

What to Do about Refusals to License?



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Summary

- IP / antitrust conflict is inevitable
- Economics (theory and empirics) offers little guidance on optimal dividing lines
 - Economics does guide some clear situations
- Economics can analyze situations given legal rules effectively if:
 - Rules are clear
 - They are grounded on coherent economic principles

Refusals to license can harm competition

- No serious dispute on this matter
 - implement tying
 - foreclosure to leverage into a second market
 - or to protect a monopoly in current market
- Reduction in aggregate consumer surplus (static welfare harm)
 - price
 - quality
 - variety

Refusals to license can benefit innovation



- Option to refuse increases expected return to creating (protected) IP
 - Another arrow in the quiver

N.B. Increased monopoly return does not always increase overall innovation!

- Less noted, but true
- Static monopoly distortion sometimes reduces aggregate innovative effort
- Example: MS leveraging desktop OS monopoly into multiple other product markets (GUI, file management, Internet browser, disk compression, screen savers, audio and video playback, productivity software)
 - Ability to leverage and exclude competition discourages innovation investments by other firms

Optimal policy?

- Even if option to refuse is a net benefit to innovation incentives: a trade-off
 - Some static harm, versus some dynamic benefit
- Where to draw the line (permit all, none, some)?
 - We don't have a theoretical answer, and none likely
 - We don't have an empirical answer either (and none likely)?

Conflict is inevitable

- Both monopolization and IP protection are intended to advance the same objective: consumer welfare
- But they are two different instruments, and since neither requires a global calculation of net benefits, they will come into conflict

IP should trump antitrust?

- Surely not
 - “IP wins” seems to be the motto du jour
 - But, unlimited incentives for innovation?
 - Why not make patent lives infinite?
 - Simple economics that when two instruments for the same goal sometimes conflict, the best solution will involve a balancing
 - Do we consume all guns, no butter?

Absent optimal policy, what can economics offer?

- Some clear cases where advice about policy is unambiguous
- Reasonably robust tools for analyzing situations whatever the rule may be (if it's clear!)

Clear cases

- Don't intervene if firm doesn't have market power
 - More robust version of the failed Chicago school dictum
 - Can get more monopoly rent by tying or leveraging
 - But, generally cannot leverage new market power where none already exists
- Some others, but very limited in applicability

Caution: Simple theories can be too simple

- Some economists (and Justice Scalia) originally believed that theory proved it was impossible to have aftermarket power with competitive foremarket
- Several later showed this was incorrect
 - Of course, there is still debate about whether likely harm is sufficient to justify intervention, but that's a fact-based, empirical inquiry

Another example: Post-Kodak Theory

- Post-Kodak theory
 - (Ordover and Shapiro, Carlton and Waldman)
Kodak / Xerox refusals economically equivalent to legally raising parts prices sufficiently, so not anticompetitive
 - But as Klein and Wiley note, substitutability between parts and service labor means raising parts prices inefficiently distorts that choice – the two options are not equivalent
 - (Also, probably runs afoul of Robinson-Patman because mfgs also sell parts to own service arm, and more notably to self-service organizations)

Another example: refusals as price discrimination

- New example: Klein & Wiley today suggest refusals to license are in truth just cases of price discrimination and should be evaluated as such
 - Not always true: there are several other profit-maximizing motivations for this strategy

Economic analysis given imperfect rules

- Case law (e.g., Supreme Court in *Kodak*, DC Circuit in *Microsoft*) clear that antitrust does impose limits on uses of IP
 - “[We have] held many times that power gained through some natural advantage such as a patent, copyright, or business acumen can give rise to liability if ‘a seller exploits his dominant position in one market to expand his empire into the next.’” (504 U.S. at 480 n.29)

Case law rule: "Beyond the scope"

- Focus often on extending power "beyond the scope" of the patent (or copyright) grant
- If "patent scope" == "relevant antitrust market" then we can apply standard market definition analysis to determine whether an exclusionary act is immune from antitrust prosecution

Does "scope" == "market"

- There is little reason to believe that "patent scope" is the same as "relevant antitrust market"
- Little guidance on what "scope" does mean
- To get scope "right" would require solving the initial problem: what restriction on refusals optimally balances consumer welfare benefits and costs?

But we still need clear rules

- Absent the “right” answer, we need a clear answer
 - Current confusion wastes resources in litigation
 - And discourages firms from investing and innovating and using possibly pro-competitive strategies

And we need economically sound rules

- Ninth Circuit ruled in *Kodak* that refusing to license IP was a presumptively pro-competitive business justification, but rebuttable
- Concluded that was not Kodak's justification
 - Probably correct in that case
 - Manager who created the policy said it was not a consideration
 - Only about 65 of about 10,000 parts were patented

But not an economically sound approach

- All refusals are generally to increase profitability
- Since the purpose of IP protection is to increase profitability as an incentive, then all refusals in general will be consistent with the purpose of IP “protection”, whether or not the firm says so in its decision memos

Concluding observation

- If primary purpose of both antitrust and IP laws is the promotion of (economic) consumer welfare...
 - ...then work towards rules that are sensible in economic terms
- May have second best rules – optimal tradeoff not known...
 - ...but can still be clear, and economically coherent
 - At present, “patent scope” is not economically coherent