INTELLECTUAL PROPERTY

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Compulsory licensing

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Despite the growing consensus that the intellectual property and antitrust laws serve the common purpose of promoting innovation and enhancing consumer welfare,[1] a 'field of dissonance' still remains at the interface of intellectual property monopolies and antitrust markets.[2] Competition authorities, courts and legislatures in various jurisdictions, including the United States and the European Union, are currently struggling to harmonise these two complementary, yet often conflicting, legal regimes. One of the most delicate and contentious issues in this area is the extent to which competition law can be used to force compulsory licensing of intellectual property rights.

In *IMS Health*,[3] the European Commission articulated its latest position on the obligations of intellectual property owners to license their rights to third parties, including competitors. Though tailored to the peculiar circumstances of that case, the decision in *IMS Health* raises significant concerns for intellectual property owners because the Commission expanded third parties' rights of access to proprietary information under Article 82. Moreover, *IMS Health* demonstrates the stark differences between the European Union and United States with respect to the compulsory licensing of intellectual property.

Background

IMS, headquartered in the United States and a major supplier of marketing data to pharmaceutical and other healthcare companies, operates in more than 100 countries, including Germany, the largest European pharmaceutical market. Among its services, IMS collects data on pharmaceutical sales from wholesalers to pharmacies, broken down into local geographic segments known as 'bricks'. Over several decades of collaboration with the German pharmaceutical industry, IMS developed a brick structure for Germany in which postal districts were aggregated to create a total of 1,860 distinct reporting districts, each containing a comparable number of pharmacies – the '1860 brick structure'. The concept behind the brick structure is to partition Germany into the maximum number of geographical units that permits data collection without the ability to match the data to a specific pharmacy, which would contravene German data protection rules. These rules stipulate that each 'brick' must contain at least three pharmacies and, as a practical matter, a brick typically includes four or more pharmacies to avoid modification of the structure each time a pharmacy goes out of business.

IMS collects and sells regional data services formated in the 1860 brick structure, which developed into the de facto industry standard for sales data collection and analysis. It is widely used, for example, by German pharmaceutical companies to analyse sales trends, measure market shares, and gauge the performance of sales representatives. According to the Commission, "[t]he 1860 brick structure is a 'common' language for communicating information between all players in the pharmaceutical industry . . . .". [4]

Invoking its copyright on its brick structure, IMS successfully sued in German courts to enjoin competitors from marketing data services using the same or similar reporting formats. Simultaneously, IMS refused to license the 1860 brick structure to competitors. One competitor, NDC Health, then filed a formal complaint with the Commission, arguing – with some support from pharmaceutical companies – that it could not effectively compete in the German market unless it was able to aggregate data in a format consistent with the 1860 brick structure. If aggregated in some other manner, the data would not serve the customers' needs and be unmarketable. Thus, it argued, IMS had a dominant position and its refusal to license the 1860 brick structure was an abuse of that dominant position in violation of Article 82.

The Commission's decision

Before ordering interim measures, the Commission had to determine whether a strong prima facie case existed that IMS had abused a dominant position. The Commission defined the relevant market as the market for "German regional sales data services" and found that IMS, by virtue of its large market share, occupied a dominant position in this market.

The competitor's complaint was based on the essential facilities doctrine, which provides that "a company which has a dominant position in the provision of facilities which are essential for the supply of goods or services abuses its dominant position where, without objective justification, it refuses access to those facilities".[5] Though neither the ECJ nor the CFI has ever explicitly referred to the essential facilities doctrine, the Commission stated that the ECJ, in Oscar Bronner,[6] established that a firm violates Article 82 where (i) "the refusal of access to the facility is likely to eliminate all competition in the relevant market;" (ii) "such refusal is not capable of being objectively justified; and" (iii) "the facility itself is indispensable to carrying on business, inasmuch as there is no actual or potential substitute in existence for that facility".[7] With respect to licensing intellectual property, the Commission noted that the "right of the proprietor of an intellectual property to prevent third parties from manufacturing and selling or importing, without its consent, products incorporating its right constitutes the very subject-matter of his exclusive right".[8] In "exceptional circumstances," however, "a refusal to grant a license may constitute abusive conduct in itself."[9]

In assessing these requirements in light of IMS's refusal to license its copyright, the Commission, apparently combining the first and third elements of the essential facilities test, found that "use of the 1860 brick structure is indispensable to carrying on business on the relevant market; there is no actual or potential substitute for it".[10] The 1860 brick structure, in part because of the role played by the German pharmaceutical industry in its development, was the "de facto industry standard". The pharmaceutical companies were "'locked in' to this standard such that to switch away from it to buy sales data formatted in a non-compatible structure, whilst theoretically possible, would [have been] a unviable economic proposition".[11] Pharmaceutical companies could not use a data services

provider implementing another brick structure because only the 1860 brick structure provided for comparability and compatibility of data, use of current software and maintenance of current sales relationships with doctors and employment contracts with sales representatives. The technical constraints of using certain standard information (eg postal codes, geographic boundaries) and legal constraints of German data protection law and IMS's copyright apparently precluded competitors from creating alternatives to the 1860 brick structure.

The Commission found that no objective justification authorised IMS's refusal to license the 1860 brick structure. The competitor's infringement, and legal challenge to the validity, of IMS's copyright were not sufficient justification because the 1860 brick structure was indispensable to compete on the relevant market and granting the competitor a licence "would not . . . impact on the question under German law of whether a copyright exists or not, and if so, who owns it".[12] The competitor's offer of a nominal sum for a licence and the criminal allegations against its officials for theft of information from IMS did not justify IMS's refusal to license because IMS made no counter-offer for license royalties and was "to address any perceived harm [from] alleged criminal behaviour through appropriate lawful means, and not by attempting to eliminate competition in the relevant market".[13]

The Commission concluded that "exceptional circumstances" were present such that IMS's refusal to license its copyright on the 1860 brick structure constituted a prima facie case of an abuse of a dominant position in violation of Article 82. Since a likelihood of serious and irreparable harm and intolerable damage to the public interest established an urgent need for protective measures, the Commission ordered IMS to license on a non-discriminatory basis the 1860 brick structure to its two competitors in the relevant market. The Commission further mandated that the compulsory licence provide for a "reasonable" royalty, which, failing mutual agreement by the parties, would be established by an independent expert. The CFI, in an order highly critical of the Commission's analysis and reasoning, has stayed implementation of these interim measures pending its review.[14]

Analysis of the Commission's Decision

Extension of the 'essential facilities' doctrine

The Commission, in *IMS Health*, continues to expand the reach of the essential facilities doctrine as it applies to intellectual property rights. For example, an issue left open after *Magill*[15] was whether a finding of "exceptional circumstances" required both that the intellectual property rights had to be linked to essential inputs for secondary markets and that a new product had to be introduced in that market for which there was significant demand which was not met by the rightholder. The ECJ ordered compulsory licensing in *Magill* primarily because the dominant firms' refusal to license their copyrights precluded another firm from offering a new product, a comprehensive weekly television guide, in a downstream market. In *IMS Health*, the Commission, marshalling principles from prior precedents on compulsory licensing and monopoly leveraging into its essential facilities rubric, answered this question in the negative and, by so doing, greatly expanded the scope of Article 82.

With respect to the 'new product' requirement for exceptional circumstances, the Commission flatly stated that "there is no requirement for a refusal to supply to prevent the emergence of a new product in order to be abusive".[16] The Commission based its conclusion on *Ladbroke*, where the CFI stated that the "refusal to supply the applicant could not fall within the prohibition laid down by Article 86 unless it concerned a product or service which was either essential for the exercise of the activity in question, in that there was no real or potential substitute, *or* was a new product whose introduction might be prevented, despite specific, constant and regular potential demand on the part of consumers".[17]

Reliance, however, on this passage from *Ladbroke* to dismiss the new product requirement is precarious. Unlike the ECJ in *Magill*, the CFI in *Ladbroke* did not find an abuse of a dominant position, primarily because the dominant firms were not present on the relevant market and the intellectual property at issue was not indispensable for competition on that market.[18] The CFI's comments on the 'new product' requirement represent, at best, an alternative holding for its conclusion, and, more likely, dicta. The Commission should not abrogate a crucial rationale for the ECJ's holding in *Magill* without a more rigorous consideration of the economic effects of compulsory licensing and, in particular, its potentially chilling effect on innovation.

In *IMS Health*, the Commission also dismissed any requirement under the essential facilities doctrine that the dominant firm's refusal to grant access must enable it to restrict competition on a second, typically downstream, market. The Commission relied on *Magill* for its conclusion, emphasising that, in both *Magill* and *IMS Health*, the dominant firm refused access to an input indispensable for an undertaking to compete on a market (the 1860 brick structure in *IMS Health*, the television listings in *Magill*), and completely ignored the importance of the existence of two markets to the ECJ's holding in *Magill*. By reading the requirement of a second market out of *Magill,* the Commission distorts *Magill* to support its result in *IMS Health* and expands the circumstances in which the licensing of intellectual property may be compelled.

In addition, *Magill* concerned not only an undertaking in a dominant position, but broadcasters which were the sole suppliers of the information on the TV programmes as only they could decide on and know about their programming in advance. The broadcasters in fact only released on a daily basis the listings of programmes to daily newspapers and refused to communicate to publishers of weekly magazines the TV programmes for a week. Access to the information was thus vital in *Magill*, while the access to the regional medical data is not so much the issue in *IMS Health*; rather, it is the right to use a format developed over several years to present this information to pharmaceutical companies. Competitors in the market for data services can develop other formats, and have developed other segmentation structures in the past. In *Magill*, the publishers trying to compete with the weekly magazines put on the market by the broadcasters could in no way develop and invent the listings of the programmes. For this reason as well, *IMS Health* goes further than *Magill*.

Divergence from US case law on compulsory licensing of intellectual property rights

The *IMS Health* decision contrasts sharply with the treatment of compulsory licensing of intellectual property in the United States. The test for compulsory licensing in the United States is linguistically similar to the one espoused in Europe; that is, a holder of an intellectual property right has no duty to license third parties absent "exceptional situations."[19] The circumstances constituting "exceptional situations" are much narrower in the United States, however, than they are in Europe.

Recently, the United States Court of Appeals for the Federal Circuit, the appeals court with exclusive jurisdiction over patents, held that the only "exceptional situations" justifying compulsory licensing of intellectual property rights were those where the holder (i) acquired the right through knowing and willful fraud, (ii) sought to gain a monopoly in a market beyond the scope of the right, or (iii) attempted to exert its monopoly through a "sham" infringement lawsuit (ie an objectively baseless suit motivated by a desire to impose

collateral, anti-competitive injury rather than to obtain a justifiable legal remedy).[20] The Ninth Circuit, but not the Federal Circuit, also requires compulsory licensing where the intellectual property owner's refusal to license is a mere pretext to mask anticompetitive conduct.[21] Absent these exceptional circumstances, a holder of an intellectual property right need not license third parties even if the result is the exclusion of competition in more than one market[22] – an outcome not permitted under *IMS Health*.

The US competition authorities also would rarely if ever consider compulsory licensing to be justified. The DoJ/FTC Guidelines state that they "will not require the owner of intellectual property to create competition in its own technology",[23] and indeed voluntary licence agreements will be treated as horizontal in nature only if the licence is between actual or potential competitors. And, a licensee will be considered as a potential competitor only "if there is evidence that entry by that firm is reasonably probable *in the absence of the licensing arrangement*".[24] Thus, in the United States, absent very narrow circumstances, a refusal to license intellectual property rights in no way justifies compulsory licensing as a competition law remedy.

In light of the current emphasis on harmonising international competition and intellectual property laws, the Commission's decision in *IMS Health* is troubling because it moves the Commission further from the United States's position on compulsory licensing. While disagreements are inevitable between the two jurisdictions, expanding the policy divide in this area should be done only after careful analysis and thorough dialogue with industry participants. The decision in *IMS Health* contains little discussion of the harmful effects compulsory licensing may have on innovation to the detriment of consumers. The Commission here may have taken a quantum leap where a more incremental approach would seem preferable.

Practical effects

The practical effects of *IMS Health* may be limited by its facts. The Commission itself stressed that its decision rested on the "extremely specific" circumstances in which the 1860 brick structure was developed into a de facto industry standard, namely through a collaboration over several years between IMS and the pharmaceutical industry.[25] Moreover, IMS was in effect a sole supplier and the pace of technical progress in its market was at best sluggish. The 1860 brick structure arguably involved much less creative input and innovation than most intellectual property. This may well be a rare fact pattern that limits the significance of the ruling.

A firm with a valuable intellectual property portfolio should not, however, rely solely on factual differences to distinguish itself from *IMS Health* since the unusual facts of *Magill* did not prevent the Commission from using that case to extend the essential facilities doctrine further into the realm of intellectual property rights. Rather, a firm with a dominant position in the relevant market must be prepared to demonstrate its economic justification for refusing to license third parties. Even then, the paucity of guidance from the Commission and the courts on what constitutes an "objective justification" for a refusal to license makes a complaint under Article 82 a very real threat.

The economic ramifications of the compulsory license remedy enhance the danger of this threat. The Commission in *IMS Health* only granted IMS a "reasonable" royalty and noted that compulsory licensing would not cause the firm to suffer an "unreasonable loss of income."[26] The Commission's comments reflect a lack of appreciation for the costs of, and motivation for, creative endeavours. For instance, suppose a firm invests in several R&D projects, but only one produces a marketable result, which the firm protects through intellectual property rights. The firm then tries to extract monopoly profits from the single result based on its intellectual property rights to achieve a reasonable return on its total R&D investment. If the firm is limited by a compulsory licensing regime to a "reasonable royalty", however defined, on the single marketable product, then its ability to cover the costs of, let alone profit from, its R&D efforts is substantially impaired and its motivation to innovate is substantially undercut. Thus, the Commission's embrace of compulsory licensing may have the unwanted long-term effect of discouraging R&D investment.

The decision in *IMS Health* arouses concern that the Commission may be losing sight of the fact that strong intellectual property rights are consistent, and not incompatible, with competitive markets and antitrust principles. Intellectual property rights ensure that new markets develop, and foster therefore a dynamic notion of competition. The emergence of new markets can only occur if rights owners are guaranteed that they can recoup their investment by controlling their licensing decisions.

Only time will determine the significance of *IMS Health* to intellectual property stakeholders. Until further guidance is given by the CFI and ECJ, firms should be wary of the Commission's increasingly aggressive use of the essential facilities doctrine and be prepared to provide economic justifications for their licensing decisions.

Finally, apart from the substantive competition issues related to compulsory licensing and essential facilities, *IMS Health* raises other

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important issues that are, unfortunately. beyond the scope of this article. For instance, the Commission's decision may be inconsistent with the European Union's international obligations under the TRIPs agreement. In addition, *IMS Health* may give rise to unusual procedural issues. Simultaneous with the Commission's consideration of the case, litigation has proceeded before various German courts with one court ruling in favour of IMS, and another asking the ECJ for a preliminary ruling on certain questions. The differences in opinion between the Commission and the German courts, and the resolution of these differences, raise numerous questions that are particularly intriguing in light of the Commission's proposal to decentralise the application of the competition rules.

Notes

1 See United States Department of Justice and Federal Trade Comm'n Antitrust Guidelines for the Licensing of Intellectual Property § 1.0 (1995) ('DoJ/FTC Guidelines').
2 *Image Technical Serv. Inc v Eastman Kodak Co*, 125 F.3d 1195, 1217 (9th Cir. 1997).
3 *NDC Health/IMS Health*, Case COMP D3/38.044 (Interim Measures), July 3 2001.
4 Id. at ¶89.
5 Id. at ¶ 63.
6 *Oscar Bronner GmbH & Co v Mediaprint Zeitungs*, 1998 ECR I-7791.
7 *IMS Health*, at ¶ 70.
8 Id. at ¶167.
9 Id. at ¶168.
10 Id. at ¶ 181.
11 Id. at ¶ 92.
12 Id. at ¶ 169.
13 Id. at ¶ 173.
14 See *IMS Health Inc v Commission*, Case T-184/01 R (August 10 2001).
15 See *RTE v Commission*, 1995 ECR I-743.
16 *IMS Health*, at ¶ 180.
17 *Tiercé Ladbroke SA v Commission*, 1997 ECR II-923 at ¶ 131 (emphasis added).
18 See id. at ¶¶ 131-132.
19 See *In re Indep. Serv. Org. Antitrust Litigation*, 203 F.3d 1322, 1328 (Fed. Cir. 2000).
20 Id. at 1326.
21 See *Image Technical Serv. Inc*, 125 F.3d at 1219.
22 See *Xerox*, 203 F.3d at 1327.
23 DoJ/FTC Guidelines, *supra* note 1, at § 3.1.
24 Id. at § 3.1 n.14 (emphasis added).
25 *IMS Health*, at ¶ 211.
26 Id. at ¶ 208.