

**Before the  
DEPARTMENT OF JUSTICE AND FEDERAL TRADE COMMISSION  
Washington, D.C.**

In the Matter of the )  
Joint Guidelines for the Licensing of )  
Intellectual Property )  
)  
)

**COMMENTS OF THE  
INTERNATIONAL CENTER FOR LAW & ECONOMICS**

**September 26, 2016**

## Introduction

The proposed guidelines are founded on a commendable set of underlying assumptions: that intellectual property (“IP”) is, for antitrust purposes, amenable to the same sort of analysis that applies to other forms of property, and, that IP licensing presents presumptively procompetitive opportunities for market actors to manage their property rights.

As the proposed guidelines recognize, licensing, along with a variety of vertical arrangements, frequently allows separate firms to realize efficiencies in the production, marketing and commercialization process that are otherwise difficult, if not impossible, to achieve individually.<sup>1</sup> As the proposed guidelines note, this translates not merely into single firms commercializing a particular discovery, but also into their undertaking a variety of licensing relationships that, for example, encourage licensees to further improve upon the original invention.

More broadly, in many cases, licensing arrangements allow inventive firms that lack sufficient capital to license inventions to firms that are better positioned to engage in the efficient production of complicated or expensive processes and products. Economic literature broadly recognizes the value of this form of specialization,<sup>2</sup> and the proposed guidelines are to be commended for likewise recognizing this reality and generally encouraging the practice.

Although, in short, our assessment of the proposed guidelines is positive, we offer some constructive criticism in the remainder of this comment. In particular, we believe, first, that the proposed guidelines should more strongly recognize that a refusal to license does not deserve special scrutiny; and, second, that traditional antitrust analysis is largely inappropriate for the examination of innovation or R&D markets.

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<sup>1</sup> See Proposed Update – Redline, Antitrust Guidelines for the Licensing of Intellectual Property, Issued by the Department of Justice and the Federal Trade Commission, at 8 (Aug. 12, 2016), available at [https://www.ftc.gov/system/files/documents/reports/antitrust-guidelines-licensing-intellectual-property-proposed-update-1995-guidelines-issued-us/ip\\_guidelines\\_published\\_proposed\\_update\\_redline.pdf](https://www.ftc.gov/system/files/documents/reports/antitrust-guidelines-licensing-intellectual-property-proposed-update-1995-guidelines-issued-us/ip_guidelines_published_proposed_update_redline.pdf).

<sup>2</sup> See, e.g., B. Zorina Khan, *Trolls and Other Patent Inventions Economic History and the Patent Controversy in the Twenty-First Century* 12 (Hoover IP<sup>2</sup> Working Paper Series No. 13001, Oct. 24, 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2344853](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2344853).

## Relevant Principles of IP and Antitrust Law

IP commercialization provides socially beneficially incentives to ensure the optimal production of innovative goods and services, and to guarantee that they can be efficiently employed by society.<sup>3</sup> As with other property rights, IP rights enable coordination of productive processes and the reduction of transaction costs, thus allowing firms to more economically bring new goods and services to market.

Importantly, when IP rights are governed by predictable legal rules, they facilitate a diverse set of complementary firms to more efficiently coordinate their activity.<sup>4</sup> As our economy becomes ever more reliant on IP, the facilitation of this firm coordination becomes ever more important.

Judge Posner accurately captured the essential characteristics of modern innovative firms in the “New Economy”:

[The New Economy is] characterized... by falling average costs (on a product, not firm, basis) over a broad range of output, modest capital requirements relative to what is available for new enterprises from the modern capital market, very high rates of innovation, quick and frequent entry and exit, and economies of scale in consumption (also known as “network externalities”), the realization of which may require either monopoly or interfirm cooperation in standards setting. And while vertical integration is a common feature of the old economy, it tends to be even more common in the new one, precipitating an unusually large number of firms into customer or supplier relations with other firms that are also its competitors.<sup>5</sup>

Judge Posner goes on to note that the “principal output of these industries... is intellectual property.”<sup>6</sup> But IP as an input in the productive process has unique features that present potential problems for rightsholders. For many products, the inclusion of IP requires standards in order to coordinate the integration of various components.<sup>7</sup> Meanwhile, increasingly integrated components require

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<sup>3</sup> See generally WILLIAM LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* (2003).

<sup>4</sup> See generally F. Scott Kieff, *Property Rights and Property Rules for Commercial Inventions*, 85 MINN. L. REV. 697 (2001).

<sup>5</sup> Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 927 (2001).

<sup>6</sup> *Id.* at 925.

<sup>7</sup> See Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust* 6 J. COMP. L. & ECON. 153, 171 (2010).

ever greater degrees of interoperability. And in many cases, the efficient deployment of IP-intensive processes will require economies of scale and will depend upon network effects.<sup>8</sup> All of these factors may tend to encourage monopolization within the relevant markets, but competition over these rents also tends to encourage a high degree of competition.

As Jorde and Teece have demonstrated, competition in high-tech markets is generally sequential rather than contemporaneous, and turns on product innovation rather than price.<sup>9</sup> This competition yields short-run consumer welfare enhancements coupled with long-term dynamic benefits to the industry as a whole (which will most likely never adequately redound to the benefit of the original innovators).<sup>10</sup>

## **Refusals to License Should Not Be Subject to Enhanced Scrutiny**

Many of the product innovation cases that have come before the courts rely upon what amounts to an implicit essential facilities argument.<sup>11</sup> The theories that drive such cases, although not explicitly relying upon the essential facilities doctrine, encourage claims based on variants of arguments about interoperability and access to intellectual property (or products protected by intellectual property).<sup>12</sup> But, the problem with such arguments is that they assume, incorrectly, that there is no opportunity for meaningful competition with a strong incumbent in

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<sup>8</sup> *Id.*

<sup>9</sup> See Thomas M. Jorde & David J. Teece, *Innovation and Cooperation: Implications for Competition and Antitrust*, 4 J. ECON. PERSPECTIVES 75 (1990).

<sup>10</sup> See Manne & Wright, *supra* note 7, at 171. See also Richard J. Gilbert, *Holding Innovation to an Antitrust Standard*, 3 COMPETITION POLICY INTERNATIONAL, no. 1, at 53 (Spring 2007) [hereinafter “Holding Innovation to an Antitrust Standard”] (“the benefits from innovation are uncertain and difficult to measure and innovation often has spillover benefits for other firms and consumers”).

<sup>11</sup> Manne & Wright, *supra* note 7, at 175.

<sup>12</sup> See, e.g., *Berkey Photo, Inc. v. Eastman Kodak Co.*, 457 F. Supp. 404 (S.D.N.Y. 1978), *aff'd in part, rev'd in part*, 603 F.2d 263 (2d Cir. 1979) (Kodak was viewed as harming competition by failing to disclose an innovative product before release); *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (Microsoft was accused of relying upon network effects to exclude competitors); Case COMP/C-3/37.792 Microsoft, Commission Decision of 24 March 2004 (By designing its products without sufficient interoperability, Microsoft allegedly refused to deal with competitors); *C.R. Bard Systems, Inc. v. M3 Systems, Inc.* 157 F.3d 1340 (Fed. Cir. 1998) (A claim of anticompetitive product design); *Abbott Laboratories v. Teva Pharmaceuticals*, 432 F. Supp. 2d 408 (D. Del. 2006) (product hopping).

the face of innovation, or that the absence of competitors in these markets indicates inefficiency.

And, as noted above, the very nature of the factors that characterize IP as an input in innovative firms — network effects, economies of scale, reliance on standards, and broad interoperability in the market — actually lead to a weaker long-term hold on markets for apparently dominant firms, which virtually destroys any “essential” characteristic of an alleged “essential facility.” Thus, regulation of companies and practices in these markets will systematically understate the extent of competition if it focuses excessively on short-term monopolies — and doing so will actually deter the sequential competition that characterizes these markets.

In the New Economy, static measures, like market structure, are misleading,<sup>13</sup> and the DOJ and FTC should continue to rely upon identifiable, dynamic consumer welfare effects in well-defined markets:

Some factors make leaders even more aggressive and tend to increase their market share (eventually until other firms exit): these are scale economies, network effects and learning by doing in dynamic contexts, product homogeneity and rapid technological development, all factors typical of New Economy markets. The consequence is that markets with high concentration due to the presence of a dominant firm are perfectly consistent with efficiency. This has major implications for competition policy: while the old approach to abuses of dominant positions needs to verify dominance through structural indicators and the existence of a certain abusive behaviour, a new economic approach would just need to verify the existence of harm to consumers... The structural indicators which traditionally serve as proxies for ‘dominance’ provide an appropriate measure of power in some markets, but not in others,” notably in the New Economy.”<sup>14</sup>

Thanks to the very elements of IP that help them to obtain market dominance, firms in New Economy technology markets are also vulnerable to smaller, more

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<sup>13</sup> See, e.g., J. Gregory Sidak & David J. Teece, *Dynamic Competition in Antitrust Law* 5 J. COMP. L. & ECON. 581 (2009).

<sup>14</sup> Federico Etro, *Competition Policy: Toward a New Approach*, 2 EUR. COMPETITION J. 29, 30–31 (2006).

nimble new entrants that can quickly enter and supplant incumbents by leveraging their own technological innovation.<sup>15</sup>

With the foregoing in mind, we respectfully offer the following comments for clarification and enhancement of the proposed guideline update.

Section 2.1 of the proposed guidelines notes that “The antitrust laws generally do not impose liability upon a firm for a unilateral refusal to assist its competitors, in part because doing so may undermine incentives for investment and innovation.”<sup>16</sup> Although this is a reasonably good overview of the law, we are concerned that it does not provide sufficient legal clarity to indicate that a refusal to deal is an important part of an IP owner’s rights. We respectfully suggest that this section should be amended as follows:

A unilateral refusal to deal with competitors “lies at or near the outer boundary of section 2 liability.”<sup>17</sup> The antitrust laws generally do not impose liability upon a firm for a unilateral refusal to assist its competitors, except in very limited circumstances, in part because doing so will likely undermine incentives for investment and innovation.

Therefore, a mere refusal to deal with competitors will not subject an IP rightsholder to particular scrutiny under the antitrust laws. Rather, as with other forms of private property, only certain types of conduct with demonstrable with respect to intellectual property may have anticompetitive effects against which the antitrust laws can and do protect. will give rise to liability. The exercise of intellectual property rights is thus neither particularly free from scrutiny under the antitrust laws, nor particularly suspect under them.

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<sup>15</sup> Although it’s easy to forget that Facebook was still seen as an upstart in the online world in 2007, it beat the mighty Google to dominance in the emerging mobile market. Max Willens, *Facebook Beats Google To Milestone: Two Million Advertisers Shows Long Tail Of Social Network’s Business*, INTERNATIONAL BUSINESS TIMES (Feb. 24, 2015), available at <http://www.ibtimes.com/facebook-beats-google-milestone-two-million-advertisers-shows-long-tail-social-1826480>. And, in its turn, Facebook was soon rivaled for online video dominance among mobile users by a yet newer company, Snapchat. Alexei Oreskovic, *Snapchat rivals Facebook with 8 billion video views on its app every day*, BUSINESS INSIDER (Feb. 29, 2016) <http://www.businessinsider.com/snapchat-now-rivals-facebook-with-8-billion-video-views-on-its-app-every-day-2016-2>.

<sup>16</sup> Guidelines, *supra* note 1, at 6.

<sup>17</sup> *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398, 407 (2004).

## R&D Markets Are Not Properly Subject to Antitrust Analysis

As the proposed guidelines repeatedly acknowledge, it is the effects on consumer welfare against which antitrust analysis and remedies are measured. As such, we also respectfully submit that R&D markets are an inappropriate focus for anti-trust regulators and enforcers.

First, competition among research and development departments is not necessarily a reliable driver of innovation.<sup>18</sup> The proposed guidelines note that “[a] licensing arrangement may have competitive effects on research and development that cannot be adequately addressed through the analysis of goods or technology markets.” Yet the assessment of consumer welfare effects in a putative R&D market *absent* analysis of the downstream market (including, for example, the practical ability of new technology to supplant incumbent standards) is fraught with deep uncertainty. To impose antitrust requirements on R&D is nothing short of institutionalized nostalgia: all innovation must be measured against the pool of previous and contemporary R&D, and must necessarily avoid straying too far from pre-ordained constraints on allowable research conduct. But the truth is that it is only once the fruits of any R&D become incorporated into downstream products or services that their effects on consumer welfare can properly be assessed.<sup>19</sup>

R&D “markets” are inevitably driven by a desire to innovate with no way of knowing exactly what form or route such an effort will take. And while innovation is important, the optimal amount of innovation is certainly not the maximum. In many cases, what may look like well-funded, well-planned R&D efforts end in resolute failure; in other cases, innovations that are commercial failures

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<sup>18</sup> *Holding Innovation to an Antitrust Standard*, *supra* note 10, at 49. (“the consequences of innovation and the link between competitive effects and the incentives to invest in R&D are difficult to evaluate with any welfare measure.”); *See also* Richard J. Gilbert, *Competition and Innovation*, in 1 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 577, 600 (W. Dale Collins ed., 2008).

<sup>19</sup> *Holding Innovation to an Antitrust Standard*, *supra* note 10, at 52 (“Private and social incentives are better aligned for changes in price. A reduction in price usually increases consumer welfare and increases economic welfare (in the short run) provided that the price is above marginal production cost. A price below marginal cost is unprofitable in the short run and socially inefficient because the cost of an incremental unit of supply exceeds its value to consumers. Thus it is not unreasonable for antitrust policy to scrutinize pricing below marginal cost in order to exclude competition. For innovation, analogous conduct is an innovation that is unprofitable in the short run and excludes competition. A rule that identifies conduct with these properties as “predatory innovation” likely would lead to false positives and chill socially desirable innovation”).

for the original inventor have positive spillover effects for others. Sussing out these effects at the R&D stage is incredibly difficult for innovators and investors themselves; it is nearly impossible for regulators and other outside observers to do after-the-fact. As Rich Gilbert has observed,

It is easy to underestimate the total social value of an innovation because benefits from new technologies are difficult to forecast and often occur in markets far removed from where the innovation occurred. A hypothetical example is a way to apply a thin film to glass beverage bottles that has application to liquid crystal displays.... [T]he social value of the innovation can be much larger than the value... in the market where the innovation occurs. When innovation has positive spillover benefits for consumers and firms in other industries, its true social value can be much larger than its value in any one industry. [If an analysis] only measures part of the social value of an innovation because other spillover benefits are hard to estimate, then it is not necessarily a waste of social resources to reward innovation with a payoff that exceeds the measured, but underestimated, social value.<sup>20</sup>

And, of course, just as it is possible for R&D to deliver far more social value than is anticipated initially, it is entirely possible – if not even probable in the majority of cases – that a research endeavor will deliver disappointingly little social value. Or, potentially, innovation can have a mixed or difficult-to-measure value: this is frequently a problem faced by economists who attempt to actually value the output of many of the IP-intensive industries in the modern economy.<sup>21</sup>

R&D is an inherently speculative endeavor, and standard antitrust analysis applied to R&D will be inherently flawed because “[a] challenge for any standard applied to innovation is that antitrust analysis is likely to occur after the innovation, but ex post outcomes reveal little about whether the innovation was a good decision ex ante, when the decision was made.”<sup>22</sup>

Further, in Section 3.2.3, the proposed guidelines also risk contradicting the established understanding in Section 2.1 that “refusals to deal” are rarely considered violations of antitrust law. For instance, the proposed guidelines note that

When research and development is directed to particular new or improved goods or processes, the close substitutes may include research

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<sup>20</sup> *Holding Innovation to an Antitrust Standard*, *supra* note 10, at 52-55.

<sup>21</sup> Joel Mokyr, *What Today's Economic Gloomers Are Missing*, WALL STREET J. (Aug. 8, 2014) available at <http://www.wsj.com/articles/joel-mokyr-what-todays-economic-gloomers-are-missing-1407536487?mg=id-wsj>.

<sup>22</sup> *Holding Innovation to an Antitrust Standard*, *supra* note 10, at 52.

and development efforts, technologies, and goods that significantly constrain the exercise of market power with respect to the relevant research and development, for example by limiting the ability and incentive of a hypothetical monopolist to reduce the pace of research and development.<sup>23</sup>

An IP holder — monopolist or otherwise — may very well be entitled to “reduce the pace of research and development” if such a reduction results from his (legitimate) refusal to license his IP. As we note above, the IP holder is entitled to exclusive use of his property, and, except in rare cases, he will not be obligated to deal with anyone — rivals or potential licensees alike. After all, the behavior of a theoretical R&D “monopolist” would amount to conduct that essentially resembles a refusal to deal, which, without additional, clearly defined anticompetitive conduct, would most likely not support antitrust liability following *Trinko*.<sup>24</sup>

Moreover, it is nearly impossible to effectively monopolize a putative market for R&D as the inputs into that process are both widely available and relatively indeterminate until a particular problem defines itself. Not only are capital, researchers, software, hardware, and other “research commodities” openly available on the worldwide market on competitive terms, the nominative aim of any particular research project is often ill-defined at its outset. Further, because of the sequential nature of competition in high-tech markets and the importance of competition for the field, efforts to circumscribe a particular R&D market with reference to an *existing* patented product or standard will miss the broader competitive effects that constrain that market. In effect, unless an enforcer seeks to establish a global market for nearly all types of innovation, it is difficult to believe that any firm could have monopoly power in a relevant R&D “market.”

Thus, in a sense, every firm is essentially a monopolist over its own research process, as it deals uniquely with each problem that arises in that process. But at the same time, each research process is itself either a distinct market, or else research generally is a broad (and deeply competitive) market. The value of a particular researcher to a particular research project may be enormous given the

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<sup>23</sup> Guidelines, *supra* note 1, at 16.

<sup>24</sup> *Holding Innovation to an Antitrust Standard*, *supra* note 10, at 5 (“The competitive impacts from a change in interface standards that prevents interoperability of complementary products are no more severe than the effects of a decision not to deal with the suppliers of these products. Given the skepticism expressed by the U.S. Supreme Court in *Verizon v. Trinko* regarding the obligation of a firm to deal with a rival, it is likely that a refusal to deal with no other anticompetitive conduct would escape antitrust liability in most circumstances. A product innovation that has the same effect should not be subject to greater antitrust scrutiny”).

human capital invested, suggesting that that firm’s “monopolization” of her time could seem exclusionary. And yet her value on the open market will necessarily be considerably less to a new employer, reflecting the broad availability of her general domain knowledge, and the need for any other employer to invest the same capital to tailor her work to any new project. In other words, it is nearly impossible to attempt a market definition for “R&D markets” such that any sort of meaningful comparison could be made between the factors in the production of research that would yield useful information for regulators.

Certainly, a new firm may not have sufficient capital or marketing acumen to successfully compete once it enters a downstream market with its invention, or it may face anticompetitive foreclosure of some sort in that market. As a result, the downstream market may thus not fully reflect the value of R&D. In the first instance, however, robust capital markets and specialists like venture funds and various specialized firms should ensure that the value of any R&D is ultimately realized, even if not via downstream entry in the intended market. And in the second instance, anticompetitive conduct that excludes entry into a product market is, indeed, the proper province of antitrust enforcers. Such conduct, particularly if it constrained the realization of a valuable new innovation, would be actionable if it meets the relevant legal criteria.

Thus it remains unclear exactly how a particular licensing arrangement could damage a competitive “R&D market.” Without more — that is, unless the proposed guidelines can adequately specify the antitrust-relevant circumstances under which a licensing arrangement could damage the R&D process itself — we respectfully suggest that the DOJ and FTC omit the proposed Section 3.2.3 from the final guidelines.

To the extent that this section remains in the guidelines, we would ask that it be limited to a discussion of possible misuse of the R&D process as a means of furthering anticompetitive conduct in actual goods and services markets. For instance, if a firm is engaging in clearly anticompetitive conduct more generally, it should not be shielded from antitrust scrutiny merely by declaring that a particular activity is in furtherance of R&D.

Respectfully submitted,

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