Economists Incorporated
Economists INK
SUMMER 2017
A BRIEF ANALYSIS OF POLICY AND LITIGATION

Tenth Circuit Rules in Suture Express About Alleged Illegal Tying

Stephanie M. Mirrow

Stephanie M. Mirrow has worked on numerous cases involving claims of monopolization, including bundling allegations. She previously was an economist in the Antitrust Division of the U.S. Department of Justice.

The Tenth Circuit recently upheld a district court ruling for Owens & Minor Distribution (O&M) and Cardinal Health in a lawsuit brought by Suture Express. Suture Express alleged the defendants had engaged in illegal tying of suture-endo products through their use of bundled discount programs. The Tenth Circuit agreed with the district court's dismissal of these claims, citing persuasive evidence that O&M and Cardinal lacked the market power needed to force a tie. The Tenth Circuit also concluded that Suture Express did not show antitrust injury.

The Tenth Circuit saw no reason why a consideration of market power would not be relevant in a rule of reason analysis, and it assumed "without deciding that a showing of tying market power is required under the rule of reason." Suture Express argued that Cardinal's and O&M's shares of 31% and 38%, respectively, should be enough to survive a summary judgment under the rule of reason. However, the Tenth Circuit found that these market shares are "insufficient to counteract the other market realities present here that point to increased competition and lower prices." Specifically, the Tenth Circuit cited evidence showing sales growth by other distributors and shrinking margins for O&M and Cardinal as inconsistent with the claim of market power. Additionally, the Tenth Circuit found that the bundled contracts had other possible explanations, and that bundle-to-bundle competition can result in a competitive marketplace.

Suture Express also argued that its expert's discount attribution test showed 77% of defendants' customers with bundled discount programs had incremental prices on suture-endo products that were below cost. However, the Tenth Circuit indicated it could find no support in the case law for using the discount attribution test to show coercion by a non-monopolist. (It contrasted the facts in this case to those in Eastman Kodak and PeaceHealth, where defendants were found to have market power.)

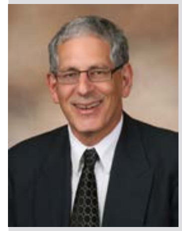
The Tenth Circuit further concluded that Suture Express failed to show antitrust injury. The Tenth Circuit cited evidence that almost half the suture-endo market was not constrained by bundled discount programs, but less than half of these unconstrained buyers purchased from Suture Express.

This decision affirms the principle that market share alone is not sufficient to establish market power. This decision also may have important implications for how courts treat claims of below-cost bundled discounts, as it reinforces the need to show market power and harm to competition as part of these claims.

Also In This Issue

Can Commercial Speech Be Exclusionary Conduct?

Robert D. Stoner



Robert D. Stoner was previously a manager in the FTC's Bureau of Economics and has provided expert assistance in many exclusionary conduct cases since joining Economists Incorporated.

The U.S. Supreme Court recently denied Retractable Technology Inc.'s ("Retractable's") writ of certiorari seeking to reverse the Fifth Circuit's decision rejecting its monopolization claim against competing syringe maker Becton, Dickinson and Co. ("Becton"). The Fifth Circuit had held that commercial speech does not constitute exclusionary conduct in a Sherman Section 2 monopolization case and reversed a previous $340 million treble damages jury verdict against Becton. Retractable alleged that Becton attempted to monopolize the U.S. market for certain safety syringes by making false claims that its needles were the "world's sharpest" and had "low waste space." (Safety syringes are designed to prevent the transmission of blood-borne diseases through accidental needle sticks.)

The Circuit Court panel that overturned the lower court verdict found that while false advertising was undisputed on appeal, the conduct could not support an antitrust claim, since it did not result in any lasting harm to competition or to the ability of other firms to enter the syringe market. The false advertising caused Retractable to lose sales, but it remained a vigorous competitor. Retractable, supported by amicus briefs from a committee of primarily plaintiff-oriented law firms, a number of law and economics professors, and several groups of inventors, argued for certiorari by claiming there was a well-defined circuit split on whether false commercial speech can violate the Sherman Act. Becton maintained that the appeals court correctly held that false commercial speech is not anti-competitive conduct.

"The Fifth Circuit had held that commercial speech does not constitute exclusionary conduct in a Sherman Section 2 monopolization case."

The Fifth Circuit decision, delivered in December 2016, made a number of arguments in striking down the jury verdict against Becton. The major contested issue was the false advertising count (there were also counts related to patent infringement and "tainting" the market). The opinion stated that "false advertising is a slim, and here nonexistent, reed for a § 2 claim." Several reasons were given, based on prior case law. First, even if comparative sales pitches are erroneous or misleading, the Court argued they are still competition on the merits that constitute attempts to persuade buyers to favor one product over another. False claims, the Court stated, can be mitigated by rivals who can counter-advertise to persuade consumers, who will make the eventual buying decision. Such false claims do not directly restrain rivals, given consumers' ability to ignore them or be persuaded by counter-advertising. In this view, far from restricting competition, the Court found that false or misleading advertising "sets competition in motion," allowing the maligned competitor to "counter with its own advertising to expose the dishonest competitor and turn the tables competitively against the malefactor."

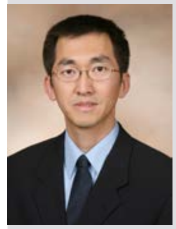
Moreover, the Court stated that it will often be difficult to determine if buyers attached any weight to the false claims or were persuaded by them in any way, a necessary pre-requisite to a finding of anticompetitive effects. Such an impact was found to be particularly unlikely in the syringe market, where the relevant consumers were viewed as sophisticated hospitals and group purchasing organizations (GPOs) who had experience with competing products. The Court observed, for example, that no customers stated that their purchases were motivated by Becton's false claims. Therefore, the Court was comfortable following previous circuit court precedent adopting "a rebuttable presumption that false advertising has only a de minimis effect on competition." To overturn that presumption and support an antitrust claim based on false advertising, plaintiffs would need to meet a six-part test first suggested in the Areeda and Turner antitrust treatise. The test requires that the advertising statements issued must be (1) clearly false, (2) clearly material, (3) clearly likely to induce unreasonable reliance, (4) made to unsophisticated parties, (5) continued for long periods, and (6) not readily cured by rivals. This test was proposed to distinguish ordinary false advertising torts from a course of conduct that could conceivably exclude competition.

On that basis, the Fifth Circuit upheld the de minimis presumption, not only based on sophistication of customers, but also because the court found that the false

continued on page 4

IWNCOMM v. Sony: Recent Development in FRAND Litigation in China

Su Sun



Su Sun has worked on antitrust and IP matters both in the U.S. and in China. He consulted for IWNCOMM on the licensing of its WAPI standard essential patents.

In the past few years, several commercial disputes concerning the licensing of standard essential patents (SEPs) have been litigated in Chinese courts. In March 2017, the Beijing Intellectual Property Court (the Court) ruled for the plaintiff in a case involving SEP licensing, *IWNCOMM v. Sony* (China). This case marks the first time an SEP-based injunction was granted in China. Treble damages were also awarded to the plaintiff SEP holder.

The plaintiff, IWNCOMM, owns a patent that is essential to China's national standard GB 15629.11 for wireless local area network (WLAN). The GB 15629.11 standard's security protocol adopts the WLAN Authentication and Privacy Infrastructure (WAPI) technology, developed by IWNCOMM. IWNCOMM had announced it would license its SEPs to any implementer on fair, reasonable and non-discriminatory (FRAND) terms. IWNCOMM and the defendant, Sony (China), engaged in licensing discussions from March 2009 through March 2015 and could not reach an agreement. Subsequently, IWNCOMM filed a lawsuit against Sony before the Court, alleging that Sony's 35 models of mobile handsets that required WAPI testing to be sold in China infringed its SEP. Sony failed in challenging the validity of the patent and on jurisdictional issues in earlier proceedings. The Beijing Intellectual Property Court's 2017 decision addressed the liability and damages issues. The Court determined that Sony committed both direct and contributory infringement, and rejected Sony's defense based on patent exhaustion and Sony's claim that the licensing of the SEP was implicitly granted by the mandatory national standard.

> " The Court's decision . . . affirms the emerging global consensus that injunctive relief is reserved against unwilling licensees in SEP licensing disputes. "

Article 66 of China's Patent Law allows for an injunction as part of the patent infringement remedies. The Court noted that in China's current legal framework, injunctive relief in patent infringement cases is generally applicable. The court also noted that when the relevant patents were SEPs and the patent holder had made FRAND commitments, implementing the SEPs was reasonable. However, the prerequisite for such reasonableness is good will negotiations between the parties. If no one is at fault, or if only the patent holder is at fault, then injunctive relief should not be supported to avoid possible abuse of the SEPs. If the patent holder is not at fault but the implementer is at fault, then injunctive relief should be supported to avoid possible reverse hold-up. If both are at fault, then the injunction decision rests on the balancing of the two sides' interests and the degrees to which they are at fault. Such reasoning is consistent with the "Second Judicial Interpretation of the Legal Issues in Patent Infringement Cases" issued by China's Supreme People's Court in 2016. In this case, the Court determined that the defendant willfully delayed the negotiations and was at fault during the six years of negotiations. In particular, the Court noted that the defendant kept asking that the plaintiff provide the detailed patent claim chart without being covered by a confidentiality agreement. The Court determined that the defendant's insistence on the patent claim chart was unreasonable given that WAPI had been a national standard, and the plaintiff had already provided sufficient documents for the defendant to determine whether their products infringed the relevant SEP. Moreover, the plaintiff's insistence that it would provide the claim chart only under a confidentiality agreement was reasonable. As a result, the Court granted injunctive relief for the plaintiff.

The plaintiff asked for a royalty rate of 1 CNY (about 0.15 USD) per device. To support its position, the plaintiff submitted four licensing agreements with third parties where the royalty rate was 1 CNY per device. The defendant argued that those licensing agreements were not comparable because they were based on a portfolio of SEPs for the WAPI standard, but there is only one relevant patent in this case. The defendant submitted some U.S. court decisions on Wi-Fi royalty rates to prove that the 1 CNY per device rate the plaintiff asked for was inconsistent with the FRAND principles. The Court decided that the patent portfolios in

continued on page 4

Commercial Speech

advertising claims were not shown to be "clearly likely to induce unreasonable reliance," and there was no showing that the false claims could not be readily disproved. The Court noted that there appeared to be no harm to competition, since Retractable continued to compete in the larger market and had a share as high as 67% in the safety syringe "sub-market," and several other competitors also provided robust competition. Moreover, according to the Fifth Circuit, Retractable's economic expert, who argued that Retractable should have had an even higher share, could not substantiate any causal connection between Becton's false advertising and its sales. The Court further noted that no customers testified they were misled and confused, and record evidence indicated that one customer, Walgreens, increased its purchases of Retractable syringes after being shown one of Becton's erroneous claims.

Retractable, along with the amici, argued for certiorari on a number of grounds. First, they presented evidence that Circuit Court decisions are actually very divided on the issue of whether and when deception can lead to an antitrust claim, with decisions ranging from "never" to "when some or all of the elements of the Areeda-Turner 6-part test are met," to "based on a rule of reason such as would be applied to any other type of exclusionary conduct." These different standards needed to be resolved, it was stated, since deceptive commercial speech is not (and was not claimed to be) protected by the First Amendment.

Second, Retractable and Amici argued that false advertising cannot be viewed as "competition on the merits," even if it produces counter-advertising and increased competition in the advertising market to correct the mis-information. That is particularly the case when the deception is by a dominant firm that targets a smaller competitor, because a smaller rival might have fewer resources to counter the dominant firm's advertising. Thus, the false advertising would increase the smaller firm's costs and erect barriers to its expansion. Competition on the merits, according to this line of argument, involves developing a superior product or service, not inhibiting market participants from being fully informed so as to make efficient buying decisions. Furthermore, an important element of a competitive market is that market participants are fully informed of relevant economic and technological data. Amici argue that dishonest commercial dealings can drive out honest dealing if honest-dealing entrants are put at an asymmetric disadvantage.

Third, Amici argued that there should not be rules or presumptions against deception-based antitrust claims because recent scholarship has shown that deception can injure competition (not just competitors) where rivals' costs are raised and competitive opportunities abridged. According to this argument, the proper mode of analysis is a rule of reason based on the facts in each specific case.

Nonetheless, with no comment, the Supreme Court last month declined to hear Retractable's appeal asking for the reinstatement of the award on antitrust and false advertising claims against Becton. The 5th Circuit opinion stands.

FRAND Litigation

the four licensing agreements were all related to the WAPI technology standard and the core patent was the one in the current case. Thus, these four licensing agreements were comparable to the current situation, and the royalty rate of 1 CNY per device could be used as a benchmark for this case. The Court did not consider the U.S. decisions on Wi-Fi royalty rates to be relevant to this case because they did not involve the WAPI technology.

Article 65 of China's Patent Law provides a framework for determining damages from patent infringements. Several bases for estimating damages are given in order of preference: (1) actual losses suffered by the patentee, (2) profits illegally gained by the infringer, (3) multiples of licensing royalty, and (4) statutory damages. Article 65 also allows damages to include reasonable expenses. In this case, neither party submitted evidence regarding actual losses or illegal gains. Given the foundational nature of the patent involved and that the defendant was at fault, the court accepted the plaintiff's request and calculated damages to be equal to three times the licensing royalty based on the government records of the number of Sony's mobile handsets sold in China from 2010-2014 and the 1 CNY per device royalty rate shown in the four comparable licenses, plus attorney fees and other reasonable expenses. The total damages amounted to more than nine million CNY, or about 1.4 million USD.

The Court's decision in IWNCOMM v. Sony affirms the emerging global consensus that injunctive relief is reserved against unwilling licensees in SEP licensing disputes. The decision also sheds light on some other important issues, such as what constitute comparable licenses and how damages might be determined in FRAND litigation before Chinese courts.

EI News and Notes

Judge Dismisses Antitrust Case

A judge recently dismissed an antitrust case against the International Longshore and Warehouse Union (ILWU). Robert D. Stoner, EI Principal, testified at deposition on liability on behalf of the ILWU. The principal allegations by plaintiffs were that the 2008 collective bargaining agreement between the ILWU and the Pacific Maritime Association (PMA) constituted an anticompetitive agreement that prohibited plaintiff contractors affiliated with non-ILWU labor from bidding on crane maintenance and repair projects in West Coast container ports. Dr. Stoner's analysis showed that plaintiffs had neither defined proper antitrust markets nor properly assessed present competition in those markets, that entry (and expansion) had occurred and was easy, and that any potential anticompetitive effects were far outweighed by efficiencies emanating from port automation that was contingent on the labor agreement. Dr. Stoner was assisted by EI Senior Economist Erica Greulich. The ILWU was represented by Leonard Carder LLP.

Ruling in Case Related to AIG Bailout

The U.S. Court of Appeals for the Federal Circuit reversed the trial court's liability ruling in a case where plaintiffs argued that the federal government acted illegally when it bailed out AIG in 2008. The case, Starr International Company Inc., et al. v. United States, was brought by former AIG CEO Maurice Greenberg on behalf of shareholders. The trial court ruled that the government was liable for illegal exaction, but that damages were zero because AIG equity would have been worthless without the government's action. The appeals court vacated the liability ruling. EI Principal Jonathan Neuberger offered damages testimony on behalf of the government in the original trial in the U.S. Court of Federal Claims.

EI Named Leading Competition Practice

Global Competition Review (GCR) has again included Economists Incorporated in its annual survey of the world's leading competition economic practices. GCR uses "a variety of criteria to select the consultancies, including size, visibility, historical pedigree, the presence of leading economists, and recent success."

Economists
INCORPORATED

OFFICES:

2121 K Street, NW
Suite 1100
Washington, DC 20037
phone: (202) 223-4700
fax: (202) 296-7138

101 Mission Street
Suite 1000
San Francisco, CA 94105
phone: (415) 975-5510
fax: (415) 281-9151

1276 Metropolitan Blvd.
Suite 303
Tallahassee, FL 32312
phone: (850) 558-6030

www.ei.com

President
Jonathan L. Walker

Editor
Henry B. McFarland

in association with
The Allen Consulting Group in Australia