Intellectual Property Rights, And Competition Law
Prof. K D Raju
Rajiv Gandhi School of Intellectual Property Law
Indian Institute of Technology, Kharagpur

Lecture - 22
Vertical Restraints and IP

Dear students, today we are going to continue with our discussion on the last class, we were discussing about the horizontal restraints and today we are going to discuss on Vertical Restraints. In the last classes we have discussed what is the vertical restraints and horizontal restraints. Horizontal restraints are on the same level of trade and vertical restraints are on different level of trade. For example, the distributor, the manufacturer, then retailer, on the same level of trade and if one person tries to control the entire system of supply chain.

In the vertical restraints we are going to look into how the intellectual property interacts with or whether it is conflicting with the competition law in certain cases.

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Especially with regard to the vertical price restraint. Almost all the jurisprudence, cases are on patents or trademarks or copyrights, but this particular case that came before the court is on trade secrets. The distributors or the manufacturer put restraints in the

licensing agreements, contracts, to what extent these are conflicting with the competition law. Today we are going to discuss this in detail, and maybe on the last class of the first part of this course.

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And this was very important case but now it is overruled. *Dr. Miles Medical company versus John D. Park and Sons company* was decided in 1911. This case set the jurisprudence for a long period of time, you can see that it got overruled only in 2007.

So, for a long period of time this was the jurisprudence set by the united states of Supreme Court. In 2007 this decision, Dr. Miles decision was overruled in *Leegin decision*. So, our subject of discussion today is these two decision and vertical restraints, and how the intellectual property is interacting with the competition law, the Sherman Act through these two cases.

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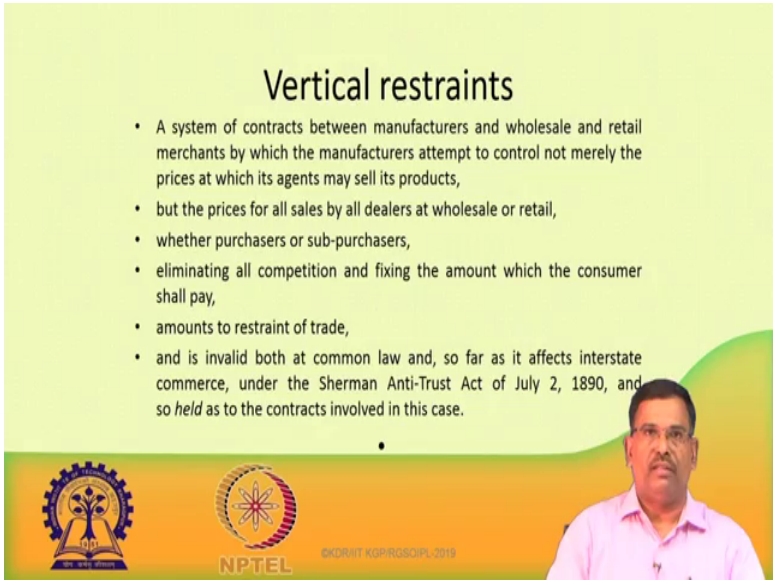

The vertical restraints are basically on the contracts. The manufactures always enters into contracts with wholesale merchants, retail merchants and tries to control the prices. The prices from manufacturing, to the wholesalers, to the retailers and ultimately to the consumers, and they put restrictions on prices on all levels. So, what is the price of these particular products when available to the consumers? There is no choice for the wholesaler or the retailer to fix prices or to give some kind of leeway; these are entirely fixed by the manufacturers.

So, the question raised in this particular case was whether this amounts to restraint of trade. If this is restraint of trade then it is definitely a violation of the Anti-Trust Act of 1890.

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We will see detail. Here the complainant was a medical company i.e. Dr. Miles medical company, an Indiana corporation which manufacturers and sells proprietary medicines. Most importantly, they were not holding any patents for these proprietary medicines rather they had trade secret protection which was again in the united states protected under legislations. So, it is a branch of intellectual property law which we saw in our earlier classes. They kept all the formulas and products as well as the process as trade secret; and they have packages, labels and trademarks.

So, there a bundle of intellectual property was protecting these particular medicines from trade secrets to the packages and labelling and also trademarks. They had trade extensively throughout the United States. Their practice was to sell the medicines to the jobbers, wholesalers, wholesale druggist and retail druggist and ultimately the medicines goes to the consumer and at all levels of trade the manufacturer used to fix the prices.

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When we look into the intellectual property protection the trade secrets are protected under the intellectual property legislations. But the question is whether there is a correlation between the intellectual property protection and controlling the market forces. Dr. Miles said that this is a proprietary medicine and different intellectual properties are owned by me. So, I have a right to protect the prices in the market.

So, you know that the processes were protected by the trade secrets. So, whether intellectual property protection grants any kind of rights to fix the prices. The answer is controversial. We have to look into whether intellectual property protection gives the patent owner or the copyright owner or the trade secret owner an absolute freedom to fix the prices, not only at one level but at every level.

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We will discuss this in detail. So, whether at any point of time this is a restraint of trade. So, here the same medical company manufactures non-patented articles also, but there is no statutory right on fixing prices for future sales or to put restrictions on the purchasers through a set of contracts.

The manufacturers set, fix conditions through a set of contracts from wholesale to retail and ultimately to the consumers. This is applicable not only in the case of the intellectual property protected medicines, but in the case of the non-patented medicines as well. So, the question is with regard to whether these agreements entered between these people are unlawful. Our point of discussion is that: these restrictive conditions put in the agreements are violative of any of the provisions of the Sherman Act. That is the question of our discussion, whether it is a restraint of trade.

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There is an arrangement between the wholesalers, manufacturer, wholesalers and retailers through a set of agreements. So, the sole purpose is to control the entire market. The manufacturer fixes the prices. The question is whether these practice are injurious to public because if any kind of agreements put restraint of trade or are injurious to the public then they are void. So, if the public interest is hurt, these kind of agreements are held to be void.

And no other legislations can save such kind of agreements. So, the argument is that this is only to enhance the prices or only to control the entire market.

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The manufacturers along with the distributors agreed to fix the prices. MSPs are fixed. The court in this particular case applied the per se rule which is there in section 1 of the Sherman Act and held that these activities are illegal. The vertical agreements between the manufacturers, distributors and retailers, and ultimately reaching to the consumers, all the prices, were held to be per se illegal. The court has taken a very tough stand and held that these kind of agreements are not going to benefit the consumers rather they are going to benefit only the manufacturers and so are per se illegal.

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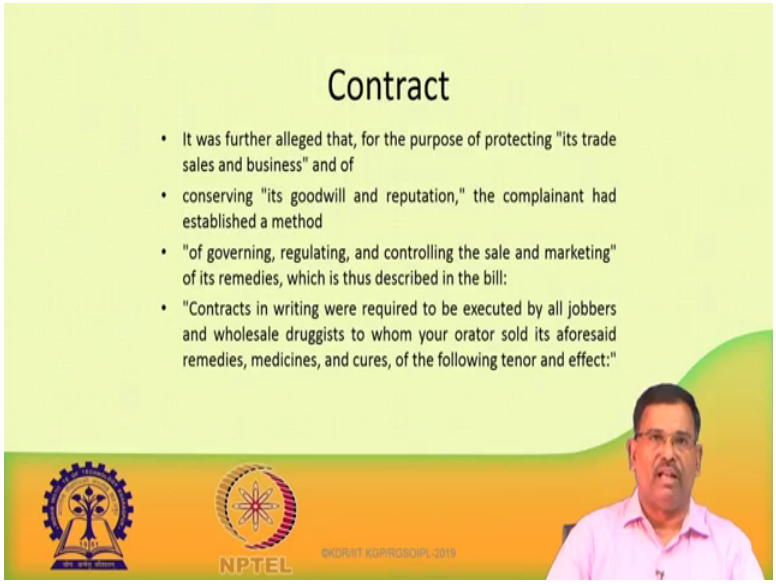

It was also further alleged that the purpose was of protecting trade, sales and business. This was one of the justification given by Dr. Miles. He said that it is to protect the sales and business and for conserving its goodwill and reputation. I am not able to understand how the reputation of a company is directly connected with the prices! Another argument was that all these were known to the defendants, through the agreement and they agreed earlier, they are part of this agreement. The defendant in this particular case co-operated with the plaintiff earlier and they knew the terms and conditions of the agreement.

Then second argument was; it is very necessary to regulate and control the sales and marketing of the company to protect the interest of the company. And thirdly the contracts are in writing, they are required to be executed by the jobbers or the retailers or the wholesalers and they knew these terms and conditions of these particular agreements. This was one of the argument.

The court looked into each and every argument. Every company wants to protect its trade and business, but not through exploiting the market, not through combinations, not through abuse of dominance. And every company wants to protect its goodwill and reputation but not by fixing prices and thirdly it is necessary to control the marketing. Yes, every company wants to control the market, but not by fixing the prices and the prices should be determined by the market forces. And if every company imposes restrictions on the wholesalers and retailers. So, the argument that the defendant knew the terms and conditions is not going to be sustainable.

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The defendant i.e. the Kentucky corporation, the wholesale drug business, they were earlier into the business. So, they dealt with the complainant, they had full knowledge of the terms and conditions and they also trade in medicines. This argument is not going to be sustainable that they knew the terms and conditions; because even though they know the terms and conditions, it is still a restraint of trade and a violation of the Sherman Act.

You know that in pharmaceuticals, everybody knows that from the manufacturer to the consumer there are a lot of chains in the supply, there are lot of actors in the supply chain.

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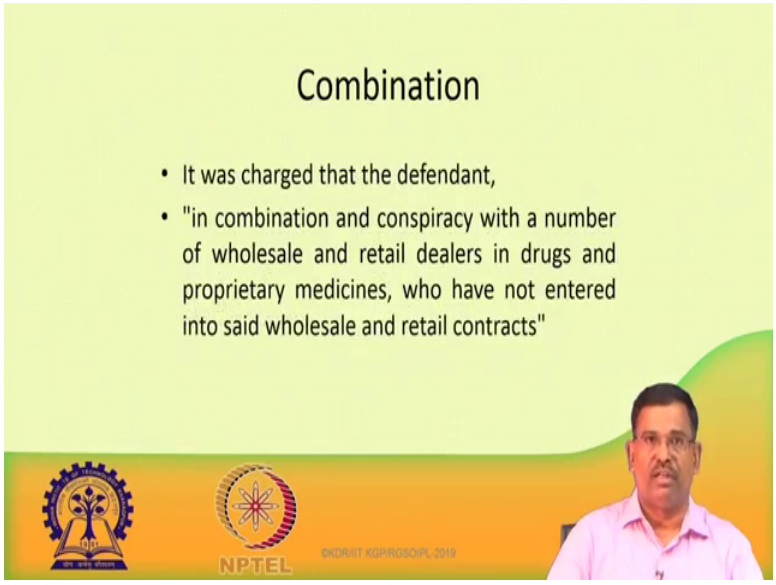

So, here there was a combination and a conspiracy with regard to the whole sellers, retailers and jobbers in the case of proprietary medicines. Even in the case of proprietary medicines, the rights are limited to the order of the intellectual property. Once the intellectual property is used to exploit the market, to violate any of the provisions of the competition law, the competition law will prevail over the intellectual property protection.

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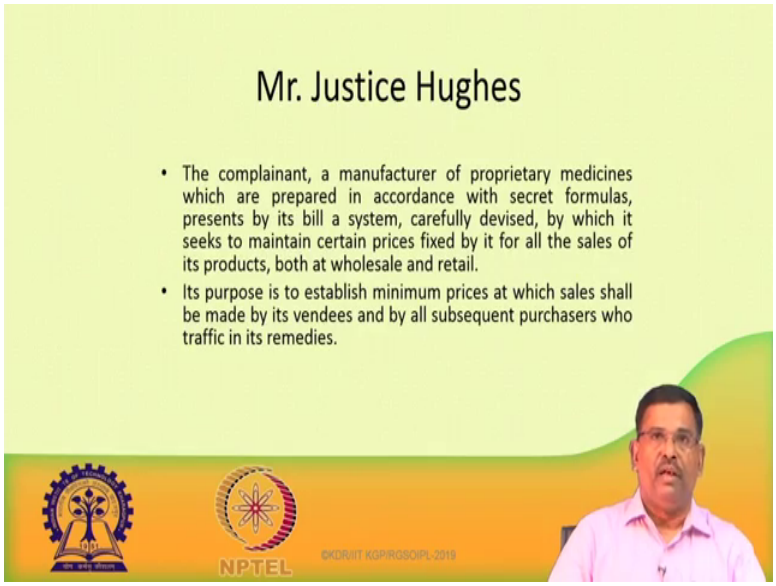

And Mr. Justice Hughes in this particular case has taken a very strong stand. He said that there is no doubt that proprietary medicine are protected under the legislations. And they prepare these particular medicines under the trade secret formulas, it is protected under legislations and they can fix certain prices for retail or wholesale. But the purpose is to establish minimum prices at which sales shall be made by its vendors and by all subsequent purchasers who traffic in these medicines. So, the companies can only fix prices to that extent.

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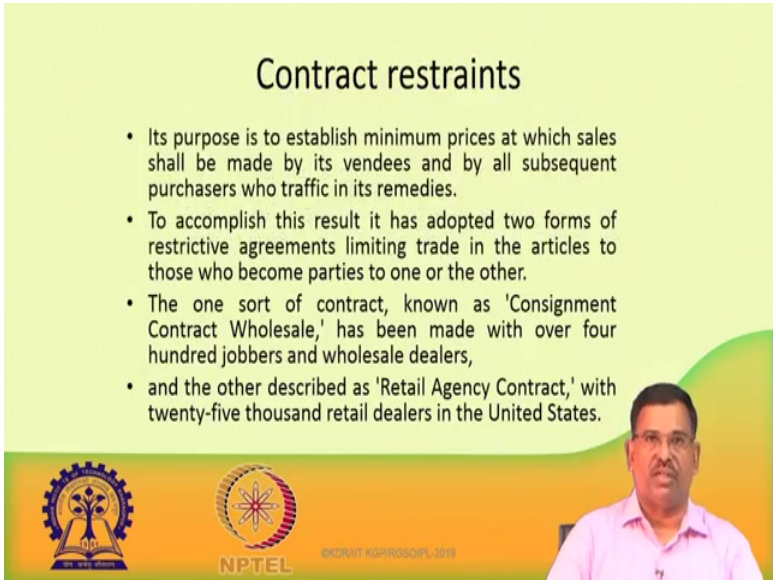

But can you put conditions on restraint of trade? The answer is no. No manufacturer can put conditions in the agreement in restraint of trade. So, these restrictive agreements, restrictive agreement conditions are void whether it is the consignment contracts or the retail contracts or the price fixing contracts, basically the retail agency contract.

So, the argument that there are 25,000 retailers are all over the United States, is not a justification to put unreasonable conditions. The conditions must satisfy the test of Sherman Act section 1 and 2, if any kind of restraint of trade provisions are put they would be a violation of the Sherman Act.

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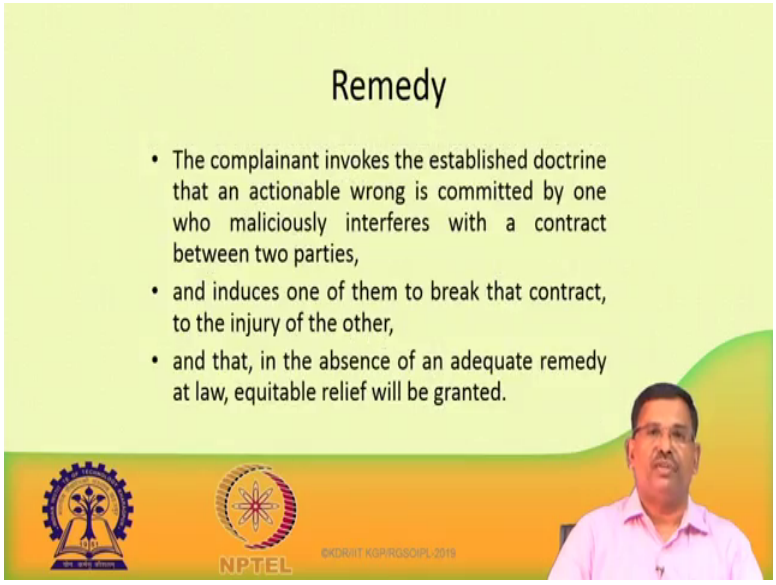

We are not going to discuss elaborately on the actionable wrong. The allegation by Dr. Miles that, the defendant has maliciously compelled other parties, other retailers and wholesalers to break the contract, that is not the question of our discussion. Our discussion is whether the intellectual property protection gives a complete freedom to the owner of the intellectual property to violate competition law?

The answer is that intellectual property protection has a limited role when it comes to the market forces.

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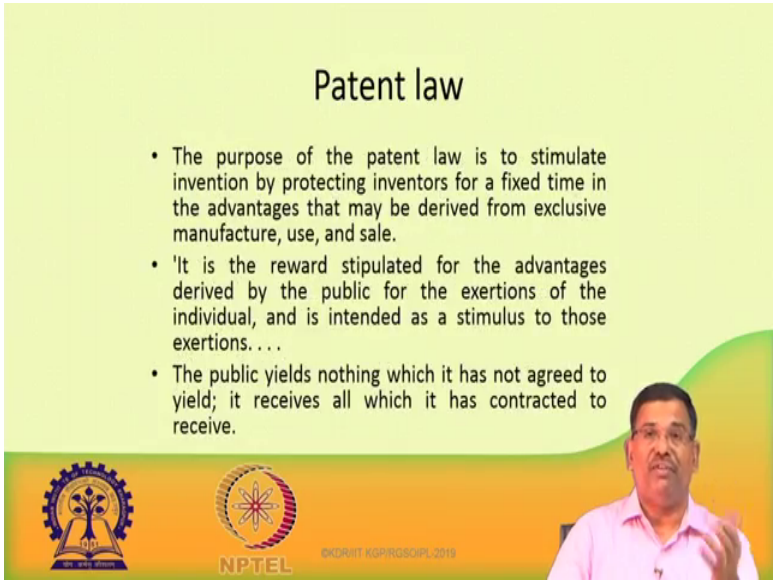

The moment you exceed the intellectual property rights in the name of intellectual property protection you cannot do whatever you like to do in the market. For example, the patent law, the objective of the patent law is to stimulate innovation or to give an incentive to the innovator, but not to exploit the market.

There can be exclusive manufacturer, but if these exclusive manufacturer adopt unfair means and refuse to deal then, as we discussed in the last class, the essential facilities doctrine will come into play. So, the competition law is to take care of the market or competitive process has to continue in the market so that there will be welfare in the market. And if the public is not going to yield any benefit, if they are not going to get any kind of benefits because of the practices of the company then definitely it is going to attract the provisions of the Sherman Act.

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So, whether a condition in the contract is a restrictive practice or not, we have to look in from the purview of intellectual property as well as the competition law. And there can be an exclusive agreement according to the intellectual property law because you have a monopoly for a limited period of time, but that does not mean that you refuse to deal.

So, the refusal to deal i.e. to be dealt under the competition law, competition law will come into play and will look into the details of why you refused, whether you are charging enormous royalties, whether you are fixing the prices, whether you are going to be making cartels. So, all these ingredients are to be checked under the competition law.

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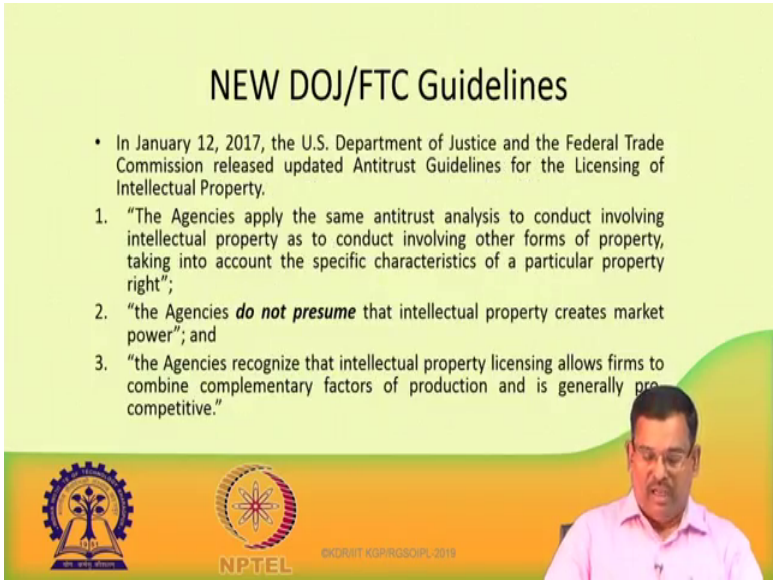

And if we look into Dr. Miles it is very clear. The court has, remember this particular case was in 1911, very clearly applied the doctrine of per se rule and they said we are not even going to look into the other doctrines, the opposite doctrines.

The next case we will look into is in 2007. In 2017, the Department of Justice and the Federal Trade Commission has issued new guidelines by looking into the new jurisprudence. The new guidelines of 2017 has accepted these particular principles and the first principle says that: "the agencies apply the same antitrust analysis to conduct involving intellectual property as to conduct involving other forms of property taking into account the specific characteristics of a particular property right".

So, they have to consider what kind of intellectual property protection is available, to what extent it is available to the owner. But at the same time "the antitrust agencies do not presume that intellectual property creates market power". So, they have changed their philosophy of the competition issue, because Dr. Miles was overruled in *Leegin* case. So, we are going to see that particular case.

Thirdly, "the agencies recognise that intellectual property licensing allows firms to combine complementary factors or production". Yesterday we talked about the complementary technologies and supplementary technologies and the agencies will

consider it as pro-competitive. So, the per se rule is not going to be applicable. So, the rule of reason is going to be applied from 2017 in the cases, so the shift has happened.

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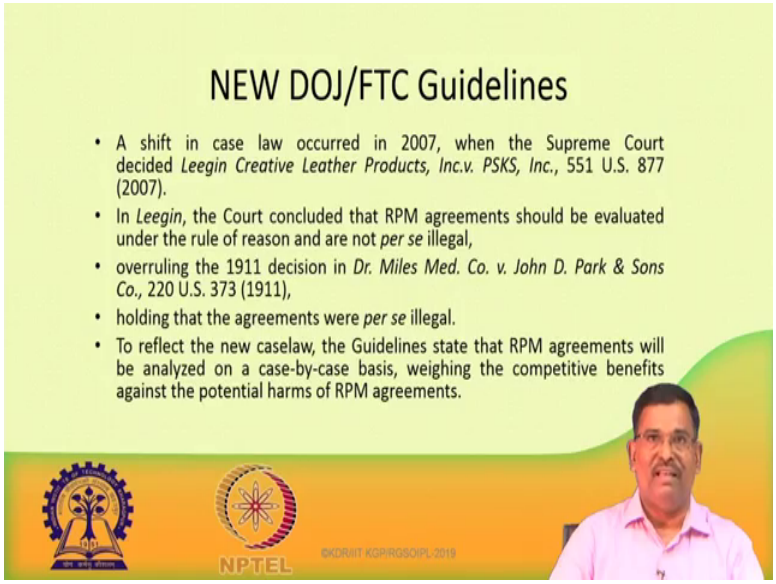

So, we talked about how in Dr. Miles, the court said that the per se rule will be applicable, fixing vertical agreements are per se illegal. But, in 2007 another case came before the supreme court of the united states i.e. *Leegin Creative Leather Products Inc. verses PSKS, Inc.*. Almost similar circumstances, similar facts. In Leegin the court reconsidered Dr. Miles case regarding resale price maintenance.

Whether the resale price maintenance is per se illegal. This question was evaluated. If you apply Dr. Miles principle then you need not re-evaluate, so blindly you can say that if you apply Dr. miles, resale price maintenance are per se illegal. But, in this particular case the court again looked into and evaluated very thoroughly whether these are per se illegal, resale price maintenance are illegal at the vertical level? Whether it has an anti-competitive effect or pro-competitive effects. So we will discuss this particular case.

Thank you.