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Defining the Limits of the EU Essential Facilities Doctrine  
on Intellectual Property Rights:  
The Primacy of Securing Optimal Innovation

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# Defining the Limits of the EU Essential Facilities Doctrine on Intellectual Property Rights:

## The Primacy of Securing Optimal Innovation

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### I. INTRODUCTION

¶1 The recent European Commission decision in the *Microsoft* case, imposing remedies and a fine of EUR 497.2 million on the computer giant, has done much to refocus attention on the essential facilities doctrine.<sup>1</sup> The decision orders Microsoft Corporation to disclose interface information, enabling competitors to develop software that will be able to integrate with Windows. For over fifteen years, the European Court of Justice (“ECJ”) has accepted that in certain exceptional circumstances, a refusal to supply a potential competitor with an essential facility can amount to a breach of Article 82 of the EC Treaty.<sup>2</sup> However, if the ECJ accepts the finding of the Commission, the *Microsoft* case will be the first to order a compulsory license over a patent developed through the resources of a private entity, and the decision will fuel the debate as to what extent it is desirable that competition law destabilizes the exclusive rights of intellectual property.

¶2 The *Microsoft* Commission decision closely preceded the judgment by the European Court of Justice in the *IMS* case.<sup>3</sup> *IMS* provided a suitable opportunity for the Court to establish a clear principle on essential facilities in the context of intellectual property rights. It is probable that the ECJ has used this opportunity to lay the foundations for the impending *Microsoft* case, since the decision emphasizes the protection of right holders. However, the *IMS* judgment is in many ways disappointing and leaves numerous questions unanswered. This legal uncertainty is particularly problematic for market participants who remain unsure whether their predicted recuperation of innovative costs will be jeopardized by an order to license to a competitor.

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<sup>1</sup> Commission of the European Communities, Commission Decision of 24 March 2004 (Case COMP/C-3/37.792 Microsoft) [hereinafter *Microsoft*].

<sup>2</sup> CONSOLIDATED VERSION OF THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Dec. 24, 2002, O.J. (C 325) 65 (2002) [hereinafter EC TREATY]. See, e.g., Case 238/87, AB Volvo v. Veng, 1988 E.C.R. 6211.

<sup>3</sup> Case C-481/01, IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, 2004 O.J. (C3) 16 (April 29, 2004) [hereinafter *IMS*].

¶3 It has been argued that many of the problems in the essential facilities doctrine relate to the nature of the intellectual property right itself. Often the claim to the right is dubious, its scope is too extensive, or the period for which the right is protected allows the undertaking to develop a real monopoly position. Since the Court has refused to directly address the issue of the existence of intellectual property rights,<sup>4</sup> it is arguable that, in the absence of harmonization measures, the essential facilities doctrine should not be extended to such rights. However, if such a principle is allowed to emerge, it should be subject to a substantial cost benefit analysis, specifically considering the impact on innovation. In any event, legal certainty must be returned to this area of law and suitable conditions established for competition to flourish.

## II. CONFLICTING OBJECTIVES

¶4 The reconciliation of competing policy objectives is never an easy task, and where both seek to protect or encourage certain conduct, inevitably one side must prevail to the detriment of sound policy on the other. This dilemma can be seen in the European Community within the context of essential facilities of intellectual property rights, where the arguments for strong intangible property rights clash with the efficiency arguments of competition law.

¶5 In the case law and academic literature on the essential facilities doctrine, one can find many references to this conflict. It is undoubtedly true that often the two areas of law appear to pursue differing objectives. Intellectual property rights bestow on the right holder a virtual monopoly which can be exploited and abused. They also enable the owner to prevent the production of derivative products which rely on access to the original intellectual property. In contrast, competition law attempts to ensure that the efficiency of the market is not prevented by abuses of a dominant position.

¶6 However, rights over intangible property do serve a valuable function within any developed economy. Competition law and intellectual property rights should not always be in conflict since both are concerned with ensuring that there are optimum incentives and opportunities to invest in innovation. The intellectual property right that is protected often requires extensive research and development costs, which the market participant will only undertake if it is likely to receive reasonable remuneration. Competition law also tries to create the right market conditions that allow undertakings to develop more efficient methods of production or superior products which will result in a benefit to consumers. Although each area of law will approach the question of optimal innovation in different ways, it is worth concentrating on these similarities and attempting to reconcile the disparities.

### A. *The Characteristics of the "New" Economy*

¶7 As the economy of the European Union develops from one primarily based upon industry and agriculture to a service and technology economy, competition regulation

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<sup>4</sup> Article 295 of the EC TREATY provides that "[t]his Treaty shall in no way prejudice the rules in Member States governing the system of property ownership." As a result the ECJ has separated the exercise of intellectual property rights from their existence and will not decide on the validity of the latter. *See also* Case 24/67, *Parke Davis & Co. v. Probel and Centrafarm*, 1968 E.C.R. 55; *AB Volvo v. Veng*, 1988 E.C.R. 6211.

must also mature to address problems within the “new” economy.<sup>5</sup> The emergence of a technology-based economy means that dominance based on intellectual property is becoming more significant. The witnessed advancements within the information technology industry have demonstrated how vital intellectual property rights can be in keeping an economic system dynamic.

¶8 The new economy also has several other characteristics. The costs of developing intangible property are generally higher, while the costs of reproduction are generally lower. It is also apparent that the holder of an innovative right stands to reap considerable profits. The goods produced within the new economy are usually durable, which leads to the unusual effect that the right holder will often be competing with its own old products by keeping the prices of superior products at a reasonable price. Technological products also produce network effects, so that a more widely used product yields greater consumer gains. Finally, competitive races are common within the new economy, and monopolies over intellectual property rights are often fragile.<sup>6</sup> For instance, the VHS video recording technology was long believed to have been an industry standard and its developers were required to license the patent to competitors. However, the new DVD technology has seen VHS largely abandoned, with many retailers in Europe refusing even to stock the old equipment.

#### *B. The Objectives of Intellectual Property Law*

¶9 Intellectual property laws are concerned with the creation and commercial exploitation of a statutory grant of monopoly power.<sup>7</sup> The innovator is rewarded for his creative effort and in this way is given an advantage over his competitors in the market. Denying the protection guaranteed by intellectual property rights would undermine the incentive to carry out research and development. It would be irresponsible to endorse a system that allowed exploitation by free-riders. Any competition law policy that seeks to achieve equal conditions for competitors to the detriment of dynamic efficiency is likely to do serious damage to the international competitiveness of the European Union.

¶10 However, exclusive rights are always open to abuse and so their operation should be observed with caution. To some extent, the anti-competitive effects of intellectual property rights are eased by temporal limitations. However, often the same rules regarding existence should not be applied to all intellectual property rights and different markets require different approaches. At the end of the period of exclusivity, the holder is obliged to allow free access to the right, restoring competition to the market. However, in some intellectual property markets, the rate of technological advancement is so rapid that monopoly power represents the only form of exploitation. In such circumstances the temporal limitation appears an unsuitable tool to achieve competitive markets.

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<sup>5</sup> Christian Ahlborn, et al., *Competition Policy in the New Economy: Is European Competition Law Up to the Challenge*, 5 EUR. COMPETITION L. REV. 156 (2001).

<sup>6</sup> *Id.*

<sup>7</sup> Romano Subiotto, *The Right to Deal With Whom One Pleases Under EEC Competition Law: A Small Contribution to a Necessary Debate*, 13 E.C.L.R. 234, 244 (1992).

### C. *The Objectives of Competition Law*

¶11 Whilst the purpose of intellectual property rights can be clearly defined, the same is not necessarily true about competition policy. At first glance, the objective of EC competition law is consumer welfare. Indeed Mario Monti, the former European Competition Commissioner, declared that “the ultimate goal of the competition rules is simple: to assure that consumers benefit from new and improved products and lower prices.”<sup>8</sup> Therefore, regulation should concentrate purely on exploitative abuses, and intervention should occur only where market conduct is likely to diminish aggregate consumer wealth. This approach is evidenced in the United States where antitrust law is used to promote maximum efficiency and to reduce deadweight loss.<sup>9</sup> However, it is apparent that consumer welfare is not the only objective that influences Community policy in this area and several other policy objectives can be identified.<sup>10</sup>

¶12 First, the Commission appears determined to ensure the promotion of small and medium-sized business and to break up the anticompetitive effects of large privatized firms.<sup>11</sup> Second, single market integration continues to influence much decision making in EC competition law.<sup>12</sup> Third, the Commission seeks to ensure that there are fair conditions for competitors and has shown particular concern about the foreclosure of markets to potential competitors even where the benefits to consumers are doubtful.<sup>13</sup> It is therefore apparent that EC competition policy also seeks to prevent practices which interfere with the market mechanism.

¶13 The development of an essential facilities doctrine within the European Union is often viewed as a natural consequence to privatization and the desire to break up the dominance associated with such firms. Indeed, the finding of a duty to share in infrastructure cases correlates to the duty of impartiality required of a public utility by Article 86 EC Treaty. Following privatization, the opening up of important

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<sup>8</sup> Mario Monti, Competition and Information Technologies, Speech before the Barriers to Cyberspace Conference, Kangaroo Group, Brussels (Sept. 18, 2000), *available at* <http://europa.eu.int/rapid/pressReleasesAction.do?reference=SPEECH/00/315&format=HTML&aged=0&language=EN&guiLanguage=en> (last visited Apr. 17, 2005).

<sup>9</sup> James B. Kobak, Jr., *Running the Gauntlet: Antitrust and Intellectual Property Pitfalls on the Two Sides of the Atlantic*, 64 ANTITRUST L. J. 341 (1995-1996).

<sup>10</sup> Ahlborn, *supra* note 5

<sup>11</sup> *See, e.g.*, European Commission, First Report on Competition Policy (1972).

<sup>12</sup> “Restrictions on competition and practices which jeopardize the unity of the Common Market are proceeded against with special vigour.” *Id.* at 15.

<sup>13</sup> VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE 81 (1997). Article 82 of the EC TREATY provides the following:

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

infrastructures to competition could only be achieved if new competitors were allowed access.<sup>14</sup> Therefore, the application of the essential facilities doctrine to intellectual property rights can perhaps be justified when the research and development was publicly funded in formerly nationalized industries. In such cases an essential facilities doctrine can aid market liberalization. However, the regulator must be cautious if applying the same principles when the property right has been privately financed. Thus viewed, the essential facilities doctrine seeks to limit illegitimately obtained advantages. Although the ECJ maintains that it does not have the competence to rule on the existence of intellectual property rights, many of the cases in this area have concerned dubious claims to exclusivity.

¶14 European competition policy has also been used as a vehicle to integrate the common market. Despite the ECJ's assertions that it will only pronounce on the exercise of intellectual property rights, it is apparent that in certain cases the competition authorities have attempted to subordinate nationally granted intangible property rights in order to further the integrationist interests of the Community. While it is a legitimate EC aim to ensure that the division of the common market is prevented, it is certainly questionable whether the grant of compulsory licenses over intellectual property is the correct method to achieve this goal.

¶15 It is also apparent from EC jurisprudence that the need to maintain some form of equality between competitors influences competition policy. By protecting the interests of competitors, it is more likely that compulsory licenses will be granted over intangible property rights. The Microsoft example serves to illustrate this point more clearly. The Windows operating system is of a high standard and available at such a competitive price that it has become a quasi consumer standard. Nevertheless EC competition law has intervened where, due to its strong market position, Microsoft has imposed unfair conditions upon other market participants.<sup>15</sup> However, as a matter of policy, competition law should not intervene to protect competitors unless the ultimate benefits to consumers outweigh the rights of the intellectual property right holder.

¶16 Competition regulation which does not have consumer welfare as its primary goal is liable to lead to greater conflicts within the new economy. The cost structure within the technological markets naturally leads to concentrations of market power. Any attempt by regulators to artificially fragment the market will likely damage the efficiency of the industry to the ultimate detriment of consumers. It is also apparent from its decisions that the Commission is highly skeptical of the network effects prevalent in the new economy and perceives this phenomenon as an unjustifiable barrier to entry.<sup>16</sup> This view has been echoed by former Commissioner Monti who stated that "the more important the network becomes, the greater the risk that competition problems will emerge."<sup>17</sup> However, opening technology markets to competitors that only offer similar products to the right holder ignores the positive effects of networks for consumers.

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<sup>14</sup> Derek Ridyard, *Essential Facilities and the Obligation to Supply Competitors under the UK and EC Competition Law*, 8 E.C.L.R. 438 (1996).

<sup>15</sup> Eleanor M. Fox, *What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect*, 70 ANTITRUST L. J. 371 (2002).

<sup>16</sup> See, e.g., Commission Decision of April 12, 2000 on Vodafone/Mannesmann Concentration, 2000 O.J. (C 141) 19; Commission Decision of June 23, 2000 on MCI WorldCom/Sprint Concentration 2000 O.J. (C 143) 4.

<sup>17</sup> Monti, *supra* note 8.

¶17 Despite assertions to the contrary, it would appear that consumer welfare often is not the only, or even the primary, goal of EC competition law. By seeking to minimize the advantage that an undertaking gains through its own innovation or efficiency, the Commission is liable to damage the long-term advancements within the new economy. It is acknowledged that competition law cannot intervene only in the face of exploitative abuses, since to do so would hinder the dynamic efficiency of the market.<sup>18</sup> However, where regulation of the market occurs, there should always be tangible benefits to consumers. It is possible for regulators to take a prospective view of the market and consider whether interference with the market mechanism will bring consumer gains. Concentrating on this sole policy objective will ultimately bring much needed coherence to the principle of essential facilities in intellectual property law.

#### D. Theories on Essential Facilities

¶18 It has already been stated that the primary objective of exclusive intangible property rights is to provide an incentive to innovate. The constant search for a competitive advantage is an important dynamic in any developed economy, and market power acquired through business acumen or a superior product does not offend competition laws. If other market participants are protected simply because they declare themselves beaten, innovation would be significantly hampered.<sup>19</sup> Therefore any essential facilities doctrine must not condemn intellectual property rights simply because the holder obtains a competitive advantage, and the concept of “abuse” must be clearly defined.

¶19 However, the owner of an intellectual property right also has a duty to ensure that its benefits are maximized. As was stated by Sir Leon Brittan, companies “cannot unreasonably sit on their intellectual property in order to stifle enterprise and prevent the emergence of new forms of competition.”<sup>20</sup> Nevertheless, this summary of the rationale for an essential facilities doctrine is vague and does not fully grasp the complexities of the problem. If compulsory licenses to intellectual property rights are granted too easily, a right holder will be required to create its *own* competition. To compel a firm to do so would be contrary to the very purpose of an intellectual property right, and therefore, regulation should only prevent firms from restricting competition, not requiring them to maximize it.

¶20 Clearly, ordering a compulsory license whenever an undertaking has an advantage in the market is an unsatisfactory criterion upon which the essential facilities doctrine should be based.<sup>21</sup> It is always pro-competitive to allow a company to exploit its legitimate advantages, although the converse is true where the benefit is used to exclude competition. A right holder should be allowed to exploit the commercial advantage on its primary market. It is only where a dominant firm seeks to lever its advantage onto an ancillary market that competition law should intervene. Where that is the case, the

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<sup>18</sup> Ridyard, *supra* note 14.

<sup>19</sup> Paul D. Marquardt & Mark Leddy, *The Essential Facilities Doctrine and Intellectual Property Rights: A Response to Pitofsky, Patterson and Hooks*, 70 ANTITRUST L.J. 847 (2003).

<sup>20</sup> See Subiotto, *supra* note 7.

<sup>21</sup> See Ridyard, *supra* note 14.

regulator should examine the downstream market and consider whether competition can exist.

¶21 Even where competition on a secondary market is restricted to such an extent, it is arguable that access should not be granted where the right holder is subject to effective competition in its primary market. In such circumstances, the right holder is less likely to abuse its dominance on the secondary market since this will affect its competitiveness in its primary area of business. Competition on the primary market will stimulate innovative developments and competitive prices on any ancillary markets because the right holder will strive to create the most successful overall package and thus dominate both markets. Indeed, the right holder may wish to license its product and encourage competition in order to make its primary activity more appealing to customers. Where the right owner chooses not to license, competition law should not impose business decisions on the market participant in the absence of any significant detriment to consumers.

¶22 An interesting new theory is based upon the supposition that intellectual property law protects ideas, not products. Thus, special protection should only be provided where the owner of a right truly denies access to its intellectual property. This occurs when the right holder deprives someone who will actually use the exclusive right. Accordingly, a competitor who seeks access to the owner's protected parts cannot be considered to be willing to *use* the owner's intellectual property. Therefore, the right holder's refusal cannot be justified on the grounds that the right incorporated in its products has patent protection.<sup>22</sup>

¶23 Nevertheless, the extent to which this proposal ensures that there are adequate incentives to maintain a high level of innovation remains unknown. The theory rests on the assumption that the right to exclusivity of the "invention" will stimulate the creation of new ideas. However, the exact amount or form of incentives needed to create optimal ingenuity remains unanswered, and it is clear that the potential to exploit the advantage in ancillary markets certainly adds to the business desirability of innovative ideas.

### *E. The Complications of Regulation*

¶24 Several practical problems can be identified in reconciling these differing objectives. The precise relationship between intellectual property rights and economic welfare is unclear. It is a notoriously difficult task to create a general rule that will limit the exclusivity of property rights when the cumulative benefits to consumers require it. Consequently, it is tempting to treat the essential facilities dilemma on a case-by-case basis. However, this uncertainty is particularly problematic for market participants and does nothing to ensure the coherence of the competition regime.

¶25 Even where a compulsory license is granted, a problem remains over defining the precise terms of the contract. Obviously a right holder can expect reasonable royalties even where he is compelled to license the intellectual property. However, whether this should be based upon the expected monopoly profit or the market value is unclear. If the regulator is merely concerned with ensuring that new derivative products are not prevented from emerging, a license based on monopoly profits would enable competitors

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<sup>22</sup> Mark R. Patterson, *When is Property Intellectual? The Leverage Problem*, 73 S. CAL. L. REV. 1133 (2000).

to penetrate the market without disturbing the right holder's expected remuneration. However, if the creation of equal conditions for competition is the primary objective, a license based on market value is more suitable.

¶26 Furthermore, it is unclear to what extent and to whom a right holder must license. An intellectual property right which is licensed to one competitor no longer forecloses the market to all competition. Therefore, in circumstances where an essential facility is found to exist, a right holder could discharge his obligations by a single license. Whether this is sufficient and how the licensee is to be chosen are unresolved questions for the competition authorities.

¶27 An order of a compulsory license also requires constant supervision as to the terms upon which it is granted and whether the circumstances requiring the license continue to exist. Such supervision is beyond the capacity of the Commission. In addition, any regulation in this area must seek to minimize the intervention with the market mechanism. It is a central tenet of modern economy theory that free markets create optimum efficiency, and therefore, an order to compulsorily license a product must be cautious about imposing artificial prices. However, leaving the parties to find their own terms could lead to the setting of prohibitively high prices, thus negating the effect of the compulsory license. Therefore, interference with the market is logically unavoidable once it has been decided that an essential facility exists.<sup>23</sup> The recognition of these difficulties should ensure that the regulator proceeds with caution.

### III. THE JURISPRUDENCE OF THE EUROPEAN COURTS

¶28 Although the ECJ had developed the concept of an essential facilities doctrine in certain infrastructure cases,<sup>24</sup> it was generally believed that intellectual property rights were immune from its impact. This was, to a large extent, due to Article 295 EC Treaty which states that property rights remain within the sole competence of national law.<sup>25</sup> In the case of *Ab Volvo v. Veng*,<sup>26</sup> the Court initially affirmed that the specific subject matter of intellectual property was the right to "prevent third parties from manufacturing and selling or importing, without its consent, products incorporating the design." However, the Court further declared that in three circumstances a right holder can be compelled to license the property to third parties; in particular, where the owner "arbitrarily" refuses to deliver spare parts to independent repairers.<sup>27</sup> This paradoxical approach cast

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<sup>23</sup> Ridyard, *supra* note 14.

<sup>24</sup> See Joined Cases T-374/94, T-375/94, T-384/94 and T-388/94, *European Night Servs. Ltd. v. Commission*, 1998 E.C.R. II-3141 (with respect to tunnels); Commission Notice on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector, 1998 O.J. (C 265) 2; Council Directive 90/547/EEC of 29 October 1990 on the Transit of Electricity Through Transmission Grids, 1990 O.J.(313) 30 (with respect to telecom and electricity gridlines).

<sup>25</sup> "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership." EC TREATY art. 295.

<sup>26</sup> 1988 E.C.R. 6211.

<sup>27</sup> The exercise of a right holder's exclusive right may be prohibited by Art. 82 where it involves: "certain abusive conduct such as the arbitrary refusal to supply spare parts to independent repairers, the fixing of prices for spare parts at an unfair level or a decision no longer to produce spare parts for a particular model even though many cars of that model are still in circulation, provided that such conduct is liable to effect trade between member states." *Id.* at para. 9.

considerable doubt upon the extent to which intellectual property rights were subject to competition scrutiny.

¶29 It was not until the *Magill* case<sup>28</sup> that the principle was developed, although the decision raised far more questions than it answered. The judgment is of particular importance as it represents the only final decision where a compulsory license has been ordered by the ECJ. *Magill* expands upon the “refusal to supply” abuse identified by the Court in *Volvo* and states that in certain “exceptional circumstances,” a right holder may be compelled to grant third party access to his property right.<sup>29</sup> However, there is little guidance as to when the essential facilities doctrine will apply and, in the aftermath of the case, both the academic and business communities were left to speculate on the scope of the principle.

¶30 In *Magill*, three television stations (RTE, ITV, and BBC) broadcasting in Ireland and Northern Ireland refused to license their copyright on the information contained in their respective program listings to the Irish publisher Magill TV Guide Ltd. Magill then briefly attempted to produce its own television guide until the broadcasters invoked their copyrights to seek an injunction. Magill complained to the Commission and the European process commenced. The ECJ upheld the Commission and CFI decisions to order a compulsory license, drawing on the principle of exceptional circumstances.

¶31 The ECJ first reaffirmed the principle from *Volvo* that the existence of an exclusive right is not, in itself, an abuse but then went on to hold that a right holder must grant third party access where three conditions were met. First, there was no actual or potential substitute for a weekly television guide offering information on the week’s upcoming programs, despite a specific, constant, and regular consumer demand. The broadcasters’ refusal to provide basic information, the “indispensable raw material” for compiling a weekly guide, prevented the emergence of a new product which would have competed with the broadcasters’ own guides. Second, no business justification existed for the refusal, although this finding was not thoroughly discussed by the Court. Third, the broadcasters had reserved for themselves a monopoly in the secondary market of weekly television guides by excluding all competition.<sup>30</sup>

¶32 *Magill* caused considerable disquiet amongst the business community who feared that an expansive interpretation of the judgment could devalue their rights. There was also concern that the holder of an improvement patent could demand access to the basic patent, since the *Magill* criteria seemed to be fulfilled.<sup>31</sup> In response to these concerns, however, it should be noted that the anticipated floodgate fears have not materialized. It

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<sup>28</sup> Joined Cases C-241/91P and C-242/91P, *Radio Telefis Eireann v. Commission*, 1995 O.J. (C 137) 3. [hereinafter *Magill*].

<sup>29</sup> The “exceptional circumstances” are stated by the ECJ in its *McGill* decision as:

“Conduct of that type – characterised by preventing the production and marketing of a new product, for which there is a potential consumer demand, on the ancillary market of television magazines and thereby excluding all competition from that market solely in order to secure the applicant’s monopoly – clearly goes beyond what is necessary to fulfil the essential function of the copyright as permitted in Community law.” 1995 E.C.R. I-743 at para. 73.

<sup>30</sup> Cases C-241/91P & C-242/91P, *Radio Telefis Eireann v. Commission*, 1995 E.C.R. I – 743 (*Magill*), at para. 73.

<sup>31</sup> Valentine Korah, *The Interface Between Intellectual Property and Antitrust: The European Experience*, 69 ANTITRUST L. J. 801 (2001).

is therefore apparent that the Commission does not believe that the current jurisprudence can support a wide application of essential facilities.

¶33 Although the development of exceptional circumstances illustrated the circumstances in which a compulsory license would be ordered, considerable doubts remained. It is possible that the ECJ's failure to establish a clear principle emphasizes its desire not to confine itself doctrinally, although the most notorious legacy of the case will continue to be the legal uncertainty brought to this area of EC competition law.<sup>32</sup> Clearly *Magill* demonstrates that competition law can take precedence over intellectual property rights, but it is ambiguous whether the case expanded upon the "refusal to supply" abuse as stated in *Volvo* or whether the exceptional circumstances were merely additional requirements which made the case against the television broadcasters more compelling. The issue of whether the requirements in *Magill* were cumulative became one of the most vexed questions in the essential facilities doctrine.

#### A. *New Product*

¶34 It has been argued by some commentators that the requirement that the competitor seeking a compulsory license should be offering a new product was an additional compelling factor in the *Magill* case and is not necessary in all situations of essential facilities within the context of intellectual property rights.<sup>33</sup> This line of reasoning claims that the only requirements for a compulsory license to be ordered are that the facility is indispensable and that the right holder is the only source.

¶35 Indeed, the partial adoption of this approach can be seen in the *Ladbroke* case.<sup>34</sup> In that case, the Commission and the CFI refused to apply *Magill* to a situation where the undertakings holding the exclusive rights to televised pictures and audio commentaries on French horse races, and an undertaking holding the exclusive rights to market such performing rights in Austria and Germany, refused to license the right to retransmit such audiovisuals of French horse races to a Belgian betting agency. The CFI distinguished *Ladbroke* from *Magill* finding that the license was not indispensable because sounds and images, although helpful, are not essential to a betting agency and that films are not indispensable since they are shown after the bets have been placed.

¶36 However, the CFI also stated *obiter* that the *Magill* requirement of a new product was not cumulative. It is apparent that if this approach were adopted, there would be a significant negative impact on innovation. It is conceded that a compulsory license can be granted where an undertaking uses the intellectual property right to stifle innovation on that market. In such circumstances the rationale for strong property rights becomes more difficult to justify, and consumer welfare is enhanced by allowing the benefits of competition to stimulate developments within the market. However, regulation should not seek to ensure equality between competitors, and access to intellectual property should not be granted where a third party merely desires to copy the right holder's product.

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<sup>32</sup> Sergio Baches Opi, *The Application of the Essential Facilities Doctrine to Intellectual Property Licensing in the European Union and the United States: Are Intellectual Property Rights Still Sacrosanct?*, 11 FORDHAM INTELL. PROP. MEDIA & ENT L. J. 409 (2001).

<sup>33</sup> Frank Fine, *NDC/IMS: In Response to Professor Korah*, 70 ANTITRUST L. J. 247 (2002).

<sup>34</sup> Case T-504/93, *Tierce Ladbroke SA v. Commission*, 1997 E.C.R. II-923.

¶37 Even if it is acknowledged that the requirement for a new product is an integral component of the *Magill* exceptional circumstances, identifying such a product is a difficult task. It is conceivable that, in order to satisfy the test, the competitor must develop a product that will compete in a separate market to that of the right holder. However, such a high barrier to the essential facilities doctrine disproportionately favors intellectual property rights and would not protect consumer welfare.

¶38 While it is conceded that the licensing of intellectual property where the third party is in direct competition with the right holder can, in some circumstances, benefit the consumer, the difficulty remains where the third party merely makes the same goods more cheaply or of a higher quality. In such circumstances, there would also be a benefit for consumers, but to grant a compulsory license would significantly undermine the property right. It is submitted that in order to qualify under the essential facilities doctrine, a third party must demonstrate that it has developed a distinct product from that of the right holder, but need not show that it will compete in a different market.

### *B. Essential*

¶39 A further difficulty of the “exceptional circumstances” in *Magill* is the definition of what is essential. The essential facilities doctrine does not require that equal conditions exist for all competitors; rather it provides a mechanism whereby competition may exist on previously foreclosed markets. Consequently a duty to provide access to an facility should occur only where there is an insurmountable barrier to entry for competitors of the dominant company, or if, without access, competitors would be subject to a serious, permanent, and inescapable competitive handicap that would make their activities uneconomical.<sup>35</sup> This approach appears to have been accepted by the Court, and the *Oscar Bronner* case,<sup>36</sup> which does not actually concern intellectual property rights, represents the clearest example of the current limited application.

¶40 Mediaprint, a publisher of two Austrian newspapers with a large market share, refused to grant its competitor, Oscar Bronner, access to its nationwide early-morning newspaper home-delivery network. According to Oscar Bronner, Mediaprint bore a duty to grant access to its distribution network claiming that a dominant company is required to allow access to competitors in the downstream market unless refusal to supply can be objectively justified. Oscar Bronner contended that the access requested was essential for its business since it was not economically feasible, due to the limited circulation of its newspaper, to establish its own distribution network.

¶41 The Court held that the facility must be truly indispensable, that it is not possible for the competitor to replicate it, and that the refusal is likely to eliminate all competition on the market. In rejecting Oscar Bronner’s argument, the Court observed that other forms of distribution existed which, while they were less favorable, did not lead to a finding that Mediaprint’s service was essential.<sup>37</sup> In addition, the ECJ noted that no technical, legal, or economic obstacles existed that would make it difficult for any other

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<sup>35</sup> John Temple Lang, *Defining Legitimate Competition: Companies’ Duties to Supply Competitors and Access to Essential Facilities*, 18 *FORDHAM INT’L L.J.* 437 (1994).

<sup>36</sup> Case C-7/97, *Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs-und Zeitschriftenverlag GmbH & Co. KG* 1998 E.C.R. I-779.

<sup>37</sup> *Id.* at para. 43.

publisher to establish its own nationwide home-delivery scheme.<sup>38</sup> The ECJ endorsed the reasoning of Advocate General Jacobs, holding that, for such access to be regarded as indispensable, a competitor has the difficult task of demonstrating the economic impracticality of creating a second newspaper delivery scheme with a circulation comparable to that of the existing scheme.<sup>39</sup>

¶42 The decision recognizes that there will only be a negative impact on consumers where the right holder's end product is sufficiently isolated from competition to give it market power. Unless such circumstances can be shown to exist, competition law should not intervene. The judgment in *Oscar Bronner* is sound and warns against the overzealous application of the essential facilities doctrine within the intellectual property rights context.

### C. Market Leverage

¶43 Another requirement of the "exceptional circumstances" established in *Magill* was that the right holder should reserve the secondary market for its own exploitation.<sup>40</sup> However, it is unclear whether the right holder must lever its advantage onto a secondary market or if it is sufficient that the secondary market has been foreclosed to competition.

¶44 It is submitted that the requirement that a right holder uses its monopoly position on the primary market in order to lever its dominance onto an ancillary market is indeed a vital component of the *Magill* test. The essential facilities doctrine cannot be used to require compulsory licensing merely because the existence of the intellectual property right creates market power in the product.<sup>41</sup> Where the right owner has invested research and development into the right, it should not be forfeited where it creates a competitive advantage, and therefore must be accompanied by some additional abuse. Any other interpretation of the essential facilities doctrine would undermine the very substance of an intellectual property right. Depriving an undertaking of its right to exploit on the primary market would interfere with the existence of the right, something that the ECJ has repeatedly stated it does not have the authority to do. Furthermore, such a principle would reduce the incentive to invest in the development of such intellectual property rights. A monopolist should be allowed to exploit its advantage to the maximum that the market will tolerate as a reward for its creativity and innovation.

¶45 A broader interpretation of essential facilities also ignores the need to compensate the right holder for the risk undertaken by investing in an evidently valuable resource without being able to predict its financial profitability. Indeed it has been argued that leveraging advantages are legitimate rewards, to which the right holder is entitled to the same extent as the primary market.<sup>42</sup> However, in response it must always be borne in mind that no regulation requires the holder to grant free access to its competitors, and so the dominant company will always be compensated for its investment. Nevertheless, it is only where innovation on the secondary market does not and cannot exist that competition concerns can outweigh the arguments in favor of incentives to invest.

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<sup>38</sup> *Id.* at para. 44.

<sup>39</sup> *Id.* at para. 45.

<sup>40</sup> *Magill*, *supra* note 28, at para. 73.

<sup>41</sup> Marquardt & Leddy, *supra* note 19.

<sup>42</sup> Richard M. Brunell, *Appropriability in Antitrust: How Much is Enough?*, 69 ANTITRUST L.J. 1 (2001).

¶46 It is also uncertain whether a compulsory license can be ordered where the right holder forecloses the secondary market to competition, rather than leveraging its advantage onto that market. It is submitted that, with reference to the policy objective of fostering maximum innovation, a competitor can be granted access to the intellectual property right in such circumstances, although the requirement for a genuine new product remains.

¶47 Advocate General Tizzano's opinion in the *IMS* case, while affirming the need for a refusal to supply on a secondary market, stated that the intellectual property right *itself* constitutes a distinct market.<sup>43</sup> According to this opinion, a market is identified where there is the potential to sell or license the product even if the owner declined to do so. Such a finding leads to the unacceptable conclusion that a right holder has levered its dominance onto an ancillary market, merely through exploiting the very subject matter of the right. In effect, this proposal dispenses of the requirement for a two market situation and is consequently undesirable.

#### *D. Objective Justification*

¶48 In *Magill*, the Court stated that where the intellectual property right owner has an objective justification for refusing to allow access to an essential facility, a compulsory license would not be granted.<sup>44</sup> However, no further guidance was provided as to which reasons the Court considers to be acceptable, and this remains the most elusive area of the judgment.

¶49 It is clear that a third party must do more than demonstrate that the right holder possessed an anticompetitive intent, since all refusals to license are due to the desire to maintain a competitive advantage within the market.<sup>45</sup> If this were not the case, the right would be licensed so that the owner could reap the benefits of any royalties. Consequently the intent of the dominant firm offers no definitive answers as to the circumstances where access can be compelled. There is also no objective justification in a refusal to supply if the owner has never dealt with the third party before, since the importance of the essential facilities doctrine is that it is not limited to existing customers.<sup>46</sup>

¶50 Indeed, it would appear that objective justifications may only be invoked where access to the facility would disrupt the business of the owner,<sup>47</sup> for instance where a compulsory license would result in negative returns. This is unlikely since such considerations would be accounted for when assessing the terms on which the license would be granted. Access should also be denied where it would result in congestion in the facility. This too is unlikely in intellectual property cases, since a license can usually be granted to an unlimited number of competitors.<sup>48</sup> Finally the holder may be able to escape an obligation where the grant of a license would undermine the quality or safety standards associated in the market.

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<sup>43</sup> Case C-418/01 Opinion of Advocate General Tizzano in *IMS Health GmbH & Co. OHG v NDC GmbH & Co. KG*, at para. 56-59.

<sup>44</sup> *Magill*, *supra* note 28, at para. 73.

<sup>45</sup> Marquardt & Leddy, *supra* note 19.

<sup>46</sup> Maurits Dolmans, *Restrictions on Innovation: An EU Antitrust Approach*, 66 ANTITRUST L.J. 455 (1998).

<sup>47</sup> Opi, *supra* note 32.

<sup>48</sup> *Id.*

*E. Summary of the Case Law Prior to IMS*

¶51 It can be seen from the above discussion that, while the *Magill* case proposed certain criteria to identify where a compulsory license would be granted, the Court's failure to establish a more principled approach has caused considerable uncertainty for business. However, the open-ended nature of the judgment has resulted in extensive academic discussion, which has done much to focus attention on the dangers of pursuing an expansive interpretation of the essential facilities doctrine.

¶52 Despite some assertions that the requirement for a new product and market leverage are not necessary for the grant of a compulsory license, it is submitted that such an approach demands caution. The removal of these components of the test fails to recognize the important role that intellectual property rights play towards guaranteeing consumer benefits. To apply the same criteria to intangible property rights as to the infrastructure cases overlooks the fact that incentives to innovate within the primary market in the latter are less compelling. A high threshold for the essential facilities test in intellectual property rights will do more to ensure the long-term efficiency of EC technology markets.

*F. The IMS Case*

¶53 On April 29, 2004, the ECJ delivered its judgment in the *IMS* case,<sup>49</sup> the latest litigation concerning the application of the essential facilities. The judgment certainly does not represent the final word on the doctrine, nor was it expected to be. However, the decision signifies the Court's current opinion on the issue and appears to strongly assert the supremacy of intellectual property rights.

¶54 IMS is the largest supplier in the world of information on sales and prescription of pharmaceutical products through a large number of small areas called bricks. IMS divided its German territory into 1860 zones or bricks. This division of the market enabled IMS to give its clients sales data while avoiding the identification of sales by individual pharmacies. IMS was assisted in establishing the brick structure by the pharmaceutical companies, but it also contributed considerable work itself.

¶55 IMS was the only firm providing regional data in Germany until, in 1992, NDC and AzyX entered the market and tried to base the information they supplied on different zones. However, after discussions with customers, it became apparent that this would not be marketable since it did not correspond to the segments already in use. The new entrants then started to use IMS's 1860 brick structure until IMS successfully obtained an injunction.

¶56 Despite the assertions of NDC and the Commission to the contrary, the ECJ unequivocally stated that *all* the criteria of the "exceptional circumstances," as stated in *Magill*, must be fulfilled in order for a compulsory license to be granted.<sup>50</sup> In fact, the Court did not discuss the misleading *obiter dictum* in *Ladbroke*, which stated that the conditions were not cumulative, and it should be considered that the confusion created by

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<sup>49</sup> Case C-481/01, *IMS Health GmbH & Co. v. NDC Health GmbH & Co.* KG (2002).

<sup>50</sup> *Id.* at para. 38.

that case has now officially ended. Instead the Court focused on the positive assertions in *Magill* and reaffirmed their importance.<sup>51</sup>

¶157 Regarding the definition of essential, the Court repeated the assessment contained in the *Oscar Bronner* judgment that it should not be economically viable for a firm of comparable size to the right holder to produce a similar facility.<sup>52</sup> The Court added that whether the participation by customers in the development of the facility constituted an additional barrier to the creation of a competing facility was a factor that should be taken into account by the national court when making its assessment of whether the copyright was essential.<sup>53</sup>

¶158 The Court accepted the Advocate General's opinion that regulation should balance the rights of the dominant firm with the need to ensure free competition in a derivative market. Emphasis was placed on the need to ensure consumer welfare and it was only where consumer welfare was increased that the interests of competition would prevail. Consequently, the ECJ emphasized the requirement that a third party bring a *new* product to the market. Unfortunately, the concept of a new product was not elaborated upon and remains for the national court to define.

¶159 Finally, the ECJ affirmed the need for two markets in the determination of an abuse of refusal to supply. However, it is only necessary to be able to identify a potential or hypothetical market. Whether such circumstances exist in the present case was left for the national court to determine. Since it is always possible to envision a potential market in the intellectual property itself, it is submitted that such an approach is inadequate and could lead to a finding of abuse where the right holder merely seeks to exploit the very product which is protected under intellectual property law.

#### IV. DUBIOUS EXISTENCE OF THE INTELLECTUAL PROPERTY RIGHTS

¶160 *Magill* was certainly a seminal decision. However, the vague nature of the judgment leads to the conclusion that the Court may have been influenced by factors other than those contained in the exceptional circumstances. In particular, it appears that both the Court and the Commission were skeptical about the existence of the copyright in the case and believed it to be unworthy of protection.

¶161 Traditionally, ECJ judges view Irish and UK copyright legislation, which protect "sweat of the brow" creations, with disfavor.<sup>54</sup> Copyright laws are designed to encourage, protect, and reward creative innovation, whereas the copyrighted television listings held little literary merit. Enforcing compulsory licensing for television listings did not significantly impact on the production and release of program listings since the copyright holders could not claim to have invested capital in the development of the intellectual property. The incentive to produce and disseminate programs would be the

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<sup>51</sup> *Id.* at para. 38.

<sup>52</sup> *Id.* at para. 28-29.

<sup>53</sup> *Id.* at para. 29.

<sup>54</sup> After the *Magill* judgment, there was much speculation that the Court had been influenced by the need to bring UK and Irish copyright law into line with the rest of Europe, where such TV listing could not be copyrighted.

same irrespective of whether the broadcasters were protected from competition in the television guide market.<sup>55</sup>

¶162 Indeed, officials of the Commission's legal service stated, in their personal capacities, that *Magill* should be limited to "unmeritorious kinds of intellectual property."<sup>56</sup> However, defining such intellectual property rights will once again prove difficult. It is only in circumstances where the proposal is undeserving of exclusivity, since it was not created through the innovation of the undertaking or where the right is a byproduct of the business' primary activity, that competition law may have a role promoting free access to the facility.

¶163 The desire to prevent the exploitation of unmeritorious intellectual property can also be evidenced in the approach of the Commission in the *IMS* case.<sup>57</sup> In that case, the 1860 brick structure was nothing more than an aggregation of German postal codes in a manner designed to prevent the identification of sales to individual pharmacies, as this would violate German rules on data protection. NDC and IMS are currently involved in German litigation concerning the copyrightability of the 1860 brick structure and, if this structure is indeed copyrightable, whether IMS is the legitimate owner of the right.

¶164 The Commission's finding that the 1860 structure represented an industry standard, which had been developed with the vital assistance of the pharmaceutical industry, was crucial since IMS's assertion of a copyright represented much more than a first mover advantage. In fact, the copyright was a semi-permanent barrier to entry, considering that the German pharmaceutical industry would not accept regional sales reports in any other brick structure.<sup>58</sup> It should also be observed that the pharmaceutical companies could have agreed with IMS that they would assist the firm in developing the 1860 brick structure if IMS gave the reciprocal commitment to allow competition on the market for the provision of the service. Competition law should not be used to rectify bad deals made by market participants.

¶165 The Court has consistently retained the distinction between the existence and exercise of intellectual property rights and, out of deference to Article 295, will not question the validity of an intellectual property right.<sup>59</sup> Indeed, despite fears that, with closer coherence within the internal market, the ECJ would look more restrictively upon intellectual property rights, the *Hag II*<sup>60</sup> judgment shows that these concerns were speculative. The judgments on spare parts in *Volvo* and *Renault*<sup>61</sup> also demonstrated that the Court was not moving in that direction.<sup>62</sup>

¶166 However, unless the ECJ is prepared to take the bold step and directly rule on the existence of the copyright, it is undesirable that the court considers the question of the legitimacy of the intellectual property right, and should instead concentrate on whether the tests for the exceptional circumstances principle have been fulfilled. Even so, in the

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<sup>55</sup> Opi, *supra* note 32.

<sup>56</sup> VALENTINE KORAH, TECHNOLOGY TRANSFER AGREEMENT AND THE EC COMPETITION RULES 244-55 (1996).

<sup>57</sup> *IMS Health*, 2004 O.J. (C3) at 20.

<sup>58</sup> Frank Fine, *NDS/IMS: A Logical Application of Essential Facilities Doctrine*, 23 E.C.L.R. 9 (2002) 457-468.

<sup>59</sup> See, e.g., *AG Volvo*, 1988 E.C.R. at 6219.

<sup>60</sup> Case C-10/89, *CNL-SUCAL NV v. Hag GF AG*, 1990 E.C.R. I-3711.

<sup>61</sup> Case 53/87, *CICRA et Maxicar v. Renault*, 1998 E.C.R. 299.

<sup>62</sup> Subiotto, *supra* note 7.

absence of competence to confront the existence of intellectual property rights, the Court could be tempted to expand the essential facilities doctrine so that an order to grant a compulsory license can be made. However, such an approach is problematic for several reasons.

¶67 Primarily, if the essential facilities doctrine is used as a tool to allow free access to intellectual property rights which are not deserving of protection, it will also capture rights which have a beneficial purpose for innovative efficiency and ultimately consumers. Even if abuses of intellectual property occasionally occur, the beneficial effects of dynamic research and development outweigh the negative effects of imperfect competition. After all, it is also one of the key aims of competition policy to increase innovation.

¶68 Second, by pursuing a doctrine that limits the exclusivity of an intangible property right, the regulator *de facto* affects the *existence* of the right. If a license to a right is granted in most circumstances where a competitor needs access in order to compete with the right holder, the advantages associated with national intellectual property protection will become illusory. As a result, the Court's distinction between the exercise and existence of the right will become inconsequential.

¶69 Third, the EC competition regulators are no more equipped to determine the existence or scope of an intellectual property right than the national authorities. In the absence of a coherent European program determining the minimum standard of qualification for and the duration of a period of exclusivity, the haphazard striking down of the vital protection will send a damaging message to the market. Concrete standards must be established so that a right holder can be confident of recouping its investment costs.

¶70 Finally, a judicial rule that disguises its true reasoning stands to do considerable damage to businesses. It may be that the Court will only apply an expansive interpretation of the essential facilities doctrine in cases where exclusive protection is debatable. However, businesses may perceive this approach as a threat to their *legitimately* obtained advantages. The threat of a compulsory license will have just as damaging an effect on innovation in the market as the obligation itself, and undertakings will be discouraged from technological advancements within the EC or even entering the European market if they perceive that the regulator is pursuing an expansive policy to essential facilities within the context of intellectual property rights. As a matter of policy, it is irresponsible to send unclear messages, upon which business plans are formulated, to the market.

¶71 It has been argued that implicitly tackling the issue of the existence of rights is a hazardous method of dealing with the essential facilities question. However, directly approaching the matter would do much to add to the coherence of the law. Many of the problems the Court has faced have been due to the differing qualification standards for exclusivity within the EU. Consequently, the adoption of a Union-wide intellectual property program, which ensures that minimum standards must be met in order to qualify for protection, would strike at the foundations of the essential facilities dilemma.

¶72 Any such proposal should include considerations concerning the nature of the right which is to be protected. It is clear that a uniform approach to all intellectual property rights fails to take into account that all rights have different characteristics. The duration of the period of exclusivity should primarily be determined by the speed of development

within the market. In the information technology sphere, for example, where innovation is typically rapid and dominance based on a particular right can often be deceptive and fragile, the owner of an essential facility should have strong property rights but for a limited duration. This would ensure that the incentives to develop important facilities are not diminished and allows a period of exploitation to recoup expenses, but also affords competitors the opportunity to enter the market with improvements on a derivative market before the essential facility has become redundant.

¶73 The grant of an intellectual property right should also consider the amount of capital invested in the development of the facility and the probable period needed by the undertaking to make a reasonable return on the product. Certainly the current practice, which has often been allowed to continue unchecked by national authorities, of drawing wide patent specifications in order to achieve exclusivity over several potential markets must be addressed and prevented.<sup>63</sup>

¶74 By tailoring the grant of an intellectual property right in this way, the competition authorities would do much to remove the need for an essential facilities doctrine altogether. Undertakings would be provided with predictable rules to forecast the recovery of expenditure, aware that during that period strong rights would be guaranteed, yet the right holder would not be able to restrict developments on either ancillary or even the primary market.

#### V. THE PRIMACY OF INNOVATION CONSIDERATIONS

¶75 Where a competition regime encroaches on the exclusivity guaranteed by intellectual property law, the regulator should consider the prospective benefits of such a policy. It is clear that a compulsory license should not be applied in such a way as to stifle desirable activity.<sup>64</sup> In order to safeguard the international competitiveness of the European Union, there should be sufficient financial incentives to encourage a high level of innovative movement. This view was reflected by the EC Commission in 1992, when it was stated that:

Although it could be argued that consumers would benefit in the short term if intellectual property rights were compulsively licensed to serve as the basis of standards, in the long term, investment in research and development in the standardised industrial sectors would dry up within the Community. Non-Community entities with extensive research activities would be encouraged to keep their technology out of Community markets, while low cost manufacturing centres outside the Community would benefit from cheap licenses to use Community technology.<sup>65</sup>

¶76 Since competitive markets, as well as exclusive protection of intellectual property rights, act as a spur to innovation, the regulator must become involved in the balancing of difficult concepts. Competitive practices must be analyzed for their prospective impact on developments within the market, as firms compete on innovation as much as price.

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<sup>63</sup> Korah, *supra* note 56.

<sup>64</sup> AREEDA & HOVENKAMP, *ANTITRUST LAW* (2d ed. 2002), 111.

<sup>65</sup> See IPR Commission Communication, COM 92/445, at ¶ 5.1.15 (1992).

But at what stage does competition create more incentives to develop a facility than the prospect of monopoly returns? Inevitably competition policy must consider the impact on both long-term and short-term innovative efficiency.

¶77 As Sullivan and Jones contend, the “evils” of a monopoly must be considered in context.<sup>66</sup> When regulation is viewed *ex post*, the more efficient solution is to demand that prices are related to cost. However, the competition authorities must also consider the *ex ante* constraint and social goals; namely, encouraging firms to be dynamic and efficient by tolerating monopolies when attained by such conduct.<sup>67</sup> After all, a monopoly supplier based on an essential facility is preferable to no facility at all, and there must be sufficient incentives to ensure the creation of such valuable components of the economy.

¶78 The most important incentive to innovate is the prospect of future profits. In technology markets, where the sunk costs in research and development are generally high, the expectation of elevated returns is a necessary spur to gain a competitive advantage. However, other factors despite the possibility to exploit the right will encourage a dominant firm to innovate. These include the fear of losing its dominant market position if improvements and developments are not made to the essential facility or within derivative markets. A right holder may also increase profits by creating more efficiencies in the manufacture of its goods. Nevertheless, these considerations are unlikely to significantly persuade a firm to innovate if the potential to exploit the product is diluted.

¶79 However, innovation is an important dynamic in both the primary and derivative markets, and the benefits of short-term innovation should always be considered. By allowing access to essential facilities, competition will be encouraged in ancillary markets to that of the intellectual property right, bringing the associated benefits of increased choice, lower prices, and higher quality. In circumstances where the essential facility has become so entrenched that it amounts to a consumer standard, allowing access may prove to be the only way to refresh the market with competitive practices.

¶80 When considering the economic arguments for the correct application of the essential facilities doctrine, the inherent difficulty is that the principle is likely to punish the most important inventions.<sup>68</sup> If the intellectual property right is unique, valuable, and difficult to duplicate, it is more likely to create a monopoly position on the primary market, and the obligation to share is more compelling. However, such facilities have a central role in the technological advancement of the Community and should be accompanied with the greatest incentives to invest in research and development.

¶81 It is conceded that participation in the new technology market is generally characterized by large market shares, however, it is also apparent that this dominance can often be deceptive. Often an essential facility in these markets is continuously under threat and the right holder is compelled to constantly keep under review or develop its primary product. Technology markets, in particular, are dynamic and ways are often found to circumvent what was previous believed to be an industry standard. If access to

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<sup>66</sup> Lawrence Sullivan & Ann Jones, *Monopoly Conduct, Especially Leveraging Power from One Product or Market to Another*, in ANTITRUST, INNOVATION, AND COMPETITIVENESS 165, 67 (Thomas M. Jorde & David J. Teece eds., 1992).

<sup>67</sup> *Id.*

<sup>68</sup> Marquardt & Leddy, *supra* note 19.

the facility is granted too easily, it will replace the incentive for the creation of other products that could compete in the primary market alongside that of the right holder. This contention is particularly persuasive where the competitor acknowledges that it is theoretically possible to develop its own facility, but claims it would be too costly, lengthy, or unpredictable. The long-term interests of the market are served by requiring increased innovation towards the establishment of more facilities with their own derivative markets.

¶82 It is therefore submitted that the competition regulator should concentrate on ensuring innovative efficiency after considering the long-term and short-term benefits of allowing access to an essential facility. In this regard, the Court should consider whether the intellectual property right is entrenched as an industry or consumer standard, or whether developments within the market are still practically possible. Justification for a compulsory license can be made where competition can only be achieved by opening up derivative markets to competitors.

## VI. A PROPOSAL FOR THE ESSENTIAL FACILITIES DOCTRINE

¶83 The above discussion has highlighted the importance of maintaining a sustainable level of innovation within the European Union. It is argued that this criterion, above all others, should be the standard against which the competition authorities base their policy regarding the essential facilities doctrine. The few cases that have come before the European Court can be characterized by well-formulated economic analysis by the Advocate General proceeded by vague statements of principle by the Court. Such an approach is misleading and can have damaging consequences for market participants.

¶84 Much of the case law and academic opinion has concentrated on the leverage of a dominant position onto an ancillary market. As a result, it has to be assessed whether there is a primary market upon which the right holder has a virtual monopoly. However, such an approach fails to recognize that the intellectual property right itself constitutes its own market, since there is always a potential to sell or license the right without actually making any products from the invention. Therefore, the regulator should concentrate on the market in question and consider whether it is included within the scope of the right. It is submitted that the following proposal seeks to offer a workable set of principles which protect intellectual property rights, while ensuring that dynamic efficiency is guaranteed.

¶85 It can be seen from an examination of the case law that there are two different kinds of markets that are based on intellectual property rights. First, where the product market is an additional consequence of the right, and second, where the product market amounts to the very essence of the exclusive right. In the latter case, the right holder can expect a higher standard of protection to his exclusivity. This principle applies in an equal manner, regardless of whether the market to which a third party requests access is the primary business of the right holder or a secondary market.

### *A. The Market is an Additional Consequence of the Right*

¶86 It is often the case that an intellectual property right bestows upon the holder exclusivity over a market which is additional to that for which the invention was developed. In such circumstances, the arguments in favor of long-term innovation are surpassed by the need to ensure development in the ancillary market, since the right

holder will be recompensed by the predicted returns on the intended market. Consequently the incentives to invest in such essential facilities will not be undermined by the grant of access to third parties.

¶87 However, it should be stated that, where the market under scrutiny is an additional consequence to the main activity of the right holder, it is still important that new facilities are developed where possible, and the facility should be truly essential for there to be an order of a compulsory license. Therefore, it should not be viable for a firm equivalent in size to the right holder to be able to develop a competing facility, having regard to the costs, time, and predictability of such a course of conduct. Nevertheless, where these circumstances are satisfied, it is argued that there is no need for a third party to demonstrate that it can offer a new product, since the right holder has no incentive to invest in developing products within the ancillary market. Short-term efficiency is improved by opening up such markets to competition.

### *B. The Market is the Essence of the Right*

¶88 Where the market in question amounts to the very essence of the protected right, different principles must be considered. It is possible that the intellectual property right covers more than one market which can be exploited. Clearly an undertaking will only inject the large sunk costs into the research and development of an invention that encapsulates its primary business if the prospects for remuneration are high. Regulation of these markets should therefore proceed with caution.

¶89 Once again, the facility in question should be truly essential and it should not be possible for a similar competitor to develop a competing facility. However, there should also be an additional consideration as to whether the facility is entrenched in the market. Even where it is not possible to develop a similar facility, dominance in certain markets, particularly within the technology industry, is often fragile. Obviously the regulator cannot perfectly predict how the market will develop. However, where the market is considered to be innovatively dynamic, a presumption should be raised that the dominance is precarious. In such cases, a compulsory license should not be granted, as the right holder may not be able to exploit the advantage for the full period of exclusivity.

¶90 Notwithstanding that the facility is essential and entrenched, it is of vital importance in cases where the market is the essence of the intellectual property right that a third party requiring access can produce a new product. A right holder should be allowed to exploit its legitimately obtained advantages unless there are tangible short-term benefits to consumers. While there is no need for a “new” product to amount to a separate market in itself, it should be clear that mere improvements to the right owner’s product or reduced costs do not add sufficiently to the level of innovation. Pursuing such a policy also encourages the right holder not to sit on its property rights, but to continue seeking a competitive advantage. Therefore, where the dominant firm provides the highest quality and most developed products, no third party can demand access to the essential facility.

¶91 The refusal to license the intellectual property right must be liable to eliminate *all* competition on the market. This requirement is necessary because where competition does exist, the addition of one more market participant will not add significantly to competition. Competition law should not be used in this way to protect competitors unless there are consumer benefits.

¶92 Finally, it must be considered whether the right holder is subject to effective competition within the intellectual property market itself. It is feasible that the right holder does not hold a monopoly over the market, although it is dominant in derivative markets. In such cases, competition within the intellectual property market will act as both a price regulator and a spur to innovation on any derivative markets since the right holder will aspire to dominant all markets based on the right. As a result, no compulsory licenses should be granted in circumstances where the market in question is the essence of the right and the holder is subject to effective competition on the intellectual property market.

### C. Summary of the Proposal

¶93 This proposal dispenses with the need to have a market leveraging aspect to the essential facilities doctrine since it focuses on the market to which the competitor requires access and questions whether this is included within the scope of the intellectual property right. Once this has been established, the regulator can concentrate on the differing tests concerning the rigidity of the market and the potential short-term gains of the competitor's new product. It therefore allows the right holder to exploit its advantage with long-term and short-term efficiency gains. The proposal also circumvents the problems associated with the dubious nature of certain intellectual property rights.

¶94 However, it is conceded that this proposal also has its own short-comings. Uncertainty still persists with the identification of a truly new product and whether an essential facility is fragile. It is also apparent that, by treating dissimilar intellectual property rights in a different manner, the Court will be seen to be regulating the existence of such rights. Nevertheless, this particular issue is central to the essential facilities problem. It would be more responsible for the Court to approach this concern directly in a way that seeks to reconcile the differences between the objectives of competition and intellectual property policy than to implicitly subvert national intellectual property laws.

## VII. CONCLUSION

¶95 On March 24, 2004, the Commission announced its intention to impose the largest fine in EC competition law history on Microsoft.<sup>69</sup> The decision finds two instances of abuse by the information technology giant; that of tying its audio-visual provider Windows Media Player to the Windows operating system to the detriment of rival operators, and failing to release key programming code to competitor servers to enable their computer systems to properly interact with Windows software.<sup>70</sup> Clearly the latter conclusion is based on a refusal to supply intellectual property information.

¶96 The European Court of Justice will be faced with a historic dispute. In particular, the Court must be mindful that the intellectual property right in question has only been developed through the investment of vast sums into the Microsoft project. A restrictive decision in such a high-profile case would send shock-waves through the European technology industry. It is therefore vital that the Court does not undermine the incentives to undertake such valuable projects. After all, although Microsoft has a long history of

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<sup>69</sup> *Microsoft*, COMP/C-3/37.792.

<sup>70</sup> *Id.*

exploiting its dominant position on the information technology market, its products are traditionally of a high quality and are offered at competitive prices. Consequently, it is doubtful that, through penalizing Microsoft, there would be many tangible consumer benefits.

¶97 The *IMS* case left both of the *Microsoft* parties speculating about its effect on their case. Both sides have claimed that the decision supports their main contentions. A spokesman for EU competition commissioner Mario Monti welcomed the *IMS* judgment, stating that “[the court] has defined the exceptional circumstances where the refusal of a license by a dominant company could be considered an abuse. And we consider that these exceptional circumstances . . . should also be fulfilled in the Microsoft case.”<sup>71</sup> However, it is clear that no definitive opinion can be reached given the complexities of the case and the nature of the *IMS* decision. Nevertheless, the ECJ in *IMS* may have been anticipating the impending Microsoft case, and the judgment seems to signify that the importance of intellectual property rights is beginning to take precedence.

¶98 Throughout European businesses, there is a widespread concern that a broad application of the essential facilities principle could have significant consequences. It would appear that both the Commission and the ECJ are aware that the implications of a decision undermining the importance of intellectual property rights could be severe. However, the failure of the Court to establish more concrete principles in order to determine when a compulsory license should be granted continues to give cause for concern when investing in the development of new ideas.

¶99 The dubious nature of some intellectual property rights has been the main catalyst for the development of an essential facilities doctrine. It is futile to pretend that every right is equally valuable, equally sacrosanct, and equally deserving of immunity or tolerant treatment under the competition rules.<sup>72</sup> It is implicit in the ECJ’s judgment in *Magill* and the Commission’s decision in *IMS* that the existence of the right itself was objectionable. If the rights in question were patents, which were the result of considerable research and development, it is submitted that different decisions would have been reached. However, the resolution of this point in the *Microsoft* case should not prevent EU harmonizing regulations. A Community-wide regime that establishes minimum criteria for the existence of intellectual property rights based on the economic and social value of the innovation could dispense with the need for an essential facilities doctrine altogether.

¶100 In the meantime, or in the absence of such an initiative, when considering the circumstances in which a compulsory license can be granted, the Court should be mindful of the need to ensure dynamic innovative efficiency. Encroachment into national intellectual property rights would be more acceptable if there was a thorough examination of the effects on long-term and short-term development of the technology industry. In any event, competition law should take precedent only where it can be demonstrated there will be a tangible consumer benefit.

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<sup>71</sup> Simon Zekaria, *IMS Ruling does not contradict Microsoft, says EU*, EUPolitix (April 2004), at [www.eupolitix.com/EN/News/200404/e96b7074-1ea1-470f-80eb-7649a2acbe99.htm](http://www.eupolitix.com/EN/News/200404/e96b7074-1ea1-470f-80eb-7649a2acbe99.htm) (last visited Apr. 17, 2005).

<sup>72</sup> Ian Forrester, *EC Competition Law as a Limitation on the Use of IP Rights in Europe: Is there Reason to Panic* (June 2003) (paper presented at the Eighth Annual EU Competition Law and Policy Workshop, European University Institute, Robert Schuman Centre for Advanced Studies) (forthcoming 2005).

¶101 Although it is probable that the EC competition authorities consider that the grant of a compulsory license should be limited to very rare instances of abuse, the ambiguity of the Court's rulings will be interpreted by market participants as a threat to their exclusivity. As a result, innovators will proceed with caution and the prospects of third party access being granted to facilities will be factored in as a risk in business calculations. The *Microsoft* case will provide the Court with a timely opportunity to establish a clear principle that rewards the most valuable innovations, while also preventing the right holder from stifling creativity in derivative markets to the detriment of consumers.