THE IP GUIDELINES: LESSONS FROM HISTORY

BY WILLARD K. TOM[1]

1 Partner, Morgan, Lewis & Bockius LLP. This paper reflects the author's own views and not those of Morgan Lewis or any of its clients. This material is provided as a general informational service and should not be construed as imparting legal advice on any specific matter. © 2019 Morgan, Lewis & Bockius, LLP. All rights reserved.

CPI ANTITRUST CHRONICLE SEPTEMBER 2019

CPI Talks…
…with Makin Delrahim

5G and the Global Economy: How Static Competition Policy Frameworks Can Defeat Open Innovation
By David J. Teece

Due Process in International Antitrust Enforcement: An Idea Whose Time has Come
By Christopher S. Yoo

5G and Anticipated Intellectual Property and Antitrust Policy Issues
By Kirti Gupta

Understanding "Balance" Requirements for Standards-Development Organizations
By Jorge L. Contreras

The IP Guidelines: Lessons from History
By Willard K. Tom

Stealth Commoditization: The Misuse of Smartphone Antitrust
By Jonathan M. Barnett

Antitrust and Balance of Interests in Standards Development – Lessons from *NSS Labs. v. Symantec*
By Justus Baron & Pierre Larouche

A New Era of Licensing with China
By Mark A. Cohen

Visit www.competitionpolicyinternational.com for access to these articles and more!

CPI Antitrust Chronicle September 2019

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

I. INTRODUCTION

The proper relationship between antitrust and intellectual property continues to be hotly debated.[2] Sometimes forgotten in these debates, however, are some of the hard-won underlying principles of the 1995 Antitrust Guidelines for the Licensing of Intellectual Property,[3] as reaffirmed by the 2017 re-issuance.[4] This may seem somewhat surprising, as there seems to be broad consensus that those Guidelines represent a sensible and balanced approach to the antitrust-intellectual property interface. It may be that the Guidelines have become so familiar that familiarity has bred, not contempt, but indifference. Or it may be that the history that preceded the Guidelines has faded so far into the past that the advances of the Guidelines over that history no longer resonates. Whatever the reason, re-examining the Guidelines in their historical context may cast some light on the principles that animated them as well as on the issues in today's debates.

---

2 Compare, e.g. Renata B. Hesse, Principal Deputy Assistant Attorney General, *Antitrust: Helping Drive the Innovation Economy,* Remarks as Prepared for the Global Competition Review 5th Annual Antitrust Law Leaders Forum, at 9 (Feb. 05, 2016), https://www.justice.gov/opa/file/897741/download ("The competitive process suffers from . . . hold up . . . . [A]ntitrust enforcers and competition advocates are addressing this behavior where appropriate."), *with* Makan Delrahim, Assistant Attorney General, *"Don't Stop Thinking About Tomorrow": Promoting Innovation by Ensuring Market-Based Application of Antitrust to Intellectual Property*, Organisation for Economic Co-operation and Development "Licensing of IP Rights and Competition Law," at 7 (June 6, 2019), https://www.justice.gov/opa/speech/file/1170241/download ("In the view of the United States, violating a FRAND commitment, by itself, should not give rise to an antitrust claim."). See generally FTC Hearing #4: Innovation and Intellectual Property Policy, https://www.ftc.gov/news-events/events-calendar/2018/10/ftc-hearing-4-competition-consumer-protection-21st-century. Perhaps the clearest recent example of the hot debate is the United States' filing of a Statement Of Interest Concerning Qualcomm's Motion For Partial Stay Of Injunction Pending Appeal, doc. no. 25-1, in *FTC v. Qualcomm Inc.,* No. 19-16122 (9th Cir. July 16, 2019), https://www.justice.gov/atr/case-document/file/1183936/download. On August 23, 2019, the Ninth Circuit granted the stay. Order, doc. no. 74, *FTC v. Qualcomm Inc.,* No. 19-16122 (9th Cir. Aug. 23, 2019), http://cdn.ca9.uscourts.gov/datastore/opinions/2019/08/23/ 19-16122.pdf. Because the author is one of the counsels of record for Qualcomm in that matter, this article will not discuss that case.

3 U.S. Department of Justice & Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property (1995), http://ftc.gov/bc/0558.pdf. Given the historical focus of this paper, all quotations and citations will be to the 1995 version unless otherwise stated.

4 U.S. Department of Justice and Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property (2017), https://www.ftc.gov/public-statements/2017/01/antitrust-guidelines-statement-antitrust-enforcement-policy-us-department.

II. NOMINALISM

For nearly a century,[5] the attitude of antitrust to intellectual property was characterized by what I have elsewhere called formalism,[6] but which might better be called nominalism. That is, the antitrust treatment of a patent-related practice was determined by the name given to the practice. The most notorious example of this habit was the infamous "Nine No-No's": a list of nine intellectual property licensing practices that, according to Bruce Wilson, an Antitrust Division official, "in virtually all cases are going to lead to antitrust trouble because of their adverse effect upon competition." Call something "tying," a "mandatory grantback," or a "mandatory package license," and the practice could be condemned straightaway. (Or, conversely, at the beginning of the 20th century, call something a "patent license" and it was essentially immune from the antitrust laws.[7])

This certainly simplified life for the agencies, but it had its costs for the world at large. Tying, the first of the No-No's, for example, was thought to be evil because it was an extension of the "patent monopoly" into an unpatented second market.[8] It took the Chicago generation of scholars — and the passage of quite a number of years — to force enforcers to confront the question, "Why would the patentee want to do that?" As the Chicago scholars pointed out, in general, there is only a single monopoly rent that the seller of a monopolized product could enjoy. A tying arrangement generally cannot increase the price a buyer is willing to pay for the second product without forgoing an equal amount of rent on the first product.[9]

More importantly, in the intellectual property area in particular, there were often strong justifications for the practice. There, fixed costs of invention are often extraordinarily high, while marginal costs can be virtually zero because it can be nearly costless to copy and use an innovation, once invented. If different users of the invention placed very different values on it — for example, because some customers used a patented machine very intensively and others used it rarely, and the patentees were forced to set a single monopoly price for the patented product, some potential customers could be priced out of the market entirely and the inventor would surely make less money (and thus have less incentive to do the R&D in the first place) than if it could price-discriminate. Tying the right to use the machine to the purchase of a complementary consumable used with the machine could be a way of accomplishing such price discrimination, thus increasing output, making the invention available to more consumers, and increasing R&D incentives, all at the same time.[10]

Similarly, there seemed little recognition in the No-No's world of the degree to which mandatory grantbacks could encourage licensing by controlling the risk of opportunism by the licensee. Undoubtedly, the hostility towards grantbacks discouraged some licensing in the first place, because the patentee could not be certain that the potential licensee's improvements, though built on the patentee's basic inventions, would end up making the patentee's products obsolete, thereby locking those products out of the market.

Package licensing is another of the No-no's in which the efficiency justifications are both obvious and large. A single product may practice tens of thousands of patented inventions. The Federal Circuit has noted that package licensing "reduces transaction costs by eliminating the need for multiple contracts and reducing licensors' administrative and monitoring costs."[11] As the court observed in Texas Instruments, Inc. v. Hyundai Electronics Industries,[12] "it is almost impossible on a patent-by-patent, country-by-country, product-by-product basis to determine whether someone is using a company's patents in a given country and provide protection for patents not yet issued."

---

5 See generally Willard Tom & Joshua Newberg, *Antitrust and Intellectual Property: From Separate Spheres to Unified Field*, 66 Antitrust L.J. 167 (1997).

6 Willard K. Tom, *Delrahim restores balance to antitrust treatment of SEPs*, Competition Policy International (June 7, 2018), https://www.competitionpolicyinternational.com/delrahim-restores-balance-to-antitrust-treatment-of-seps/.

7 See Tom & Newberg, *supra* note 5, at 168-70.

8 See *International Salt Co. v. United States*, 332 U.S. 392, 395-96 (1947); see also *United States v. Loew's, Inc.*, 371 U.S. 38, 49 (1962).

9 See, e.g. Ward S. Bowman, Jr., *Tying Arrangements and the Leverage Problem*, 67 Yale L.J. 19 (1957); Robert H. Bork, The Antitrust Paradox 365–81 (1993 ed.); Richard A. Posner & Frank H. Easterbrook, Antitrust: Cases, Economic Notes, and Other Materials 777–856 (2d ed. 1981). There are many exceptions, but none warranting the general condemnation of tying in the intellectual property context.

10 See, e.g. Tom & Newberg, *supra* note 5, at 210-12.

11 *U.S. Philips Corp. v. ITC*, 424 F.3d 1179, 1192 (Fed. Cir. 2005).

12 49 F. Supp. 2d 893, 901 (1999).

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

One could go through the whole remaining list of No-No's — post-sale restrictions on resale, tie-outs, vetoes over further licensing, royalties not reasonably related to patented products, restrictions on sales of products made with a patented process, and resale price maintenance — and think of the circumstances in which such restrictions could control opportunism and further the goals of the patent system and of licensing. But the nominalist mindset condemned with broad strokes.

III. THE REPUDIATION OF NOMINALISM

While this mindset was reaching its apotheosis at the enforcement agencies in the form of the Nine No-No's, scholars such as Ward Bowman and Bill Baxter[13] were moving in quite a different direction. They were focused instead on how particular conduct in particular market circumstances would actually affect consumer welfare. In Bowman's words, "Both antitrust law and patent law have a common central economic goal: to maximize wealth by producing what consumers want at the lowest cost."[14] When Baxter became the head of the Antitrust Division of Justice, his deputy Tad Lipsky made a speech denouncing the Nine No-No's.[15] These ideas were carried forward into the 1988 International Operations Guidelines[16] and formalized and developed further in the 1995 Guidelines, commissioned by Anne Bingaman, President Clinton's first head of the Antitrust Division, on January 10, 1994.[17]

IV. KEY PRINCIPLES OF THE 1995 GUIDELINES

The 1995 Guidelines state a number of broad principles, both in the section labeled "General principles"[18] and elsewhere, but three in particular have always struck me as most important and perhaps least understood:

1. The banal-seeming statement in Section 3.4 that "[i]n the vast majority of cases, restraints in intellectual property licensing arrangements are evaluated under the rule of reason."

2. The discussion of how to distinguish horizontal from vertical relationships in Section 3.3.

3. The statement in Section 2.0 that "the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive."

V. THE RULE OF REASON

First, the emphasis on the rule of reason in Section 3.4 is a decisive rejection of the nominalism mentioned earlier. The Guidelines recognized that the very same practice can have procompetitive or anticompetitive effects in different markets and at different times, depending on a wide variety of circumstances.

---

13 See Ward S. Bowman, Jr., Patent & Antitrust Law: A Legal & Economic Appraisal (1973); William F. Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 Yale L.J. 267 (1966).

14 Bowman, *supra* note 13, at 1.

15 See Abbott B. Lipsky, Jr., *Current Antitrust Division Views on Patent Licensing Practices*, Remarks before the ABA Antitrust Section National Institute on Critical Issues in International Antitrust and Unfair Competition Law (Nov. 5, 1981), https://ipmall.law.unh.edu/sites/default/files/BAYHDOLE/bremmerPDF/Lipsky_Speech_ Attacking_Nine_No-No%27s._11-26-1981.pdf.

16 Antitrust Division, U.S. Department of Justice, Antitrust Enforcement Guidelines for International Operations §3.6 (1988), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,109.

17 Anne K. Bingaman, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *Antitrust and Innovation in a High Technology Society* (Jan. 10, 1994), https://www.justice.gov/atr/file/519466/download.

18 "§**2.0** These Guidelines embody three general principles: (a) for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property; (b) the Agencies do not presume that intellectual property creates market power in the antitrust context; and (c) the Agencies recognize that intellectual property licensing allows firms to combine complementary factors of production and is generally procompetitive."

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

One particularly stark example of the Guidelines moving decisively away from the nominalism of an earlier era was in its treatment of tying. More than a decade before the Supreme Court overturned the doctrine that market power could be presumed from ownership of a patent,[19] a doctrine of particular salience in tying cases, the Guidelines declared in Section 2.2 that "[t]he Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner." And in Section 5.3, the Guidelines took a step that the Supreme Court still has not yet fully taken to this day: declare that because tying arrangements can "result in significant efficiencies and procompetitive benefits," "[i]n the exercise of their prosecutorial discretion, the Agencies will consider both the anticompetitive effects and the efficiencies attributable to a tie-in" — i.e. they would apply the rule of reason. This was a decisive move away from the simple-minded notion in cases such as International Salt that any contractual restriction affecting a product outside the patent was necessarily an antitrust violation because "it is unreasonable, per se, to foreclose competitors from any substantial market."[20]

The circumstances affecting whether a practice has procompetitive or anticompetitive effects are quite broad — the market power of the party engaging in the practice; the ability and incentive of counterparties to engage in opportunism, against which the practice might guard; the difficulty of valuing the contribution of the patent, especially at the time of contracting; and so on. Practices to reduce the risk of opportunism may be especially pervasive in the context of intellectual property, for at least three reasons: (1) as already mentioned, fixed costs are large (and sunk early in the inventive process) and marginal costs are low; (2) being intangible, intellectual property may be difficult to secure and easy to misappropriate; and (3) because the prevention of misappropriation often requires resort to legal systems — with attendant cost, uncertainty, and risk — many practices that may appear odd or unusual may simply be measures to reduce such cost, uncertainty, and risk. Similarly, the need for licensing contracts to take into account the difficulty of valuing the contribution of the patent can be accentuated by (1) the strong complementarities with other factors of production, (2) the fact that the patent may have applications in different markets and may make vastly different contributions in each, and (3) the fact that contracting may take place far in advance of the actual utilization of the patent.

The law has often recognized the need to account for some of these valuation issues, for example in its lenient treatment of field-of-use restrictions,[21] which are necessitated by the fact that the value of a particular set of patents (as well as the identity of the most efficient complementors) can vary greatly among its applications in different markets. The agencies, have, in turn, extended the logic of those cases by recognizing how a particular practice might help overcome the difficulty of valuing the contribution of the patent. A good example of this came a dozen years after the Guidelines, in the 2007 IP Report.[22] There, the FTC and DOJ considered the implications of "reach-through licensing agreements" — i.e. agreements that "grant the owner of a patent on an upstream research tool the right to receive consideration based on sales or usage of a subsequent downstream product created with that tool."[23] The Report observed that, according to panelists, "reach-through licensing agreements can create efficiencies . . . by, for example, creating a way to value the research tool or establish a reasonable royalty."[24] It noted the testimony of participants that such arrangements help capture the value created by intellectual property and allow for a broader dissemination of the technology, and that they provide an expedient way of measuring the value of the technology.[25] The Report also noted the observation of one panelist that "reach-through royalties can be a mechanism for metering,[26] which antitrust law has generally treated favorably."[27]

The discussion of reach-through royalties in the 2007 Report is particularly interesting to revisit in light of the intense debate over whether it is appropriate to use a royalty base larger than the smallest saleable patent-practicing unit ("SSPPU"). Although the use of the SSPPU has been adopted by the Institute of Electrical and Electronics Engineers, Inc. ("IEEE") as a "recommended factor" in royalty calculation, and the U.S. DOJ signified "no current intention to challenge" that adoption (in a Business Review Letter issued on February 2, 2015) — in large part because that

---

19 *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 45-46 (2006).

20 332 U.S. at 396.

21 See, e.g. *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 181 (1938).

22 U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (2007), https://www.ftc.gov/reports/antitrust-enforcement-intellectual-property-rights-promoting-innovation-competition-report.

23 2007 IP Report, at 93.

24 *Id.* at 94.

25 *Id.* at 94 n. 62, 64.

26 "Metering" generally refers to collecting compensation for one good or service by charging for a different — usually tied — good or service that more accurately reflects the value of the first good or service. Such a practice aligns pricing more closely with value, which tends to be efficient.

27 *Id.* at 97.

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

factor was not mandatory[28] — the positions of the U.S. agencies in 2007, and of the European Commission more recently,[29] strongly indicate that there is no antitrust principle requiring such a royalty base.

The rule-of-reason treatment of IP licensing arrangements has ramifications for remedies as well as for liability. Banning a particular practice long into the future would make no sense if its anticompetitive or procompetitive nature depends on market power and other circumstances that could evolve over time. Similarly, an excessively broad order divorced from the particular circumstances in which a practice was found to be anticompetitive could be affirmatively harmful. As discussed below, for example, a licensing restriction affecting a horizontal relationship could have very different effects when applied to vertical relationships.

VI. HORIZONTAL AND VERTICAL RELATIONSHIPS

The heart of the Guidelines is the identification of whether the relationship between two parties is a competitive one ("horizontal" in the parlance of antitrust) or a complementary one ("vertical"). Section 3.3 of the Guidelines state: "[T]he Agencies ordinarily will treat a relationship between a licensor and its licensees, or between licensees, as having a horizontal component when they would have been actual or potential competitors in a relevant market in the absence of the license . . ." In other words, if two companies could not compete without one or both companies infringing patents of the other, they are not competitors.

The horizontal/vertical distinction comes up over and over again in the Guidelines as a critical determinant of the procompetitive or anticompetitive nature of a practice. In Section 3.1, describing at the outset the "Nature of the concerns," the Guidelines note that "a licensing arrangement could include restraints that adversely affect competition in goods markets by dividing the markets among firms that would have competed using different technologies" (emphasis added) and that "antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license." It mentions the concept again in Example 2 of Section 3.2.2., explaining when harm can occur in technology markets, specifying that "Alpha and Beta independently develop different patented process technologies to manufacture the same off-patent drug." (Emphasis added.) The concept arises again in Example 4 of Section 3.2.3., explaining when harm can occur in innovation markets. In Section 3.4, "Framework for evaluating licensing restraints," it begins the analysis of Example 7, a price-fixing example, by specifying that the parties "are in a horizontal relationship." And all of this is before the Guidelines analyze specific restraints in Section 5, where the concept plays a key role in evaluating price fixing, market allocation, output restraints, exclusive dealing, cross-licensing, and pooling.

A contemporary setting in which one might expect the horizontal/vertical distinction to play a role is the conduct of participants in standards development organizations. A typical SDO has many members that implement standards adopted by the SDO and far fewer members that contribute significant amounts of technology. Clearly, many of the implementers are horizontal competitors: they make physical goods that compete with each other, and if a new standard is not adopted they would compete with each other using the old standard. It is far less clear that the innovators are horizontal competitors. Once the standard is adopted, the owners of standard-essential patents ("SEPs") clearly are not: by definition, if their patents are essential, then they stand in a complementary (vertical) relationship. Thus, they are only competitors in an *ex ante* sense, and only if they own closely substitutable technology that competes to be included in the standard. If one technology is clearly superior, then any competition is, at best, highly attenuated, if it exists at all. One would expect, therefore, that the antitrust agencies would be highly attuned to the risks of monopsony in connection with SDOs, and would at least probe with a skeptical and inquisitive mind claims of monopoly in that context. And in fact, that does indeed appear to be the orientation of the current Antitrust Division of DOJ.[30]

---

28 Letter from Renata B. Hesse, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice, to Michael A. Lindsay, Esq., Dorsey & Whitney, L.L.P., at 12 (Feb. 2, 2015), https://www.justice.gov/sites/default/files/atr/legacy/2015/02/02/311470.pdf.

29 See *Guidelines on the Application of Article 101 of the Treaty on the Functioning of the European Union to Technology Transfer Agreements*, ¶ 184 (2014/C 89/03), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF /?uri=CELEX:52014XC0328(01)&from=EN ("it is as a general rule not restrictive of competition that royalties are calculated on the basis of the price of the final product, provided that it incorporates the licensed technology").

30 See, e.g. Makan Delrahim, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *The "New Madison" Approach to Antitrust and Intellectual Property Law* at 5, 10-12 (Mar. 16, 2018), https://www.justice.gov/opa/speech/ file/1044316/download.

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing
this article is forbidden by anyone other than the publisher or author.

VII. PROCOMPETITIVE BENEFITS OF LICENSING

In discussing the procompetitive benefits of licensing, Section 2.3 of the Guidelines states:

> Intellectual property typically is one component among many in a production process and derives value from its combination with complementary factors. . . . The owner of intellectual property has to arrange for its combination with other necessary factors to realize its commercial value. . . . Often, the owner finds it most efficient to contract with others for these factors, . . . rather than supplying these complementary factors itself.
>
> Licensing . . . can facilitate integration of the licensed property with complementary factors of production. This integration can lead to more efficient exploitation of the intellectual property, benefiting consumers through the reduction of costs and the introduction of new products. Such arrangements increase the value of intellectual property to consumers and to the developers of the technology. By potentially increasing the expected returns from intellectual property, licensing also can increase the incentive for its creation and thus promote greater investment in research and development.

In other words, licensing increases overall social welfare through specialization.

The flip side of this observation is that making licensing more difficult, costly, or risky will lead to the diversion of investment into less socially productive ends. Put to a choice of investing in innovations that will increase social welfare tremendously but faces such costs and risks before they can be monetized, and investing in innovations that are less socially productive but can be monetized directly by the innovator without the involvement or cooperation of complementors, the scale will be tipped toward the latter. Investments will be directed toward prettier casings for products rather than fundamental innovations that transform entire industries. One way to impose such costs and risks, of course, is misguided antitrust enforcement. Ill-informed antitrust policy is thus a tax on innovation.

VIII. CONCLUSION

It has been said that that "[t]hose who cannot remember the past are condemned to repeat it."[31] In that spirit, it is worth recalling some of the misguided antitrust enforcement that preceded the 1995 Guidelines, the principles that those Guidelines were meant to establish, and the harm that can flow from forgetting the lessons of history.

31 George Santayana, The Life of Reason: Reason in Common Sense at 284 (Scribner's 1905).

www.competitionpolicyinternational.com
Competition Policy International, Inc. 2019© Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

CPI COMPETITION POLICY INTERNATIONAL

CPI Subscriptions

CPI reaches more than 20,000 readers in over 150 countries every day. Our online library houses over 23,000 papers, articles and interviews.

Visit competitionpolicyinternational.com today to see our available plans and join CPI's global community of antitrust experts.