Intellectual Property and Competition

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Introduction: The Political Economy of Intellectual Property Law

A legal system that relies on private property rights to promote economic development must consider that profits can come from two different sources. First, both competition under constant technology and innovation promote economic growth by granting many of the returns to the successful developer. Competition and innovation both increase output, whether measured by quantity or quality. Second, however, profits can also come from practices that reduce output, in some cases by reducing quantity, or in others by reducing innovation.

IP rights (IPRs) and competition policy were once regarded as in conflict. IP rights create monopoly, which was thought to be inimical to competition. By contrast, competition policy values free entry and asset mobility, which IP rights limit in order to create incentives. Today our view of this relationship is more complex. First, most IP rights are insufficient to produce durable monopoly, although they do facilitate product differentiation. Second, we tend to see IP rules as creating a property rights system in which competition exists for the property rights themselves. Firms compete by innovating and appropriating whatever payoffs they are able to capture, including IPRs. Third, and most importantly, we define competition in terms of output or welfare rather than simple rivalry. A market structure or practice that increases output is more "competitive" than a lower output alternative, even though the amount of daily rivalry among firms is less. For example, output in the cellular phone market is much higher because hardware, software, and telecommunications links are all networked by cooperative agreements and standard setting.

Under conventional neoclassical assumptions, both innovation and competition increase output, whether measured by the number of units or their quality. At the same time, however, excessive IP protection limits competition by reducing asset mobility further than necessary to facilitate innovation. The policy trick is to find the “sweet spot” where the aggregate effects of IP competition and exclusion are optimized.

That innovation contributes significantly more to economic growth than does competition under constant technology is beyond dispute, both theoretically and empirically.1 While the theoretical and empirical literature employ different and sometimes inconsistent models, all agree on this basic conclusion.2 In addition, the "debate" between Joseph Schumpeter's position that monopoly is most favorable to innovation and Kenneth Arrow's position that competition is

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more favorable is somewhat settled (Schumpeter, 1943; Arrow, 1962). A broad consensus today tends toward the more Arrovian view that the market structure/innovation curve is a lopsided, inverted "U."³ Neither monopoly nor atomistic competition is especially conducive to innovation, but most innovation occurs in moderately competitive, product differentiated markets. Some more recent literature tilts the inverted U more to the competitive side, concluding that on balance more competition yields more innovation (Hashmi, 2011; Schmitz & Holmes, 2010).

Although the relationship between innovation and economic growth is clear, the relationship between innovation rates and particular IPR systems is not. The literature on the relationship between the strength of patent systems and the rate of economic growth is at best inconclusive, with most of it suggesting little or no correlation. (Gould & Gruben, 1996, at 328–38; Park & Ginarte, 1997, at 54–56).⁴ Relatively little literature exists that correlates innovation or growth rates with the existence or strength of any specific patent doctrine, although there is a robust "meta" empirical literature on the behavior of judges with respect to certain doctrines.⁵

Further, the innovation effect of IPRs is market specific, just as is true of other market characteristics such as economies of scale, product differentiation, ease of entry, or nature of information flow. In addition, the competitive impact of IPRs varies with differences in industry structure and the market position of the rights owners. For example, for a dominant firm additional IP protection may serve to entrench or prolong its monopoly position, while the same right to a small rival might serve to destabilize the dominant firm and make the industry more competitive. So who gets an IPR is extremely important for competition policy.

That the performance of IPRs varies from market to market is beyond dispute. For example, chemical and pharmaceutical innovations tend to benefit from a robust patent system with protection of fairly long duration. By contrast, in some markets for information

⁴One study finds a correlation between the existence of a patent system and total factor production (TFP) growth, but also concludes that there is an inverse correlation between the strength of patent rights and TFP growth. (Chang, 2014). The authors conclude that while patent rights lead to more patents, "our findings also suggest that patent rights slow the diffusion of new innovations throughout the economy, as we find that the effect of patents on TFP growth is weaker in countries with stronger patent rights. Our results suggest that finding the optimum level of patent protections requires the consideration of these two offsetting effects." See also Falvey, 2006 (at least in middle income countries, intellectual property rights cause more harm by restricting the dissemination of technology than they contribute to economic growth). For an experimental test, see Torrance and Tomlinson, 2011, which find an inverse relationship between innovation and patenting.
⁵E.g., Rantanen, 2013 (nonobviousness); Mojibi, 2010 (nonobviousness); Anderson & Menell, 2013 (claim construction); Seaman, 2012 (willful infringement); Crouch, 2010 (written description).
technologies the patent system is much less valuable and may even produce greater harms than benefits. The same thing is true of copyright. For example, many books have long economic lives and can benefit from a lengthy term of protection, while more journalistic writing and software does not.

Unfortunately, our knowledge about market diversity has had little impact on the creation or application of intellectual property law, which is largely indifferent to issues of market structure, information transmittal, ease of copying, and other barriers to market entry or mobility. This is in very sharp contrast to antitrust law, which is acutely sensitive to market differences, perhaps overly so. For example, questions concerning the legality of a merger or allegedly monopolistic practice can be answered only after a detailed expert inquiry into the markets at issue and the rationally expected results of certain practices. By contrast, questions of patent validity, scope and infringement are largely indifferent to the markets in which these queries occur.

One result of inadequate information about the relationship between innovation and specific IP rules is that attitudes often go to extremes. Some believe that the patent or other IP systems are worthless or even affirmatively harmful because they hinder rather than promote innovation (e.g., Boldrin & Levine, 2008), while others defend IPRs enthusiastically (e.g., Epstein, 2010, at 455; Mossoff, 2013). Even within the United States Supreme Court these views have gyrated from periods in which the Court was extremely tolerant of patenting and patent practices to periods in which it struck down nearly every patent it encountered and held exaggerated views about the anticompetitive effects of patent practices.

Further, IPRs are hardly the only inducement to innovation, and their relative importance varies from one market to another. When firm managers are questioned, a plurality believe that the biggest inducement is first mover advantages, while patent protection is at most a secondary (Bohannan & Hovenkamp, 2012, pp. 100–102). In some markets, such as digital content, copying is so cheap and quick that little innovation might occur but for IP protection. Innovations in processes that are not readily observable or reverse engineered might be better protected by simple first mover advantages or trade secrets. Patent protection is secondary and may even be counterproductive to the extent that patenting requires disclosure. Some markets exhibit high rates of innovation without any intellectual property protection at all. (Raustiala & Sprigman, 2012).

The lack of empirical validation for specific IP rules is troublesome, because some rules may be far from optimal. A good example is the way that patent law's requirement of nonobvious subject matter is administered. Because patent infringement does not require copying or even knowledge of another's patent, it is crucial that the nonobviousness requirement be interpreted so as to keep patent issuance within proper bounds: we do not want to give patents

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on things that independent entrepreneurs would develop on their own. An empirically-based inquiry into nonobviousness would consider the extent to which new technology results from copying rather than independent invention, a forward looking inquiry. But that is not how nonobviousness subject matter is determined. Rather, patent examiners or courts deciding infringement cases assess "inventive step" by doing backward looking searches through prior art. The likely result is that far too many patents are granted on things that other businesses develop on their own in the ordinary course of competition. The recent experience with patent trolls in information technology markets suggests as much. Most of the defendants in those cases are independent developers rather than copyists.

The statutory systems of competition law and IPRs differ significantly. For example, the United States antitrust laws are highly general and do not reflect specific "deals" between legislators and particular special interests. The Sherman and Clayton Acts simply condemn practices that "restrain trade," "monopolize," or whose effects "may be substantially to lessen competition." As a result, assessment of specific practices is left largely to judges. In addition, after more than thirty years of redefinition and retrenchment, antitrust policy in the United States has become much more focused on promoting consumer welfare, which it does by facilitating structures or practices that maximize output, measured by quantity or quality (Bohannan & Hovenkamp, 2012, pp. 33-59).

By contrast, most IPR systems are detailed codes that reflect considerable producer involvement but relatively little input from consumers. The 1976 Copyright Act currently in force, together with the Copyright Term Extension Act, are examples (Bohannan, 2006; Patry, 1996), but the patent laws are not far behind (Merges, 2000). For example, over history Congress has repeatedly granted retroactive term extensions to both patent and copyrights (Ochoa, 2001). Retroactive extensions do not facilitate innovation insofar as the rights that they apply to have already been created. They are pure rent seeking, prolonging exclusive rights and reducing output. Such extensions have come to the Supreme Court twice, 150 years apart. In Bloomer v. McQuewan the Supreme Court held that retroactive patent extensions could not be applied to patented articles that had already been sold, thus creating the foundation for the modern patent "exhaustion," or first sale, doctrine. In Eldred v. Ashcroft the Supreme Court upheld a retroactive extension of the copyright term.

This history is unsettling because consumer welfare should be the ultimate goal of innovation policy just as it is of traditional competition policy. Consumers profit from lower prices and higher innovation rates, giving them the correct set of incentives to determine optimal

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8 Bloomer v. McQuewan, 55 U.S. 539 (1852).
IP rules. By contrast, producer incentives are more mixed. While producers profit from lower costs and increased innovation, they also profit from increased protection for their own IPRs or reduced protection for the innovations of others, whether or not these protection levels are optimal (Hovenkamp, 2014).

The Relationship Between the IP Policy and Antitrust Policy

Approaches to Market Diversity

While the antitrust laws do not explicitly require different analysis for different markets, the spare, highly general statutes have been interpreted that way at least since the Supreme Court's Chicago Board of Trade decision in 1918. The decision approved an agreement that literally fixed prices, but in a way that was unique to that market and, in the Court's view, promoted rather than restricted competition.\footnote{Chicago Board of Trade v. United States, 246 U.S. 231 (1918).} The antitrust merger provision requires proof of an acquisition “where the effect may be substantially to lessen competition or tend to create a monopoly”—a requirement that has always been held to require highly specific market analysis.\footnote{E.g., United States v. Columbia Steel Co., 334 U.S. 495 (1948).} For well over a half century the law of monopolization under Sherman Act § 2 has required detailed inquiries into market structure, producing different outcomes in different industries.\footnote{United States v. Aluminum Co. of America (Alcoa), 148 f.2d 416 (2d. 1945); United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (1956) (Cellophane); Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).} By contrast, IP law largely disregards market differences.\footnote{For some qualifiers, see Burk & Lemley, 2003.} Terms of protection are largely invariant to the industry, even though rates of technological turnover vary widely. If protected technology or expression routinely becomes obsolete in the market before the IPRs expire, then the Constitution's requirement of "limited times" is largely meaningless. The premise of the "limited times" provision in the Constitution's IP Clause\footnote{U.S. CONST. art. I, § 8, cl. 8 (giving Congress the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.").} is that the protection period should be sufficient to induce innovation, but after expiration the protected good goes into the public domain. Even requirements such as nonobvious subject matter for patents generally avoid market specific questions about how information is disseminated in a particular market. An IP policy truly concerned with innovation would need to develop more market specific rules, reflecting how innovation works in different situations, what amount and nature of inducement is required, and the extent of harm caused by the resulting exclusion.

Changing Attitudes Toward Antitrust and IP

Competition policy and IP policy should be considered complements rather than competitors. They share social welfare as a goal, and an optimal policy includes elements of...
both. Public policy has been erratic, however, and the two legal systems have not always accommodated each other in socially beneficial ways. Prior to 1917 the Supreme Court approved virtually every patent practice had been alleged to restrict competition, including product price fixing.\footnote{E. Bement & Sons v. Nat'l Harrow Co., 186 U.S. 70, 91 (1902) (product price fixing in patent pool); Cont'l Paper Bag Co. v. E. Paper Bag Co., 210 U.S. 405 (1908) (permitting dominant firm to use unused patent acquired from outside inventor to enjoin competing technology); Henry v. A.B. Dick Co., 224 U.S. 1 (1912) (permitting infringement action enforcing tying of patented machine and unpatented products).} A single mention of patents in the 1914 Clayton Act, passed at the high point of the Progressive Era, changed that dramatically. Beginning in the 1917 Motion Picture Patents case\footnote{Motion Picture Patents Co. v. Universal Film Co., 243 U.S. 502 (1917), overruling Henry, supra.} the Supreme Court embarked on a war against patent practices thought to be anticompetitive, in the process developing an expansive, judge made doctrine of patent “misuse,” of which more later. Beginning in the late 1930s the Supreme Court applied increasingly harsh standards for patent issuance, eliciting Justice Robert H. Jackson’s famous complaint that “the only patent that is valid is one which this Court has not been able to get its hands on.”\footnote{Jungersen v. Ostby & Barton Co., 335 U.S. 560, 572 (1949) (Jackson, J. dissenting); see Hovenkamp, 2015c, Ch. 10.}

Three events gradually turned the tide again. First was the 1952 Patent Act, a significant revision, which restated the patentability requirement as “nonobvious” subject matter and also limited the reach of patent misuse law (Duffy, 2007; Hovenkamp, 2015c, Ch. 10). The second was the establishment of the Federal Circuit Court of Appeals in 1982, with a mandate to unify and strengthen patent law (Dreyfuss, 1989; Dreyfuss, 2008). The third development, which occurred more gradually and within antitrust and patent misuse law, was a doctrinal reformulation that required much more explicit proof of anticompetitive effects (Bohannan & Hovenkamp, 2012, at 33–59). The high point of antitrust hostility toward patents was 1970, when the U.S. Antitrust Division issued its “nine no nos” of patenting that were almost certain to provoke an antitrust challenge (Wilson, 1970). Today nearly all of the “nine no nos,” including such things as mandatory packaging licensing, grantback clauses, reach through royalties, and resale price maintenance, are widely regarded as competitively benign in most situations (Hovenkamp, 2015a). Antitrust courts and scholars increasingly came to believe that many post-issuance patent practices that had been condemned as “misuse” were in fact competitively harmless. This was particularly true of tying arrangements, the most frequent generator of misuse findings, as well as vertical price and nonprice restraints, package licensing, provisions that tied royalty payments to unpatented goods, and most unilateral refusals to license. (Bowman, 1973; Areeda & Hovenkamp, 2009-2015, ¶¶1781–1782; Hovenkamp, 2015a).

One important result of significant antitrust revision is that overreaching is far less likely to occur today than it was thirty years ago. By contrast, patent law has continued on an expansion course in both issuance and doctrine that until recently seemed unstoppable. Today
antitrust law is in a much better position to accommodate concerns about innovation than patent law is to accommodate concerns for traditional competition. Antitrust law's sensitivity to innovation manifests itself in several ways. One is a very broad rule that innovation itself can never be an antitrust violation, no matter how exclusionary. One limited exception is situations where the cost of product changes is very small in relation to competitive harm and the changes are readily reversible. This is true mainly of software, where a minor change in code can serve to make rivals' products incompatible (Newman, 2012). Another area is the deferential treatment that the courts have afforded to settlements of IP lawsuits, and a third is increasingly strict limitations on the use of antitrust to challenge anticompetitive IP infringement actions. Yet another is deferential treatment of technology sharing agreements under antitrust law, which rarely condemns them unless they involve explicit restraints in the product market (Hovenkamp, 2015a).

By contrast, IP case law often operates as if competition was the affirmative evil. One example is the Federal Circuit's 2014 Trebro decision. The court permitted a dominant firm in a concentrated market to enjoin patent infringement on unpracticed patents. The dominant firm had purchased from a third party two patents that covered an alternative technology to that in its own product. After the acquisition it continued to use its older technology and brought an infringement suit against the defendant, a recent entrant whose technology very likely infringed the acquired patents. The Federal Circuit distinguished a line of lower court decisions which, following the Supreme Court's eBay decision, had refused injunctions to non-practicing entities. In this case the patentee was actually competing in the market, even though it was not practicing the patent whose infringement was claimed. In the court's defense, no one apparently raised an antitrust issue. Nevertheless, the court's decision did considerable harm to competition by giving dominant firms an excuse to buy up alternative technologies in order to keep them out of production, thus limiting the avenues through which new entry can occur.

**Anticompetitive Restraints: Defensive Use of "Scope of the Patent" Test**

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Historically, competition policy presumed that an IP practice that increased the profits of an IP right would also increase the incentive to innovate. Competition law enforcers should stand aside if the practice fell "within the scope of the patent." This formulation originated in the nineteenth century as a rationale for the exhaustion, or "first sale," doctrine, which held that "when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly." For example, even if a patent license limited the geographic range over which a good could be used, once the good was sold that right could no longer be enforced against the purchaser by means of a patent infringement suit. Later on the Supreme Court used the "beyond the scope" formulation to describe overly broad patent claim constructions or use of the doctrine of equivalents. Beginning in the 1930s, the formulation was employed in patent "misuse" cases, particularly those involving the tying of unpatented goods. The tie was said to extend the patent's power beyond its proper scope by bringing the tied but unpatented product within the patent monopoly.

The "scope of the patent" formulation was also used defensively, however, to exonerate practices challenged as anticompetitive but that were found to remain within the patent's scope. For example, in 1926 the Supreme Court upheld product price fixing contained in patent licenses on the theory that setting the product price was the patentee's right, and the licensee agreement did no more than retain that right, while transferring the right to produce to the licensee. In the 1970s Ward Bowman's important book on patent and antitrust law took this approach, envisioning the patent as a walled garden protecting everything within its scope, but not necessarily activities that spilled outside. In the 1948 Line Material Case, however, the majority condemned a product price fix in a cross-license, over the dissent of three Justices who objected that the price fix was within the scope of the patent. The dissenters in the Supreme Court's 2013 Actavis decision would have exonerated a settlement agreement in which a patentee paid an accused infringer a large sum to delay its entry into production, provided that the permitted entry date was prior to the expiry of the patent. In that case the

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23 Bloomer v. McQuewan, 55 U.S. 539, 548 (1852).
25 E.g., Coupe v. Royer, 155 U.S. 565, 576 (1895) (overly broad claim construction effectively extended patent monopoly beyond its rightful scope); Johnson & Johnston Assocs., Inc. v. R.E. Svee Co., Inc., 285 F.3d 1046 (Fed. Cir. 2002) (broad infringement claim under doctrine of equivalents was attempt to extend patent beyond its rightful scope). See also Sarnoff, 2005.
26 Carbice Corp. of Am. v. Am. Patents Dev. Corp., 283 U.S. 27, 32 (1931) (patent tie was attempt to control "unpatented material" and is thus "beyond the scope of the patentee's monopoly").
27 United States v. General Electric Co., 272 U.S. 476, 485 (1926) (product price fix in license agreement did not "step[] out of the scope of his patent rights").
settlement agreement was no more exclusionary than a judicial determination of validity and infringement; thus the agreement fell within the scope of the patent.\textsuperscript{29}

Pay-for-delay settlements came into existence with the passage of the Hatch-Waxman Act, which gives a generic firm 180 days from commencement of its production as a reward for being the first to challenge a pioneer’s patent or entering upon that patent’s expiry. Under a pay-for-delay settlement no third party can enter the market until 180 days after the generic actually produces, making the patent virtually immune to challenge by other potential competitors. This gives the patentee and the generic infringement defendant a strong incentive to share the patent monopoly, thus largely eliminating adversity between them. The equilibrium duration of such an agreement is the remaining term of the patent, assuming that the antitrust laws permit such an agreement (Hovenkamp, 2015d). That is, the joint-maximizing agreement for the settling parties would share the returns permitted by the patent for its full period.

But the \textit{Actavis} majority rejected that approach, perhaps heralding an important change in the relationship between competition policy and intellectual property law. If patent rights are presumed to be valid, valuable, and clearly defined, then the scope of the patent formulation functions much like similar scope formulations might do for, say, real property. But if patents are of questionable validity or dubious value, then the scope of the patent formulation can permit significant anticompetitive overreaching. This issue was highlighted in \textit{Actavis} because the legislative framework largely immunized suspiciously weak patents from challenge while the pay-for-delay agreement was pending. Further, because the owner of a robust patent would not pay much more than avoided litigation costs in order to enforce its rights, the high pay-for-delay payment (often several hundred million dollars) is a strong signal that the patent is invalid or, in a few cases, not infringed (Edlin, et al., 2013; Edlin, et al, 2014). For example, a landowner attempting to exclude a trespasser would not pay the trespasser a very large sum of money to stay off her land unless she had serious doubts about the validity of her legal claim. If her title were good she could exclude the trespasser by paying nothing more than litigation costs.

In other cases the scope of the patent formulation fails, not because the patents in question are invalid, but because their value is much lower than the restraints in question. Licenses that include product price fixing are a good illustration. Even for relatively sound patents, license fees range from .5 to 6 percent, with rates below 3 percent being the norm. The rates on individual patents can be much lower than that in patent intensive technologies such as computers and telecommunications. Further, these rates are for licensed patents, and only a small percentage of patents are licensed. By contrast, the markups of successful cartels often run in the range of 10 to 50 percent (Connor, 2014). If the firms in an industry cross license their patents and also fix the product price, the agreement as measured by a scope of the patent test attributes the value of the entire cartel markup to that of the patents.

\textsuperscript{29}FTC v. Actavis, Inc., 133 S.Ct. 2223, 2240 (2013) (Roberts, C.J., dissenting: pay-for-delay settlement should be lawful if it does not exclude "beyond the limits of the patent monopoly").
Justice Breyer’s majority opinion in *Actavis* held that courts evaluating such settlements need not address questions of patent validity or infringement. That proposition is consistent with long-standing reluctance by federal judges to refuse to review the IP merits when considering competition-based challenges to settlements, except for obvious cases of patents that are almost certainly invalid or not infringed. Most of those cases go on to uphold the settlement, however, while the *Actavis* decision did not.

More importantly, as *Actavis* recognized, antitrust’s purpose is to create appropriate incentives at the point of decision. The relevant question is not the *ex post* one whether the patent was valid and infringed, but rather the *ex ante* question of what the parties' expectations were at the time the settlement was entered. By settling, the parties have already implicitly agreed that getting a judicial determination of patent validity and infringement is not worth the cost and attendant risk of a judicial determination. As a result it makes little sense to insist on that same query before passing judgment on the settlement (Edlin, et al, 2015).

Of course, most settlements raise no competition issues because the settlements themselves tend to increase rather than decrease output. The most common settlement of an IP infringement dispute is a production license under which the defendant pays the plaintiff for the right to produce. Such a license is likely to increase rather than decrease output, but in any event production licenses are explicitly authorized by the Patent Act. They are legal whether or not they are in settlement of litigation. The more problematic settlements are those that fix product prices, divide product markets (as in *Actavis*), or in some cases that involve an agreement among the settlors not to license to or otherwise deal with third parties.

Finally, one thing that makes an *Actavis* style pay-for-delay settlement unusual is that it does not involve a license at all, but at most an agreement to license at some future date. While the Patent Act explicitly permits licensing, the Supreme Court observed that an agreement providing for delayed entry was not authorized by the Patent Act. Until actual production under a license occurs, the settlement is nothing more than a naked market division agreement. Even so, the *Actavis* Court held that the agreement in question should be addressed under antitrust’s rule of reason, which requires proof of market power and anticompetitive effects. It also held, however, that both power and harmful effects could be inferred from the large payment itself.

**IP and Antitrust: Specific Issues and Applications**

Prior to patent issuance the patent process operates under intensive government supervision and control. To be sure, improper conduct in patent prosecution is not rare, but the patent system itself has tools for policing it. In any event, it is not antitrust’s purpose to ride herd on the procedures and rules of other federal agencies. Even if we believe that the existing system issues too many patents, that too many of these are worthless, or that the process has other flaws,

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these are not antitrust problems. This position is mandated by the ordinary antitrust rules of implied immunity, which limit or remove antitrust involvement from activities that are actively regulated by other federal agencies (Areeda & Hovenkamp, 2009-2015, vols. 1 & 1A).

The situation after patent issuance is much different. Patents are largely treated as property rights requiring little government supervision, other than the USPTO’s power to re-examine, collect renewal fees, and a few other housekeeping matters. Because issued patents are largely subject to private control, antitrust policy becomes relevant.

Another distinction that is important for antitrust purposes is between practices that are expressly authorized by the Patent Act and those that are not. Under the rules of express immunity, a practice that is compelled or authorized by a federal statute cannot be an antitrust violation, provided that the practice stays within the expressly authorized boundaries.

After considering how market power should be assessed in IP-intensive markets, this section briefly addresses specific intellectual property practices that might also be antitrust violations. All are post-issuance practices and most of them are either not authorized by the Patent Act itself, or else they fall outside the scope of the authorization. As a result, antitrust analysis is appropriate. Of course this does not mean that they are unlawful. Nor does it entail that the presence of an IP right or license is irrelevant (Cotter, 2015).

Assessing Market Power in IP Intensive Markets

No anticompetitive practice can succeed unless its participants have significant market power, which is the power profitably to raise prices above cost by reducing market wide output. This requirement applies both to anticompetitive exclusion and anticompetitive collusion. To be sure, a certain class of practices, such as price-fixing, is said to be unlawful "per se," which means that proof of illegality does not require a showing of market power. This is not because market power is irrelevant, however. To the contrary, naked practices such as price fixing, which produce no efficiency gains to the participants, are profitable only on the premise that power exists. As a result, proper identification of the practice eliminates the need to assess market power separately (Areeda & Hovenkamp, 2009-2015, Ch. 19).

In 2006 the Supreme Court overruled a half century old presumption that a patent conferred sufficient market power on its owner so as to make certain anticompetitive practices such as tying unlawful.\(^{32}\) The Supreme Court had also extended the presumption to copyrights,\(^ {33}\) and a few lower courts had applied it to trademarks.\(^ {34}\) Most courts limited the presumption to tying cases, but where it applied the challenger needed to show only that the challenged restraint


\(^{34}\) E.g., Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971).
involved a patent (or copyrighted) product, and the requisite market power would then be presumed.

The end of the power presumption hardly means that IPRs are irrelevant to inquiries about market power. Today they are properly regarded as one important element of market structure that determines the amount of market power a firm has (Areeda & Hovenkamp, 2009-2015, ¶518). More particularly, a few very powerful patents and some software copyrights may have so much exclusionary power that they give their owners dominant market positions. One likely example is Microsoft’s Windows operating system, which is protected from duplication by copyright and some patents. Other good historical examples are the patents that protected Polaroid’s self-developing camera and film system, which Kodak tried in vain to invent around (Fierstein, 2015), and the array of patents that Xerox acquired from outside inventors that led to its long held dominance of plain paper copying technology.

Some aggregations of patents can become so essential to operation in a market that they give significant market power to their owners. That would certainly be the case if the aggregation were owned by a single firm. Most of the time aggregations of essential patents are owned by pools in which a large number of firms have nonexclusive rights. Good examples are MPEG-LA, whose members control standards for digital video technology, and 3GPP, whose members control the technology for 3G and 4G wireless telecommunications. Once a particular patent in such a pool is declared "standards essential" it may be necessary for any firm wishing to compete in that technology to purchase a license. That obligation can confer significant market power, limited by the fact that standards-essential patents, or SEPS, are also typically subject to FRAND licensing obligations, which are generally interpreted to require licensing to willing participants at fair and nondiscriminatory rates (Contreras, 2015). So far there have been few antitrust cases challenging the creation and enforcement of SEPs, and these have been largely unsuccessful.

IPRs of all forms can limit asset mobility and facilitate product differentiation. As a result, prices in such markets will be higher than short run marginal cost, even though the market has several competing firms. The impact of IPRs in these situations depends heavily on the number of firms in a market and the strength of the IPRs in question. Suffice it to say that many products from automobiles to computers to kitchen appliances contain numerous patents but are yet sold in moderately competitive markets.

37 E.g., Golden Bridge Technology, Inc. v. Motorola, Inc., 547 F.3d 266 (5th Cir. 2008) (rejecting antitrust claim that SSO rejected plaintiff’s technology in favor of their own alternative technologies).
One technical difficulty for assessing power is that IP development is often subject to large development costs, which are paid at the front end, but very low marginal costs. Most of the technical tools used for market power measurement examine the relationship between price and marginal cost. The result can be false positives, depending on how prevalent the IPRs are. For example, an unpatented lawn chair with a patented recliner button may sell at a small markup over cost, reflecting licensing of the button patent. At the other extreme, purely digital products such as streamed ebooks, songs, or software may have distribution costs very close to zero, meaning that the entire price is markup. As a result any measure of market power based on the relationship between price and short run marginal cost will exaggerate the seller’s power.

Because digital content is so easily duplicated, the ability to sell at a substantial markup over short run cost is largely a result of IP protection. For example, one can obtain an ebook version of *Moby Dick* at a price of zero, even though it is a very famous and widely read book. The reason is that *Moby Dick* is in the public domain, which means that no one is earning a royalty on its sales and copying is free. By contrast, the ebook version of a recent novel of much more mediocre stature will be much higher because royalties must be paid and it cannot be copied without a license from the publisher or author. For antitrust purposes, the main takeaway from these situations is that assessment of price-cost margins is rarely a useful way of assessing market power in markets for purely digital goods. Theoretically, one could address the problem by querying whether the returns to a product are significantly positive over its entire life. For example, the fact that a digital computer program sells at a high ratio of price to short run cost tells us nothing if the product becomes obsolete or loses its commercial viability before recouping development costs. As a practical matter these measurements can be very difficult to make, particularly when the IP right in question is a copyright with a century-long duration. (Hovenkamp, 2015b).

With relatively few exceptions, non-patent IPRs make even a smaller contribution to power than do patents. Copyrights and trademarks are easier to obtain than patents are. A few highly popular publications or computer programs are counterexamples, but as a general rule one cannot infer significant power from the existence of an IPR of any kind (Areeda & Hovenkamp, 2009-2015, ¶518c).

*Horizontal Restraints: Price Fixing and Market Division*

A restraint is "horizontal" if the participants are competitors or would be competitors but for the restraint. Identification of firms as "competitors" is usually a reference to the product or service markets in which the firms operate, although it may also refer to the technologies that they license. In any event, it is always important to distinguish restraints in the patent and licensing market from restraints in the product market.

A good example is price-fixing. Setting a price is inherent in licensing and rarely anticompetitive. Even if firms cross-license they must agree on the price that each will charge to
the other. Price fixing in the product market is another matter and is highly suspicious. For example, firms with worthless patents or other IPRs might use licenses or cross licenses as a cover for price fixing, as Judge Posner observed in his opinion in *Asahi Glass*.

As noted previously, the competition problem with product price fixing actually reaches far beyond invalid patents. Even if a patent is valid and essential, it may contribute only a small amount to a product's value. As a result the market price of the license can be far less than the cartel markup on the product. For this reason product price fixes in IP licenses should be regarded as competitively harmful whether or not the IPRs in question are valid.

Market division agreements operate economically much like price fixing. By dividing up the market (by territory, customer, or product) a group of firms can create individual monopolies for themselves. One important difference between price fixing and market division is that the Patent Act expressly authorizes patents to grant exclusive licenses to "any part" of the United States, thus making most domestic territorial division agreements lawful. While the Patent Act says nothing about licenses restricted to specific customers or products, these "field of use" restrictions are treated benignly, mainly because they are viewed as organizers of production enabling the patentee to take advantage of the unique characteristics of different producers. For example, in *General Talking Pictures* the Supreme Court upheld an arrangement in which the patentee reserved to itself the market for commercial use of its patented sound amplifier, while other licensees were authorized to make the amplifiers only for residential customers.

As is true of price fixing, the tolerance for market division agreements applies to the IP right, not to products that might include it. For example, suppose that Ford patented a desirable windshield wiper blade and gave a restricted license to Chrysler. Ford might authorize Chrysler to sell cars with the patented blade in any state, but excepting California. That would be a territorially restricted license expressly authorized by the Patent Act. Ford could very likely also authorize Chrysler to put the blade only on its pickup trucks, but not its cars. That would be a field-of-use restriction and would ordinarily be lawful under antitrust law's rule of reason. What Ford could not do, however, is agree that Chrysler would not sell any pickup trucks in California, whether or not they contain the patented blade. That would be a restraint on the product market rather than on the use of the patent. Unless other factors suggesting joint development were present, that agreement would be unlawful per se under the antitrust laws.

**Vertical Restraints involving IPRs**

A restraint is purely vertical when the parties stand in a buyer-seller (licensor-licensee) relationship but are not actual or potential competitors. Today the antitrust attitude toward

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vertical restraints is benign, although it was not always so (Hovenkamp, Opening, Ch. 12).
Resale price maintenance (RPM), vertical nonprice restraints and tying were all once unlawful per se.

Vertical restraints come in two classes, generally called "intrabrand" and "interbrand," even though at least some of the products and services that they control are not branded at all. A restraint is said to be "intrabrand" if it controls distribution only of the supplier's own product; it is "interbrand" if it places limits on the products of rivals. The principal intrabrand price restraint is RPM, or seller dictation of the price at which its own product can be resold. As a general rule the fact that the price restraints are included in an IP license is irrelevant, and when the per se rule against RPM was in place it applied to patented and copyrighted goods, as well as those protected by trade secrets (Areeda & Hovenkamp, 2009-2015, ¶1621). Since 2007 RPM has been assessed under the rule of reason.\(^{40}\) Today, few instances are found to be unlawful.

Vertical nonprice restraints restrict a dealer's or retailer's sale of the supplier's own product in some way other than by setting price. The most common ones are territorial restrictions, customer restrictions, and product restrictions. There are also numerous others, such as restrictions regulating the hours that a firm is open for business, franchise restrictions dictating menu items, employee uniforms, and the like. Section 261 of the Patent Act expressly permits territorial restrictions in patent licenses, but in any event the Supreme Court has been applying the rule of reason to purely vertical nonprice restraints since the 1970s and under it they are rarely found to be unlawful.\(^{41}\)

The Copyright Act expressly permits nonprice restrictions, both horizontal and vertical, by making separate statutory authorizations for the right to reproduce, to prepare derivative works, to distribute, to perform, and to display, depending on the nature of the copyright good.\(^{42}\) However, even a purely vertical licensing restriction that was not expressly authorized by the Copyright Act would probably be legal under the antitrust laws. Restrictions that attached to a copyrighted article after it is sold might not be enforceable under copyright law's statutory first sale doctrine, but these would not be antitrust challenges.\(^{43}\)

*Interbrand* vertical price restraints, which include tying and exclusive dealing, have historically been treated with greater suspicion than intrabrand restraints, mainly because they explicitly reduce the opportunities of rivals. Under exclusive dealing a firm, typically a retailer or other intermediary, promises to deal exclusively in the supplier's product or service. An "output contract" does the same thing except that it places the exclusivity obligation on the seller

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rather than the buyer. In the IP context the exclusive license is a form of output contract, under which the IP holder promises to license only one firm for all or a particular subset of production under the license. The Patent Act expressly authorizes domestic exclusive patent licenses. The Copyright Act also authorizes exclusive licenses, although without an express territorial limitation. By contrast, § 3 of the Clayton Act makes it unlawful to sell a good or article, "whether patented or unpatented" on the condition that the buyer not deal in the goods of a competitor, provided that the agreement's effect "may be to substantially lessen competition or tend to create a monopoly...." In addition, anticompetitive output contracts are prohibited by § 1 of the Sherman Act, as well as § 2 if the firm imposing them is a monopolist.

Because the sale of a patented good implies a license to practice any patents necessary to use that good, the Patent Act's unrestricted authorization of exclusive licenses exists in some tension with the Sherman Act's prohibition of anticompetitive output contracts. The tension is partly reduced by the first sale doctrine (patent exhaustion), which exhausts the patents in any good once it is sold. However, that answer is incomplete because it is still possible to license patents in goods directly, and the first sale doctrine does not apply to licenses. The best reading is that the antitrust laws qualify the Patent Act in those cases where competitive harm can be shown. This reading is consistent with the general rule of statutory interpretation in this area, which is that the general statutory authority to do something is not authority to do so in violation of the antitrust laws. For example, numerous state and some federal corporation statutes authorize corporations to acquire the stock or assets of other corporations, but that does not mean that they can make an anticompetitive stock or asset acquisition in violation of § 7 of the Clayton Act. Already in the 1916 the American Can antitrust decision held that it was unlawful for the defendant to purchase exclusive rights to patented can making machinery when the effect was to deny mechanization to rivals. Because American Can made no can making machinery itself, these agreements were purely vertical. In any event, after a lengthy period of hostility the courts now accept that exclusivity provisions in sale or license contracts are only infrequently anticompetitive, depending on such factors as the market share foreclosed by the agreement, the duration of the contracts and frequency of rebidding, and offsetting efficiencies that might justify an exclusive deal (Areeda & Hovenkamp, 2009-2015, ¶1821).

Tying arrangements are more complex and have generated considerable controversy. A tying arrangement occurs when a firm conditions the sale of one product or service (the "tying" product) on the purchaser's taking of a second product or service (the "tied" product). Most ties

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47 See, e.g., F.T.C. v. Phoebe-Putney Health Sys., Inc., 133 S. Ct. 1003 (2013) (hospital corporation's statutory power to acquire other hospitals did not immunize an anticompetitive acquisition).
are contractual, which means that the tie is imposed by agreement. Some, however, are "technological," or "tech ties," which means that tying is accomplished by a technological design or feature that makes the seller's tying product incompatible with the tied products of rivals. Well known examples are Microsoft's "commingling" of the code for the Internet Explorer browser into the Windows operating system,49 Apple's technological tying of its iTunes content and devices so that they worked best only when used together,50 or Kodak's introduction of the Instamatic pocket camera which was compatible only with its own film cartridges.51 Because product design is a unilateral act, technological ties are usually treated under antitrust's monopolization provision, § 2 of the Sherman Act. By contrast, ordinary contractual ties are addressed under § 1 of the Sherman Act or § 3 of the Clayton Act, both of which require an agreement.

Today legal and scholarly opinion has shifted dramatically from the belief expressed at mid-twentieth century that tying arrangements serve "hardly any purpose beyond the suppression of competition,"52 to the view that most ties are competitively benign or even beneficial. The Patent Act expressly addresses tying arrangements in the 1988 Patent Misuse Reform Act, which provides that patent ties are not unlawful unless the tying firm has market power in the tying product.53 This provision was passed in response to serious excesses in the application of misuse doctrine, which refused to enforce patent ties in markets where there was no serious risk of competitive harm. For example, Justice Brandeis's opinion for the Court in Carbice54 found patent misuse when the manufacturer of a patented ice box required purchasers of the box to use its own unpatentable dry ice. The market for the unmechanized boxes was competitive and dry ice was a common commodity produced in "carbonic" plants in many places.

Today showing that a tie is unlawful under the antitrust laws requires proof of tying product market power, which may not be inferred simply from a patent on the tying product.55 Beyond that, the analysis of ties depends in part on whether the tying and tied products are used in fixed or variable proportions. The tie of Microsoft's Windows computer operating system and its Internet Explorer browser is a fixed proportion tie. A buyer purchases one copy of each. The most common anticompetitive rationale for such a tie is exclusion of rivals in the tied product market, which requires that the firm employing the tie have dominance in the tying market. For example, by tying Windows and Internet Explorer (initially by contract and later by technological integration of the code), Microsoft was able to dry up the market for independent

50 Apple iPod iTunes Antitrust Litigation, 2014 WL 4809288 (N.D.Cal. Sept. 26, 2014). At this writing the case has been tried and resulted in a jury verdict for defendant apple.
51 Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979).
web browser Netscape. However, fixed proportion ties can also be beneficial when joint production or distribution reduces costs or makes a product work better. Many fixed proportion ties are a consequence of nothing more than technological improvement, which often proceeds by making products more integrated. For example, IBM's desktop computers were attacked as tying arrangements to the extent that they merged processors, motherboards, controllers, storage devices, and memory into a single box. Previously these products had been sold separately and connected by cables, making it possible for one person to sell the processing box and another the disc drive, etc.\textsuperscript{56} But the new systems were more reliable, faster, and cheaper (Fisher, 1983). In sum, overly aggressive use of the law governing technological tying can serve to limit innovation.

Variable proportion ties can serve all of the same functions as fixed proportion ties. In addition, however, variable proportioning can operate as a metering or price discrimination device. Such uses are usually either competitively harmless or actually beneficial to the extent that they increase overall output. For example, the manufacturer of a printer that uses ink cartridges might tie the printer and the ink cartridges, either by contract or technological design. It then drops the price of the printer, often substantially and sometimes even to zero, but charges a premium for the ink cartridges. The result of this practice is that the firm obtains a higher overall return from high intensity users who consume more ink cartridges. This is a form of second degree price discrimination which results in larger printer sales to the extent the printer price is lower, but captures the revenue from higher intensity users. In most cases consumers as a group are better off, although high intensity consumers may be injured (Hovenkamp & Hovenkamp, 2015). The same type of tying arrangements are commonly used by franchisors, such as those in the fast food industry, where the tying product is commonly trademarked or occasionally copyrighted rather than patented. For example, the franchisor might charge a very low price or even zero for the right to a franchise, but then place an overcharge on various food products or supplies that the franchisee uses in variable proportions. As a result the franchisor makes more money from franchisees that have larger sales.\textsuperscript{57} Importantly, the profitability of these variable proportion ties does not depend on the seller's market power, but only on sufficient product differentiation or branding to make its tying product attractive. In fact, many of the defendants in franchise tying claims have been relatively minor firms whose own claim to uniqueness was a trademark that distinguished their product from those of numerous rivals.\textsuperscript{58}

\textit{Patent Pools}

\textsuperscript{56} See California Computer Prods., Inc. v. IBM Corp., 613 F.2d 727, 742–744 (9th Cir. 1979) (rejecting tying, "design manipulation" claim by competing disc drive manufacturer).


\textsuperscript{58} E.g., Siegel v. Chicken Delight, Inc., 448 F.2d 43, 47 (9th Cir. 1971), cert. denied, 405 U.S. 955 (1972) (finding liability for franchise tie from relatively minor fast food franchisor; market power presumed from trademarks).
In a patent pool several patent holders exchange patent licenses with one another, but they may also license to other producers who do not own relevant patents of their own. While patent pools have existed for a long time, in recent decades their growth has been exponential, thanks largely to the rapid development of networked products sold by multiple firms. The products include telecommunications and other digital devices as well as computer technology.

A patent pool is a "horizontal" restraint to the extent that its participants are competitors in the product market or license competing technologies. The relationship among the parties is often more complex, however. First of all, one important value of patent pooling is to facilitate the coordinated use of complementary technologies, but firms that produce pure complements are not competitors. Another use, equally or more important in some markets, is to minimize the transaction costs of patent management. For such savings to occur the pool members can have any relationship, from competitor, to vertically related, or complementary.

Historical rationales for pooling focused on the differences between complements and substitutes (Gilbert, 2004). Pooling or cross licensing among different producers in the same industry was thought to be procompetitive if the shared patents were complements with one another, but more likely to be anticompetitive if they were substitutes. If a patent is a discrete unit of innovation whose validity and boundaries are easily assessed, this distinction makes sense. Complements are ordinarily used together, meaning that joining them can create social benefits. For example, if one firm owns a patent on a desirable lawn mower motor and another on a desirable lawn mower throttle, pooling will enable the two firms to produce mowers that have both improvements, which would be better than a mower that had one but not the other. By contrast, substitutes are used in the alternative rather than together. This makes price fixing a more likely motive.

While these explanations are still occasionally helpful, they make far less sense in a world where patents are numerous and complex, with many claims, costly to interpret, and of uncertain quality. In such a setting the economics of transaction costs and boundary enforcement dominates other explanations. That is to say, the modern patent pool in information technologies is a type of commons for which sharing with management rules is cheaper and more effective than individual appropriation and enforcement.

Patent pools for complex information technologies can contain thousands of patents. For example, the MPEG-LA pool for digital video technology controls about 5000. Validity for most of the patents in such a pool has not been litigated, and even getting a legal opinion on validity and scope is very costly. Many of the patents have numerous claims, often making the relationship among different patents far more complex than simple substitutes or complements. For example, the licensees of the MPEG-LA pool include multiple competing makers of digital

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cameras and phones. However, they also include complementary products such as flash memories, video displays or projectors, film or photo editing software, and the like.

One example of these complex relationships is the *Princo* litigation in the Federal Circuit, which involved shared technology for developing rewritable digital discs. One feature that located the stylus on a rewritable disc came in both patented analog and digital versions. The two versions were substitutes, because a manufacturer would use one of them but not both. However, at least one claim of the analog version wrote on the digital patent, making the two patents complements as well. Regardless of their function, two patents are complements if you cannot practice one without practicing the other.⁶⁰ Indeed, not until after costly claim construction would we know how the patents related to one another. Even then, claim construction reversal rates are unacceptably high.⁶¹

A more robust explanation for pooling in high tech information markets comes from the theory of common development, in this case the "innovation commons" (Bohannan & Hovenkamp, 2012, pp. 325–364). As Ronald Coase argued in *The Nature of the Firm* (Coase, 1937), the boundaries of a firm are determined by its costs of doing business. A firm makes for itself or buys from others, depending on which alternative is more profitable. When it makes something for itself its boundaries expand, and when it buys from others they contract (Hovenkamp, 2011a).

Property rights, including IPRs, provide the legal power to exclude, but they do not always establish that individual exclusion is the best choice. The traditional property world is full of instances, ranging from shared driveways and party walls to community owned tennis courts and swimming pools, where individuals share because it is cheaper to share than to exclude everyone. The same thing has been true for many centuries of so-called commons pool resources such as fisheries, irrigation rights, or grazing rights. One hundred fishermen who own a large lake could if they wished build fences cutting the lake into 100 pieces. But subdividing would be costly, would very likely produce many disputes, and would be devastating to the yield of a mobile species of fish (Ostrom, 1990, pp. 61–73).

The same thing is true of patent rights in information technologies. While firms are certainly entitled to own patents individually, defining and defending boundaries can be very costly. If the patents are weak or easily invented around a successful defense may not make all that much difference. It may be much more economical to share the technology by pooling on a large scale.

While patent pools created to limit boundary problems have some similarities to common pool resources, they are not identical and some differences are critical to competitive impact.

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⁶¹See Brief of the ABA as Amicus Curiae, Teva Pharmaceuticals USA, Inc. v. Sandoz, Inc., 2014 WL 2885379 (June 20, 2014).
Most traditional common pool resources are "rivalrous," which means that each unit taken depletes what is left. Uncontrolled sharing will lead to overuse. Witness the fate of the American Bison as well as chronic overfishing in many fishing commons. For this reason catch or harvest limitations are essential if the commons is to operate efficiently. Indeed, a principal difficulty in commons management is making and enforcing access or harvest rules (Ostrom, 1990). By contrast, IPRs are generally nonrivalrous. An IP right such as a patent can be used many times without depleting what is left over. As a result, output restraints in the product market are more suspicious in IP commons than in traditional commons (Bohannan & Hovenkamp, 2012, 328–330).

Another difference between modern information technology patent pools and traditional commons is the diversity of the participants. All those sharing rights on a common fishery or pasture are likely to be fishermen and ranchers with relatively undifferentiated businesses. By contrast, given the nature of multi-claim patents, those who practice them might be highly diverse, producing complements or unrelated technologies as much as they produce substitutes. For example, the MPEG-LA pool has a diverse set of firms as members. These include manufacturers of cameras, computer screens, cell phones, storage media, graphics processors, graphics processing software, and the like. Some of these firms build devices that produce digital images, some make devices that process the data or transmit other. Still other firms build devices that display the images. Further, a complex device such as a digital videocam might employ many patents in the pool, while a simple device such as a memory chip employs few.

These differences have led to claims akin to anticompetitive tying. A firm that is required to license all of a pool's package of 5000 patents may complain that it really uses only 200 of the patents. In this case the patents it uses are the "tying product," while the unwanted patents are the "tied product." These antitrust claims nearly always fail, for the simple reason that competition is not injured. Forcing someone to take a bigger product than he might want—such as 100 acres of land instead of a single residential lot—might present a bargaining problem. It is not anticompetitive, however, because no one is being excluded.62 Further, the cost of determining which of the pool's patents the complaining licensee actually practiced could be much greater than the cost of the license fee itself. As one court observed, “[I]t is not anticompetitive for a patent pool to include numerous potentially blocking patents, patents which may or may not be essential but which are more efficient to license as part of the pool than to risk the expense of future litigation.”63 For some questions, we are better off not knowing the answers.

62 See Nero AG v. MPEC LA, LLC, 2010 WL 4366448, *1 (C.D. Cal. Sep. 14, 2010), which rejected such a claim. Nero's product is software used for recording content to video discs and editing photos.
63 Id., 2010 WL 4366448, at *5.
By their nature IPRs create a power to exclude. Further simply asserting those rights is protected by the Patent Act as well as constitutional protections of the right of access to the courts (Areeda & Hovenkamp, 2009-2015, ¶205). No protection exists for "baseless" claims, however, with no foundation in fact or law. The Walker Process doctrine, which the Supreme Court recognized in 1965, refers to monopolization or attempted monopolization facilitated by an improper patent infringement action. As noted previously, antitrust has little or no role in policing pre-issuance patent applicant conduct. Many Walker Process cases, including Walker Process itself, involve some pre-issuance conduct. In Walker Process the patent applicant failed to inform the patent examiner about sales made prior to patent application that, if disclosed, would have barred the patent. Other cases have involved other forms of inequitable conduct before the USPTO, including failures to inform the examiner of known prior art that would have defeated patentability. Importantly, however, merely obtaining a patent improperly is not an antitrust violation. Further the patent system has numerous remedies for improper conduct before the USPTO. Walker Process itself involves the post-issuance practice of filing an infringement suit, or engaging in other enforcement activity such as a threat to sue, on a patent that the owner should reasonably have known to be invalid or unenforceable under the circumstances.

Antitrust liability for Walker Process violations require not only the improper infringement action, but also a structural basis for thinking that the lawsuit either perpetuates or threatens to create a market monopoly. This distinguishes the antitrust remedy from the "exceptional case" remedy in the Patent Act that authorizes a judge to award attorneys fees against a patentee who makes an improper claim or commits other litigation misconduct.

Neither United States antitrust law nor the Patent Act recognizes a general duty to license a patent or to share patented technology. Indeed, the Patent Act provides that a refusal to license shall not be considered to be "misuse or illegal extension of the patent right...." This language appears to refer to unilateral refusals to deal, but some language in a 2010 Federal Circuit dissent suggested that it reached concerted refusals to deal as well. (Bohannan & Hovenkamp, 2011). That rule, if accepted, would be unfortunate, for concerted refusals have significantly more anticompetitive potential than unilateral refusals.

In its Kodak decision the Ninth Circuit held that the antitrust laws did give Kodak a duty to sell patented parts to independent repair persons who wished to fix its high speed

70 Princo Corp. v. Int'l Trade Comm'n, 616 F.3d 1338, 1330 (Fed. Cir. 2010) (en banc).
photocopiers. The decision has been widely criticized and was expressly rejected by the Federal Circuit in a similar case involving Xerox. As of this writing the Supreme Court has not resolved the split (Areeda & Hovenkamp, 2009-2015, Ch. 7D-2).

Currently the courts have not settled on the scope of a patentee’s duty to license a patent encumbered by a FRAND commitment, or a promise made as part of a standard setting process to license on "fair reasonable, and nondiscriminatory terms." In 2014 the Federal Circuit split three ways on the question. Importantly, however, to the extent that this duty exists it is not imposed by the antitrust laws, but rather by whatever contractual or quasi-contractual obligations are created by the FRAND process.

Finally, one must distinguish between simple and conditional refusals to grant an IP license or sell a good covered by an IP right. Section 3 of the Clayton act, discussed above, expressly limits certain conditional licensing contracts that threaten competition, and expressly covers goods that are patented as well as unpatented. For example, a tying arrangement can readily be construed as a refusal to sell or license a tying product unless the buyer also takes the tied product. Quite simply, the legality of a conditional refusal depends on the legality of the underlying condition.

Another important distinction is between compulsory licensing as a general antitrust duty and compulsory licensing as a remedy for some other antitrust violation. In many antitrust cases the courts have determined that compulsory licensing is the only way or the best way to undo the effects of some other violation. Merger remedies often require IP licensing as a condition of approving the merger, and many structural breakups, such as the one that dismantled the nationwide AT&T telephone network, could not have succeeded unless each of the spun off companies received nonexclusive licenses to the parent’s intellectual property portfolio.

Finally, it is worth noting that the question of compulsory licensing duties is an important and controversial one, raising serious questions in market dominating networks, life saving pharmaceuticals, and other areas involving questions about patent social value. Antitrust is rarely the best vehicle for resolving these issues. It offers no useful tools for determining when such a dealing obligation is socially necessary. Nor does it have any mechanisms for setting a price, other than through ordinary damages measurement tools. These questions should remain legislative.

**IP Law’s Own Internal Rules for Facilitating Competition**

71 Eastman Kodak Co. v. Image Tech. Servs., Inc., 125 F.3d 1195 (9th Cir. 1997).

72 *ISO Antitrust Litigation*, 203 F.3d 1322 (Fed. Cir. 2000).

73 Apple, Inc. v. Motorola, Inc., 757 F.3d 1286 (Fed. Cir. 2014).

Intellectual property law also has internal rules for facilitating competition in the scope or use of IPRs (Cotter, 2006). Most of these rules are quite different from antitrust rules. IP law's internal competition rules do not require a market definition, proof of anticompetitive market exclusion, or even an attempt to measure the impact of a particular practice on price or output. Rather they are best seen as rules that limit IP "overreaching" of various kinds.

The First Sale (Exhaustion) Doctrine

Patent and copyright law's "first sale," or exhaustion rule, limits the power of a right holder to restrict the use or resale of a protected good once it has been sold. Both the patent and copyright rules were originally judge made, but subsequently Congress enacted the copyright first sale doctrine into the statute. In its simplest form the rule states that the sale, not the license, of a patented or copyrighted good, exhausts the right holder's legal interest insofar as that particular copy of the good is concerned. The exhaustion doctrine has been used to strike down resale price restrictions, quasi-exclusive dealing restrictions, and limitations on where purchased goods can be sold. (Hovenkamp, 2011b).

Even though the first sale rule reaches many of the same practices that antitrust law reaches, it cannot be counted as an antitrust or even antitrust-like provision. Its application is completely indifferent to competitive effects, requiring only that there be a qualifying "sale." Once such a sale has been found the post-sale restraint becomes unenforceable per se, without regard to competitive effects. It is best viewed as a limitation on the power that patentees and copyright holders can exert over protected goods as they are distributed away from the original rights holder. As such it is strictly a creature of IP law, not of competition law.

"Misuse"

The misuse doctrine originated in patent law and was later expanded to copyright. It was entirely judge made, and the only references to it in the Patent Act are limitations rather than recognition. From the beginning misuse doctrine got off to a bad start. The Motion Picture Patents case, where a version of the doctrine was first recognized, almost surely involved an anticompetitive restraint. But the Clayton Act had already been passed, and it expressly

79 But see Bowman v. Monsanto co., 133 S.Ct. 1761 (2013) (exhaustion did not apply to self-replicating seed where the replanted seed was a subsequent generation and not the selfsame seed that the infringement defendant had purchased).
81 Motion Picture Patents Co. v. Universal Film Mfg. co., 243 U.S. 502 (1917).
prohibited patent ties that injured competition (15 U.S.C. § 14). That made the patent tie there unlawful. To be sure, the competition issue was raised as a defense to an infringement action rather than an antitrust claim, but by this time the Supreme Court had already held that illegality under the antitrust laws was a complete defense to an enforcement action, such as a breach of contract suit.\(^\text{82}\) So a patent-law-generated misuse doctrine was unnecessarily.

Later on, misuse was applied aggressively to patent tying, exclusive dealing, royalty extensions and other licensing arrangements where injury to competition was nowhere in view. It is no wonder that during the era of antitrust contraction both courts and commentators began calling for limits on "misuse" to actions that would violate the antitrust laws, most notably in Judge Posner's decision in the \textit{USM} case.\(^\text{83}\) Later on, however, Judge Posner also wrote a decision recognizing a form of copyright "misuse" where the copyright infringement plaintiff had attempted to "sequester" uncopyrightable public data in a copyrighted database program. Judge Posner made clear that the violation in question was not of the antitrust laws. It was a unilateral act and there was no finding that the infringement plaintiff had sufficient market power.\(^\text{84}\) Rather, the concern was strictly one of copyright law, which both protects copyrighted content but also seeks to ensure that material in the public domain can be accessed.

As developed, "misuse" doctrine was an opportunity lost. Courts have a legitimate concern about IP overreaching as a matter of intellectual property law. The 70-year-long escapade, stretching from the 1917 \textit{Motion Picture Patents} case to the 1988 Patent Misuse Reform Act,\(^\text{85}\) represented gross overreaching in tying doctrine under both misuse and antitrust. Further, the Supreme Court developed the draconian remedy that once misuse was found the patent would be unenforceable against the entire world until the misuse was "purged."\(^\text{86}\) A revitalized doctrine of patent misuse should do two things. First, it should identify conduct that is socially harmful because it threatens the balance between exclusion and access created by the intellectual property laws themselves. Second, the remedy should ordinarily be limited to an injunction against the practice, or recognition that violation of the practice is not an act of infringement. (Bohannan, 2011).

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\(^{82}\) Cont'l Wall Paper Co. v. Louis Voight & Sons Co., 212 U.S. 227 (1909).
\(^{83}\) USM corp. v. SPS Tech., Inc., 694 F.2d 505 (7th Cir. 1982). See also Bohannan, 2011; Lim, 2013.
\(^{84}\) Assessment Tech. of Wisconsin., LLC v. Wiredata, Inc., 350 F.2d 640, 646 (7th Cir. 2003). The court also relied on the Fourth Circuit's decision in Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970 (4th Cir. 1990), which found misuse in a restriction on a copyright licensee's development of new technology, even though that restraint did not violate the antitrust laws, \textit{See also} Omega S.A. v. Costco Wholesale corp., ___ F.3d ___, 2015 WL 235479 (9th Cir. Jan. 20, 2015) (concurring opinion indicating that copyright holder committed misuse by trying to leverage copyrighted design into prohibition on product sale in United States).
\(^{85}\) 35 U.S.C. § 271(d) (4 & 5).
"Functionality" Limitations

One important limiting principle of IP law generally is that protection of a "function" must come by means of a utility patent, which is more difficult to obtain than other IPRs and has a shorter duration than copyrights or trademarks. For this purpose, design patents are treated more like copyrights and trademarks rather than patents.

The fundamental principle undergirding functionality limitations is that people should not be able to use IPRs to create product monopolies any more than is justified by the limitations inherent in utility patents. An important corollary is that people should not be able to turn other IPRs into quasi-patent rights in order to broaden their scope or duration. The grandparent of the doctrine is Baker v. Selden, which held that a copyrighted book teaching the author's method of accounting served to protect against making unauthorized copies of the book, but not against using or teaching the method itself. In the area of trademark or trade dress, the Supreme Court's important decision in TrafFix Devices held that a sign support that was an essential element of a now expired utility patent could not be grandparented into a trademark, effectively extending the use of this particular design indefinitely. Similarly, copyright protection does not extend to purely functional names or commands in computer programs if good alternatives are lacking and the result serves to limit the ability of rival programmers to replicate that function.

While the Supreme Court has not yet reached the issue, several lower courts have held that design patents cannot be expanded so as to perform a utility function, excluding the products of rivals. For example, Chrysler attempted to enforce a design patent on an automobile bumper mount so as to exclude competing bumper makers because they could not make a Chrysler-compatible bumper with infringing the design patent. In another decision the owner of a design patent on a key attempted to enforce the patent in such a way as to make competitors' keys incompatible with its locks. In both of these cases the firms in question were trying to use a design patent to create a "technological tie." No determination of the patentee's market power was made, and the ties may or may not have been an antitrust violation. But that is beside the point. The issue is sequestration, not monopoly. Utility patents permit firms to keep rivals out of the product market, but design patents do not.

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88 TrafFix Devices, Inc. v. Market Displays, Inc., 532 U.S. 23 (2001). Cf. the so-called "trademark use" doctrine, which in its most extreme form would make it unlawful under the Lanham Act to use the trademarked name of a competitor for purposes such as comparative advertising. See Rosetta Stone, Ltd. v. Google, Inc., 676 F.3d 144 (4th Cir. 2012); 1-800-CONTACTS, Inc. v. WhenU.Com, Inc., 414 F.3d 400 (2d cir. 2005).
89 E.g., Lotus Development Corp. v. Borland Intern., Inc., 49 F.3d 807 (1st Cir. 1995), limited by Oracle America, Inc. v. Google, Inc., 750 F.3d 1339 (Fed. Cir. 2014).
90 Chrysler Motors Corp. v Auto body Panels of Ohio, Inc., 908 F.2d 951 (Fed. Cir. 1990); Best Lock Corp. v. Ilco Unican Corp., 94 F.3d 1563 (Fed. Cir. 1996).
References


