

CANADIAN COMPETITION RECORD

REGULATORY AND TRADE DEVELOPMENTS

WTO APPELLATE BODY ISSUES FIRST RULING

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On April 29, 1996, the Appellate Body of the World Trade Organization (the "WTO") affirmed the Dispute Settlement Panel's decision against the United States in the *Reformulated Gasoline* case. The case involved the United States government's application of different regulatory baselines for domestic and foreign gasoline under the U.S. Clean Air Act. The decision is the Appellate Body's first. Although the Appellate Body affirmed the Panel's conclusion that the use of different baselines unjustifiably discriminates against foreign gasoline, the Appellate Body overruled the Panel's reasoning with respect to the controversial natural resources exception, Article XX(g) of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), making it more likely that environmental measures will be found to be consistent with WTO rules in the future.

The Appellate Body is an important new feature of the Dispute Settlement Understanding (the "DSU") of the WTO. Its purpose is to review WTO panel interpretations of Uruguay Round agreements and legal issues. Under the previous dispute settlement system of the General Agreement on Tariffs and Trade

(the "GATT"), provisions for hearing appeals of panel decisions were not provided to parties in a dispute.

Under WTO rules, either party in a panel proceeding is allowed the possibility to appeal a panel decision. Appeals are brought before a standing Appellate Body which is established by the Dispute Settlement Body. The Appellate Body is composed of seven independent persons who serve four year terms. They must be persons of recognized standing in the fields of law and international trade who are broadly representative of WTO membership and are not affiliated with any government.

Panels consisting of three persons drawn from the Appellate Body hear appeals of any one case. Appellate panels can uphold, modify or reverse legal findings and conclusions of the panel. Third parties who have notified the Dispute Settlement Body of their substantial interest in the matter may make written submissions and be heard by the Appellate Body.

Appeal proceedings are not to exceed sixty days after the disputing party files an appeal. However, they may take up an additional thirty days if necessary. Within thirty days after the issuance of the report, an Appellate Body report must be

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adopted by the Dispute Settlement Body and unconditionally accepted by the parties in the dispute unless there is a consensus against the adoption. On May 20, 1996, the Dispute Settlement Body formally adopted the findings of the Appellate Body in *Reformulated Gasoline*.

The U.S. regulations at issue in *Reformulated Gasoline* establish baseline requirements for gasoline. The regulations expressly apply different air emission baseline requirements for domestic gasoline and imported gasoline. While individual domestic gasoline refiners are subject to requirements based on their own 1990 data, foreign refiners are subject to requirements based on the 1990 U.S. market average. The panel found that this results in less favorable treatment for imported gasoline that would meet clean air requirements based on the refiner's own data, but not based on the industry average.

Although the Appellate Body did not reverse the Panel Report's finding that the U.S. reformulated gasoline standards discriminate against foreign products in violation of the GATT 1994, the U.S. achieved its objective of reversing the Panel Report's reasoning with respect to the Article XX(g) exception, which covers measures "relating to the conservation of exhaustible natural resources." The Appellate Body's decision may make it easier to justify discriminatory measures that are based on a conservation objective.

The Article XX(g) exception covers otherwise WTO-inconsistent measures

relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

The Panel Report interpreted the Article XX(g) exception very narrowly to require that no less trade-restrictive measures are available, which would have virtually eliminated sub-paragraph (g) as an independent exception under Article XX. The Appellate Body overturned the Panel Report and adopted the much more liberal interpretation of Article XX(g) presented by the United States, which is to ask whether a WTO-inconsistent measure is "primarily aimed at" conservation, without reference to whether less trade-restrictive measures are available. The panel concluded that the U.S. Gasoline Rule was primarily aimed at conservation, notwithstanding the fact that it was discriminatory, and that the measure was "made effective in conjunction with restrictions on domestic production or consumption."

Although it found that the U.S. Gasoline Rule falls within the terms of Article XX(g), the Appellate Body found that the Rule failed to comply with the overarching requirement set forth in the introduction to Article XX that a measure may not be "applied in a manner which would constitute arbitrary or unjustifiable discrimination ..., or a disguised restriction on international trade" The United States argued that it was necessary to apply a discriminatory baseline to foreign gasoline because of difficulties in verifying foreign data. The Appellate Body rejected this justification, noting that the U.S. verified foreign data in other contexts. The Appellate Body concluded that the failure of the U.S. to explore alternatives, and to consider the cost to foreign manufacturers, indicated that the discrimination was foreseeable and was not inadvertent, and thus constituted "unjustifiable discrimination" and a "disguised restriction on international trade."

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The Appellate Body's decision thus may shift the focus in cases involving conservation measures to the question of whether such measures arbitrarily or unjustifiably discriminate or are a disguised restriction on international trade prohibited under the chapeau to Article XX. The Appellate Body did not establish a definitive analytical framework for answering this question (or for distinguishing between "unjustifiable discrimination" and a "disguised restriction on international trade"), and it appears that it will be necessary to await further Appellate Body and panel decisions before such a framework is provided. Nevertheless, the *Reformulated Gasoline* case at a minimum demonstrates that future dispute settlement panels will view with skepticism discriminatory measures where there is evidence showing that discrimination against foreign products was intentional, or at least that a government did not take steps to prevent or mitigate foreseeable discrimination.

The United States has stated that it will conform its regulations to the ruling within a reasonable period of time.

**FTC FINAL ORDER AGAINST DELL
COMPUTER CORPORATION MISSES
THE "BUS" ON INTENT AND
MARKET POWER ANALYSIS**

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On May 20, 1996, the FTC issued its complaint and final consent order against Dell Computer Corporation ("Dell") for Dell's failure to disclose its patent rights to a standards setting association.¹ The final order is substantially the same as the

proposed consent decree issued November 2, 1995, with minor modifications.² It suggests that where a company holds patent rights in some aspect of a proposed standard but the company's representative fails to disclose the patent to fellow members of a standard setting association: (1) in a manner which is "not inadvertent"; and (2) the implemented standard will "effectively confer market power" on the patent holder, this behaviour will unreasonably restrain competition in violation of Section 5 of the Federal Trade Commission Act. The offending company will be barred from relying on its patent rights against not only those other members who relied on its full disclosure, but all those who will subsequently rely on the standard.

In this case, a Dell representative to the Video Electronics Standards Association ("VESA") Local Bus Committee participated in the 1992 approval of a new design standard for the manufacture of VESA Local bus ("VL-bus") components. These parts are used to convey data between a computer and its peripheral devices. The Dell representative certified that, to the best of his knowledge, "this proposal does not infringe on any trademarks, copyrights or patents that Dell possesses." Dell in fact possessed patent rights to the motherboard configuration of the VL-bus card, and later sought to enforce these rights against other VESA members once the standard had already been used in over 1.4 million computers.

Based on the complaint and order, Dell's behaviour unreasonably restrains competition under section 5 of the *Federal Trade Commission Act* for the following reasons:

- (a) Industry acceptance of the VL-bus design standard was hindered because some computer manufacturers delayed their use

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of the design standard until the patent issue was clarified.

- (b) Systems utilizing the VL-bus design standard were avoided due to concerns that patent issues would affect the VL-bus' success as an industry standard.
- (c) The uncertainty concerning the acceptance of the VL-bus design standard raised the costs of implementing the VL-bus design as well as the costs of developing competing bus designs.
- (d) Willingness to participate in industry standard-setting efforts ha[s] been chilled.

Previous FTC consent orders involving intellectual property assets have primarily involved pharmaceutical mergers. Accordingly, the FTC's venture into the computer industry provoked much interest in the public comment period following the proposed order last fall.³

There was no general consensus amongst the public comments on the issue of an owner's duty to search and disclose its intellectual property during a standard setting process. Suggestions ranged from calls for a strict liability duty to disclose to proposals for no duty whatsoever. There was also disagreement on the need for an intent requirement in any new standard. The AIPLA also questioned the very need for a Section 5 proceeding at all where private patent estoppel litigation is available to the private parties affected.

This order offered the FTC an opportunity to make a clear ruling on duty of care, intent, and market power questions in the areas of information

technology and standard setting organizations. Unfortunately, the majority opinion's *Statement of the Federal Trade Commission* instead takes pains to limit this decision to the specific facts of the Dell case. Yet Dell's dilemma is not unique; as dissenting Commissioner Azcuenaga notes, the facts here are not complex. It is not uncommon to find a corporate representative making representations about company business practices which others will rely on.

It will be difficult to apply even a narrow reading of the order, since the precise facts relied on by the Commission are unclear. While the complaint does not allege Dell intentionally and knowingly misled VESA, the majority has inferred some type of active conduct by Dell based on facts not found in the record.⁴ The complaint also makes no allegation that Dell obtained market power as a result of the misstatement at issue, yet the majority finds that Dell acquired such power. The majority's position on intent and market power requirements are thus worthy of brief discussion in order to assess their application.

On the issue of intent, the majority categorizes the Dell representative's actions as "not inadvertent" and a violation of the expectation of "good faith" disclosure amongst VESA members. It cautions that "the order should not be read to create a general rule that inadvertence in the standard setting process provides a basis for an enforcement action" and the decision "should not be read to impose a general duty to search [for patents before signing a certification]." It considers Dell's offending actions to be more than mere inadvertence, but does not explicitly state that the misstatements were made to intentionally mislead VESA. The order thus appears to support a new "not inadvertent" standard which is less than

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an intent to mislead, but more than inadvertence.⁵ As dissenting Commissioner Azcuenaga notes, the "not inadvertent" standard appears to resemble negligence, but such a standard would imply the existence of a general duty of care which the majority has already specifically rejected. As an added wrinkle, the new standard is not uniformly applicable, but will depend on the disclosure policy of the individual association (VESA, ANSI, etc.) and the expectations of its members.⁶ Such a vague standard based on a varying association-specific duty to disclose may chill industry participants more deeply than the actions it seeks to remedy.

The problems with the majority's articulation do not end with the intent requirement. It also ignores any analysis of market power, noting only that "once VESA's VL-bus standard had become widely accepted, the standard effectively conferred market power upon Dell as the patent holder." The majority omits any analysis of product and geographic markets which might support this comment. As a result, the product in question is unclear: was the VL-bus architecture grouped together with the microprocessor and other components in one combined computer product market,⁷ or is the bus instead a separate industry independent of other computer part and peripheral storage device markets?

The FTC has perhaps avoided a detailed market analysis due to its relative inexperience ruling on the technologies involved. Nonetheless, computer industry knowledge is vital to a rigorous discussion of relevant product market elasticities, and, despite the wishes of both the majority and the dissent, such technical distinctions cannot be left to the Patent and Trademark Office if the FTC wishes to effectively enforce in this area.

The majority notes that but for the commitment to Dell's standard, VESA could have picked another standard which was "equally effective". This assumption of available substitutes ignores the reality of the market for IBM-PC compatible bus architecture in the early 1990s: the VL-bus became popular *precisely because* it offered a superior, low cost solution to low data transfer rates available from the dominant Industry Standard Architecture ("ISA") bus. It was arguably the best choice at the time the standard was chosen.

The FTC's lack of analysis of the product market impacts in two other ways. Firstly, it affects the rationale for FTC involvement itself. Although private litigation may have been adequate here, the FTC rationalizes a need for its involvement based on the public interest and the Commission's judicious use of prospective relief under Section 5. However, the case for future policing of VL-bus patent rights on this basis is not compelling, as the use of this standard is now in relative decline. The VL-bus is dependent on a direct connection to the 486 chip, and its success peaked in 1994 prior to the market entry of the more powerful Pentium and PowerPC chips. More recently, the Peripheral Component Interconnect ("PCI") bus, featuring previously unavailable processor-independent capabilities and a larger data path, has become popular as an option to the less flexible VL-bus with its dependence on the older 486 chip.

In other words, the FTC offers prospective relief in 1996 for harm related to a 1992 standard linked in part to older technology. Meanwhile, raw computer power continues to double every 18 months, driving the need for new hardware. The peripheral devices which the bus connects will also migrate upward to capitalize on expanded computer capabilities. Intel,

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the Pentium chip manufacturer, has already backed PCI as the standard bus of the future, and a combination PCI/ISA bus system will likely become the new standard as the demand for the VL-bus tapers off. The need for relief from the FTC based on a likelihood of future harm to VL-bus consumers and manufacturers is not an urgent concern.

The FTC's lack of market analysis also impacts a second way by clouding related study of the competitive effect of standards on product markets. These markets should be well defined if the effects of industry standards on overall restraint of competition are to be assessed. The role of standards in competition is not settled, and short product life cycles and merging markets in quickly changing information technologies make this assessment even more difficult. Definition of separate markets and evaluation of their relationship to each other over time is a helpful preliminary step which gives the impact of standards on competition real context.

While the complaint's enumerated restraints on competition cite hindered industry acceptance of the VL-bus standard and increased costs of its implementation, these results may not be anti-competitive in and of themselves if the standard does not affect price and output in the market.⁸ Although the dissent disagrees with the majority finding that high switching costs hindered substitution after implementation of the standard, neither side supports their comments with analysis. This is perhaps due to a lack of preliminary market analysis necessary to set up such a discussion.⁹ Perhaps the adoption of the VL-bus standard may itself have hindered faster migration upward to a superior, more flexible bus architecture standard. In such a scenario, delay in implementing a standard might even create incentive to "invent around" to find a superior alternative before the industry is committed.

In summary, the FTC's foray into the information technology sector has, at least for the present, failed to clearly articulate intent and market power rules within the context of duty of care to disclose intellectual property rights to standards associations. On a more positive note, the June 1996 FTC staff report on competition policy in the high-technology markets has identified numerous areas beyond the existing *Intellectual Property Guidelines* where such clarification is needed. This may be a sign of encouragement for the future.

Notes

¹ *In the Matter of Dell Computer Corporation* (May 20, 1996), Decision and Order, Federal Trade Commission Docket No. C-3658.

² *In the Matter of Dell Computer Corporation*, Agreement Containing Consent Order to Cease and Desist, Federal Trade Commission File No. 931-0097, reported in (1995-1996) 16:4 Can. Comp. Rec. at 21.

³ Comments were submitted to the FTC by, among others, the American Intellectual Property Law Association (AIPLA), the American National Standards Institute (ANSI), Bay Networks, the Electronics Industries Association and the Telecommunications Industry Association (EIA/TIA), the Institute of Electrical and Electronics Engineers (IEEE), and the Video Electronics Standards Association (VESA).

⁴ The majority responds to this concern by citing its discretionary powers to interpret the complaint and provide information it deems helpful. It notes "it would be odd, indeed, for the Commission to spell out in the complaint each and every fact on which it relies when it issues a consent order."

⁵ The FTC has relied on analogy to the equitable estoppel principles applied under patent law, yet common law fraud claims there require proof of material misrepresentation *intentionally* made to deceive. Inequitable conduct defences in the patent law also require either intent or knowledge of information withheld. Nothing in the complaint suggests Dell's representative had any knowledge of the offending patent's existence.

⁶ Commissioner Azcuenaga opines that actions grounded in such expectation of individual parties may best be enforced in private action, leaving the FTC to defend the public interest.

⁷ In defining relevant product markets in a tying case, the Seventh Circuit Court of Appeals has held that

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a computer and its operating system are not separate products since the computer is unable to function without the operating system. Since the two were part of the same product, no tying could occur. *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.* (January 16, 1996), 7th Cir. Docket 95-1794.

⁸ Dissenting Commissioner Azcuenaga describes the anti-competitive effects alleged in the complaint as "highly ephemeral."

⁹ The FTC staff report "Anticipating the 21st Century: Competition Policy in the New High-Tech, Global Marketplace" acknowledges that competition may be more or less effective in different intersystem versus intrasystem effects of access to group standards. See: (June 1996) 1:70 Antitrust & Trade Regulation Report 1765.
