramatically, especially with the rapid growth of satellite and Internet providers. This Court has previously described the massive transformation, explaining that cable operators “no longer have the bottleneck power over programming that concerned the Congress in 1992.” [Comcast Corp. v. FCC, 579 F.3d 1, 8 \(D.C.Cir.2009\)](#); see also [Cablevision Systems Corp. v. FCC, 597 F.3d 1306, 1324 \(D.C.Cir.2010\)](#) (Kavanaugh, J., dissenting) (“This radically changed and highly competitive marketplace—where no cable operator exercises market power in the downstream or upstream markets and no national video programming network is so powerful as to dominate the programming market—completely eviscerates the justification we relied on in *Time Warner* for the ban on exclusive contracts.”); Christopher S. Yoo, [Vertical Integration and Media Regulation in the New Economy, 19 YALE J. ON REG. 171, 229 \(2002\)](#) (“It thus appears that the national market for MVPDs is already too unconcentrated to support the conclusion that vertical integration could have any anti-competitive effects.”).

In today's highly competitive market, neither Comcast nor any other video programming distributor possesses market power in the national video programming distribution market....

In light of the Supreme Court's precedents interpreting the First Amendment and the massive changes to the video programming distribution market over the last two decades, the FCC's interference with Comcast's editorial discretion cannot stand. In restricting the editorial discretion of video programming distributors, the FCC cannot continue to implement a regulatory model premised on a 1990s snapshot of the cable market.

The Supreme Court's precedents amply demonstrate that the FCC's interpretation of Section 616 violates the First Amendment. At a minimum, the Supreme Court's precedents raise serious First Amendment questions about the FCC's interpretation of Section 616. Under the constitutional avoidance canon, those serious constitutional questions require that we construe Section 616 to apply only when a video programming distributor possesses market power....

**TIME WARNER CABLE, INC. V. FCC**  
**2013 WL 4733668 (2d Cir. Sept. 4, 2013)**

RAGGI, Circuit Judge.

Time Warner Cable Inc. (“Time Warner”) and the National Cable & Telecommunications Association (“NCTA” and, collectively with Time Warner, the “Cable Companies”) petition for review of an August 1, 2011 order of the Federal Communications Commission (“FCC” or “Commission”). . . . Section 616(a)(3) and (5) and that part of the 2011 FCC Order establishing the standard for demonstrating a *prima facie* violation of these statutory provisions (collectively, the “program carriage regime”) are intended to curb anticompetitive behavior by limiting the circumstances under which a distributor of video programming can discriminate against unaffiliated networks that provide such programming. The Cable Companies contend that, on its face, the program carriage regime violates their First Amendment right to free speech....

For the reasons set forth in this opinion, we reject the Cable Companies' First Amendment challenge to the program carriage regime . . . .

## **I. Background**

### **A. The Video Programming Industry**

[T]he video programming industry includes video programming vendors, multichannel video programming distributors (“MVPDs”), and online video distributors (“OVDs”). Video programming vendors are primarily programming networks, such as ESPN, Bravo, and CNN, which create or acquire video programming, such as television shows and movies, and which contract with MVPDs and OVDs to distribute that programming to consumers. MVPDs and OVDs are services that transmit video programming to subscribers for viewing on televisions, computers, and other electronic devices. MVPDs and OVDs generally do not alter the programming that they transmit; rather, once an MVPD or OVD acquires programming from networks, it functions as a “conduit for the speech of others, transmitting it on a continuous and unedited basis to [consumers].” *Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 629 (1994) (“*Turner I*”).

MVPDs include (1) cable operators, such as Time Warner and Comcast Corporation (“Comcast”), which transmit programming over physical cable systems; (2) direct broadcast satellite (“DBS”) providers, such as DISH Network and DIRECTV, which transmit programming via direct-to-home satellite; and (3) telephone companies, such as AT & T and Verizon, which transmit programming via fiber-optic cable. While MVPDs primarily transmit programming to televisions, increasingly, they also offer access to their programming through the Internet. MVPDs sometimes acquire ownership interests in the networks from which they obtain video

programming, and vice versa. Such networks are deemed “affiliated” with MVPDs, whereas networks without any shared ownership interests are deemed “unaffiliated.” The “geographic footprint [ ]” of an MVPD varies based on the type and size of the MVPD. Cable operators, for instance, operate in “discrete geographic areas defined by the boundaries of their individual systems,” and “[n]o cable operator provides nationwide coverage or statewide coverage.” Telephone companies are similarly limited by their physical systems. By contrast, DBS providers have “national footprints,” offering “service to most of the land area and population of the United States.”

OVDs, like Hulu and Netflix, are relatively new services that transmit video programming to consumers via broadband Internet for viewing on television and other electronic devices. OVDs may offer programming for free, by subscription, on a rental basis, or for sale. “[A]n OVD's market generally covers the entire national broadband footprint.”

Two markets in the video programming industry are relevant to this case. The first, which we will refer to as the “video programming market,” is the market in which programming networks and other video programming vendors compete with each other to have MVPDs and OVDs carry their video programming. The second market, which we will refer to as the “MVPD market,” consists of MVPDs and, to a lesser extent, OVDs competing to deliver video programming to consumers.

#### *B. The Cable Act*

[In 1992, Congress enacted the Cable Act to regulate the video programming industry. During this time, cable operators controlled 95% of the MVPD market because other MVPD systems like DBS, fiber-optic telephone, and OVDs either did not pose a significant competitive threat to cable operators or did not yet exist.]. Cable operators also generally did not compete against one another in any given locality... Thus, the country was effectively divided into numerous local cable monopolies, with few consumers having a choice of MVPDs.

[C]able operators [also] exercised “bottleneck” control, a power that allowed them to prevent certain programming networks from reaching consumers in particular geographic areas. It is the “physical connection between the [subscriber's] television set and the cable network” that affords cable operators this power to “silence the voice” of a particular network “with a mere flick of the switch.” *Turner I*, 512 U.S. at 656 (observing that

“simply by virtue of its ownership of the essential pathway for cable speech, a cable operator [could] prevent its subscribers from obtaining access to programming it [chose] to exclude”); *see generally* 3B P. Areeda & H. Hovenkamp, *Antitrust Law* ¶¶ 771a, 772a (3d ed.2008) (discussing bottleneck control and essential facilities doctrine in antitrust context).

Concerns about cable operators' anticompetitive market power informed Congress's enactment of the Cable Act. [T]he Act sought to promote the availability to the public of diverse views through cable television, to protect consumer interests where cable operators were not subject to effective competition, and to ensure that cable operators did not have undue market power vis-à-vis programming networks and consumers. Toward these ends, the Cable Act imposed various restrictions on cable operators and other MVPDs and directed the FCC to establish further regulations. The focus of this appeal is certain statutory restrictions on MVPDs dealings with programming networks and the FCC regulations promulgated thereunder, namely, the program carriage regime...

*C. The Program Carriage Regime and Standstill Rule*

*1. Section 616(a)(3) and (5)*

[T]he Communications Act directs the FCC to “establish regulations governing program carriage agreements and related practices between cable operators or other [MVPDs] and video programming vendors.” 47 U.S.C. § 536(a). Section 616(a)(3) specifies that such regulations shall [prevent an MVPD from “engaging in conduct the effect of which is to unreasonably restrain the ability of an unaffiliated video programming vendor to compete fairly by discriminating in video programming distribution on the basis of affiliation or nonaffiliation of vendors.”].

Congress enacted these provisions to prevent cable operators from using their market power to take unfair advantage of unaffiliated programming networks. As the Senate and House Reports indicate, Congress was concerned that cable operators were leveraging “their market power derived from their de facto exclusive franchises and lack of local competition” to require networks to give them “an exclusive right to carry the programming, a financial interest, or some other added consideration as a condition of carriage on the cable system.” ... Congress remained concerned that “in certain instances” a cable operator would be able to “abuse its locally-derived market power to the detriment of programmers.”

This concern was exacerbated by pervasive vertical integration in the video programming industry. “Vertical integration occurs when a firm provides for itself some input that it might otherwise purchase on the market.” Areeda & Hovenkamp ¶ 755a. “A vertically integrated cable company is a company that owns both the programming and the distribution system.” S.Rep. No. 102–92, at 24–25, *reprinted in* 1992 U.S.C.C.A.N. at 1157–58. In 1992, when the Cable Act was enacted, 39 of the 68 national programming networks, or approximately 57%, were vertically integrated with cable operators. This vertical integration provided cable operators with the incentive and ability to favor their affiliated networks, for example, by giving an affiliated network a more desirable channel position than an unaffiliated network or by refusing to carry an unaffiliated network altogether. Indeed, the Senate Report noted hearing testimony that stated as much:

Because of the trend toward vertical integration, cable operators now have a clear vested interest in the competitive success of some of the programming services seeking access through their conduit. You don't need a Ph.D. in Economics to figure out that the guy who controls a monopoly conduit is in a unique position to control the flow of programming traffic to the advantage of the program services in which he has an equity investment and/or in which he is selling advertising availabilities, and to the disadvantage of those services ... in which he does not have an equity position.

S.Rep. No. 102–92, at 25–26, *reprinted in* 1992 U.S.C.C.A.N. at 1158–59 (internal quotation marks omitted); *see also* Areeda & Hovenkamp ¶ 756b (stating that vertically-integrated monopolist “at one stage of the production-distribution process may carry with it the power to affect competition in earlier and later stages”).

On the other hand, Congress recognized that vertical integration could sometimes promote competition. The Senate Report cited hearing testimony recounting how vertical integration had allowed cable operators to “stimulate[ ] the development of programming that was necessary to flesh out the promise of cable ... when nobody else was really willing to step up and put up the money.” S.Rep. No. 102–92, at 27, *reprinted in* 1992 U.S.C.C.A.N. at 1160; *see also* Areeda & Hovenkamp ¶ 756b (“[V]ertical integration by a monopolist may or may not have desirable or adverse consequences on economic performance.”).

Given these mixed views on the competitive impact of vertical integration in the video programming industry, Congress rejected proposals to ban vertical integration and instead enacted “legislation bar[ring] cable operators from discriminating against unaffiliated programmers” to ensure “competitive dealings between programmers and cable operators.”

### 2. *The 1993 FCC Order*

[In October 1993, the FCC released an order establishing a procedural framework for addressing § 616(a)(3) discrimination complaints by unaffiliated networks against MVPDS. Under the framework, the FCC would analyze complaints on a case-by-case basis and balance the need to proscribe “behavior prohibited by the specific language of the statute” with the need to preserve “the ability of affected parties to engage in legitimate, aggressive negotiations.”].

### 3. *The 2007 FCC Notice of Proposed Rule Making* [(“2007 NPRM”)]

On June 15, 2007, the FCC issued a notice of proposed rule making that solicited comments on potential changes to the procedures established in the 1993 FCC Order. Among other things, the FCC sought comment on the need to clarify the elements of a *prima facie* § 616(a)(3) violation and to “adopt rules to address the complaint process itself.” ...

### 4. *The 2011 FCC Order*

... The FCC concluded that the record developed in response to the 2007 NPRM showed that its “current program carriage procedures [were] ineffective and in need of reform.” Accordingly, in the 2011 FCC Order, the agency stated that it was taking “initial steps to improve [its] procedures for addressing program carriage complaints.” Among these steps were two rule changes relevant to the petitions for this court's review: (a) pronouncement of a new *prima facie* standard, and (b) creation of a standstill rule. [At issue in this case is the 2011 FCC Order.].

#### a. *Prima Facie Standard*

[Instead of eliminating the *prima facie* standard, the FCC attempted to clarify what was required to establish a *prima facie* case and codify those requirements into FCC rules.].

Under the revised standard for a *prima facie* § 616(a)(3) violation, a complaining unaffiliated network must show, first, that an MVPD discriminated against it “on the basis of affiliation or non-affiliation” in the “selection, terms, or conditions for carriage” of the MVPD's video

programming. The network can make this showing by reference to either direct or circumstantial evidence. [The Court explains the kinds of circumstantial evidence that would show an MVPD discriminated against an unaffiliated network on the basis of affiliation or non-affiliation.].

To demonstrate a *prima facie* violation, a complainant must further show that the discrimination had the effect of “unreasonably restraining” its ability “to compete fairly.” [Whether discrimination unreasonably restrains the complainant’s ability to compete fairly is analyzed on a case-by-case basis.].

\*\*\* Standstill rule section omitted

#### 5. *Time Warner's First Amendment Challenge*

In releasing the 2011 FCC Order, the agency rejected Time Warner's claim, made in response to the 2007 NPRM, that the program carriage regime violated the First Amendment. Time Warner had argued that, insofar as the program carriage regime required MVPDs to carry certain unaffiliated networks on the same terms as affiliated networks, it constituted a content-based infringement on MVPDs' editorial determinations of which programming networks to provide to their subscribers. As such, it was subject to strict scrutiny, which Time Warner maintained it could not withstand because increased competition in the MVPD market had deprived cable operators of any bottleneck power that might have justified the regime's initial creation in 1992.

Construing the program carriage regime as content neutral, the FCC applied intermediate, rather than strict, scrutiny to Time Warner's First Amendment challenge, and concluded that, even with the increased competition in the MVPD market, the program carriage regime continued to serve important government interests in promoting competition and diverse viewpoints. In so concluding, the FCC relied on the program carriage discrimination provision of the Cable Act that “directed the Commission to assess on a case-by-case basis the impact of anticompetitive conduct on an unaffiliated programming vendor's ability to compete.”

The FCC further concluded that case-by-case analysis of unaffiliated networks' complaints under the program carriage regime was narrowly tailored to promote diversity and competition in the video programming industry because it restricted an MVPD's speech only upon proof that the MVPD had discriminated on the basis of network affiliation and that such

discrimination unreasonably restrained a network's ability to compete fairly.

*D. The Current State of the Video Programming Industry*

[The Court describes how the video programming industry has become more competitive since 1992. Today, cable operators' market share is smaller than it was in 1992. DBS providers, such as DIRECTV and DISH Network, and OVDs now serve a significant portion of the market. Additionally, many geographic areas are now served by multiple competing MVPDs, usually the local cable operator and two DBS providers. Even though competition has increased since 1992, many cable operators continue to control significant market share in many areas.]. For example, as of mid-2010, Comcast maintained at least a 40% share in 13 of the 20 largest MVPD markets in the United States, ranging from as low as 43% in Houston to as high as 62% in Chicago and 67% in Philadelphia....

Since 1992, there also has been a decline in vertical integration among cable operators and programming networks in the video programming industry. At the same time, however, Time Warner maintains an ownership interest in four national networks, including MLB Network; Cox Communications has an interest in six national networks, including MLB Network and the Travel Channel; Cablevision has an ownership in ten, including AMC and IFC; and Bright House Networks has an interest in 29, including Animal Planet and Discovery Channel. [In addition to owning interests in national networks, cable operators own various regional news and sports networks.].

Like Congress in 1992, the FCC continues to view the effects of vertical integration on the video programming industry as mixed. While potential benefits include "efficiencies in the production, distribution, and marketing of video programming, as well as the incentive to expand channel capacity and create new programming by lowering the risks associated with program production ventures," possible harms include "unfair methods of competition, discriminatory conduct, and exclusive contracts that are the result of coercive activity."

*E. The Instant Appeal*

Upon issuance of the 2011 FCC Order, the Cable Companies timely filed petitions for judicial review. They argue that the program carriage regime violates the First Amendment in light of the current state of the MVPD market....

## **II. Discussion**

### **A. First Amendment Challenge**

The First Amendment states that “Congress shall make no law ... abridging the freedom of speech.” U.S. Const. amend. I. There is no question that cable operators and other MVPDs “engage in and transmit speech” protected by the First Amendment. ... Nor is there any dispute that the program carriage regime regulates MVPDs' protected speech by restraining their editorial discretion over which programming networks to carry and on what terms. ... The question here, then, is whether such regulation is justified by a countervailing government interest under the appropriate level of First Amendment scrutiny.

[T]he Cable Companies contend that the FCC erred when, in issuing the 2011 FCC Order, it subjected the program carriage regime to intermediate scrutiny. The Cable Companies submit that the regime's restrictions are content and speaker based, thus requiring strict scrutiny. In any event, the Cable Companies argue that the program carriage regime cannot survive either strict or intermediate scrutiny.

On *de novo* review of this constitutional challenge to the 2011 FCC Order...we conclude that intermediate scrutiny is the appropriate level of review and that the FCC program carriage regime satisfies that standard. While rapidly increasing competition in the video programming industry may undermine that conclusion in the not-too-distant future, that time has not yet come. We thus deny the Cable Companies' petitions insofar as they challenge the program carriage regime under the First Amendment.

#### **1. The Appropriate Level of Scrutiny**

“At the heart of the First Amendment lies the principle that each person should decide for himself or herself the ideas and beliefs deserving of expression, consideration, and adherence.” *Turner I*, 512 U.S. at 641. The First Amendment thus stands against government “attempts to disfavor certain subjects or viewpoints.” *Citizens United v. FEC*, 558 U.S. 310, 340 (2010). “Prohibited, too, are restrictions distinguishing among different speakers, allowing speech by some but not others.” *Citizens United v. FEC*, 558 U.S. at 340. A content- or speaker-based restriction on protected speech is subject to strict scrutiny and will be tolerated only upon a showing that it is narrowly tailored to a compelling government interest. On the other hand, a regulation of protected speech that is content neutral and that does not disfavor certain speakers is reviewed under the less-stringent intermediate

level of scrutiny. Courts have consistently reviewed challenges to the Cable Act and regulations promulgated pursuant thereto under intermediate scrutiny. *See, e.g., Turner II*, 520 U.S. at 213. Because the program carriage regime is content and speaker neutral, it warrants no different treatment.

a. *Content Neutrality*

“Deciding whether a particular regulation is content based or content neutral is not always a simple task.” *Turner I*, 512 U.S. at 642. “The principal inquiry ... is whether the government has adopted a regulation of speech because of agreement or disagreement with the message it conveys.” *Id.* (alterations and internal quotation marks omitted). In making this determination, “we look to the purpose behind the regulation.” *Bartnicki v. Vopper*, 532 U.S. 514, 526 (2001). “[T]ypically, government regulation of expressive activity is content neutral so long as it is *justified* without reference to the content of the regulated speech.” *Id.* (emphasis in original; alteration and internal quotation marks omitted)....

Applying these principles here, we conclude that § 616(a)(3) and (5) of the Cable Act, by its terms, neither favors nor disfavors any particular message or view and, indeed, makes no reference to content. *See* 47 U.S.C. § 536(a)(3), (5). To invoke the protections of that statute, an unaffiliated network must establish that a cable operator or other MVPD (1) discriminated against it on the basis of affiliation, or more precisely its lack of affiliation with the MVPD, and (2) thereby unreasonably restrained its ability to compete fairly. *See id.* § 536(a)(3). The statute thus prohibits only discrimination on the basis of affiliation. It confers no protections based on the content of an unaffiliated network's programming....

Moreover, the Cable Companies do not—and, in light of the statute's legislative history, cannot—claim that the purpose of § 616(a)(3) and (5) is to suppress any particular message or idea. Congress's concern in enacting the statute “was not with what a cable operator might say,” but with the possibility that, as a result of its bottleneck power and vertical integration with affiliated networks, “it might not let others say anything at all in the principal medium for reaching much of the public.” *Time Warner Entm't Co. v. United States*, 211 F.3d at 1317–18. Congress enacted § 616(a)(3) and (5) to minimize this threat, not to suppress any particular message or viewpoint. Such a purpose is not content based.

We reach the same conclusion with respect to the 2011 FCC Order's *prima facie* standard. Under that standard, an unaffiliated network may

show affiliation-based discrimination through (1) direct evidence or (2) circumstantial evidence that an MVPD treated it differently than a “similarly situated” affiliated network. 47 C.F.R. § 76.1302(d)(3)(iii)(B). In determining whether two networks are similarly situated, the FCC acknowledges that it examines the content of the networks' programming. *See id.* (stating that FCC considers, among other factors, “genre” and “target programming”). In light of this examination, the *prima facie* standard “ ‘might in a formal sense be described as content-based,’ “ but not as that term has been employed by the Supreme Court. *Cablevision Sys. Corp. v. FCC*, 649 F.3d at 717 (quoting *BellSouth Corp. v. FCC*, 144 F.3d 58, 69 (D.C.Cir.1998)). Not only is there “absolutely no evidence” that “the Commission issued its [*prima facie* standard] to disfavor certain messages or ideas,” but also the Cable Companies point to no specific content that the standard disfavors. *Id.*

That conspicuous omission from their argument is explained by a simple fact: the *prima facie* standard, like § 616(a)(3) under which it was promulgated, treats all content equally. Depending on the circumstances of a given case, *any* content may weigh in favor of or against a finding that an unaffiliated network is similarly situated to an affiliated network. But the standard does not itself favor or disfavor particular content. To illustrate, assume that an unaffiliated network devoted to sports files a § 616(a)(3) complaint against a cable operator. If the cable operator is affiliated with a sports network, the unaffiliated network's sports content will weigh in favor of a finding that it is similarly situated. Meanwhile, if the cable operator is not affiliated with a sports network, the unaffiliated network is less likely to be found similarly situated. In either instance, though, it is the cable operator's own content choice, not the government's, that determines whether the unaffiliated network's sports content is favored.

Thus, the *prima facie* standard may favor certain content in one case while disfavoring the same content in another case. But neither in its adoption nor in its operation does the standard reflect government “agreement or disagreement” with any particular ideas or viewpoints....

Where, as here, the government examines content to determine whether a regulation applies, with no indication that the regulation favors or disfavors any particular content, the concerns that compel strict scrutiny of content-based laws are not present. ... The program carriage regime expresses no government content preference for particular ideas or viewpoints. It simply prohibits MVPDs from discriminating against

unaffiliated networks similarly situated to the MVPDs' affiliated networks. As such, the regime is properly considered content neutral.

b. *Speaker Neutrality*

“[S]peaker-based laws demand strict scrutiny when they reflect the Government's preference for the substance of what the favored speakers have to say (or aversion to what the disfavored speakers have to say).” *Turner I*, 512 U.S. at 658. But “[s]o long as they are not a subtle means of exercising a content preference, speaker distinctions ... are not presumed invalid under the First Amendment.” *Id.* at 645.

Here, the program carriage regime reflected in § 616(a)(3) and (5) of the Cable Act and the FCC's *prima facie* standard does distinguish among speakers. Unaffiliated networks are favored because the regime affords protections to them that are not afforded to affiliated networks, *i.e.*, it prohibits affiliation-based discrimination that unreasonably restrains unaffiliated networks' ability to compete fairly....

In asserting that strict scrutiny is warranted here, the Cable Companies contend that all speaker-based regulations, regardless of whether they are grounded in a content preference, are presumptively invalid. The Supreme Court rejected this argument in *Turner I*. ... Indeed, in that case, the Court subjected a speaker-based regulation under the Cable Act to intermediate scrutiny precisely because it did not reflect a content preference.

...

Accordingly, because the program carriage regime is neither content based nor impermissibly speaker based, we subject it to intermediate scrutiny.

2. *Intermediate Scrutiny*

“[T]he intermediate level of scrutiny [is] applicable to content-neutral restrictions that impose an incidental burden on speech.” *Turner I*, 512 U.S. at 662. Such a restriction will be sustained under this standard if it (1) “advances important governmental interests unrelated to the suppression of free speech” and (2) “does not burden substantially more speech than necessary to further those interests.” *Turner II*, 520 U.S. at 189 (citing *United States v. O'Brien*, 391 U.S. 367 (1968)). The program carriage regime satisfies these two requirements.

a. *Important Government Interests*

The FCC submits that the program carriage regime serves two important government interests by promoting (1) fair competition and (2) a diversity of information sources in the video programming market. ... The government's "interest in eliminating restraints on fair competition is always substantial, even when the individuals or entities subject to particular regulations are engaged in expressive activity protected by the First Amendment." *Turner I*, 520 U.S. at 664. "Likewise, assuring that the public has access to a multiplicity of information sources is a governmental purpose of the highest order, for it promotes values central to the First Amendment." *Id.* at 663....

... When, as here, "the government defends a regulation on speech as a means to redress past harms or prevent anticipated harms, it must demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Id.* (alterations omitted) (quoting *Turner I*, 512 U.S. at 664 (plurality)). Thus, the FCC's determination that the program carriage regime protects against unfair competition and promotes diverse video programming sources must be based on "reasonable inferences" drawn from "substantial evidence." *Cablevision Sys. Corp. v. FCC*, 597 F.3d at 1311 (quoting *Turner I*, 512 U.S. at 666 (plurality))....

Applying these principles here, we begin by noting that the program carriage regime calls for a "case-by-case" assessment of the anticompetitive effect of an MVPD's purported discrimination against an unaffiliated network. 2011 FCC Order ¶ 33. To justify such a regime, the FCC "has no obligation to establish that vertically integrated cable companies retain a stranglehold on competition nationally." *Cablevision Sys. Corp. v. FCC*, 649 F.3d at 712. Rather, it must show a reasonable basis for concluding that some markets exist in which MVPDs have the incentive and ability to harm unaffiliated networks and that application of the program carriage regime will alleviate that harm. *See Turner II*, 520 U.S. at 195. The FCC has met this burden.

In reaching this conclusion, we are mindful that a law "impos[ing] current burdens ... must be justified by current needs." *Shelby County v. Holder*, 133 S.Ct. 2612, 2622 (2013) (internal quotation marks omitted). [The Court acknowledged a trend in the video programming industry over the past twenty years toward increased competition—especially from DBS providers, telephone companies, and OVDs—but noted that this trend has

not yet eliminated the need for government regulation of MVPDs' carriage decisions. The Court recognized that if this trend continues, it may one day eliminate the need for government intrusion. Despite the trend, however, the Court concluded that such a day has not yet arrived.].

The industry's current competitive posture presents "a 'mixed picture' when considered as a whole." *Cablevision Sys. Corp. v. FCC*, 649 F.3d at 712 (quoting *Cablevision Sys. Corp. v. FCC*, 597 F.3d at 1314). Cable operators may not be as dominant as they were in 1992 when Congress enacted the Cable Act. Nevertheless, cable operators continue to hold more than 55% of the national MVPD market and to enjoy still higher shares in a number of local MVPD markets....

Indeed, despite the Cable Companies' assertions to the contrary, the 2011 FCC Order cited substantial record evidence that cable operators maintain significant shares in various local markets and that vertical integration remains pervasive in the video programming industry. In particular, the 2011 FCC Order relied on the 2011 Comcast/NBCU Order, which points out that, as of mid-2010, Comcast held a more-than-60% share in certain major MVPD markets. Additionally, the 2011 Comcast/NBCU Order explained that the vertical integration of Comcast, the nation's largest cable operator and MVPD, with NBCU, the nation's fourth largest owner of programming networks, provides Comcast with an increased incentive and ability to harm unaffiliated networks.

From this record evidence, the FCC could reasonably conclude that cable operators continue to "have the incentive and ability to favor their affiliated programming vendors in individual cases, with the potential to unreasonably restrain the ability of an unaffiliated programming vendor to compete fairly." 2011 FCC Order ¶ 33....

The record also permitted the FCC reasonably to conclude that the program carriage regime would ameliorate the anticompetitive harm that vertically integrated cable operators pose to unaffiliated networks. Under that regime, when anticompetitive conduct is proved in a particular case, the FCC has the authority to order remedies appropriate to that case. The regime thus directly targets the threatened harm and provides the FCC with the means to redress it. In so doing, it promotes important government interests in fair competition and diversity of information sources in the video programming market.

b. *Narrow Tailoring*

To show that a regulation is narrowly tailored under intermediate scrutiny, the government need not demonstrate that the regulation is “the least speech-restrictive means of advancing the Government's interests.” *Turner I*, 512 U.S. at 662. It must, however, show that the “regulation promotes a substantial government interest that would be achieved less effectively absent the regulation.” *Id.* (internal quotation marks omitted). “Narrow tailoring in this context requires, in other words, that the means chosen do not burden substantially more speech than is necessary to further the government's legitimate interests.” *Id.* (internal quotation marks omitted).

The program carriage regime is carefully tailored to avoid placing any greater burden on MVPDs' editorial discretion than is warranted to promote competition and diverse programming sources. The regime prohibits only affiliation-based discrimination by MVPDs and only when such discrimination is shown to have an anticompetitive effect. It does not prohibit an MVPD from declining to carry an unaffiliated network because it opposes the views expressed by that network. It does not prohibit MVPDs from declining to carry an unaffiliated network for legitimate business reasons. ... Nor does it necessarily prohibit affiliation-based discrimination in competitive markets, where there is a showing that such discrimination has beneficial effects that are not anticompetitive. ... Moreover, the regime requires the FCC to evaluate individual unaffiliated networks' complaints on a case-by-case basis, and it demands proof of impermissible affiliation-based discrimination and anticompetitive effect before any restrictions are placed on the MVPD's carriage decision.

The Cable Companies nevertheless argue that the program carriage regime is not sufficiently tailored because neither § 616(a)(3) nor the *prima facie* standard established by the 2011 FCC Order explicitly requires an unaffiliated network to demonstrate that a purportedly discriminating MVPD possesses market power. The FCC responds that proof of market power is not necessarily a prerequisite to relief under the regime. ... The program carriage regime requires an unaffiliated-network complainant to make a case-specific showing that an MVPD “unreasonably restrain[ed]” its ability to “compete fairly,” 47 U.S.C. § 536(a)(3), and market power is generally a “significant consideration” under such a requirement, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885–86 (2007) (identifying market power as “significant consideration” in determining whether conduct is unreasonable restraint under § 1 of Sherman Act)....

Thus, on this facial challenge to the overall program carriage regime, we conclude that the regime's "unreasonable restraint" requirement renders it narrowly tailored so as not to burden more speech than necessary to advance the government's interests....

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### **III. Conclusion**

To summarize, we conclude as follows:

1. Section 616(a)(3) and (5) of the Communications Act of 1934, as amended by the Cable Television Consumer Protection and Competition Act of 1992, and the *prima facie* standard established thereunder by the 2011 FCC Order, are content and speaker neutral and, thus, petitioners' First Amendment challenge warrants intermediate, rather than strict, scrutiny. The challenged program carriage regime satisfies intermediate scrutiny because its case-specific standards for identifying affiliation-based discrimination (a) serve important government interests in promoting competition and diversity in an industry still posing serious competitive risks, and (b) are narrowly tailored not to burden substantially more speech than necessary to further those interests.

Accordingly, the petitions for review are DENIED . . . insofar as they raise a First Amendment challenge to the program carriage regime . . . .

### **NOTES AND QUESTIONS**

1. In *Comcast*, the concurring opinion stated that Section 616 of the Cable Act applies "only when a video programming distributor possesses market power." It also stated "[i]n today's highly competitive market, neither Comcast nor any other video programming distributor possesses market power in the national video programming distribution market." Does this render the Cable Act currently irrelevant? How should the court's approach to "market power" change with the rise of innovative OVDs like Netflix, if it should change at all? What about the merits of the conclusion that the only cable company in town lacks market power because there are alternatives that use different technologies (internet, satellite, etc)?

2. "Net neutrality," or "internet neutrality," refers very generally to a principle that the internet be open, without undue private restrictions on websites, platforms, contents, the types of equipment that can be attached to

it. At a high level of generality the concept is pleasing, but implementation has proven to be very difficult, in part because net neutrality can encompass so many things. Consider these definitions:

1. Absolute non-discrimination

- “Net Neutrality means that Internet service providers may not discriminate between different kinds of content and applications online. It guarantees a level playing field for all Web sites and Internet technologies.”
- Network neutrality is best defined as a network design principle. The idea is that a maximally useful public information network aspires to treat all content, sites, and platforms equally. This allows the network to carry every form of information and support every kind of application. The principle suggests that information networks are often more valuable when they are less specialized – when they are a platform for multiple uses, present and future.”
- “Net neutrality refers to the concept that a broadband network should operate without any restrictions on the kinds of equipment attached to it, or on the mode of communication allowed.”
- “a neutral Internet must forward packets [of digital information] on a first-come, first served basis, without regard for quality-of-service considerations.”

2. Limited discrimination without Quality of Service tiering (QoS)

- United States lawmakers have introduced bills that would allow quality of service discrimination as long as no special fee is charged for higher-quality service.

3. Limited discrimination with tiering

- This approach allows higher fees for QoS as long as there is no exclusivity in service contracts. The principle is this: “If I pay to connect to the Net with a certain quality of service, and you pay to connect with that or greater quality of service, then we can communicate at that level.”
- “This allows higher fees for quality of service as long as there is no exclusivity in service contracts. This means that nobody can have exclusivity to any site, but each site can pay to have higher qualities of service.”

Consider the following possibilities:

1. An Internet subscriber uses an automated system to download thousands of videos from the Internet, using 100 times as many resources as the average subscriber to that internet service provider's (ISP) system. The ISP responds by disconnecting the customer, placing a limit on the amount of data it can receive in a given time period, or charging it a higher price.
2. An ISP owns a television network or other subsidiary that earns money by transmitting video content, or perhaps owns a cable television company that transmits video content; it then shuts down a website that offers video content, such as Netflix.
3. An ISP shuts down a website that is relentlessly critical of the ISP's parent company.
4. In an effort to aid in the United State's "War on Terror," an ISP refuses to allow costumers with "anti-American" names to access websites that actively promote and encourage the destruction of the American government.
5. An ISP charges private universities a higher price to access the Internet than it does public universities.

In "Preserving the Open Internet and Broadband Industry Practices,"<sup>3</sup> the Federal Communications Commission adopted guidelines for internet service providers and other members of the internet industry:

1. "Transparency. Fixed and mobile broadband providers must disclose the network management practices, performance characteristics, and terms and conditions of their broadband services;"
  - a. "A person engaged in the provision of broadband Internet access service shall publicly disclose accurate information regarding the network management practices, performance, and commercial terms of its broadband Internet access services sufficient for consumers to make informed choices regarding use of such services and for content, application, service, and device providers to develop, market, and maintain Internet offerings."
  - b. The FCC requires broadband providers to disclose: Congestion management practices, application-specific behavior practices, device attachment rules, security practices, service description, impact of specialized services description, pricing, privacy

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<sup>3</sup> Currently available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/FCC-10-201A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-201A1.pdf).

policies, and redress options

2. “No blocking. Fixed broadband providers may not block lawful content, applications, services, or non-harmful devices; mobile broadband providers may not block lawful websites, or block applications that compete with their voice or video telephony services; and”
  - a. The rule only protects lawful content. This rule entitles users to use any device to connect to the network, so long as the device does not do any harm to the network. ...
3. “No unreasonable discrimination. Fixed broadband providers may not unreasonably discriminate in transmitting lawful network traffic.”
  - a. “A network management practice is reasonable if it is appropriate and tailored to achieving a legitimate network management purpose, taking into account the particular network architecture and technology of the broadband Internet access service.”...

The purpose of these rules are to “ensure the Internet remains an open platform— one characterized by free markets and free speech—that enables consumer choice, end-user control, competition through low barriers to entry, and the freedom to innovate without permission.”

The FCC concluded that had jurisdiction to establish these rules under the Communications Act and the Telecommunications Act of 1996; that the rules do not violate the First Amendment (because they are content neutral) and do not constitute a Taking under the Fifth Amendment.

The FCC concluded the benefits of keeping the Internet open far exceeds the costs. Internet interference would slow or break the cycle of innovation and would cause harms “that may be irreversible or very costly to undo.” Internet openness can solve this problem by reducing the risk of harm as well as allowing end users unfettered access to information. The costs of keeping the Internet open are very small. “Our rules against blocking and unreasonable discrimination are subject to reasonable network management, and our rules do not prevent broadband providers from offering specialized services.”

The rules apply to “broadband Internet access service.” And apply only “to the provision of broadband Internet access service and not to edge provider activities, such as the provision of content or applications over the

Internet.” The rules do not apply “to dial-up Internet access service because telephone service has historically provided the easy ability to switch among competing dial-up Internet access services.” Lastly, the rules do not apply to coffee shops, Internet cafes, bookstores, or “other entities when they acquire Internet service from a broadband provider to enable their patrons to access the Internet from their establishments.”

3. *Limits on the FCC’s Power to Enforce Network Neutrality Policy.* In *Comcast Corp. v. Federal Commns. Comm’n* 600 F. 3d 642 (D.C. Cir. 2010) the D.C. Circuit imposed significant limits on the FCC’s ability to enforce its adopted net neutrality policies. The Communications Act of 1934 grants the FCC ancillary authority to “perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with [the Act], as may be necessary in the execution of its functions.” 47 U.S.C. § 154(i). The FCC may exercise this “ancillary” authority only if it demonstrates that its action is “reasonably ancillary to the . . . effective performance of its statutorily mandated responsibilities.” In 2007 several subscribers to Comcast’s high-speed Internet service discovered that the company was interfering with their use of peer-to-peer networking applications. When the FCC intervened the D.C. Circuit held that the FCC lacked the ancillary authority to regulate Comcast’s network management policies. The court based its decision on a two-part test for ancillary jurisdiction:

The Commission ... may exercise ancillary jurisdiction only when two conditions are satisfied: (1) the Commission’s general jurisdictional grant under Title I [of the Communications Act] covers the regulated subject and (2) the regulations are reasonably ancillary to the Commission’s effective performance of its statutorily mandated responsibilities.

The court found that the FCC had erroneously relied on statements of its own policy which were unable to “anchor the exercise of ancillary authority” instead of relying on statutorily mandated duties. Declarations that “the policy of the United States . . . [is] to promote the continued development of the Internet,” 47 U.S.C. § 230(c)(2), or the FCC’s mandated goal of providing “a rapid, efficient, Nation-wide, and world-wide wire and radio communication service,” 47 U.S.C. § 151, are able to “shed light on any express statutory delegation of authority” but are unable to provide such authority on their own. The court further held that, had it allowed the FCC

to proceed with such regulation in the absence of explicit Congressional support, it would have acted to “virtually free the Commission from its congressional tether” and that there would then be few regulations that the FCC would be “be unable to impose upon Internet service providers.”

Prior to *Comcast* the courts had generally held that the FCC’s ancillary jurisdiction allowed it to pursue basic broadband policies by ensuring transparency, protecting consumers’ privacy, ensuring that persons with disabilities have access to broadband, protecting against cyber-attacks, and preserving the free and open Internet. *American Library Ass’n*, 406 F.3d at 694-96. Now, the FCC’s ancillary authority is more limited than previously thought, requiring the Agency to develop additional legal frameworks that will comply with the *Comcast* decision.

On the ways available to the FCC control the internet and possible legal limitations, see Tim Wu, *Agency Threats*, 60 DUKE L. J. 1841 (2011). What if the regulation is of content (such as limiting pornography) rather than economic structure? See Daniel A. Lyons, *Virtual Takings: The Coming Fifth Amendment Challenge to Net Neutrality Regulation*, 86 NOTRE DAME L. REV. 65, 92-114 (2011); Hannibal Travis, *The FCC’s New Theory of the First Amendment*, 51 SANTA CLARA L REV 417 (2011).

4. Unlike general ISPs (internet service providers), *mobile* service providers such as Verizon and AT&T have significant discretion to decide whether or not to allow certain mobile applications on their cellular devices. At this writing this position is being challenged for “fail[ing] to protect wireless users from discrimination, and ... let[ting] mobile providers block innovative applications with impunity.” Josh Levy, *Net Neutrality: What’s Mobile Got to Do With It?* (2011), <http://www.savetheinternet.com/blog/11/09/30/net-neutrality-whats-mobile-got-do-it>.

Does a mobile service provider who allows consumers to access the Internet on its devices have an obligation equivalent to that of a traditional ISP to provide open access to the Internet? Do you think the same underlying consumer protection and open Internet policies will apply in this case or will the mobile service provider’s role as the “middle man” be enough to allow for greater discretion? For example, should the maker of a Smartphone such as Apple be able to block an internet application such as Skype, which might enable a customer to completely bypass the user’s

subscription for cellphone minutes when a wi-fi internet connection is available? Would antitrust law be a better way to deal with such problems?

3. Good writing on the internet as a public forum includes Derek E. Bambauer, *Orwell's Armchair*, 79 UNIV. CHI.L.REV. 863 (2012); Brian Leiter, "Cleaning Cyber-Cesspools: Google and Free Speech," in SAUL LEVMORE AND MARTHA C. NUSSBAUM, EDS, *THE OFFENSIVE INTERNET: PRIVACY, SPEECH, AND REPUTATION* 155 (2010).