Point

Per Se Legality for Unilateral Refusals to License IP Is Correct as a Matter of Law and Policy

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The most fundamental question in the interface between antitrust law and intellectual property law is the issue of whether the antitrust laws prohibit an intellectual property owner from refusing unilaterally to license its intellectual property. In other words, can an intellectual property owner violate the antitrust laws by doing precisely what the Patent Act and Copyright Act authorize? This question was squarely addressed in Federal Circuit's decision in the *Xerox* case,[1] which rejected contrary Ninth Circuit precedent in the *Kodak* case[2] and held that an IP owner's unilateral exercise of rights granted by the Patent Act and Copyright Act cannot violate the antitrust laws.[3] The *Xerox* and *Kodak* decisions have provoked extensive commentary, and there remains a substantial dispute among members of the antitrust bar regarding the scope of antitrust liability for refusals to license intellectual property.[4]

There is no serious dispute that ownership of intellectual property provides no general immunity from the antitrust laws. A tying arrangement involving a patented good can be just as unlawful as a tying arrangement involving unpatented goods.[5] And *United States v. General Electric*[6] notwithstanding, price fixing involving patented goods is recognized as just as unlawful as price fixing of any other good or service.[7] But neither the Patent Act nor the Copyright Act authorizes tying or price fixing. Both do, however, expressly authorize intellectual property owners to refuse to provide their inventions and works to others.

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[1] *In re* Independent Serv. Orgs. Antitrust Litig. (*CSU, L.L.C. v. Xerox Corp.*), 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied*, 121 S. Ct. 1077 (2001) [hereinafter *Xerox*].

[2] Image Technical Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997).

[3] *See Xerox*, 203 F.3d at 1328 ("Xerox was under no obligation to sell or license its patented parts and did not violate the antitrust laws by refusing to do so."); *id.* at 1329 ("Xerox's refusal to sell or license its copyrighted works was squarely within the rights granted by Congress to the copyright holder and did not constitute a violation of the antitrust laws.").

[4] A full day was devoted to the subject during the FTC-DOJ Hearings on "Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy." Presentations and papers, including materials from the author, are available online at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%201: .

[5] Indeed, some of the Supreme Court's leading tying cases involved intellectual property. *See, e.g.*, United States v. Loew's Inc., 371 U.S. 38 (1962); United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948).

[6] 272 U.S. 476 (1926).

[7] In *General Electric* the Supreme Court held that fixing the price at which a licensee must sell a patented good is not unlawful. *Id.* at 489–90. Although the case has never been overruled, it was limited in subsequent decisions. *See, e.g.*, United States v. Univis Lens, 316 U.S. 241, 249–51 (1942) (*General Electric* does not apply after the "first sale"). The Department of Justice has sought a case in which *General Electric* could be overruled, but a DOJ official has stated that the Department could never find a potential defendant willing to defend its conduct. *See* Remarks of Richard Stern, 377 PAT. TRADEMARK & COPYRIGHT J. (BNA) E-2 (May 4, 1978).

[C]an an intellectual property owner violate the antitrust laws by doing precisely what the Patent Act and Copyright Act authorize?

Although a number of Supreme Court decisions contain dicta that seem relevant to the dispute, the Court has never directly addressed this fundamental question. Indeed, antitrust challenges to unilateral refusals to license intellectual property were few and far between for the Sherman Act's first hundred years. This began to change, however, in the early 1990s. The challenges came from independent service organizations (ISOs) that serviced durable equipment manufactured by Data General, Kodak, Xerox, Siemens, and others and sought access to patented parts and patented or copyrighted diagnostic software. A flurry of decisions in these cases over the last decade have thus confronted this issue head-on, yielding a variety of proposed standards for evaluating unilateral refusals to license IP. Commentators have proposed still more standards.

This article addresses the question of how to resolve this conflict between the antitrust laws and the intellectual property laws. The statutory scheme, principles of statutory construction, and the little relevant legislative history all support a rule of per se legality for unilateral refusals to license intellectual property. This result is supported by the best reading of the relevant Supreme Court precedents and by sound policy considerations. Finally, the alternatives to a rule of per se legality that have been proposed suffer from both legal and policy flaws.

The Statutory Scheme and Legislative Intent

The Patent and Copyright Acts. The Patent Act authorizes the owner of a patent "to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States."[8] The Copyright Act affords copyright holders the right to exclude others from reproducing or distributing the copyrighted work.[9] As the Supreme Court has held many times, the core right of an intellectual property owner is the right to exclude.[10]

The entire American intellectual property system is built around this key principle. Intellectual property owners are granted only the right to exclude. They have no statutory right to commercialize or profit from their inventions and works. (For example, commercialization might be barred by the existence of essential IP rights owned by others; I may receive a patent for an innovative new microprocessor technology, but I'm likely to need additional IP rights from others to commercialize and profit from my technology.) Because IP rights provide no right to compensation at all, it makes no sense to say that an IP right provides a right that is limited to compensation (i.e., selling at a high price) rather than exclusion.

Accordingly, infringement of a patent will be enjoined no matter the economic harm to the infringer or the public; permanent injunctions against infringement have been denied only in the rarest of circumstances presenting a direct threat to public health.[11] As the Supreme Court noted in *Dawson Chemical Co. v. Rohm & Haas Co.*, "[c]ompulsory licensing is a rarity in our patent system"; although compulsory licensing has occasionally been considered by Congress, it has never

[8] 35 U.S.C. § 154(a)(1). When the patent claims a process, a patentee also has the "right to exclude others from using, offering for sale or selling throughout the United States, or importing into the United States, products made by that process." *Id.*

[9] 17 U.S.C. § 106(1), (3). The Act also permits the copyright holder to prevent others from making derivative works, and in the case of literary or artistic works, to prevent others from publicly performing or displaying the work. *Id.* § 106(4)–(5).

[10] *See, e.g.*, Dawson Chem. Co. v. Rohm & Haas Co., 448 U.S. 176, 215 (1980) ("essence" of the patent grant is the "right to exclude others from profiting by the patented invention"); Stewart v. Abend, 495 U.S. 207, 228–29 (1990) ("a copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work").

[11] *See, e.g.*, City of Milwaukee v. Activated Sludge, 69 F.2d 577, 593 (7th Cir. 1934) (denying injunction in case involving patent on sewage treatment technology because "the health and the lives of more than half a million people are involved").

been adopted.[12] The Court's rejection of compulsory licensing in *Dawson* is consistent with the principle that courts hesitate to act where Congress has refused to do so.[13]

The Copyright Act similarly creates no general requirement that a copyright owner license his work. "The owner of the copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property."[14] Although the Copyright Act, unlike the Patent Act, does provide for certain limited forms of compulsory licensing (generally involving the entertainment industry[15]), Congress's creation of compulsory licenses under limited circumstances indicates a legislative intent not to require compulsory licensing in other circumstances.[16]

The 1988 Patent Act Amendments

In 1988 Congress amended Section 271(d) of the Patent Act to add, inter alia, a new subpart (4). The statute provides: "No patent owner otherwise entitled to relief for infringement or contributory infringement shall be denied relief or deemed guilty of misuse *or illegal extension of the patent right* by reason of having . . . (4) refused to license or use any rights in the patent."[17] The best reading of this amendment under established principles of statutory construction, as well as the legislative history of the section, suggest that it operates to bar antitrust claims based on a refusal to license patents, not just assertion of a misuse defense.[18]

First, reading the statutory language "illegal extension of the patent right" to mean nothing more than patent misuse would render the phrase a nullity; under this reading the statute would provide that a patent owner could not be guilty of "misuse or misuse." Such a reading conflicts with the "elementary canon of construction that a statute should be interpreted so as not to render one part inoperative . . ."[19] Indeed, such a reading would render the entire statute a nullity, for where "conduct [does] not constitute patent misuse, neither [can] it be violative of the antitrust laws."[20] "[I]nterpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available."[21] The interpretation of Section 271(d)(4) consistent with the legislative purpose is one that bars a finding of antitrust violations, not just misuse.

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[12] 448 U.S. 176, 215 (1980).

[13] *See, e.g.*, Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 60 (2000) (rejecting FDA's claim to jurisdiction over tobacco where Congress had consistently rejected legislation giving it such jurisdiction).

[14] Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932).

[15] *See* 17 U.S.C. § 111(d) (compulsory licensing for secondary transmissions by cable TV systems); *id.* § 115 (compulsory licensing for creation of sound recordings of previously published dramatic works); *id.* § 116 (compulsory license for public performance using coin-operated jukeboxes).

[16] *Cf., e.g.*, United States v. Brockamp, 519 U.S. 347, 352 (1997) ("explicit listing of exceptions" to running of limitations period considered indicative of Congress' intent to preclude "courts [from] read[ing] other unmentioned, open-ended, 'equitable' exceptions into the statute"). The Latin version of this canon of construction is *"expressio unius est exclusio alterius."*

[17] 35 U.S.C. § 271(d)(4) (emphasis added).

[18] *See generally Xerox*, 203 F.3d at 1325 (noting that "[t]he patentee's right to exclude is further supported by section 271(d) of the Patent Act"); ISO Antitrust Litig., 989 F. Supp. 1131, 1135–36 (D. Kan. 1997) (discussing statutory construction and legislative history of Section 271(d) in depth).

[19] Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985) (citation omitted).

[20] Zenith Radio Corp. v. Hazeltine Research, Inc. 395 U.S. 100, 134–35 (1969).

[21] Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982).

Second, the legislative history of the statute supports a reading that would bar antitrust claims based on unilateral refusals to license. The relevant legislative history is that of the original 1952 statute, which contains the "misuse or unlawful extension" language. Although we do not have any direct expressions of legislative intent one way or the other regarding preemption of antitrust claims, we do have some helpful hearsay. Wilbur Fugate, testifying on behalf of the Department of Justice, specifically objected to the provision that became Section 271(d) because "its effect might be to carve out an area in which the antitrust laws would not operate. . . . The proponents of the bill indicate that such a result is contemplated in the language of section [271(d)]."[22]

[A]lmost every court to address the question has held that Section 271(d) bars both antitrust claims as well as a misuse defense.

Consistent with the principles of statutory construction and the legislative history discussed in this section, almost every court to address the question has held that Section 271(d) bars both antitrust claims as well as a misuse defense.[23]

The Sherman Act

Section 2 of the Sherman Act makes it unlawful to "monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several states."[24] The language of the statute itself tells us nothing about whether Congress intended that exercise of a right conveyed by the intellectual property laws could violate the Sherman Act. But the legislative history of the Sherman Act, although sparse, is helpful on this point. Senator Sherman, the Act's sponsor, stated on the Senate floor that, "A limited monopoly secured by a patent right is an admitted exception, for this is the only way by which an inventor can be paid for his invention."[25]

Reconciling the IP Laws and the Sherman Act. Consistent with this legislative history, the Supreme Court has on several occasions stated that the exercise of patent rights is an "exception" to the antitrust laws. Most famously, in *Simpson v. United Oil Co. of California*, the Court noted that "[t]he patent laws which give a 17-year monopoly on 'making, using, or selling the invention' are *in pari materia* with the antitrust laws and modify them *pro tanto*."[26] In other words, because the patent laws modify the antitrust laws "as far as they go," that which is lawful under the patent laws does not violate the antitrust laws. Section 271(d)(4) of the Patent Act only reinforces this result. The *Simpson* principle, combined with Section 271(d)(4), requires a rule of per se legality for unilateral refusals to license IP. In such a case the IP owner is doing only what his patent or copyright authorizes him to do.

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[22] Hearings before Subcommittee No. 3 of the Committee on the Judiciary, House of Representatives, 82 Cong., 1st Sess. on H.R. 3760, June 13, 14, and 15, 1951, Serial No. 9, at 207. Moreover, even the legislative history of the 1988 amendments to Section 271(d) that expressly immunized refusals to license supports a reading of the provision as barring antitrust claims. Representative Kastenmeier, the prime sponsor of the legislation, cited *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1203–06 (2d Cir. 1981), as a basis for the statute, but the *SCM* case involved only antitrust claims, not patent claims or a misuse defense. *See* 34 Cong. Rec. H10646, H10648 (Oct. 20, 1988).

[23] *See* ISO Antitrust Litig., 203 F.3d 1322, 1326 (Fed. Cir. 2000); Carpet Seaming Tape Licensing Corp. v. Best Seam, Inc., 616 F.2d 1133, 1143 (9th Cir. 1980) (citing Section 271(d)(3) to conclude that "[a]ttempted enforcement of a patent does not amount to a violation of the antitrust laws."); Polysius Corp. v. Fuller Co., 709 F. Supp. 560, 576 (E.D. Pa. 1989) (finding, based on Section 271(d)(1), that "Congress has mandated . . . [that] plaintiffs cannot be guilty of either antitrust violations or patent misuse . . ."); Rohm & Haas Co. v. Dawson Chem. Co., 557 F. Supp. 739, 835 (S.D. Tex.) (Section 271 "necessarily extends into the antitrust arena" because "it would be superfluous to sanction and protect activity within one area of the law and concurrently prohibit and expose a patentee to damages by reason of another body of law."), *rev'd on other grounds sub nom.* Rohm & Haas Co. v. Crystal Chem. Co., 722 F.2d 1556 (Fed. Cir. 1983). *But see* Image Technical Servs., Inc. v. Eastman Kodak Co., 125 F.3d 1195, 1215 n.7 (9th Cir. 1997) (Section 271(d) applies only to misuse claims).

[24] 15 U.S.C. § 2.

[25] 21 Cong. Rec. 2457 (Mar. 21, 1890).

[26] 377 U.S. 13, 24 (1964).

It is a commonplace that "exemptions from the antitrust laws are strictly construed and strongly disfavored"[27] and that such exemptions "have only been found in cases of plain repugnancy between the antitrust and regulatory provisions."[28] Although "it is crystal clear from the legislative history and accepted judicial interpretations of the Sherman Act that competition on prices is the rule of congressional purpose and that where exceptions are made, Congress should make them . . . [t]he monopoly granted by the patent laws is a statutory exception to this freedom for competition."[29] Accordingly, a patentee's decision "to exclude others from the use of the invention . . . is not an offense against the Anti-Trust Act."[30] It is true that this language is not found in cases directly addressing antitrust liability for unilateral refusals to deal. But the question of antitrust liability for unilateral refusals to license presents a case of "true repugnancy" between the antitrust laws and the IP laws. As discussed below, we cannot apply standard antitrust rules to refusals to license IP without reading the right to exclude out of the IP laws.

But the question of antitrust liability for unilateral refusals to license presents a case of "true repugnancy" between the antitrust laws and the IP laws.

The Limited Benefits of Any Compulsory Licensing Obligation. Even if compulsory licensing were required in some cases to avoid antitrust liability, it is not clear how this would serve to benefit consumers unless the antitrust laws imposed not just an obligation to license, but an unprecedented obligation to license at some "reasonable" price. "A patent empowers the owner to extract royalties as high as he can negotiate with the leverage of that monopoly."[31] Indeed, it is not unlawful for an IP owner to set a price so high that it is the equivalent of a refusal to deal. In *Stewart v. Abend* the Court rejected the idea that it was in any way improper for a copyright holder to "make demands—like respondent's demand for 50% of petitioners' gross proceeds in excess of advertising expenses—which are so exorbitant that a negotiated economic accommodation will be impossible."[32]

Even if the antitrust laws were read to require an IP owner to set a price that is not the equivalent of a refusal to deal, surely nothing in the antitrust laws would require an IP owner to set a price that would allow the licensee to undercut the price that the IP owner charges. Even a firm with monopoly power is not required to help its competitors "by holding a price umbrella over their heads."[33] Assuming that Xerox is not required to charge a price that allows ISOs to undercut its price, the consumer benefit of any rule requiring compulsory licensing is unclear. And even some other hypothetical benefit, such as some consumers' preference for ISO service, would hardly

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[27] Square D Co. v. Niagara Frontier Tariff Bureau, Inc. 476 U.S. 409, 421 (1986).

[28] U.S. v. National Ass'n of Securities Dealers, Inc. 422 U.S. 694, 746 (1975).

[29] U.S. v. Line Material Co. 333 U.S. 287, 310 (1948); *see also* Precision Instrument Mfg. Co. v. Automotive Maint. Mach. Co., 324 U.S. 806, 816 (1945) ("[A] patent is an exception to the general rule against monopolies and to the right to access to a free and open market.").

[30] U.S. v. United Shoe Mach. Co., 247 U.S. 32, 57 (1918).

[31] Brulotte v. Thys Co., 379 U.S. 29, 33 (1964). Accord Stewart v. Abend, 495 U.S. 207, 228 (1990) (high price for copyrighted work "was contemplated by Congress and is consistent with the goals of the Copyright Act"). In this regard, an IP owner is no different than any other lawful monopolist. *See, e.g.*, Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1412–13 (7th Cir. 1995) ("A natural monopolist that acquired and maintained its monopoly without excluding competitors by improper means is not guilty of 'monopolizing' in violation of the Sherman Act, and can therefore charge any price it wants, for the antitrust laws are not a price-control statute or a public-utility or common-carrier rate regulation statute.").

[32] 495 U.S. at 228.

[33] United States Football League v. National Football League, 842 F.2d 1335, 1360–61 (2d Cir. 1988).

appear to outweigh the disincentives for innovation created by a compulsory licensing scheme.[34]

Alternatives to a Rule of Per Se Legality. Another reason for a rule of per se legality for refusals to license IP is that none of the alternatives that have been proposed are workable, let alone consistent with precedent.

Treat IP Like Any Other Property. Some, including Professor MacKie-Mason, have suggested that because the right to exclude is a key attribute of all property, there is no basis for treating a refusal to license IP differently from any other refusal to deal.[35] As an initial matter, this argument oversimplifies the issue significantly. Unlike the case of IP, where the statutory right to exclude is absolute (with the limited exceptions discussed above), the right to exclude from private property has never been absolute—it is limited, for example, by the common law doctrine of easements. Moreover, regardless of whether state law property rights are limited or absolute, Federal law (including antitrust law) preempts inconsistent state law.[36] But the federal antitrust laws do not preempt inconsistent federal law. Quite the opposite; the Supreme Court has held even outside the IP law context that conduct expressly authorized by federal law cannot violate the antitrust laws.[37]

The Solicitor General suggested in the *Xerox* case that no special rules should apply to refusals to license IP, and that under general antitrust principles a refusal to license will not be unlawful "if it does not involve a sacrifice of profits in order to exclude competition and thereby create market power."[38] But even if the "sacrifice of profits test" were an accurate summary of the caselaw on anticompetitive conduct—and it is not a complete one[39]—the test would invalidate unexceptionable refusals to license.

Because of the low marginal cost of many products built on IP rights (think of pharmaceuticals or software), introducing additional competitors will result in a speedy decline in prices. The magnitude of these declines is such that it will almost always be more profitable to be, for example, the monopoly supplier of a pharmaceutical than to be a monopoly licensor of the pharmaceutical

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[34] In his Counterpoint, Professor MacKie-Mason notes that existence of a strong right to exclude may discourage follow-on innovation. Jeffrey K. MacKie-Mason, *Antitrust Immunity for Refusals to Deal in (Intellectual) Property Is a Slippery Slope*, ANTITRUST SOURCE, July 2002. As he recognizes, this loss is entirely speculative. It is also irrelevant to the Xerox case, because ISOs were certainly not engaging in any form of innovation.

[35] *See id.*

[36] *See, e.g.*, Hisquierdo v. Hisquierdo 439 U.S. 572, 582 (U.S. 1979) (collecting cases in which state property laws were held preempted by federal legislation).

[37] *See, e.g.*, United States v. Rock Royal Co-op., 307 U.S. 533, 560 (1939) (defendants' price fixing authorized by agricultural cooperative statute activity did not violate the antitrust laws even "[i]f ulterior motives of corporate aggrandizement stimulated their activities . . .").

[38] *See* Brief for the United States as Amicus Curiae at 11–12, *CSU, L.L.C. v. Xerox*, 121 S. Ct. 1077 (2001) (No. 00-62) (quoting Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985) and citing ROBERT H. BORK, THE ANTITRUST PARADOX 144 (2d ed. 1993)) (defining predation as conduct "that would not be considered profit maximizing except for the expectation" of a resulting reduction in competition), *available at* http://www.usdoj.gov/osg/briefs/2000/2pet/6invit/2000-0062.pet.ami.inv.pdf. Douglas Melamed and Ali Stoeppelworth make the same argument in a draft article submitted for the FTC hearings. *See* A. Douglas Melamed & Ali M. Stoeppelwerth, The *CSU* Case: Facts, Formalism and the Intersection of Antitrust and Intellectual Property Law, *available at* http://www.ftc.gov/opp/intellect/020501adouglasmelamed.pdf.

[39] Courts have held that the category of anticompetitive conduct "can come in too many different forms, and is too dependent upon context, for any court or commentator ever to have enumerated all the varieties." Caribbean Broadcasting v. Cable & Wireless PLC, 148 F.3d 1080, 1087 (D.C. Cir. 1998). Even the Solicitor General's standard, which he attributed to *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, is actually a gloss on the Court's actual standard in *Aspen*, which held that conduct is anticompetitive where a monopolist is "attempting to exclude rivals on some basis other than efficiency." 472 U.S. 585, 605 (1985).

IP to firms making generics.[40] This choice could be characterized as trading off short-term profits from licensing for monopoly profits from the exclusion of downstream competitors. But plainly the antitrust laws do not (and should not) require the owner of a drug patent to license generic manufacturers to avoid antitrust liability—precisely the result mandated under the "sacrifice of profits" test.

The problem with the "sacrifice of profits" test is that it inappropriately focuses on static efficiency (the impact of the refusal to license upon competition with the IP owner) and ignores the long-term effects of a rule requiring licensing upon incentives to innovate. As the First Circuit noted, however, in *Data General Corp. v. Grumman Systems Support Corp.*:

> [I]n passing the Copyright Act, Congress itself made an empirical assumption that allowing copyright holders to collect license fees and exclude others from using their works creates a system of incentives that promotes consumer welfare in the long term by encouraging investment in the creation of desirable artistic and functional works of expression . . . We cannot require antitrust defendants to prove and reprove the merits of this legislative assumption in every case where a refusal to license a copyrighted work comes under attack.[41]

It is hard enough to do the static efficiency analysis. Given the uncertainty regarding the long-term effects of any particular IP rule, it is essentially impossible to know whether dynamic efficiency is served by permitting a given refusal to license.[42]

An Exception for "Leveraging." Because most would agree that the owner of a pharmaceutical patent need not license a generic firm, some have suggested that IP owners be subject to antitrust liability when they "leverage" market power afforded by a patent to obtain a monopoly in a "different" market. This argument is usually based on footnote 29 of the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services, Inc.*, that "power gained through some natural and legal 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."[43]

There are a number of problems with this approach as well, not the least of which is the fact that footnote 29 addresses tying arrangements, not unilateral refusals to deal.[44] As the Supreme Court has recognized, "The difference is clear and vital between the exclusive right to use the machine, which the law gives to the inventor, and the right to use it exclusively with prescribed

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[40] Imagine a pharmaceutical firm that has developed IP that will lead to a blockbuster drug, perhaps a cancer vaccine. While the drug is in clinical trials, the firm receives requests from generic drug firms for licenses that would permit them to sell generic versions of the blockbuster. Given that a generic will sell for half the price of the branded product, the generic suppliers could never pay a license fee that would compensate the branded firm for the lost profits on sales of branded product (regardless of what the branded firm does with the pricing of its own product). Thus, the branded firm will always refuse to license because it is more profitable to become a drug monopolist than to reap "monopoly" licensing profits as the sole licensor of the relevant IP. In other words, the branded firm will always sacrifice the short-run profits available to it as a monopoly licensor for the long-term monopoly profits available to it as a monopoly seller of the blockbuster drug—monopoly profits available only because it has foreclosed generic competitors.

[41] 36 F.3d 1147, 1186–87 (1st Cir. 1994).

[42] Several economists on the DOJ-FTC hearings May 1 panel addressed this issue. Their papers are available at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%201:.

[43] 504 U.S. 451, 480 n.29 (1992).

[44] The footnote appears in the Court's discussion of tying claims, and the footnote characterizes its discussion as one of Kodak's "tying policy" and "tying in derivative aftermarkets." 504 U.S. 480 n.29. *See generally Xerox*, 203 F.3d at 1326–27 (distinguishing footnote 29 on these grounds).

materials . . ."[45] There is a world of difference between telling licensees that you will license your IP only if they buy another product or service from you (or refuse to buy from your competitors, which is the same thing), and refusing absolutely to license your IP. Similarly, in holding a price-fixing scheme involving intellectual property unlawful, the Court noted that it "does far more than secure to inventors the 'exclusive right' to their discoveries, . . . [i]t gives them a leverage on the market that only a combination, not a patent by itself, can create."[46] Unilateral refusals to license are lawful because the only "leverage" that an IP owner receives when it refuses to license—regardless of the number of markets affected—is the leverage created by the "patent by itself."

More fundamentally, a "leveraging" rule would arbitrarily limit the patent "monopoly" (when it conveys one) to a single market. But patents convey the exclusive right to use an invention, which may have utility in a number of markets. One patent on a key photocopier part in the *Xerox* litigation noted that invention had utility "in the production of cooking utensils and other surfaces used in the culinary arts." But Xerox has the right to exclude competitors from using goods that infringe the claims of the patent regardless of whether the competitors seek to use photocopier fuser rolls or non-stick cookware. Any other rule would read the right to "use" out of the Patent Act, for all inventions are by definition "used" in markets other than the market in which they are "sold."

Moreover, despite the complaint that Xerox's patents do not give it the right to monopolize a "service market," there would be nothing to stop Xerox from adding a method or process claim to its patents claiming the use of the invention in the servicing of a copier.[47] In such a case, it would be the patent itself that affords the right to prevent others from servicing copiers using the part. A patentee could avoid liability under the "leveraging" test simply by clever claim drafting. Antitrust liability should not turn on such exaltation of form over substance.

An Exception for "Conditional" Refusals to Deal. Closely related to the proposed "leveraging" exception is the exception, proposed by Professor MacKie-Mason and others, for "conditional" refusals to license.[48] This exception has no support in the caselaw.

An IP owner has a "right to select its licensees."[49] Even the Ninth Circuit in *Kodak* recognized that the distinction between "a selective refusal to sell" and "an absolute refusal to license . . . makes no difference."[50] As the Supreme Court held in *United States v. United Shoe Machinery Co.*, an owner of intellectual property "necessarily has the power of granting [a license] to some and withholding it from others."[51]

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[45] Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 512 (1917). *Accord* D.B. Cole v. Hughes Tool Co., 215 F.2d 924, 937 (10th Cir. 1954) (antitrust laws do "not prohibit [the patentee] from inhibiting the manufacture, use or sale . . . of the patented device by others," but only "prohibits the patentee from making a contract which imposes limitations beyond his lawful patent monopoly on the right of his lessee or purchaser to use or deal in goods . . .").

[46] Unites States v. Line Material Co., 333 U.S. 287 (1948).

[47] Xerox has actually done this for some of its inventions. For example, Patent 5,202,726, assigned to Xerox, claims a "method of servicing a reproduction machine" using the claimed invention.

[48] *See* MacKie-Mason, *supra* note 34.

[49] Genentech, Inc. v. Eli Lilly & Co., 998 F.2d 931, 948 (Fed. Cir. 1993).

[50] 125 F.3d at 1216. Two other ISO cases have reached the same result. *See* Service Training, Inc. v. Data Gen. Corp., 963 F.2d 680, 690 (4th Cir. 1992); Advanced Computer Servs. of Michigan v. MAI Systems Corp., 845 F. Supp. 356 (E.D. Va. 1994).

[51] 247 U.S. 32 (1918). *See also* E. Bement & Sons v. National Harrow Co., 186 U.S. 70, 94 (1902) (lawful for patentee to grant license but agree to refuse to license others); Extractol Process Ltd. v. Hiram Walker & Sons Inc., 153 F.2d 264, 268 (7th Cir. 1946) ("No legitimate attack can be made on the patent or patent grant because the patentee chooses A and B as its licensees and refuses a license to X, Y, or Z.").

Although a "failed tie"—one not accepted by the buyer—is just as illegal as a consummated tying arrangement,[52] it is a mistake to characterize every conditional refusal to license as a tying arrangement. At the extreme, every refusal to grant a bare IP license can be characterized as a tying arrangement; a refusal to license a pharmaceutical patent could be characterized as a tie between a license to use the pharmaceutical IP and the purchase of a pill. But it makes no sense to characterize such a refusal to license as an illegitimate exercise of IP rights.

There is a straightforward way to distinguish these unlawful "failed ties" from lawful conditional refusals to license: strict application of the "two products" test from Justice O'Connor's concurrence in *Jefferson Parish*.[53] Under that test, it is irrelevant whether consumers might wish to purchase the tying product alone; what matters is whether they wish to buy the tied product alone. Because there is no demand for my pharmaceutical pills (the tied product) without the IP right to use them (the tying product), there is no tying agreement and my refusal to license is lawful. In contrast, because there is plenty of demand for salt without salt machines, refusing to sell salt machines to customers that won't buy salt is unlawful.[54] The refusal to sell patented parts to ISOs in the *Xerox* case is not unlawful because even if there is demand (by the ISOs) for parts without also buying service from Xerox, there is no demand (by anyone) for service without parts.[55] Indeed, the *Xerox* plaintiffs never even alleged a tie between parts and service.

Intent and "Pretext." After remand from the Supreme Court and a jury verdict against Kodak, the Ninth Circuit affirmed a finding of liability based on a refusal to sell patented parts because Kodak's justification was "pretextual"; the evidence showed that "Kodak was not actually motivated by protecting its intellectual property rights."[56] This focus on subjective intent is meaningless. Because IP rights are by their very nature exclusionary, there is no difference between an intent to "protect intellectual property rights" and an intent to foreclose competitors. As the Supreme Court recognized, "[C]ondition[ing] a copyright upon a demonstrated lack of anticompetitive intent would upset the notion of copyright as a limited grant of monopoly privileges intended simultaneously to motivate the creative activity of authors and to give the public appropriate access to their work product."[57]

Any rule that relied on subjective intent would turn every case involving a refusal to license into a disputed question of fact. No IP owner would be entitled to summary judgment, let alone a motion to dismiss, and every case would need to go to the jury. Any such rule would impose huge costs on IP owners, for little or no benefit to consumers.

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[52] *See, e.g.*, Thompson v. Metropolitan Multi-List, Inc., 934 F.2d 1566, 1572 (11th Cir. 1991).

[53] *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 38 & n.8 (1984) (O'Connor, J., concurring).

[54] *See* Int'l Salt Co. v. United States, 332 U.S. 392 (1947).

[55] *See* Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 494 n.2 (1992) (Scalia, J., dissenting). I recognize that this was the view of the dissent, not the majority. But the majority's factual support for the idea that there was demand for parts without service was minimal, albeit enough to require reversal of the grant of summary judgment. *Id.* at 463 & n.7. The plaintiffs in *Kodak* did not pursue their tying claims after remand. *Kodak*, 125 F.3d at 1201.

[56] *Kodak*, 125 F.3d at 1219.

[57] Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 64 (1993). *Accord* Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1072 (Fed. Cir. 1998) (if a [patent infringement] suit is not objectively baseless, an antitrust defendant's subjective motivation is immaterial"); Data Gen. Corp. v. Grumman Sys. Support Corp., 36 F.3d 1147, 1189 (1st Cir. 1994) (holding that a "search for an overriding 'antisocial' motivation" behind the exercise of IP rights is "unilluminating"). *See generally ISO Litig.*, 203 F.3d at 1327–28 (citing *Nobelpharma* and noting that the court saw "no more reason to inquire into the subjective motivation of Xerox in refusing to sell or license its patented works that we found in evaluating the subjective motivation of a patentee in bringing suit to enforce that same right.").

Conclusion

The statutory scheme of the IP laws, the legislative history of the IP and antitrust laws, and sound policy all support a rule of per se legality for unilateral refusals to license. The benefits of such a rule are reinforced by the modest benefit (if any) of a rule of compulsory licensing and the failings of alternative rules that would govern compulsory licensing. ●