Intellectual Property Rights, And Competition Law
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Lecture - 21
Market Allocation and IPR

Dear students, We will discuss in this particular class Market Allocation and IPR, how the market allocation is affecting competition in the market. Whether the patent holders or patent owners are using their intellectual property to control the geographical market, whether the big stores controlling or dividing the geographical market and putting unnecessary conditions on the distributors or the retailers. We will see different examples even some of the cases on “study materials” where you combine together some of the very good study materials and then you increase the prices.

Market allocation is one of the very important part of controlling the market and the competition law takes allocation of the markets very seriously.

So, if any of the companies want to allocate market; for example, this particular dealer can deal only in that particular market and nobody else can do the same business. They restrict it through different licensing agreements, then the court looks into the licensing provisions for violation of any of the provisions of the Sherman Act.

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In this class we will look into the market allocation and IP, then some of the horizontal agreements affecting the competition law.

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The first case of market allocation is *Hartford empire company versus US case* in 1945. One of the early cases. Here the companies combined together to exploit the patents for automatic glass making machinery, these two companies owned around 94 percent of the complete glass manufacturing.

Glass manufacturing means not only the glass, but glass bottles as well. These two companies were responsible for all the materials which were made using glass in these machineries, these two companies had the patents for automatic glass making machineries. So, if anybody wanted to engage into this particular business they had to take license from this particular company, Hartford empire company.

In 1938 this particular company controlled 100 patents. Remember in 1938 they controlled 100 patents, they pooled it together and they cross-licensed many of these technologies and thus they effectively controlled the particular market. Remember during 1938 intellectual property was not developed as of today.

So, they effectively controlled 100 patents and completely controlled 94 percent of the market, they controlled the glass containers manufacturing, the entire glass manufacturing industry was controlled, the machinery was controlled by this particular company.

So one company through pooling and cross licensing controlling 100 patents, they do not want anybody to come to their business. So, the question is whether they are discouraging anybody from coming into the market in glass making machinery. At the same time through these licensing agreement whether they are allocating the markets? Whether these licensing agreements are anti-competitive in nature?

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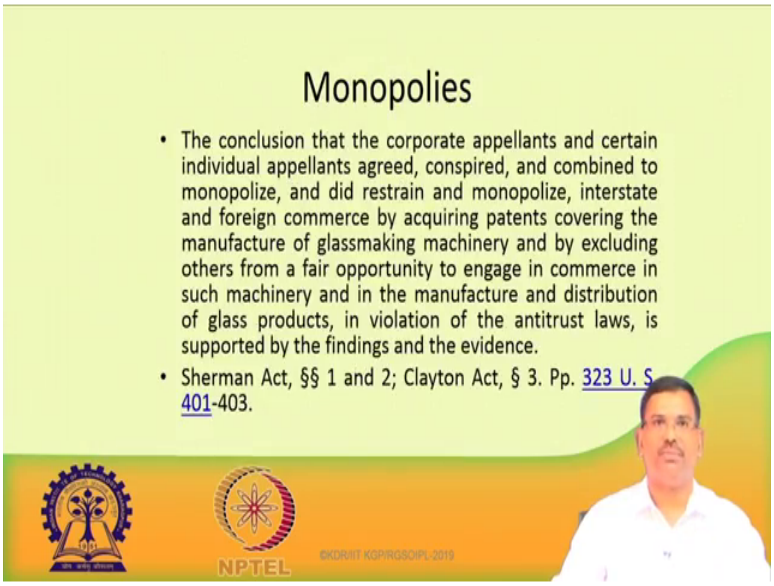

The court looked into these issues and came to the conclusion that the appellants agreed, conspired, combined together to monopolize and restrain interstate trade and also the foreign commerce by acquiring patents. As I told you in the earlier class that patent pools can have a pro-competitive effect and anti-competitive effect as well.

Here the court found that these patent pools have anti-competitive effects as far as the manufacturing of glass making machinery is concerned and they are excluding all others from this particular business and no fair opportunity is being given to anybody in these machinery manufacturing and distribution of glass products. So, the court finally held that this is absolute violation of Sherman Act Section 1 and 2 and the Clayton Act Section 3.

You can see that this company is controlling 100 patents, it means that the competition authorities will look into such situation. Because unless and until it has a highly pro-competitive effect, the authorities are going to look into this with a suspicious eye of competition law.

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Here the market allocation happened through licensing agreements. So, here you can see that these licensing agreements are with restrictive conditions.

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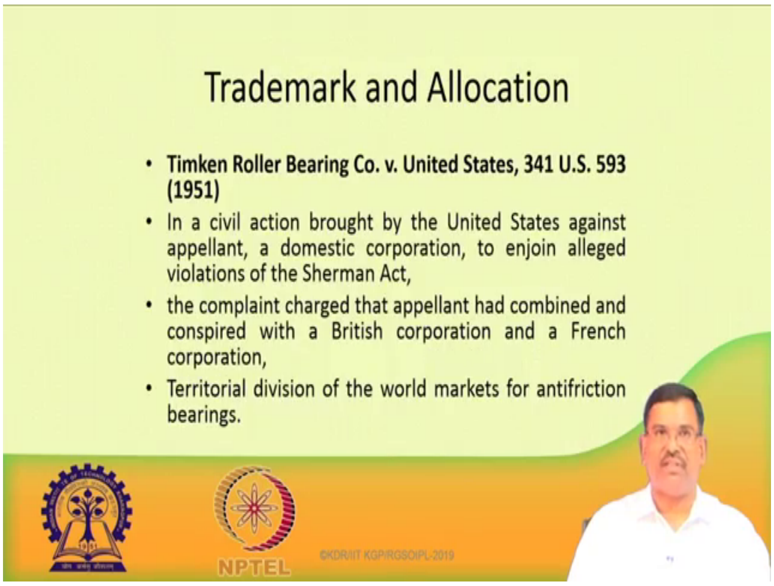

We can find that these restrictive conditions definitely violate the Sherman Act. We come to another case i.e. *Timken Roller Bearing Company versus United States* 1951 case. Here a civil action was filed against this particular company, a domestic corporation for alleged violation of the Sherman Act.

The two corporations conspired with the British corporation and French corporation to control the market. So, what they did is that they divided the territorial market all over the world; the world market. They were making bearings, anti-friction bearings. So, they divided the whole world market geographically. So, the question is can you sitting somewhere in the United States or India or somewhere in China control the world market by allocating particular markets? We will see some of these cases, very interesting cases.

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Here we can see that every company has a financial interest and the objective of every company is to increase the profits, whether it is in the domestic market or it is in the foreign market. Now, the markets have become very small and everybody is looking into international trade. So, the globe became very small and everybody is exporting their materials, manufacturing.

So, here they divided the complete market. The district court found that the agreement between these corporations to allocate trade territories all over the world violates the Sherman Act.

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So, here the allocation of territories happened through these licensing agreements and they fixed the prices according to the geographical markets, non-uniform prices. Prices were fixed according to geographical markets and they co-operated the licensing agreements, through the licensing agreements they co-operated each other to protect other markets and eliminate outside competition. So, other people, other competitors cannot enter the particular market of bearings and more over they entered into cartels to restrict imports and exports from United States.

So, whether you do business within the territories or outside the territories it does not matter, they are going to look into the activities where any of the particular provisions are violated. Here fixing world territories clearly violated the Sherman Act.

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So, if there is no trade restraint then there is no violation of Sherman Act. Joint venture; you can very well make a joint venture, but the objective must be very clear and "this is just incidental" argument is not going to work every time. And also we can, the agencies can look into the decision making of the companies ,who is the director and what kind of decisions he is taking and common ownership and control of different corporations, different corporations can form cartels.

That is why I said if two corporations form a joint venture, whether it is a cartel or not will be decided by the competition authorities. So, the common ownership and control of corporations is also not prohibited, but their activities must be very clear, the competition authorities can very well look into what are the activities of this corporation after and before the merger or acquisition that has happened.

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So, if you look into the United States we can find big supply chain, big stores like Walmart or Spencer or KFC or other marts. This is a supply chain case *United States versus Topco Association Inc.,*1972. Here we can see that an association of dealers *Topco association* which is its brand name, it is a corporative association of 25 small and medium size independent regional super market chains operating in 33 states of Unites States.

They have a lot of customers and more than 1000 items. This brand is always owned by Topco. The stores are all over 33 states of the United States. So, if it is a chain of stores then definitely the franchising or the licensing agreements are going to be very strict.

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In 1967 their market share was 2.3 billion, so; that means, they are fourth, only three other national grocery chains have more than their business. So, definitely they have a market power under the competition law. And also their average market share is 6 percent and competitive position is very strong because it is a chain of stores.

And the Topco stores common stock, voting stock, selection of directors, selection of managers. They completely control the association's operations as well of the people those who are involved in this. They control the activities and take decisions as well.

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The Topco bylaws very clearly said that the agreement are exclusive category territorial licenses. Why there is territorial licenses? Topco says that if there is no territorial licenses they cannot continue with their business, because if too many Topco stores are going to be allowed in a particular region, then the business is not going to be profitable.

So, they divided different geographical markets, and so territorial licenses were issued. As I told you two other membership categories are also there, their exclusive membership categories. So, one person cannot sell any product outside this particular territorial market and expansion of one member to the other member’s territory is absolutely prohibited. So; that means, if you want to extend your business to the other member’s territory you have to take a prior consent.

So it means that a new member cannot enter into the territory of another member and start business. You require a prior permission of Topco and the other member because the members itself control this particular association. So, here the competition is severely curtailed within the territorial limits because this association will decide, they will make sure that this one person is not encroaching upon the territory of the other person. So, the territorial market restrictions are put.

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Topco put restrictions on the whole sale business as well as the retail business. Retail business is specific to that particular geographical area and the Topco members are completely prohibited from selling any products supplied by the association at whole sale. And also special permission is required, they cannot use the Topco trademarked product without securing special permission.

So; that means, without consent nobody can do business in the name of Topco. And a new member entering into the retail business must agree to the restrictive licensing provisions of Topco and Topco product can be only sold in that particular geographical area under the terms and conditions put by the Topco association. So, it means they geographically distributed and operated in all the states and one dealer cannot overlap into the other dealer, there is a restriction on whole sale business as well, so there are restrictions all over.

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So, the market power restrictions are there. So, the government alleged that dividing the market was violative of the Sherman Act because it prohibits competition, Topco brand competition, Topco brand products among grocery items. So, no person can enter into this particular grocery, Topco grocery business where already there is a Topco shop unless until Topco is giving a permission.

And also there are restrictions on retail as well as whole sale business. So, this is a violation of the Sherman Act, this was the allegation. But the Topco contended that the entire business depends upon the geographical division and if exclusive geographical division goes, if this exclusively goes their businesses are going to be in loss and they are going to lose the business. Topco, as I told you, is very specific with regard to the Topco brand.

So, the Topco brand enabled these stores to sell these particular products and that these restrictions are necessary to compete with larger stores. This was the justification by the Topco.

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But the court held that the Topco scheme of allocating territories and minimising competition to virtually no competition at the retail level as well as at the whole sale level is a horizontal restraint. So, it is per se violation of Section 1 of the Sherman Act.

And the court also held that the district court has erred in its decision to restrict the practices which involves the rule of reason application. So, Topco's limitation upon reselling, retailing, wholesale is per se the violation of Sherman Act. So, even if you are selling under a single brand you cannot put restrictions, the market must be competitive. Even if the same brand products are being sold the market should be open. So, the conditions about dividing the geographical markets are absolutely against the competition law or the Sherman Act.

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The restrictions in the name of competing with the larger stores are not going to be sustainable. These are going to increase the competition is also not sustainable. The court never accepted these particular arguments of Topco. The area divisions are also prima facie considered to be per se violation of the Sherman Act.

Very importantly the court said that if the members are not adequately promoting Topco brands then you can terminate the members. Most importantly this district court judgement was affirmed by the Supreme Court in 1973. So, once you give the franchise or if you are entering into exclusive licensing agreement of any brands, any top brands, any top trademarks then you have to be very careful, there must be pro-competitive provisions, there cannot be anti-competitive provisions.

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We talked about trademark now we will see copyright, how the copyright intellectual property protection is going to cross with the competition law. Earlier I mentioned about the reading material, *palmer versus BRG of Georgia* is a 1990 case. Here the respondents are BRG of Georgia Inc, Harcourt Brace Jovanovich Legal and Professional Publications These people entered into an agreement.

An exclusive license to publish and market HBJ i.e. publisher's trade name. And at the same time publisher agreed not to compete with BRJ in Georgia and BRG agreed not to compete with HBJ outside the state. So, it was mutual, that you do not come here and we will market your products so that I have the exclusivity in this particular region and outside the state you can go and market and we do not have any problem. So, this was discussed in this particular case.

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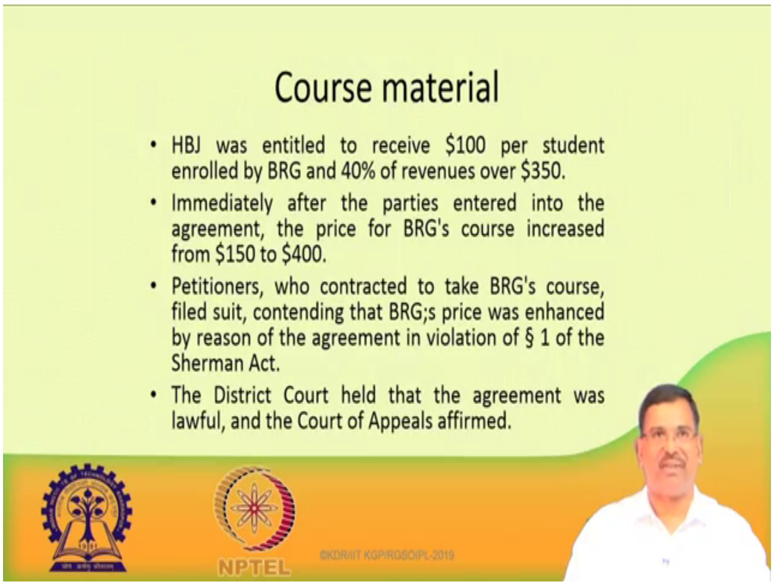

If you look into the transaction, the licensing agreement immediately after the parties entered into the agreement the prices of course material increased from 150 dollars to 400. It means more than double. Whether this violates any of the competition provisions? If two people come together and fix the prices very high then there is no competition.

So, they argued that the price for the course materials was enhanced by reason of agreement. The main allegation was that the prices increased from 150 to 400 dollars are violation of the Sherman Act, violation of Section 1 of the Sherman Act. The district court held that the agreement was lawful because this is a copyrighted material and even the court of appeal affirmed that you can sell the copyrighted material according to your prices because the material is a copyrighted material protected by intellectual property law, so you can put your own price.

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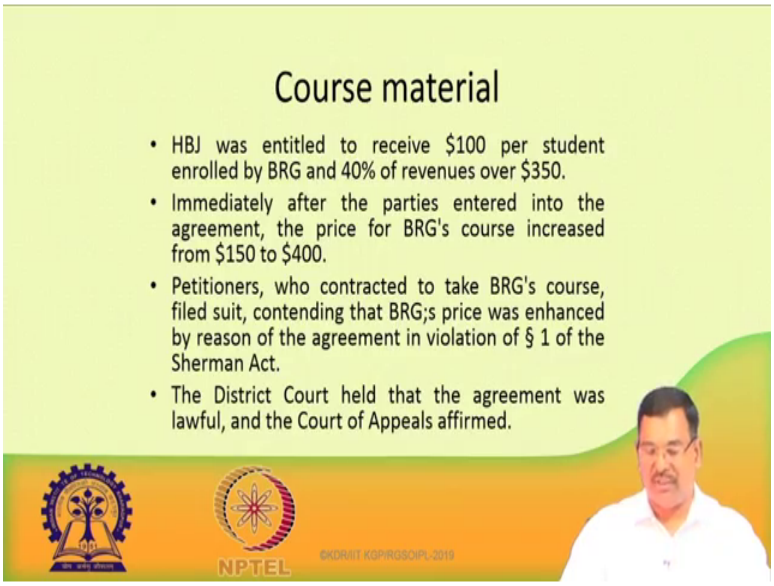

But the provisions of the agreement to divide the geographical area for example I am not going to come to your region, but at the same time you do not come to my region. The provisions of the agreement are revenue sharing formula to increase the prices, to fix the prices. So, these are very suspicious in nature because the prices went up. So, the question is whether this is a violation of the Sherman Act? The court referred to other cases.

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The agreement between competitors to allocate territories to minimise competition is illegal. Whether it is your copyrighted material or whether you have a trademark if it is limiting or allocating the territories for limiting the competition it is a violation of the Sherman Act. So, the earlier decision in Topco whether the parties split the market, whether doing the business, whether reserving the market. So, these are absolute violation because the prices went up and the conditions of the competition provisions are violated.

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Every law is territorial in nature but the question is whether the competition law provisions are extra territorial in nature. If you do business outside the territory of United States whether the United States Sherman Act have a control over the activities you do outside your territory.

Metro Industries inc versus Sammi corporation, a 1960 case, here the Metro Industries is an importer of wholesale kitchenware products from Korea and Sammi is South Korean exporting company. Remember this is an international market. Can you do an international market allocation, whether it is a violation of the domestic law? This was considered by the US authorities.

The American subsidiary, the Metro industries alleged that the Korean design registration system gives holloware producers an exclusive right to export the particular holloware design for 3 years.

So, the Korean law permits holloware producers an exclusive right for a period of 3 years to export the particular product, whether this is a market division and whether this is a per se violation of Section 1 of the Sherman Act? This was the allegation because it gave 3 years exclusive right to export the holloware design products. So, it was considered by this court in this particular case.

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The main the allegation was that the registration system was used by the kitchenware importers, the US people. So, the stainless steel steamers from any of the Sammi’s competitors in Korea cannot be imported because there is an exclusive right.

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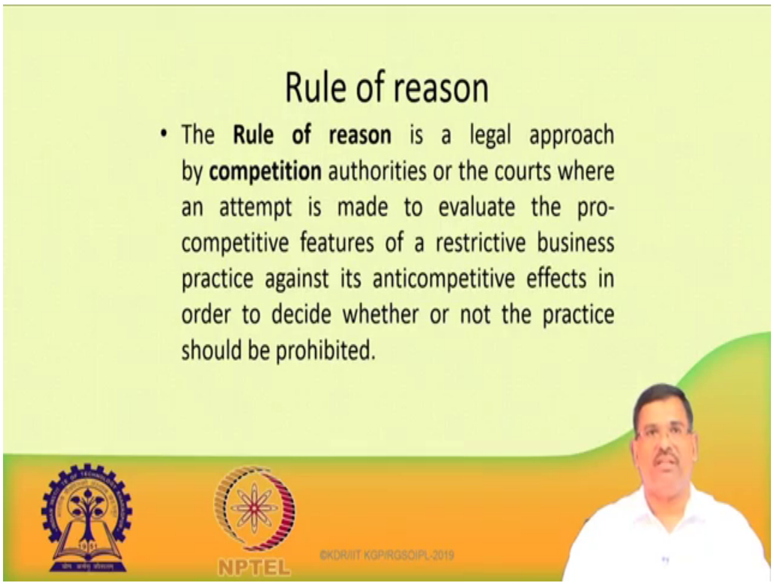

So these US importers alleging that there is a violation of the Sherman Act because of the Korean law which permits a 3 year exclusive right, here comes the two principles: the rule of reason as well as the per se rule. So, we will see these two rule because if you apple either of these rule, the result will be different.

So, the legal approach of rule of reason says that the competition authorities or the courts should make an attempt to evaluate the pro-competitive effects, but in the per se rule the court need not apply. The rule of reason gives an opportunity to the court or the authorities to look into the competitive features, whether the restrictive business is pro-competitive in nature or whether it is anti-competitive in nature.

And then decide whether the practice should be prohibited or not, the authorities will get a chance to decide, but in the per se rule the authorities are not going to get a chance to decide in between pro-competitive effect and anti-competitive effects.

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Ordinarily we can say that if the defendant can justify or can prove the pro-competitive effects, then the rule of reason will be applicable. Because if the facts and circumstances clearly prove that these restrictions are necessary to continue with the business and they are pro-competitive in nature, but most of the time it never happens. If a reasonable restraint is there, reasonable restraint plus pro-competitive effect on the market then the rule of reason will be applicable otherwise per se rule will be applicable.

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So, if it is per se anti-competitive behaviour, that anti-competitive behaviour is considered to be per se illegal under the Sherman Act; that means, unreasonable restraint on trade is considered as anti-competitive as well as illegal per se under the Sherman Act.

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The per se rule clearly says that certain categories of agreements are per se illegal. So, case by case evaluation is not required. So, those which tend to restrict competition are per se illegal in nature. So, with reference to *United States versus brown,* another case the court very clearly said that if restrictive provisions are there, then it is the per se rule which will be applicable. Market allocation agreement is per se illegal and any restraint on trade is per se illegal.

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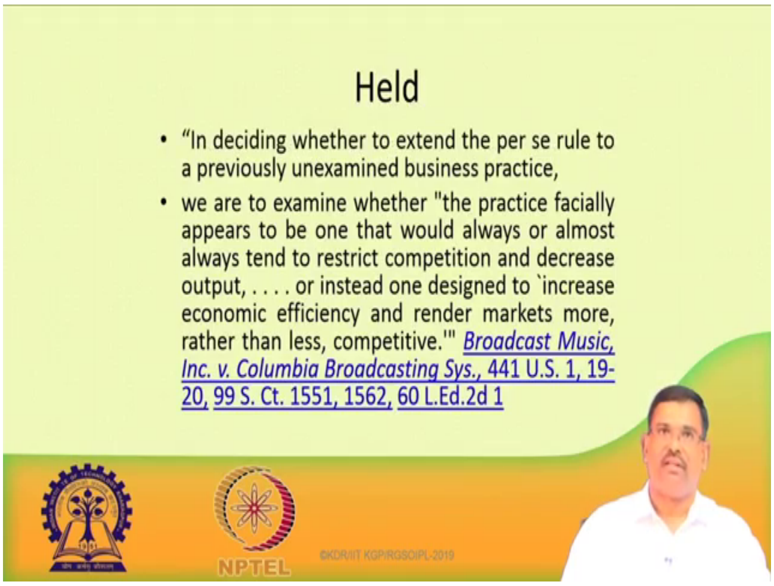

In deciding whether to extend the per se rule to the previously unexamined business practices. According to the words of the court "the practice facially appears to be one that would always or almost always tend to restrict competition and decreases output. Or instead one designed to increase economic efficiency and render markets more rather than less competitive" in *Broadcast Music Inc versus Columbia broadcasting*. So, which rule is applicable? It will give an opportunity for the authorities to look on a case by case basis whether it is pro-competitive or anti-competitive in nature.

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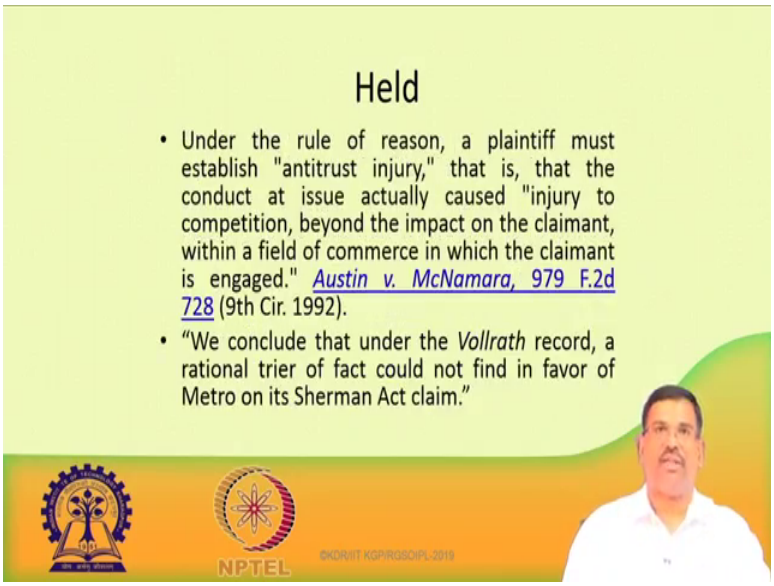

So, here in the rule of reason the plaintiff must establish antitrust injury, the conduct at issue has actually caused injury to competition beyond the impact on the claimant within the field of commerce in which the claimant is engaged; that means, here the rationale should be proved.

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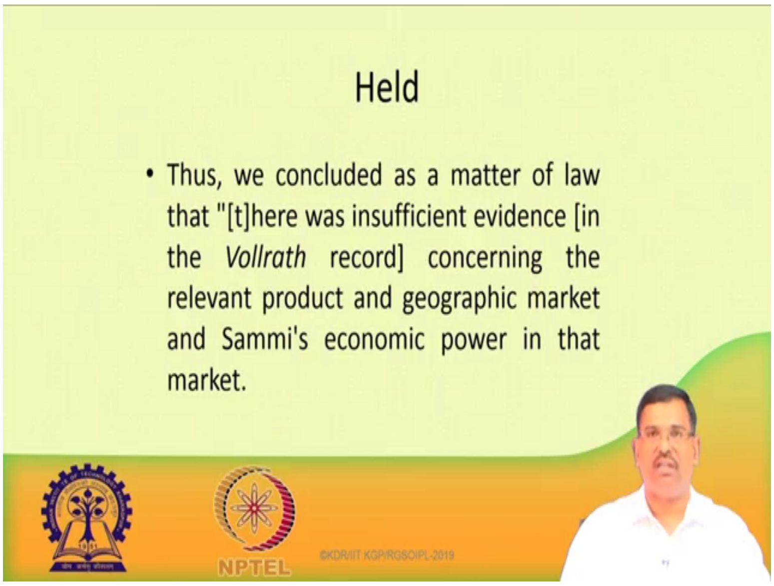

This particular case went in favour of metro; that means, if a particular rule outside the premises is effecting your market you can always look into it, but which rule will be applicable whether the per se rule or rule of reason you have to look into the type of transactions. In this case the court concluded that as a matter of law there was insufficient evidence in the vollrath record concerning the relevant product and geographical market and Sammi's economic power in that particular market.

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So, you can see that in this particular case the court held the rule very clearly, but certain questions arises regarding the conduct of incidents happening outside your jurisdiction. So, the Korean law permits 3 years exclusive exporting. By using your law can you say that this is against your law, which is an extra territorial application of your competition law.

The discussion is very clear, do you have an applicability of extra-territorial jurisdiction to your competition laws. The Sherman Act is only applicable in the United States, if there is anything happening outside the territory, but which has an effect on your commerce in the United States then only there is an application of the principles of competition law or the Sherman Act.

If the Korean registration system permits something you do not have any jurisdiction, but whether it divides the market, the world market and has a pernicious effect on your market, then definitely your competition law can look into such kind of transactions. But if such market allocation increases economic efficiency and render market more competitive then these competition law provisions cannot be applicable.

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If there is a restraint of trade, restraint of licensing agreement that affect parties in a horizontal relationship but does not necessarily cause the agreement to be anti-competitive in nature, you have to look into each and every case. Joint ventures are very well permitted and they are not always going to form cartels.

Licensing agreement among horizontal competitors may promote rather than hinder competition and which results in integrative efficiencies. That is why I said in the case of joint ventures specially in the case of horizontal competitors you have to look into the pro-competitive effects. So, per se rule and rule of reason we have to apply both and look very closely into the type of transactions. So, the supplementary technologies and integrative technologies may increase the efficiencies as well.

So, here you can see that the courts very clearly said that market allocation whether it is domestic in nature or international in nature is absolutely violating the Sherman Act this legal point is very clear. In the case of supply management, you manage many stores in the country, you can have provisions with pro-competitive effects and also with anti-competitive effects and then it is going to be violation of the Sherman Act. You cannot put highly restrictive provisions in the licensing agreement to divide the geographical market, it would be a violation of the Sherman Act. If there is a restraint of trade and you are not allowing anybody to enter into the market that would be a violation of the relevant provisions of the Sherman Act and Clayton Act.

So, the application of per se rule and the application of rule of reason gives the competition authorities a chance to evaluate if there is any justification for the pro-competitive nature of their activities. If it is pro-competitive in nature, if it is not anti-competitive, then there is no application of the Sherman Act in the United States.

More over, we discussed the extra territorial application of the Sherman Act. So, if there is any effect in the United States then there is an application of the Sherman Act. So, we will continue with the market allocation in the next class.

Thank you.