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# Federal Court Finds Allegations of "Bad Faith" in Sprinkler License Agreements to be "Vox Clamantis in Deserto"

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On March 22, 2011, the United States District Court for the Northern District of California entered an order granting defendants The Toro Company's ("Toro") motion to dismiss plaintiff Digital Sun's ("Digital") monopolization, unfair competition and fraud claims pursuant to FRCP 12(b)(6). *Digital Sun v. The Toro Company*, Case No. 10-CV-4567-LHK (N.D. Cal. 3/22/11). United States District Judge Lucy H. Koh granted the motion without oral argument, and dismissed all of the allegations, but with leave to amend. In so doing, she held that the complaint was bereft of any plausible allegation that would support a claim under Section 2 of the Sherman Act. The execution of an exclusive and a non-exclusive patent license for various fields of use do not raise antitrust concerns where one alleged monopolist is simply substituted for another. As such, the complaint can be currently described as a "dry hole".

Digital developed a wireless sprinkler system that utilizes wireless sensors to activate a watering system based upon the dampness of the soil, thus improving efficiency and reducing water waste. Digital applied for and was granted patents in this technology. Defendant Toro was a leading provider of turf, landscape and irrigation equipment. It contacted Digital, and entered into negotiations to acquire it. During negotiations, Toro made a loan to Digital. A letter of intent provided that if Toro did not purchase Digital, the loans would be repaid at a set future date. Toro subsequently terminated negotiations.

Later, however, the parties entered into an agreement whereby Digital licensed Toro exclusive rights to sell its product through five home improvement retailers. Digital defaulted on its loan to Toro. The parties then negotiated a license agreement granting Toro an exclusive license to Digital's patents in the golf and sports fields of use, in exchange for a cancellation of the defaulted debts to Toro.

Subsequently, the parties entered into a second license agreement, which granted Toro a non-exclusive license to Digital's patents in all fields of use other than golf and sports. Negotiations for the acquisition of Digital by Toro continued, but were eventually terminated by Toro.

Subsequent to the termination of the acquisition negotiations, Digital brought an action in the district court alleging that Toro had attempted to monopolize the wireless sprinkler market by engaging in bad faith negotiations, in order to secure the negotiated patent licenses described above.

In dismissing the complaint, the court held that Digital had not sufficiently pleaded any of the elements of an attempted monopolization claim under Section 2 of the Sherman Act. The court began its analysis with *Bell Atlantic v. Twombly*, 550 U.S. 544 (2007). It held that Digital's allegations were not plausible in the light of basic economic principles. Even taking all of the allegations of the complaint as true, the court held that Digital had done nothing more than describe a situation where one alleged monopolist was substituted for another. This, an antitrust claim does not make. Even assuming these facts to be true, there would be no downstream impact on competition, no allocative inefficiency, and no potential for consumer rents transfers.

The court articulated a litany of reasons why Digital's allegations were insufficient under traditional antitrust and economic principles. Perhaps most importantly of all, the court noted that Digital had failed to plead that Toro possessed market power in a relevant market. Long gone is the former dicta that the grant of a U.S. patent is sufficient to raise a presumption of market power under the antitrust

laws. *See Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006). While *Illinois Tool* was a tying case, the truism remains that the starting point for any set of alleged facts under Section 2 is the articulation of a proper relevant market, and that the defendant, through acts of exclusionary conduct, has obtained or will obtain monopoly power, or in an attempt of monopolization context, has obtained the "dangerous probability of success" of actual monopolization.

The court noted that Toro had not obtained even whatever market power Digital may have had in the wireless sensor sprinkler systems market. This is because it only had an exclusive in one field of use, and a non-exclusive in others. Even assuming the transfer and substitution of whatever market power Digital may have had, at the end of the day, the net result is that there is at least one additional competitor in the market, that would tend to ameliorate the exclusionary exercise of market power, and tend to create expanded output and consumer welfare opportunities. Here, the complaint is bereft of allegations, plausible or otherwise, that Toro's course of conduct could have injured either Digital, or competition, or either of them, or at all. The court noted that it must be careful to avoid constructions of Section 2 that might have a chilling effect on competition, citing *Spectrum Sports v. McQuillan*, 506 U.S. 447, 457 (1993).

Finally, the court was dismissive of Digital's argument that Toro's conduct should be analyzed "as a whole", and not analyzed in its individual component parts. This would appear to be an appeal to the venerable dicta of the Supreme Court in *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690 (1962). There, the Court in commenting on the appropriateness of inferences to be drawn in support of an "agreement", stated that courts should give plaintiff's

> the full benefit of their proof without tightly
> compartmentalizing the various factual components
> and wiping the slate clean after scrutiny of each.

This dicta, historically referred to as the "monopoly broth" or "monopoly soup" hypothesis, has been at odds with further developments under the concept of "antitrust injury", as developed by the Supreme Court over the last 49 plus years. *See, e.g., Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977).

In the modern jurisprudence of antitrust injury, the piling of one non-exclusionary act upon another is insufficient. This is clearly so, as here, where the plaintiff has not even articulated a proper relevant market, or identified any acts which could be plausibly described as "exclusionary" or "anticompetitive". At most, we have two license agreements which have created an additional competitor in whatever the relevant market may be. The glass is neither half full, nor half empty. It is empty.

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