Analysis of Proposed Consent Order to Aid Public Comment

The Federal Trade Commission has accepted agreements to proposed consent orders from Summit Technology, Inc. ("Summit"), located at 21 Hickory Drive, Waltham, Massachusetts 02154 and VISX, Inc. ("VISX"), located at 3400 Central Expressway, Santa Clara, California 95051.

The proposed consent orders ("Orders") have been placed on the public record for sixty (60) days for reception of comments by interested persons. Comments received during this period will become part of the public record. After sixty (60) days, the Commission will again review the agreements and the comments received and will decide whether it should withdraw from the agreements or make final the agreements' proposed orders.

On March 24, 1998, the Commission issued a complaint alleging that Summit and VISX violated Section 5 of the FTC Act, as amended, 15 U.S.C. § 45 (the "Complaint"). The Orders, if issued by the Commission, would settle all of the allegations of the Complaint against Summit and settle part of the allegations of the Complaint against VISX (the "Complaint").

The Complaint alleges that Summit and VISX are competitors in the market for photorefractive keratectomy ("PRK"), a form of eye surgery that corrects refractive vision disorders through the use of specialized, computer-guided laser equipment that reshapes the cornea. Summit and VISX each own patents related to PRK, and are also the only firms whose PRK laser systems have received marketing approval from the U.S. Food and Drug Administration.

As set forth in the Complaint, on or about June 3, 1992, VISX and Summit pooled most of their existing patents related to PRK (as well as certain future ones) in a newly created partnership called Pillar Point Partners ("PPP"). According to the Complaint, this pooling arrangement eliminated horizontal competition between VISX and Summit.

The U.S. Department of Justice and the Federal Trade Commission's *Antitrust Guidelines for the Licensing of Intellectual Property* (April 6, 1995) (the "Guidelines") address the analysis of intellectual property licensing in general, and patent pool arrangements such as that between Summit and VISX in particular. The Guidelines recognize that intellectual property licensing arrangements are "typically welfare-enhancing and procompetitive." Guidelines § 3.1. However, "antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license" -- what the Guidelines call a "horizontal relationship" *Id.* With respect to pooling arrangements, the Guidelines repeat the same analytical principles. The Guidelines note that pooling arrangements "may provide procompetitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation." *Guidelines* § 5.5. However, where pooling arrangements "are mechanisms to accomplish naked price fixing or market division," or where they "diminish competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the cross-license," they are subject to challenge. *Id.*

In this case, the Complaint alleges that Summit and VISX were horizontal competitors at the time they formed PPP, because they could and would have competed with one another in the sale or lease of PRK equipment by using their own technology embodied in their respective patents. In addition, Summit and VISX could have engaged in competition with each other in connection with the licensing of technology related to PRK. The pooling arrangement restricted both forms of competition. Price competition in the sale or lease of PRK equipment was restricted because, under the PPP agreement, VISX and Summit were required to pay a fixed "per procedure fee" to PPP for each PRK procedure performed with its machinery That "per procedure fee" -- set at the higher of the two proposals submitted by VISX and Summit to PPP ($250) -- functioned as a price floor. Because each firm was obligated to pay $250 per use into the pool, neither had any incentive to lower the usage charge below that level. In the absence of the pool, Summit and VISX would have competed with each other, resulting in lower prices to doctors and consumers for the use of each company's PRK equipment.

PPP has also had an anticompetitive effect in the market for PRK technology licensing. Under the PPP agreement, only PPP can license to third parties the PRK patents contributed by VISX and Summit, but VISX and Summit each retain a veto power over licensing of any of the patents in the pool. In effect, this provision of the pool gave each firm a veto over the licensing of the other's patents. Whereas prior to the pool, each firm could have licensed its own patents unilaterally, after the pool no patent could be licensed without the consent of both companies. Since its formation, the Complaint alleges that PPP has not licensed its patents to any third-party manufacturers and any offers have been economically prohibitive.

The Guidelines add that if a pooling arrangement has an anticompetitive effect in the relevant markets, the Commission should consider whether the pool is "reasonably necessary to achieve procompetitive efficiencies." *Guidelines,* § 4.2. In analyzing whether the pool is "reasonably necessary," the Guidelines further instruct that

> The existence of practical and significantly less restrict alternatives is relevant to a determination of whether a restraint is reasonably necessary. If it is clear that the parties could have achieved similar efficiencies by means that are significantly less restrictive, then the [FTC] will not give weight to the parties' efficiency claim. In making this assessment, however, the [FTC] will not engage in a search for a theoretically least restrictive alternative that is not realistic in the practical prospective business situation faced by the parties.

Id.

Summit and VISX contended that PPP reduced the uncertainty and expense associated with the patent litigation that would have inevitably ensued without PPP, and PPP allows both parties to be in the market, when patent infringement might have precluded one or both from coming to market. As to the first part of that argument, Summit and VISX could have achieved these efficiencies by any number of significantly less restrictive means, including simple licenses or cross-licenses that did not dictate prices to users or restrict entry. As to the second part of that argument, the Complaint alleges that patent infringement would not have precluded either firm from coming to market.

After concluding that there was reason to believe that the pooling of patents by VISX and Summit was anticompetitive and that PPP was not reasonably necessary to achieve any procompetitive efficiencies, the FTC issued the Complaint. Thereafter, Summit and VISX decided to enter into agreements with the FTC to end the dispute. The Orders achieve all of the goals of Counts I and II of the Complaint. As discussed below, PPP has been dissolved and the Orders require Summit and VISX to make pricing and licensing decisions independently. In essence, the Orders return VISX and Summit to the status of competitors in the PRK industry.

The Orders prohibit Summit and VISX (a) from agreeing in any way to fix the prices they charge for the use of their PRK lasers and patents, including the "per-procedure fee" charged to doctors each time he or she uses one of the firms' PRK lasers, and (b) from agreeing in any way to restrict each other's licensing rights and decisions for their PRK lasers and patents.

The Orders require Summit and VISX to cross-license, on a royalty-free and non-exclusive basis the patents each firm contributed to PPP. Although the Complaint contends that VISX and Summit could have competed absent the pool, subsequent sunk-cost investments in reliance on the pool make a cross-license desirable to approximate the competitive conditions that would have been achieved by this point in time had the pool not been formed.

The Orders also require Summit and VISX (a) to take no action inconsistent with the dissolution of PPP, except to the extent necessary for PPP to wind up its affairs and to defend or settle litigation in which it is a defendant, and (b) to return the PPP patents to the firm that contributed them to PPP.

The Orders further require Summit and VISX to give notice of the Orders to any person that previously requested a license to use any of the PPP patents in the manufacture, assembly or sale of PRK equipment since June 3, 1992 (the date PPP was created). Summit and VISX must also give notice to their customers that they have the opportunity to stop using the lasers without any penalty or continuing obligation (with certain exceptions as set forth in the Orders). Customers that entered into any agreement with Summit or VISX between June 3, 1992 (the date PPP was formed) and June 5, 1998 (the date of PPP's dissolution) that included an obligation to pay a per-procedure fee to license any of the PPP patents will have the opportunity to stop using the laser covered by the patents and negotiate a new licensing agreement with their current licensor or, alternatively, seek a licensing agreement with a competitor. This provision is necessary to restore competitive conditions to those which would have existed had there been no pool at the time these contracts were entered into.

The Orders also compel Summit and VISX to fulfill certain standard notification, reporting and inspection requirements.

The Orders will terminate upon the expiration of the last PPP patent to expire.

The purpose of this analysis is to facilitate public comment on the Orders, and it is not intended to constitute an official interpretation of the agreements and the Orders or to modify them in any way. Additionally, the proposed consent orders have been entered into for settlement purposes only, and do not constitute admissions by Summit and VISX that the law has been violated as alleged in the Complaint.