



Know IP - Stockholm Network Monthly Bulletin on IPRS

Commentary

Interoperability or Interoper-IP-ability? Helen Disney & Meir P. Pugatch*

In an age of slogans and catchy titles June 6 2005 marks the date when the European Commission brought the evil Microsoft to its knees. The European regulator - the protector of the little citizen - was able to subdue the mighty software giant from behaving like a vicious monopolist.

Or is it more complex than that?

The term '*Interoperability*' seems to be the key to all of Microsoft's mischief (at least according to the European Commission, which referred to this term 317 times in its 2004 report). Indeed, the headlines and press release argue that Microsoft has agreed to "implement the interoperability measures on a worldwide basis".

So what is interoperability? The problem is, we can't really tell. The European Software Directive defines interoperability as "the ability to exchange information and mutually to use the information which has been exchanged". In other words, interoperability can mean anything and nothing.

The debate over interoperability and which protocols should be disclosed or licensed, and under what conditions, is secondary to a much more fundamental issue: the Commission's decision to sacrifice one principle - the protection of intellectual property rights - over another principle - competition.

To put it simply, implementing

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interoperability means forcing Microsoft to release its proprietary know-how to its competitors.

Is that bad? The answer depends on one's perspective and understanding of the highly delicate relationship between antitrust and intellectual property rights.

A monopoly is a market condition in which there is only one provider (the monopolist) of a certain article or a service. The monopolist is able to exert almost total control over prices by changing the quantity of the product or service supplied. Basic economic theory concludes that a monopoly will sell a lower quantity of goods or services at a higher price than other firms would under purely competitive conditions. In other words, economists tell us that monopoly is usually bad for consumers.

Since government authorities are, in many cases justifiably, alert to market monopolies, legal and regulatory mechanisms (anti-trust) are put in place to increase competition (in the market).

While anti-trust mechanisms may well be appropriate for combating anti-competitive and monopolistic practices in general, the use of these tools in the case of proprietary knowledge-based products is highly problematic.

This is because the establishment of property rights in knowledge-products (such as software, medicines, processors, and so on) is based on a very different type of monopoly - intellectual property rights. Patents, copyrights, trademarks and other forms of intellectual property rights establish exclusive ownership (monopoly), although temporary, on various types of knowledge.



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Consider for example, the case of patents. On the one hand, in the absence of adequate safeguards for inventions, society would probably face a state of under-production in inventive activities due to the problem of free-riding. Establishing property rights on inventions, i.e. patents, would allow inventors - both firms and individuals - to secure commercial returns for their work, thereby increasing their incentive to invest in future inventive activities. To this extent, intellectual property rights provide a powerful incentive for innovation.

On the other hand, the market exclusivity that derives from the intellectual property system restricts the rapid dissemination of existing knowledge products.

The system of intellectual property rights has therefore a built-in tradeoff: the incentive to innovate and to create new knowledge for the future, in exchange for a temporary exclusivity on this knowledge at present. The term "paradox of patents", which was coined by Robinson as early as 1956, seems to capture the true nature of the system as a whole: 'by slowing down the diffusion of technical progress, patents ensure that there will be more progress to diffuse'

The system of intellectual property rights is probably the most unique form of monopoly that is legally protected by the regulator.

We should therefore examine the tension between the protection of intellectual property rights on the one hand and competition-based rules, especially antitrust, on the other.

European practices in this area are based on Article 82 of the EC Treaty, which prohibits companies from using their dominant (monopolistic) position in an abusive and non-competitive

manner. In recent years the European Commission has been following a more active policy, which goes beyond the McGill Principle of 1995 (where it was decided that Intellectual property rights were abused in such a way that prevented the introduction of a completely new product to the market).

In the case of Microsoft, the European Commission has essentially forced it to release its intellectual property rights to its competitors, who were not seeking to design a new product or technology, but are actually looking to provide the same products to consumers.

There is nothing bad with competition between rival products. On the contrary, competition is good both for Microsoft and its rivals. The question is what means should be used to increase competition, and the willingness to override the intellectual property rights of one party for the sake of another party.

It is time we stopped treating interoperability as a purely technical concept. The Commission should state with clarity whether it is favoring anti-trust remedies over the protection of intellectual property rights. This is a matter of policy. And, as with all policies, one must face the consequences of one's choices.

In fact, it is possible that EU actions are in contradiction to the Lisbon Agenda, which put a significant emphasis on the protection and exploitation of intellectual property rights.

Invoking anti-trust rules with regards to intellectual property rights should be limited to extreme cases only, where such rights block the market's ability to experiment on new ground-breaking technologies. In these cases, anti-trust regulations may prove more efficient than other tools. But this should be the exception rather than the rule.



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Topic of the Month

IPRs and SMEs - Anne Jensen *

In an attempt to convince MEPs and other sceptics of the importance of a strong European IP regime in general and patentability of computer implemented inventions (CII) in particular, the European Information and Communications Technology Industry Association (EICTA) recently hosted "the European Innovation Day" in Brussels.

EICTA gathered a distinguished panel of speakers including former president of the European Parliament Pat Cox, former Polish Prime Minister Jerzy Buzek, and a selection of prominent MEPs.

What made this event particularly interesting was the presence of representatives from European small and medium sized enterprises (SMEs), putting a face to the many businesses whose commercial survival depends, among other things, on harmonisation of the EU's intellectual property policies, including the proposed European Community Patent Directive and the CII Directive.

Many SMEs are at the cutting edge of European innovation. Entrepreneurs like Annie Brooking from the Cambridge-based Astron Clinica, a company that specialises in the development of medical imaging systems used for diagnosing skin cancer and other skin diseases, and Farrukh Younus of Eisar, a sales, marketing and branding firm specialising in the development of new mobile technology such as dual sim-cards, are leading the way. Both work for small enterprises that have created technical inventions with strong market value and both rely on patents to protect their innovations.

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For small and medium sized firms like these patent protection could be a make or break issue.

The European Commission defines an SME as an enterprise with fewer than 250 employees and an annual turnover not exceeding € 40 million. There is also a criterion of independence which states that 'independent enterprises are those which are not owned as to 25% or more of the capital or the voting rights by one enterprise, or jointly by several enterprises, falling outside the definition of an SME or a small enterprise, whichever may apply (DG Enterprise: 2002).

SMEs currently account for two-thirds of Europe's employment and almost 60% of economic output (Ueapme: 2005). In the US, SMEs are almost equally significant and comprise roughly 85% of business firms, 40% of employment and one-third of total economic output (Association for Competitive Technology: 2005).

According to the World Intellectual Property Organisation (WIPO), the protection of IPRs is particularly important to new technology-based firms (or NTBFs), "which are established for the purpose of commercialising new technology or providing an innovative service on the basis of new technology". Such enterprises, WIPO argues, "generally have limited capital and tangible assets and largely depend on intangible assets to succeed in the marketplace. "The innovative idea is usually the main asset of the company during its start-up phase and the basis on which it will seek investors to take the product or service to market."¹

¹. World Intellectual Property Organisation, Intellectual Property Rights and Innovations in Small and Medium Enterprises (WIPO: Geneva, 2004), http://www.wipo.int/sme/en/documents/pdf/iprs_innovation.pdf



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Yet despite European SMEs' growing awareness of IP policies, many of the knowledge-based SMEs still lack the ability to fully protect and exploit their intellectual property assets. WIPO argues that SMEs are often the driving force behind knowledge-based innovations. Their innovative and creative capacity, however, is not always fully exploited as many SMEs are not aware of the intellectual property system or the protection it can provide for their inventions, brands, and designs.¹

Indeed, a study commissioned by DG Enterprise in 1999 aimed specifically to investigate how SMEs involved in the development of software felt about intellectual property rights (DG Enterprise: 2004). The results showed a rather low level of awareness of patents and how these could protect companies' inventions, which could help explain why some SMEs were hostile to the idea in the beginning. According to the study, patents were seen as 'complex, expensive and difficult to enforce for small entities and therefore less valuable than copyright or informal means of protection'.

Two major obstacles facing SMEs are financing and enforcement. The cost alone of applying and maintaining a patent is estimated at about 50 thousand Euros (twice as much as in the US). SMEs are also at a disadvantage vis-à-vis large companies in the area of litigation and enforcement, as these companies are equipped with lawyers and the necessary budgets to fight in the court rooms. The time, costs and overall efforts that are often typical of IP disputes often deter many SMEs from using IPRs as protection for their innovations.

¹http://www.wipo.int/about-ip/en/studies/publications/ip_smes.htm

As a result of the financial burden related to preventing infringement of existing patents, the UK Patent Office established a Patent Enforcement Project Working Group last year to investigate ways of assisting SME patent holders (Michael Edwards & Associates: 2004). The working group considered several models such as mutual insurance societies, the current IP insurance market, and commercial companies which would invest in a patent by funding the cost of enforcement in return for a share of any settlement or damages award. The conclusion reached by the group was that the establishment of a mutual insurance association would provide the best solution to the financial challenges faced by SME patent holders. The mutual would be funded by subscriptions and by capital from patent holders whom the mutual has successfully assisted in obtaining favourable settlements or damages in the past.

Despite SMEs' initial suspicion of patents in general and to the CII Directive in particular, it seems now that these businesses have realised the benefits of security for their innovations and have therefore started supporting development of a stronger European IP regime. At the European Innovation Day, an SME Manifesto on Patents for Computer-Implemented Inventions was presented, signed by almost seventy European SME leaders calling for the European Parliament to confirm the Council Common Position and adopt the CII directive.

As SMEs are becoming more strategic in their approach to IPRs, European policy makers are trying to provide them with a more IP-friendly environment. Such policies should focus not only on harmonisation of IPRs, but also on financial and technical assistance as suggested by the Patent Enforcement Project Working Group.



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Experts' Corner

Patents, Tying Agreements and Market Power - Joseph Cook*

Firms may violate US antitrust laws with a tying arrangement that conditions the sale of one product (the tied product) on the purchase of another (the tying product). For the antitrust laws to be violated, certain elements should be present. For example, the tied product and the tying product should have separate markets; this eliminates situations such as ties between left and right shoes, as shoes are not generally sold outside a pair.

Perhaps the most important element is that the tying product must possess market power that is used to 'force' the consumer to purchase the tied product instead of some competing alternative. In so doing, the effects of a monopoly may be extended from one market into another.

In this respect, one of the most fascinating aspects in the delicate relationship between anti-trust laws and IP protection is the extent to which tying provisions are based on the "abuse" of the market power conferred by a patent.

On June 20, the US Supreme Court agreed to hear argument in *Independent Ink, Inc. v. Illinois Tool Works, Inc. and Trident, Inc.*, as part of its October term for 2005. The case is being appealed from the Court of Appeals for the Federal Circuit (CAFC), which lays out the background of the case.

At issue is the CAFC holding from January of this year that, based on Supreme Court precedent, "a rebuttable presumption of market

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power arises from the possession of a patent over a tying product."

According to the CAFC opinion, Trident has a patented inkjet printhead technology used by manufacturers of printheads principally that are used in the printing of bar codes and is a wholly-owned subsidiary of Illinois Tool Works. Trident sells ink to be used in the printheads embodying its technology, and Independent Ink is a competing manufacturer of ink. Trident conditioned its license for the use of its patented inkjet printhead technology on the use of its own specially formulated ink. Independent Ink brought a declaratory action for non-infringement and invalidity of the Trident patent on printhead technology. Later, Independent Ink added the antitrust claim that Trident violated Section 1 of the Sherman Act through an illegal tying arrangement.

The district court had dismissed the tying claim because Independent Ink had failed to produce any evidence of market power. On appeal, the CAFC overturned that decision based on two main factors.

In the first instance, the CAFC held that controlling Supreme Court precedents meant that no such showing was necessary when the tying product was patented as the patent raised a rebuttable presumption of market power. Second, that although there was some evidence in the record that their customers use labels as a substitute for the printheads and at least two competing printheads that did not employ the technology in the Trident patent, such evidence was not sufficient to rebut the presumption of market power.

For the former proposition, that the possession of market power by a patented product is a rebuttable presumption, the CAFC relied principally on the Supreme Courts opinions in *International Salt* and



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Loew's.¹ In *International Salt*, the defendant held patents over machines that used salt and required that lessees of their machines purchase their salt from the defendant. The Supreme Court held that the patents conferred no rights of restraint over unpatented salt but made no investigation into market power as the matter was 'obvious'. However, in *Loew's*, relying on *International Salt*, the Supreme Court made it clear that, if the tying product is patented or copyrighted, market power can be presumed. Although widely criticised by many, the Supreme Court's position has, thus far, not changed.

For the latter proposition, that one needs to do more than merely identify competitive alternatives to rebut the presumption, again, the CAFC relied on language in *Loew's* that "[t]he mere presence of competing substitutes for the tying product ... is insufficient to destroy the legal, and indeed the economic, distinctiveness of the [patented] product"² Instead, [t]he presumption can only be rebutted by expert testimony or other credible economic evidence of the cross-elasticity of demand, the area of competition, or other evidence of lack of market power."³

Because the idea that a patent presumptively confers market power has been so widely criticised, one might expect the Supreme Court to change its position and overrule *International Salt* and *Loew's* on this point. Such a ruling would put the burden of establishing market power, with "credible economic evidence", on the plaintiff. Given that is where the burden lies in tying cases that do not involve patents and copyrights, this

shift has the appeal of symmetry. After all, there is no economic basis for assuming that the tying product possesses market power simply because it is covered by patents or copyrights.

The US has seen explosive growth in patenting since the early 1980s. According to figures from the US Patent & Trademark Office, the annual number of US patents granted each year has nearly tripled, rising from 66,170 in 1980 to 187,017 in 2003. Of course, most patents have little or no real value, let alone have the ability to substantially raise market prices.

Patents are granted on the basis of providing an innovation, i.e., a unique technology. Of course, just because a patent covers a unique technology, that is not to say that it provide something that is economically unique.

And, of course, it is the lack of sufficient close substitutes in the eyes of consumers that will form the basis for substantial market power. For example, any number of pharmaceuticals might be therapeutic equivalents and effective alternatives for treating the same medical condition, even though each is contains a different patented chemical.

The claims of a patent do not necessarily define the boundaries of a market capable of being monopolized nor do they necessarily convey substantial power over market price.

¹ *Int'l Salt Co. v United States*, 332 U.S. 392 (1947) and *United States v Loew's, Inc.*, 371 U.S. 38 (1962).

² *Digidyne*, 734 F.2d at 1345 (quoting *Loew's*, 371 U.S. at 49).

³ *Independent Ink*, at 17 (citations omitted).



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Views

Protecting 21st Century Know-How - Rev. Robert A. Sirico*

Hopeful signs are emerging for the future of economic prosperity in Europe despite some serious opposition. On 20 June, the European Parliament's Legal Affairs Committee adopted the draft directive on patentability of computer-implemented inventions and decided to reject most of the major amendments proposed by the rapporteur, Michel Rocard, and other MEPs.

Though there is still a long way to go, this vote is an encouraging sign, given the series of delays in the last four months that have undermined the push for broader patent protections.

The rule of law expressed in the recognition and respect for intellectual property is absolutely critical to the flourishing of information technology. In the Internet-era, the protection of non-material property rights is just as important, if not more so, than the protection of material property rights.

"Property" should not be limited to merely physical objects, but also includes the effort, talent, time and risk (i.e., lives) that go into producing legitimate property. While the right to property is not absolute, its protection is in fact necessary for the common good.

This is affirmed throughout the social teaching of the Catholic Church especially in the encyclical *Centesimus Annus* by Pope John Paul II where he writes, "In our time, in particular, there

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exists another form of ownership which is becoming no less important than land: the possession of know-how, technology and skill. The wealth of the industrialised nations is based much more on this kind of ownership than on natural resources."

The essential link between economic productivity and intellectual property (or between things and persons) in the Information Age is underscored, as "at one time the decisive factor of production was the land, and later capital understood as a total complex of the instruments of production – today the decisive factor is increasingly man himself, that is, his knowledge, especially his scientific knowledge, his capacity for interrelated and compact organization, as well as his ability to perceive the needs of others and to satisfy them."

One of the key roles of government is the ardent defense of an exclusive right to market one's ideas in the form of intellectual property. Even the European Constitution, states, "Intellectual property shall be protected" (Article II-77.2). Indeed, intellectual property can be viewed as the cornerstone of modern enterprise, since it works as a morally necessary incentive for human creativity. This defence of intellectual property by the government is fundamental to constructing a framework within which economic activity can prosper, to the benefit of all.

Respect for property rights *qua* human rights on the national and international level is, therefore, vital to meeting the needs of the human family. And the lack of such protections is having real economic consequences for Europe. A 2001 study by the World Customs Organisation concluded that about one third of software across Western Europe is pirated and that "counterfeit music CDs have become more valuable, by weight, than



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cannabis – a kilo of cannabis will fetch EUR 2,000, while a kilo of counterfeit CDs is worth EUR 3,000."

The popularity of digital media and broadband distribution has only exacerbated the availability of pirated materials. Music, movies, and software are readily available for download via global file-sharing software. Without the legal protection from such electronic theft, the proliferation of such piracy can only increase.

The approval process of the directive on computer implemented inventions now depends on the will of the European Parliament.

One can only hope that this time around the result will not be another request for a total restart to the policy debate. Going back to "square one" would only serve to embolden the purveyors of software piracy, giving them more time and opportunity to sow the seeds of economic destruction.