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The Common Purposes of Intellectual Property and Antitrust: Promoting Creative and Innovative Output

by

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Introduction and Summary

Intellectual property is a potent and increasingly vital driver of value in America's Digital Age economy. Indeed, along with the Internet, intellectual property is one of the pillars upon which the Digital Age economy rests.

According to the U.S. Commerce Department's comprehensive report, "Intellectual Property and the U.S. Economy: 2016 Update," industries heavily focused on IP "accounted for $6.6 trillion in value added in 2014," up more 30% from 2000. Nearly 35% of the U.S. GDP was attributable to IP-intensive industries in 2014. In addition, revenues from licensing IP rights totaled $115.2 billion in 2012, with 28 different industries deriving revenues from IP licensing. These totals are surely higher in 2017, and they will climb higher still in years to come.

Unfortunately, these substantial public benefits of output-enhancing intellectual property protections and their connection to private rights are frequently overlooked. With the widely acknowledged and quantifiable benefits in mind, along with the broader public purposes served by protection of individual rights in IP, it is instructive to take a closer look at the relationship between antitrust law and IP protection. Some mistakenly suggest they are in conflict. The purpose of this paper is to show how protection of IP rights and enforcement of the antitrust laws not only are compatible but how they reinforce each other.

Intellectual property's benefits to the American public and to individual IP owners depend on the existence of a fundamental legal framework that secures ownership rights to control IP rights and to obtain financial returns from such rights. That framework is provided in the U.S. Constitution's Article I, Section 8 IP Clause, which provides that Congress has the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

There are dual purposes underlying the IP Clause. New creative works and inventions further "the Progress of Science and useful Arts" to the benefit of the public. Copyright protections facilitate the diffusion of knowledge through the publication of books and other written works, as well as the proliferation of artistic expressions in music, motion pictures, and other media. Disclosure of new discoveries through patent applications also increases the public stock of useful knowledge and offers the public a means for improving the quality of life.

First, the "exclusive Right" to creative works and inventions provides essential private benefits to artists and inventors. Copyrights and patent rights are unique types of property rights. They are rooted in an individual's intellectual labors, and thus in an individual's natural right to receive the fruits of his or her labors. IP rights entail legal protections to ensure that creative artists and inventors maintain control over their works and inventions, so that, pursuant to the Constitution's IP Clause, they receive the just rewards for their labors.

Second, exclusive individual rights protections in IP also serve as an indispensable means of furthering the public good, by stimulating creativity and innovation and expanding the choices of goods and services to be made available to the public. Describing the IP Clause's provisions for securing "the copyright of authors" and "the right to useful inventions" in *Federalist No. 43*, James Madison concluded that "[t]he public good fully coincides in both cases with the claims of individuals."

With this background, we may now examine how IP rights protection and antitrust law reinforce each other – rather than conflict, as some suggest.

Antitrust is directed at private actors and private exercises of market power that pose harm to market competition, whereas IP involves federal exercise of power to secure private rights. Moreover, free market competition, private property rights, and liberty of contract are default presumptions in antitrust. IP therefore fits comfortably within the background assumptions of antitrust. Given IP's constitutional, congressional, and judicial pedigree, the congruence between IP rights and antitrust was widely assumed when the Centennial Congress passed the Sherman Antitrust Act in 1890 and the International Copyright Act in 1891. That basic congruence was reaffirmed by early Supreme Court antitrust decisions, as if an afterthought.

Although IP's principled compatibility with antitrust has been widely recognized by Congress and the Supreme Court, the relationship between antitrust and contracts for the sale or use of IP is more complex. IP policy in American constitutionalism is closely connected to liberty of contract. Meanwhile, the Sherman Antitrust Act restricts certain types of contracts; namely, "contracts in restraint of trade" or contract terms that "substantially lessen competition or tend to create a monopoly in any line of commerce." Thus, antitrust issues do surface with respect to licensing or other agreements involving patented inventions as well as copyrighted works – just as they surface with respect to contracts involving goods not protected by IP laws.

By virtue of its being an exception to liberty of contract, antitrust may likewise be deemed an exception to the general policy of liberty of contract concerning intellectual property rights. Yet in this respect, antitrust treats contracts involving IP just like commercial contracts involving other types of property. Upon closer examination, there is no inherent conflict between antitrust principles and licensing contracts involving IP.

Respect for freedom to contract – a critical means for exchange in a market economy – has factored into the Supreme Court's construction of antitrust statutory provisions. According to Professor Alan J. Meese, "since the beginning, liberty of contract has played a substantial role in shaping antitrust caselaw at both the federal and state level." Indeed, the connection between IP rights and liberty of contract was a central aspect of the Supreme Court's decision upholding a patent licensing contract in *Bement v. National Harrow* (1902). In *Bement*, Justice Rufus Peckham wrote for the Court that, "the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States."

However, the Supreme Court's early respect for the general policy of liberty of contract regarding IP eroded over the course of the 20th Century. During that period, certain types of business contracts were disfavored by antitrust jurisprudence, regardless whether IP rights were at issue. Between the 1920s and the 1960s, the Supreme Court developed a wariness of so-called tying arrangements or tie-in contracts. Also during that period, the Supreme Court developed hostility to price-restrictive contracts. Part and parcel with those broader jurisprudential developments, by the middle of the 20th Century the Supreme Court's stance towards restrictive licensing contracts involving patents and copyrights was arguably antagonistic. Much of that antagonism was fueled by erroneous ideas about competition and conflicting goals that animated the Supreme Court's antitrust jurisprudence.

By the 1970s, the Supreme Court's antitrust jurisprudence came under heavy criticism for its pursuit of widely varying goals and reliance on unsound economic ideas. Beginning in the late 1970s and continuing to the present, the Supreme Court's antitrust jurisprudence largely has been reoriented toward maximizing consumer welfare based on economic analysis. The adoption of consumer welfare as the primary goal of antitrust law, along with more rigorous economic analysis of marketplace competition by the Supreme Court and by federal antitrust enforcement agencies, has had important implications for IP. In recent years, the Supreme Court has overruled or limited the holdings of older decisions that expressed skepticism toward IP licensing practices, such as those involving tying and resale price maintenance agreements. Modern Supreme Court decisions, including *Illinois Tool Works Inc. v. Independent Ink, Inc*. (2006) and *Leegin Creative Leather Products, Inc. v. PSKS, Inc*. (2007), have come to recognize important efficiencies or consumer welfare benefits that result from trade practices involving tying and resale price maintenance agreements, including agreements involving IP rights.

The U.S. Department of Justice and Federal Trade Commission's "Antitrust Guidelines for the Licensing of Intellectual Property" (2017), take a similar approach, rejecting the older antitrust jurisprudential presumption that possession of a patent or copyright conferred market power on the IP rights holder, and thereby posed likely threats of anticompetitive harm.

Neoclassical or consumer welfare economics – reflected in the Supreme Court's more recent antitrust jurisprudence and the policies and guidance of federal antitrust enforcement agencies – bring into sharper focus how the aims of IP and of antitrust are ultimately consistent. The public and private purposes of the IP Clause are by no means solely reducible to the maximization of consumer welfare. But the promotion of progress of science and useful arts and securing of exclusive rights in creative works and inventions surely is consistent with the promotion of consumer welfare.

Professor Ward Bowman aptly described the modern view of the common purposes of antitrust and IP with respect to patents: "Both antitrust law and patent law have a common economic goal: to maximize wealth by producing what consumers want at the lowest cost. In serving this common goal, reconciliation between patent and antitrust law involves serious problems of assessing affects, but not conflicting purposes." The 2017 Guidelines also recognize the common goals: "[T]he aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are actually complementary, as both are aimed at encouraging innovation, industry and competition."

The obvious differences between IP and antitrust lie in the means by which they facilitate achievement of their shared goal. For IP, the means of increasing output are exclusive rights protections over a term of years to incentivize intellectual labor and investment in new creative works or novel inventions for consumption in the market. And for antitrust, the means are prohibitions on output-reducing restraints on trade where the circumstances and economic reasoning provide strong justification for intervention in the market.

Ultimately, it is the constitutional responsibility of Congress to strike the proper balance in determining the term lengths and other boundaries of copyright and patent rights protections in order "To promote the Progress of Science and useful Arts." But there should be no doubt that Congress can advance both the public and private purposes of the IP Clause consistently with the consumer welfare purpose of antitrust.

The Public and Private Purposes of the IP Clause

The Constitution's Article I, Section 8 IP Clause provides that Congress has the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." There are dual purposes underlying the IP Clause, as the first half of the text is directed at promoting public benefits and the second half directed at protecting private benefits.

New creative works and inventions further "the Progress of Science and useful Arts" – a clear public purpose. The Copyright Act of 1790, which was passed by the First Congress and signed by President George Washington, was titled "An Act for the encouragement of learning, by securing the copies of maps, Charts, And books, to the authors and proprietors of such copies, during the times therein mentioned." Copyright protections facilitate the diffusion of knowledge by financially incentivizing the composition and publication of books and other written works, as well as the proliferation of artistic expressions in music, motion pictures, and other media. Such creative works, brought to the market with the assurance of copyright protections, provide new sources of value for public consumption. Disclosure of new discoveries through patent applications also increases the public stock of valuable and useful knowledge. And technological advancements embodied in novel inventions likewise offer the public means for improving the quality of life. Over time, creative works and inventions that are secured by IP rights offer the public an ever-increasing range of consumer choices. The promise of exclusive returns backed by IP protections provides open and equal opportunity for members of the public to pursue their callings in a variety of fields as creative artists and inventors. And when the terms of protection for copyrighted works or patented inventions elapse, such works and inventions become common property or part of the public domain and may be reproduced or otherwise used by members as they see fit. Ultimately, Congress has a constitutional responsibility to determine the term lengths and conditions of copyright and patent rights protections.

The "exclusive Right" to creative works and inventions also provides essential benefits to artists and inventors – constituting a clear private purpose. Copyrights and patent rights are unique types of property rights. They are rooted in an individual's intellectual labors, and thus in an individual's natural right to receive the fruits of his or her labors. IP rights entail legal protections to ensure that creative artists and inventors maintain control over their works and inventions, including proceeds that may result from such works and inventions.

Throughout American history, jurists and legal scholars have analyzed the relationship between the public and private purposes of the IP Clause and laws passed pursuant to it. In some instances, a public purpose is described as the paramount constitutional and statutory object. For instance, Justice Joseph Story memorably described the relationship between those dual purposes the IP Clause in *Pennock v. Dialogue* (1829):

> While one great object was, by holding out a reasonable reward to inventors, and them an exclusive right to their inventions for a limited period, to stimulate the efforts of genius; the main object was "to promote the progress of science and useful arts;" and this could be done best, by giving the public at large a right to make, construct, use, and vend the thing invented, at as early a period as possible, having a due regard to the rights of the inventor.

Writing for the Supreme Court in *Kendall v. Windsor* (1858), Justice Benjamin Curtis similarly recognized that the granting of patent protection to inventors "was never designed for their exclusive profit or advantage," but "the benefit to the public or community at large was another and doubtless the primary object." According to Curtis, "[t]he true policy and ends of the patent laws enacted under this government are disclosed in that article of the Constitution, the source of all these laws, *viz.,* 'to promote the progress of science and the useful arts.'" Justice John Clarke, looking back on nearly a century of jurisprudence, declared on behalf of the Supreme Court in *Motion Picture Patents Co. v. Universal Film Co.* (1917): "[T]his Court has consistently held that the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents, but is 'to promote the progress of science and the useful arts.'"

Judicial decisions in copyright cases, from the late 19th and early 20th centuries likewise recognized the public purpose of the IP Clause and the embodiment of that purpose in federal copyright statutes. For example, in *Baker v. Selden* (1880), Justice Joseph Bradley described the obvious public benefits that result from publication of books protected by copyright law: "The very object of publishing a book on science or the useful arts is to communicate to the world the useful knowledge which it contains." Discussing the teachings of science and the rules and methods of useful art," Justice Bradley further explained that their "application and use are what the public derives from the publication of a book which teaches them."

More emphatic statements about the primacy of the public purposes of the IP Clause also appear in Supreme Court decisions. Chief Justice Charles Evans Hughes declared in *Fox Film Corp. v. Doyal* (1932): "The copyright law, like the patent statutes, makes reward to the owner a secondary consideration." Also: "The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors." Similarly, in *Crown Die & Tool Company v. Nye Tool & Machine Works* (1923), Chief Justice William Howard Taft identified a single object, consisting in the entirety of the IP Clause: "The sole reason and purpose of the constitutional grant to Congress to enact patent laws is to promote the progress of science and useful arts by securing for limited times to inventors the exclusive right to their respective discoveries."

On many other occasions jurists have concluded that the IP Clause and laws passed pursuant to it principally further a private purpose. Writing for the Supreme Court's majority in *Grant v. Raymond* (1832), for instance, Chief Justice John Marshall quoted the IP Clause and explained that "it cannot be doubted that the settled purpose of the United States has ever been and continues to be to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent." Likewise, in *American Tobacco Co. v. Werckmeister* (1907), Justice William Day's opinion for the Supreme Court quoted the IP Clause and identified its private purpose:

> Under this grant of authority a series of statutes have been passed, having for their object the protection of the property which the author has in the right to publish his production, the purpose of the statute being to protect this right in such manner that the author may have the benefit of this property for a limited term of years. These statutes should be given a fair and reasonable construction with a view to effecting such purpose.

The next year, in *Bobbs-Merrill Co. v. Straus* (1908), Justice Day wrote for the Supreme Court: "While the nature of the property and the protection intended to be given the inventor or author as the reward of genius or intellect in the production of his book or work of art is to be considered in construing the act of Congress, it is evident that to secure the author the right to multiply copies of his work may be said to have been the main purpose of the copyright statutes."

At least on the surface, these observations by the Supreme Court regarding the public and private purposes of the IP Clause and IP laws seem to be at odds. Yet it would be mistaken to read into such judicial pronouncements the view that the IP Clause is internally contradictory. A more searching analysis reveals that public and private purposes underlying the IP Clause and IP laws are, at their core, united and inseparable. The dual purposes of the IP Clause reinforce each other.

For starters, a disjunctive reading of the IP Clause would be contrary to the understanding of the Founding Fathers. Describing the IP Clause's provisions for securing "the copyright of authors" and "the right to useful inventions" in *Federalist No. 43*, James Madison, concluded that "[t]he public good fully coincides in both cases with the claims of individuals."

Several Supreme Court decisions also expressly affirm that the dual purposes of the IP Clause are closely and necessarily connected. As Justice John McLean stated, for the Supreme Court in *Shaw v. Cooper* (1833), "[t]he patent law was designed for the public benefit, as well as for the benefit of inventors." Beyond merely affirming the unity of public and private purposes underlying the IP Clause, Chief Justice Marshall's opinion for the Supreme Court in *Grant v. Raymond* offers an insight into how those dual purposes are connected. Discussing the Patent Act of 1793, Marshall wrote: "The great object and intention of the act is to secure to the public the advantages to be derived from the discoveries of individuals, and the means it employs are the compensation made to those individuals for the time and labor devoted to these discoveries by the exclusive right to make, use, and sell the things discovered for a limited time." In other words, the immediate object of the IP Clause and IP laws is to incentivize creative artists and inventors to undertake the labor and expense of producing new works and pursuing new inventions and useful improvements that benefit the public. By means of securing exclusive rights, for limited periods of time, the IP Clause and IP laws facilitate the production and distribution of creative works and inventions in the public marketplace. The ultimate long-term object of the IP Clause and IP laws is thereby furthered as successive generations of stimulated creative and innovative activity increase the value, volume, and variety of choices for public consumption in copyrighted works as well as patented inventions.

For sake of simplicity, one may describe the public purpose in promoting the progress of science and useful arts as the end of the IP Clause and the securing of exclusive IP rights as the means to that end. But IP rights are also ends in themselves. Treating copyrights and patent rights merely as means overlooks the natural law basis of the exclusive, individual rights secured by the IP Clause and IP laws.

The natural law background to the powers conferred on Congress by the IP Clause was aptly summarized by George Ticknor Curtis in his *History of the Origin, Formation, And Adoption of the Constitution of the United States* (1858):

> We know…historically, that these were powers not only possessed by all the States, but exercised by some of them, before the Constitution of the United States was formed. Some of the States had general copyright laws, not unlike those which have since been enacted by Congress; but patents for useful inventions were granted by special acts of legislation in each case. When the power to legislate on these subjects was surrendered by the States to the general

> government, it was surrendered as a power to legislate for the purpose of securing a natural right to the fruits of mental labor. This was the view of it taken in the previous legislation of the States, by which the power conferred upon Congress must of course, to a large extent, be construed.

This historical and philosophical understanding was analyzed more fully in our book, *The Constitutional Foundations of Intellectual Property: A Natural Rights Perspective* (2015). As we explain therein, the Founding Fathers' recognition that copyrights and patent rights secured by the Constitution are rooted in individuals' natural rights to the fruits of their labors is integral to the historical understanding and logic of the IP Clause. The proceeds resulting from the sale or licensed use of creative works and inventions belong to the artists and inventors – or their assigns – as matter of justice, and not merely as a means of expediency or a furtherance of other ends.

The indispensable connection between the dual purposes of the IP Clause finds another, more particularized expression in constitutional jurisprudence. The dual purposes embodied in the IP Clause constitute elements of an agreement between the general public and private individuals. This was described in further detail in our *Perspectives from FSF Scholars* paper, "The Public Basis Contract of Intellectual Property Rights." The elements of this tacit public contract consist in the law's offer of exclusive IP protections in consideration for the labor and investment required to produce new creative works and inventions, so long as those works and inventions are disclosed consistent with application or registration procedures. The public contract basis of IP rights also reinforces just claims of creative artists and inventors to exclusive rights in their copyrighted works and patented inventions.

In sum, the IP Clause and laws passed pursuant to the IP Clause further reinforcing dual purposes. In the near term, the exclusive private rights of creative artists and inventors to their IP are secured. This near term purpose is rooted in the natural rights of creative artists and inventors to the fruits of their labor. But exclusive individual rights protections in IP also further the public good over the long term by stimulating creativity and innovation and expanding the choices of goods and services to be made available to the public.

Unfortunately, the significant public benefits of output-enhancing IP protections and their corresponding connection to private rights are sometimes overlooked. Disregarding IP's public purposes in stimulating creativity and innovation contributes to an inaccurate, myopic perspective on copyrights and patent rights. Such disregard makes IP a straw man for false claims that principles of IP are inherently in conflict with principles of antitrust. With the public purposes of IP and the means of furthering those purposes kept in mind, a closer look at antitrust law helps to reveal the compatibility of IP and antitrust principles.

A Brief Introduction to Antitrust Concepts

"Antitrust" is defined by Black's Law Dictionary as "[p]olicies and regulations that restrict the formation of oligopoly or monopoly power in order to promote free market competition." The main sources of antitrust law are the Sherman Antitrust Act of 1890 and the Clayton Antitrust Act of 1914 (the latter having been amended in 1936 and 1950). Section 1 of the Sherman Act, the first and oldest federal antitrust law, declares: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." And Section 2 of the Sherman Act provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony."

Key antitrust terms, such as "restraints of trade" and "monopolize," are not defined in the statute. Scholars have debated the precise intentions of Congress when it passed the Sherman Act. Some have argued, for instance, that both acts were intended as protectionist measures for small business competitors. Others have maintained that the Sherman Act was designed to promote consumer welfare. The legislative history and the consensus of scholarship recognize that the Centennial Congress was familiar with and adopted the terminology of the common law of restraints of trade and monopolies when it passed the Sherman Act. However, the text of the Sherman Act was sparse and Congress employed common law terminology in a broad sense. According to Professor Herbert Hovenkamp, "Congress picked economic words and chose not to tie its own idiosyncratic meanings to them," and thus "interpretation of these terms was left entirely up to the courts."

Early Supreme Court decisions, such as *U.S. v. Joint-Traffic Association* (1897), declined to narrowly construe statutory antitrust terms or confine them to precedents found in the common law. Rather, the Supreme Court has applied the terms of the Sherman and Clayton Acts in light of developing intuitions and economic understandings about market competition. This economics-based approach was later encapsulated by the Supreme Court's decision in *Business Electronics Corporation v. Sharp Electronics Corporation* (1988):

> In resting our decision upon the foregoing economic analysis, we do not ignore common-law precedent concerning what constituted "restraint of trade" at the time the Sherman Act was adopted. But neither do we give that pre-1890 precedent the dispositive effect some would. The term "restraint of trade" in the statute, like the term at common law, refers not to a particular list of agreements, but to a particular economic consequence, which may be produced by quite different sorts of agreements in varying times and circumstances. The changing content of the term "restraint of trade" was well recognized at the time the Sherman Act was enacted.

In its *Standard Oil Company of New Jersey v. U.S.* (1911) and *U.S. v. American Tobacco Company* (1911) decisions, the Supreme Court established a "rule of reason" standard for weighing all of the circumstances of an antitrust case and drawing on economic insights to decide whether an alleged restrictive trade practice should be prohibited as an unreasonable restraint on competition. The rule of reason considers such factors as the inherent effect of the trade practice under examination, the market power – or ability to charge prices substantially above competitive market levels for a significant period of time – of the parties involved, as well as specific intent of the parties. The purpose of the rule is to ascertain whether restraints under examination have anticompetitive effects that harm consumers and whether those restraints enhance competition and consumer welfare. However, categorical rules rather than the rule of reason apply in certain instances. Trade practices that always or nearly always tend to restrict competition and lower output are deemed "unlawful *per se*." Such practices are not weighed in a balancing process, but are prohibited categorically.

Free market competition is an essential background assumption for economically informed interpretation of antitrust laws. As Professor Hovenkamp explained in *The Antitrust Enterprise: Principle and Execution* (2005), "antitrust is a form of regulation—a type of market intervention in an economy whose nucleus is private markets." When applying antitrust law in a free market context, "intervention is the exception rather than the rule." Since exchangeable property secured by legal title is a prerequisite for commercial activity in a free market, the property rights character of copyrights and patent rights belies any claimed incompatibility between IP and antitrust principles. In antitrust law, a free market setting and the existence of property rights, including IP rights, are presumed.

The Compatibility of IP and Antitrust Concepts

Any comparison and contrast of IP and antitrust concepts must begin with the recognition that antitrust is directed not at federal exercises of power to secure private rights – as is the case for IP protections. In other words, antitrust is directed at private actors and private exercises of market power that risk causing harm to competition and undermining consumer welfare.

The congruence between IP rights and antitrust was widely assumed when Congress passed the Sherman Antitrust Act in 1890. The Sherman Act made no mention of copyrights or patent rights. Nor was any mention necessary. Congress's power to secure copyrights and patent rights is expressly provided for in the IP Clause. And IP had a century of Congressional and judicial precedent behind it by the time of the inauguration of the Centennial Congress. By contrast, antitrust is an implied means of regulating interstate commerce pursuant to the Commerce Clause, located in Article I, Section 8, Clause 3 of the U.S. Constitution. Moreover, the Centennial Congress that passed the Sherman Act also passed the International Copyright Act of 1891, a strong indicator that Congress recognized the compatibility of IP and antitrust concepts.

Against this backdrop, it is not surprisingly that in *Bement v. National Harrow Company* (1902), the Supreme Court concluded that license contracts involving patented harrows – mechanical devices related to plows – were permissible under the Sherman Act. Writing for the Court, Justice Rufus Peckham pointed out: "The very object of these laws is monopoly." This same observation regarding the object of patent laws was made by Justice Horace Lurton in *Bauer v. O'Donnell* (1913), a case wherein the Court rejected claims that licenses setting retail sale prices for a patented water-soluble drug product violated the Sherman Act.

Of course, equivocation in the use of the term "monopoly" lends a highly misleading surface plausibility to claims that IP and antitrust are in conflict. Not infrequently, 19th Century jurists and legal scholars articulated a common-sense distinction among different uses of the term. On the one hand, "limited monopolies" for copyrighted works and patented inventions were property rights secured by government but originating from individual labor. And, on the other hand, "odious" monopolies were government grants of special privileges, based not on labor but on favoritism. Such odious monopolies included special grants of power to individuals or chartered corporations to control a particular trade or to operate an exclusive enterprise in connection with a common property, such as a waterway. Nineteenth Century Supreme Court and lower court decisions made clear that copyright and patent rights are not special privileges bestowed by the Crown for benefit of the Kingdom, as in Great Britain. We addressed this early understanding of the difference between limited monopoly protections in IP and odious monopoly privileges at greater length in Chapter 4 of our book *The Constitutional Foundations of Intellectual Property: A Natural Rights Perspective* (2015).

This important distinction between limited and odious monopolies was reinforced in late 19th and early 20th Century Supreme Court decisions. For instance, Justice David Brewer's opinion for the Supreme Court in *U.S. v American Bell Telephone Company* (1897) included this observation concerning the nature of the IP rights of inventors:

> Congress, by its legislation made in pursuance of the Constitution, has guaranteed to him an exclusive right to it for a limited time, and the purpose of the patent is to protect him in this monopoly, not to give him a use which, save for the patent, he did not have before, but only to separate to him an exclusive use. The government parted with nothing by the patent. It lost no property. Its possessions were not diminished. The patentee, so far as a personal use is concerned, received nothing which he did not have without the patent, and the monopoly which he did receive was only for a few years.

More than a dozen years later, in *Bauer v O'Donnell*, Justice Lurton's opinion for the Supreme Court identified an individual's right to the fruits of his or her labor as well as liberty of contract as the basis for patent rights:

> The right to make, use, and sell an invented article is not derived from the patent law. This right existed before and without the passage of the law, and was always the right of an inventor. The act secured to the inventor the *exclusive* right to make, use, and vend the thing patented, and consequently to prevent others from exercising like privileges without the consent of the patentee.

Thus, antitrust is directed at private actors and private exercises of market power that pose harm to market competition, whereas IP involves federal exercise of power to secure private rights. Moreover, free market competition, private property rights, and liberty of contract are default presumptions in antitrust. IP therefore fits comfortably within the background assumptions of antitrust. Given IP's constitutional, congressional, and judicial pedigree, the congruence between IP rights and antitrust was widely assumed when the Centennial Congress passed the Sherman Antitrust Act in 1890. That basic congruence was reaffirmed by early Supreme Court antitrust decisions, as if an afterthought. And late 19th and early 20th Century jurists readily recognized the clear distinction between a limited monopoly in IP and an odious monopoly resulting from special favoritism.

Liberty of Contract and Early Antitrust Jurisprudence

Although IP's principled compatibility with antitrust has been widely recognized by Congress and the Supreme Court, the relationship between antitrust and contracts for the sale or use of IP is more complex. IP policy in American constitutionalism is closely connected to liberty of contract, and federal antitrust laws restrict certain types of contracts; namely, "contracts in restraint of trade" or contract terms that "substantially lessen competition or tend to create a monopoly in any line of commerce." Thus, antitrust issues regularly surface with respect licensing or other agreements involving patented inventions and copyrighted works – just as antitrust issues arise concerning licensing agreements involving goods not secured by IP protections. By virtue of its being an exception to liberty of contract, antitrust may be deemed an exception to what has been termed "the general rule is absolute freedom in the use or sale of rights" protected by patent and copyright laws. Yet in this respect, antitrust treats contracts involving IP just like commercial contracts involving other types of property. Upon closer examination, there is no inherent conflict between antitrust principles and licensing contracts involving IP.

As with other types of property, IP ownership includes the right to possess, control, and enjoy such property to the exclusion of others. IP ownership also includes the right to assign or transfer legal title to copyrights and patent rights. And copyright and patent laws include certain unique, exclusive rights in IP. Both copyright and patent include the exclusive right to reproduce and vend copyrighted works or patented inventions. Patent also includes the exclusive right to use an invention or improvement. Freedom of exchange in IP rights has been the general policy in American constitutionalism since the First Congress. And it is a subject we examined in our *Perspectives from FSF Scholars* paper, "Liberty of Contract and the Free Market Foundations of Intellectual Property."

The Sherman Act of 1890 prohibits every contract or combination "in restraint of trade or commerce" or contract terms that "substantially lessen competition or tend to create a monopoly in any line of commerce." The Sherman Act thus constitutes an exception to contractual liberty. And since copyrights and patent rights are forms of private property and are exchanged or licensed like other types of property, it is not surprising that antitrust issues were frequently raised regarding licensing or other agreements involving patented inventions and copyrighted works.

As described in the previous section, however, the Supreme Court has applied antitrust statutory terms in light of developing intuitions and economic understandings about market competition. Respect for freedom to contract – a critical means for exchange in a market economy – has factored into the Supreme Court's construing of antitrust statutory provisions. According to Professor Alan J. Meese, "since the beginning, liberty of contract has played a substantial role in shaping antitrust caselaw at both the federal and state level."

Indeed, the connection between IP rights and liberty of contract was a central aspect of the Supreme Court's decision upholding a patent licensing contract in *Bement v. National Harrow*:

> The first important and most material fact in considering this question is that the agreements concern articles protected by letters patent of the government of the United States. The plaintiff…was at the time when these licenses were executed the absolute owner of the letters patent relating to the float spring tooth harrow business. It was therefore the owner of a monopoly recognized by the

> Constitution and by the statutes of Congress. An owner of a patent has the right to sell it or to keep it; to manufacture the article himself or to license others to manufacture it; to sell such article himself or to authorize others to sell it.

The Court in *Bement* recognized that state exercises of police powers for public health and safety purposes and common carrier franchises placed certain limits on the commercial uses of patented property. "Notwithstanding these exceptions," Justice Rufus Peckham wrote for the Court, "the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States." Discussing patents, Justice Peckham explained:

> The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does not render them illegal.

Addressing the scope of the Sherman Act, Peckham further explained:

> It is true that it has been held by this Court that the act included any restraint of commerce, whether reasonable or unreasonable… But that statute clearly does not refer to that kind of a restraint of interstate commerce which may arise from reasonable and legal conditions imposed upon the assignee or licensee of a patent by the owner thereof, restricting the terms upon which the article may be used and the price to be demanded therefor. Such a construction of the act, we have no doubt, was never contemplated by its framers.

In addition to *Bement*, the Supreme Court's decision in *Henry v. A. B. Dick Co*. (1912) and the influential decision by then-Judge William Howard Taft of the Sixth Circuit Court of Appeals in the *Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co*. (1896) recognized broad latitude for patent rights holders to set retail prices through licensing agreements. Applying the same logic, Judge Horace Lurton, who would later be appointed to the Supreme Court by President William Howard Taft, reached a similar conclusion in the copyright context. Upholding a licensing agreement involving copyrighted works from a claim brought under the Sherman Act, Judge Lurton wrote in *John D. Park & Sons Co. v. Hartman*, (1907): "[T]he statutory right to exclusively publish and vend copies of a copyrighted production would seem to take direct contracts between the publisher and his vendees in respect to the price at which subsequent sales shall be made outside of the rule as to restraints of trade which might otherwise apply."

Early judicial acceptance of such latitude was not without controversy, however. Discussing patent policy disputes in the early 20th Century, historian Morton Keller concluded that "[t]he most heated issue was the degree to which the use of patents by large corporations conflicted with antitrust. From one point of view a patent granted 'a true monopoly,' bringing corporate patentees in interstate commerce within the purview of the Sherman Act."

A notable episode in those disputes was recounted in an article by antitrust attorney Gilbert H. Montague in the *Harvard Law Review* – an article which the Senate ordered the U.S. Government Printing Office to reprint in 1913. The House Committees on the Judiciary and on Patents held hearings over the course of several weeks in 1912 to consider various proposals to amend the patent laws. In August of that year, the House Patent Committee favorably reported a bill that would have authorized federal courts to impose compulsory licenses based on certain patent holders and to set the terms and rates by judicial decree. According to the bill, patent compulsory licenses were authorized upon findings that a patent holder who purchased his or her rights from the original inventor withheld it "with the result of preventing any other person for using the patented process" more than three years after issuance of the patent. The bill also provided that a variety of trade practices involving sales and pricing for patented goods would be "conclusively presumed" to be violations of the Sherman Act.

The bill favorably reported by the House Patent Committee was opposed by well-known inventors, including Thomas Edison. Summing up testimony before the House Committee, Montague wrote:

> By numerous witnesses, who cited scores of examples, it was shown that the difficulties of merchandising are enormously increased in the instance of novelties. All patented articles are novelties at first, and most of them continue to be novelties to most of the public until the 17-year patent period expires. Considering the natural handicap thus imposed on the selling of patented articles, and the further fact that the patent owner must reap his reward before the expiration of the 17-year patent period, no aid which the existing law lends to the merchandising of patented articles can well be called unfair.

Louis D. Brandeis, who was among the attorneys who testified against the bill, addressed the importance of a patent owner being able to set the price for a patented good sold at retail:

> The fixing of a price has possibly prevented one dealer from selling the article a little lower than the other, but the fixing of that price has tended not to suppress but to develop competition, because it has made it possible in the distribution of those goods to go to an expense and to open up another sphere of merchandising which would have been absolutely impossible without a fixed price. The whole world can be drawn into the field. Every dealer, every small stationer, every small druggist, every small hardware man, can be made a purveyor of that article by comprehensive advertising. You have stimulated through the fixed price, the little man as against the department store and as against the large unit which may otherwise monopolize the trade… As you develop the article you are inciting invention, and what is more important than the invention, you are inciting the commercial development of the competing article.

Montague also identified the fallacy behind the idea that tying arrangements involving patented goods create new monopolies:

> The notion that such license restrictions might give patent owners the 'practical monopoly of the market' for unpatentable products used with a patented device is disposed of by the fact that such a practical monopoly, far from offending public policy, actually promotes the general welfare; because the patent owner can attain it only by cheapening the cost of manufacture of the patented article, and can continue it only so long as their invention is not superseded by subsequent inventions still further cheapening the cost of manufacture.

Ultimately, the bill favorably reported by the House Patent Committee failed to become law. Nor did Congress pass similar legislation introduced in the Senate that same session.

Two years later, passage of the Clayton Act did impact sales and licensing terms regarding prices of patented goods. As indicated, Section 3 prohibits contracts for leases or sales of goods "whether patented or unpatented" that fixes the prices to that the lessee or purchaser can charge for such goods when such pricing conditions "substantially lessen competition or tend to create a monopoly in any line of commerce."

However, the Clayton Act placed no specific restrictions on patents as such. Section 3's prohibitions on price fixing and other exclusionary commercial or trade practices treated licensing contracts involving patented goods just like any other goods. Thus, "the general rule" of "absolute freedom in the use or sale of rights" under the patent and copyright laws was respected. The Clayton Act and early Supreme Court decisions construing it placed limits on liberty of contract in general, but placed no specific limits on liberty of contract involving IP.

Skepticism of Copyrights and Patent Rights in 20th Century Antitrust Jurisprudence

The Supreme Court's early respect for the general policy of liberty of contract regarding IP eroded over the course of the 20th Century. Indeed, by the middle of the century the Supreme Court's stance towards restrictive licensing contracts involving patents and copyrights was antagonistic. Between the 1920s and the 1960s, in particular, the Supreme Court developed a wariness of so-called tying arrangements or tie-in contracts. During this same time period, the Supreme Court also developed hostility to price-restrictive contracts. Those decisions have lent credence to claims that there is an inherent conflict between antitrust and IP concepts. As will be seen, however, the Supreme Court's antagonism toward IP rights was fueled by erroneous ideas about competition and also by conflicting goals that animated its antitrust jurisprudence.

Tying Agreements Involving Patented Goods

In a typical tying arrangement, the owner of a particular good offers to license that good to another for use or for resale at retail, provided the licensing party uses or sells that particular good along with another good provided by the owner. And in the patent context, a tying arrangement involves a patent rights holder – or licensor – licensing the use or retail sale of its patented property on condition that the licensee also use or sell it exclusively with non-patented property supplied by the licensor.

Early antitrust judicial decisions perceived that contracts tying patented property to unpatented property were likely to be competitively benign or even offer pro-competitive benefits, depending upon the underlying facts involved. The *Button-Fastener* case involved an antitrust claim raised against a licensing contract by which button-fastening machines for manufacturing shoes were sold on condition that they be used only with staples sold by the manufacturer of the patented machine – thereby excluding use of the patented machine by staples supplied from third parties. Writing for the 6th Circuit in that case, then-Judge Lurton expressed strong skepticism that such a tying arrangement would enable the manufacturer to create a new monopoly in unpatented staples or shoe manufacturing.

Moreover, even assuming a new monopoly were to be created in an unpatented product through such a tying arrangement, Judge Lurton perceived that such a monopoly "would be the legitimate consequence of the meritorious character of their invention." As Judge Lurton explained: "The great consuming public would be benefited, rather than injured for the monopoly could endure so long only as shoes were supplied at a less price than prevailed before the invention." "Their monopoly in an unpatented article," wrote Judge Lurton "will depend upon the merit of their patented device, and the extent to which other clinching devices are superseded by it." If a patented machine could reduce manufacturing costs and enable the patent owner to unilaterally and legitimately acquire a patent right in manufacturing shoes, "why may they not, by a system of restricted licenses, permit others to use their devices on condition that only some minor part of the shoe—the pegs, the tips, the thread, or the buttons, or button fasteners—shall be bought from them?" As Professor Ward S. Bowman, Jr., has explained: "Lurton had found in *Button-Fastener* that the tie-in of staples to the fastening machine did not involve a violation of antitrust law because the license contract was shown to be a means of maximizing the reward due to the *competitive superiority* of the button-fastener patents and not a means of restraining trade *beyond* the scope of the patents involved."

In an opinion by Justice Lurton, the Supreme Court similarly upheld a tying arrangement involving patented invention in *Henry v. A.B. Dick Company* (1912). The licensing contract at issue involved a patented stencil-duplicating machine that was sold by the patent holder on the express condition that the licensee use the patent machine only with stencils, paper, ink, and other supplies sold by the patent holder. A.B. Dick expressly reaffirmed that "the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States." And Justice Lurton emphasized that a patent owner's exclusive right to use – and thereby exclude others from use – "embraces the lesser of permitting others to use upon such terms as the patentee chooses to prescribe. Moreover: "It must not be forgotten that we are dealing with a constitutional and statutory monopoly. An attack upon the rights under a patent because it secures a monopoly to make, to sell, and to use is an attack upon the whole patent system."

Justice Edward White dissented in *A.B. Dick*. White concluded that "a patentee in selling the machine covered by his patent has the power by contract to extend the patent so as to cause it to embrace things which it does not include," and thereby result in a power "to multiply monopolies at the will of an interested party." His opinion espoused what would generally become known as the “leverage theory” of vertical integration. When applied in the patent context, the same idea would become known as the “patent leverage fallacy.” As Professor Herbert Hovenkamp has explained: “The theory condemned vertical practices such as tying arrangements by assuming that a monopolist in one product could use tying to create a second monopoly in a tied product, thus earning two monopoly profits while destroying competition in the tied product.” In reality, however, the monopolist still has the single monopoly. The tie-in, as Professor Bowman has explained, is means of “maximizing the return the patent affords.” Tying arrangements are “profit-maximizing techniques” and not leveraging techniques. To the extent the monopolist increases its profits in the tied (non-IP) product’s market, it loses its leverage to profit in the tying (IP) product’s market.

The *A.B. Dick* decision was overruled in the *Motion Picture Patents Company v. Universal Film Manufacturing Corporation* (1917). In an opinion by Justice William Day, the Supreme Court adopted the leverage theory previously advanced by Justice White. The Court thereby approached tying arrangements involving patented goods with heightened suspicion and discounted the possibility that such an arrangement could bring benefits to consumers by virtue of the competitive superiority of the patented good.

Cases decided under the Clayton Act solidified the Supreme Court’s judicial hostility to tying arrangements involving patented property. *United Shoe Machinery Corp. v. U.S.* (1922), for example, applied stricter standards to patent tying arrangements based on the Clayton Act’s provision prohibiting acts creating incipient monopoly. According to Bowman, *United Shoe* “construed the ‘incipiency’ hypothesis of the Clayton Act so as to greatly bolster the leveraging theory of *Motion Picture Patents*.” The *United Shoe* decision bolstered the “mythology…that an adverse effect on competitors is the presumptive equivalent of an adverse effect upon competition—almost as if the Clayton Act, particularly its section 3, had omitted the qualifying clause calling for some probability of a substantial lessening of competition or a tendency or the creation of monopoly.” And *Carbice Corp. v. American Patents Corp*. (1931), for instance, reflected what Professor Hovenkamp has described as a belief “that monopoly is ubiquitous and easily spread by the simple device of contracts tying monopoly to nonmonopoly products. It also reveals the period’s deep distrust of patents.”

Subsequently, *International Salt Company, Inc. v. U.S*. (1947) adopted a presumption that patent ownership constituted possession of market power for antitrust analytical purposes. This presumption was imported into antitrust jurisprudence from patent misuse doctrine – a facet of patent law addressed to actions that improperly expand the scope or duration of a patent beyond what was granted. *International Salt* expressly held tying arrangements to be illegal *per se*. Justice Robert Jackson concluded, on behalf of the Supreme Court, that a patent holder’s leasing a patented machine on condition that the lessee use only the patent holder’s unpatented products violates Section 1 of the Sherman Act and Section 3 of the Clayton Act. This holding was reinforced in *Northern Pacific Railway Company, v. U.S*. (1958). Writing for the Court, Justice Hugo Black approvingly quoted Justice Felix Frankfurter’s declaration: “tying agreements serve hardly any purpose beyond the suppression of competition.”

Price-Restrictive Contracts Involving Patented Goods

Aside from tying arrangements, hostility to price-restrictive contracts became another facet of the Supreme Court's antitrust jurisprudence for much of the 20th Century. Price-restrictive contracts fix the price at which goods sold by a supplier are resold at retail. One type of such contracts is a resale price maintenance agreement, whereby the supplier offers goods on condition that the retailer does not resell the goods below a minimum set price.

Some early judicial decisions perceived the ability to fix prices was inherently within the scope of a patent owner's exclusive rights to use the patented property. For instance, the Supreme Court's decision in *Bement* upheld price-restrictive licensing contracts involving patents. As Professor Bowman summarized the logic in *Bement*, "since a patentee has the clear right to exclude others from using his patent (total exclusion), the lesser exclusion, use at a prescribed price being an example, was within the patentee's rights."

Additionally, the *Rubber Tire Wheel Company v. Milwaukee Rubber Tire Works* (1907), decided by the 7th Circuit, upheld patent licensing contracts that fixed prices for the sale of tires and also the output or volume of tires that each licensor could sell in the market. The 7th Circuit recognized that contract terms that touch on "any matter outside the monopoly of the patent" that harmed competition could trigger a Sherman Act violation, yet found no exceeding of the scope of the patent in the case. Rather, as Professor Bowman has written in his book, *Patent and Antitrust Law: A Legal and Economic Appraisal* (1973): "the relevant issue in assessing the applicability of the Sherman Act to patent licensing practices, according to this court, was the advantage provided by a valid patent."

However, outside the patent context the Supreme Court declared resale price maintenance agreements to be illegal *per se* in *Dr. Miles Medical Co. v. John D. Park & Sons Co*. (1911). In *Bauer v. O'Donnell* (1913), the Supreme Court applied *Dr. Miles* to resale price maintenance agreements involving patented goods. *Bauer* thus declared resale price maintenance agreements involving patented goods illegal *per se*. According to Professor Hovenkamp: "The *per se* rules against practices such as tying and resale price maintenance were developed without real inquiry into their effects of the challenged practice on the marketwise output." Such rules were instead "concerned with such values as maximizing the freedom of independent dealers, which is often limited by practices that enlarge rather than reduce output." The Supreme Court's application of *per se* rules against resale price maintenance continued at least through *Sears, Roebuck & Co. v. Stiffel Company* (1964), wherein the Court held:

> Once the patent issues, it is strictly construed…it cannot be used to secure any monopoly beyond that contained in the patent… the patentee's control over the product when it leaves his hands is sharply limited… and the patent monopoly cannot be used in disregard of the antitrust laws.

And that same year, the Supreme Court held in *Simpson v. Union Oil Company of California* (1964) that a "patent is an exception to the general rule against monopolies and to the right to access to a free and open market."

Copyright Licensing Practices

Although the Supreme Court and lower courts decided significantly less tying or price-restrictive agreement cases involving copyrighted works than patented works, it did apply similar reasoning in copyright-related cases.

For example, in *U.S. v. Paramount Pictures, Inc.* (1948), the Supreme Court held that inclusion of minimum resale price maintenance provisions in licenses to show copyrighted motion pictures at theaters was contrary to Section 1 of the Sherman Act. Reviewing precedents prohibiting resale price maintenance provisions in patent licensing agreements, Justice William Douglas concluded: “Certainly the rights of the copyright owner are no greater than those of the patentee.” Moreover, in *Paramount Pictures* the Supreme Court applied antitrust precedents involving patent licensing and tying arrangements in the copyright context, holding that it was illegal for a copyright holder to “refus[e] to license one or more copyrights unless another copyright is accepted.” Specifically, the Supreme Court concluded that “block-booking” – licensing one motion picture for exhibition at a theater on condition that one or more other licensed motion pictures will be exhibited within a certain time period – contravened antitrust laws. Also, in *United States* v. *Loew’s Inc.* (1962), another case involving the practice of block-booking, the Supreme Court emphatically declared that market power “is presumed when the tying product is patented or copyrighted.”

Federal Agency Antitrust Enforcement

Lawsuits filed by federal agencies responsible for enforcing antitrust law often provided the occasion for decisions by the Supreme Court that were unfavorable to licensing contracts involving IP. Between 1970 and 1975, Bruce Wilson, a Deputy Assistant Attorney General in the DOJ Antitrust Division gave three speeches in which he identified nine licensing practices that DOJ asserted were *per se* illegal. They became known as “the Nine No-No’s.” As summarized by Richard Gilbert and Carl Shapiro – both law professors and former antitrust enforcement officials – those licensing practices included:

1. Royalties not reasonably related to sales of the patented products;
2. Restraints on licensees' commerce outside the scope of the patent (tie-outs);
3. Requiring the licensee to purchase unpatented materials from the licensor (tie-ins);
4. Mandatory package licensing;
5. Requiring the licensee to assign to the patentee patents that may be issued to the licensee after the licensing arrangement is executed (exclusive grantbacks):
6. Licensee veto power over grants of further licenses;
7. Restraints on sales of unpatented products made with a patented process;
8. Post-sale restraints on resale; and
9. Setting minimum prices on resale of the patent products.

According to Gilbert and Shapiro, the approach embodied in the Nine No-No’s “shunned a direct evaluation” of the trade-off between “the role of the IP laws in creating and protecting property rights to encourage investment in research and development” and “the role of the antitrust laws in protecting consumers from anticompetitive restraints.” Instead, the Nine No-No’s approach, which presumed that IP rights confer market power, focused on "whether the practice in question extends a patentee's economic power beyond the legitimate scope of the patent grant."

The Reorientation of Antitrust to Consumer Welfare and Rigorous Economic Analysis

By the 1970s, the Supreme Court's antitrust jurisprudence came under heavy criticism for its pursuit of widely varying goals and reliance on unsound economic ideas. Beginning in the late 1970s and continuing to the present, the Supreme Court's antitrust jurisprudence has largely reoriented toward maximizing consumer welfare based on economic analysis. Federal agencies responsible for antitrust enforcement have adopted a similar outlook in their policy guidelines. Antitrust doctrines rooted in other goals or based on old assumptions rather than modern economic scholarship have been overruled or significantly limited.

The impact of the Chicago school of antitrust analysis on the Supreme Court's antitrust jurisprudence has been widely acknowledged. Members of the Chicago school contended that maximization of consumer welfare ought to be the exclusive goal of antitrust law. In his heavily influential book, *The Antitrust Paradox* (1978), the late Judge Robert Bork wrote: "[T]he only legitimate goal of antitrust is the maximization of consumer welfare." That is, "[t]he whole task of antitrust can be summed up as the effort to improve allocative efficiency without impairing productive efficiency so greatly as to produce either no gain or a net loss in consumer welfare." Chicago-school scholars also emphasized more rigorous application of microeconomic analysis in antitrust law.

From those starting points, the Chicago-school scholars such as Bork and Ward Bowman criticized 20th Century Supreme Court antitrust doctrines. For instance, in the *Antitrust Paradox,* then-Professor Bork pointed to "the problem of how a tie-in sale can be distinguished from any sale." That is: "Any product or service can be broken down into smaller components, and the seller who refuses to do so is insisting upon tying the components together." Moreover, when it comes to everyday products like automobiles that are comprised of different parts that could conceivably be broken up and sold individually, "requiring the seller to deal in smaller quantities…would introduce obvious diseconomies. It would be inefficient and, therefore, anticonsumer."

Instead, as Bork and others pointed out, tying arrangements can create significant efficiencies and thereby enhance consumer welfare." For example, tying a patented invention or copyrighted work with a good not protected by IP laws could provide a way for the seller or licensor to monitor or meter the buyer or licensee's volume of use. This can enable the seller or licensor to maximize his or her returns by charging more to the heavy users and less to the lighter users – or what is known as "price discrimination." Further, tying a patented invention or copyrighted work with a good not protected by IP laws might result in cost reductions for the seller or licensor and thereby create efficiencies that benefit consumers through increased output or reduced prices. According to Bork, tying arrangements "simply do not threaten competition, as the courts have supposed for so long."

Tying arrangements involving IP can also improve quality of service and protect the goodwill of the seller or licensor. Explained Professor Bowman: "The usefulness of a particular product or device may depend not only on its own adaptability but equally upon the adaptability of some essential component. If the essential component does not conform to exact specifications, it might impair the operation or usefulness of the principal product." Tying a non-patented or non-copyrighted good to a good protected by IP can enable sellers or licensors to have responsible involvement in addressing troubleshooting and quality control concerns. This can also allow such sellers or licensors to better avoid misplaced blame from a buyer or user when encountered problems are actually the result of non-patented non-copyrighted goods.

Scholars associated with the new Harvard school of antitrust analysis have also stressed the importance of consumer welfare as the goal of antitrust and criticized 20th Century Supreme Court doctrines that have restricted trade practices without considering their likely benefits. According to one such scholar, Professor Hovenkamp: "The per se rules against practices such as tying and resale price maintenance were developed without real inquiry into the effects of the challenged practice on marketwide output. Rather, they were concerned with such values as maximizing the freedom of independent dealers, which is often limited by practices that enlarge rather than reduce output."

A turning point in the Supreme Court's antitrust jurisprudence occurred in *Continental T.V., Inc. v. GTE Sylvania, Inc*. (1977), which stated firmly that economic analysis rather formalistic rules are to be the guiding standard for decisionmaking:

> Since the early years of this century, a judicial gloss on this statutory language has established the "rule of reason" as the prevailing standard of analysis. Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition. *Per se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive.

The thesis that antitrust must be guided by the single goal of consumer welfare was expressly adopted by the Supreme Court in *Reiter v. Sonotone* (1979), which characterized the Sherman Act as a "consumer welfare prescription." Thereafter, the Supreme Court's jurisprudence has increasingly become attuned to consumer welfare as the primary goal of antitrust law and to neoclassical welfare economics as the analytical criteria for determining when government intervention in the market is justified. The U.S. Department of Justice and the Federal Trade Commission – the federal agencies responsible for enforcing antitrust laws – have similarly adopted consumer welfare-oriented guidance and policies that emphasizes the analytical insights of neoclassical welfare economics.

For antitrust purposes, government interference with the free market is justified only insofar as it prohibits anticompetitive conduct and makes markets function more competitively. More particularly, antitrust addresses the willful acquisition or maintenance of monopoly power to fix prices above competitive levels or to reduce the supply of goods and services in the relevant market. According to Hovenkamp, the main concern of antitrust is restrictions on output: "Competition is injured when a firm or group of firms is able to reduce output in some market, and 'output' can be measured by either quantity or innovation."

The adoption of consumer welfare as the primary goal of antitrust law and more rigorous economic analysis by the Supreme Court and by federal antitrust enforcement agencies has had important implications for IP.

Vindication of Copyrights and Patent Rights in 21st Century Antitrust Jurisprudence

In recent years, the Supreme Court has overruled or limited the holdings of older decisions that expressed skepticism toward IP licensing practices, such as those involving tying and resale price maintenance agreements. Modern Supreme Court jurisprudence and the Antitrust Guidelines of the DOJ and FTC have come to recognize important efficiencies or consumer welfare benefits that result from trade practices involving tying and resale price maintenance agreements, including agreements involving IP.

The Supreme Court overturned its long-held presumption of market power in a patented good that is tied to the purchase of a second good on *Illinois Tool Works Inc. v. Independent Ink, Inc.* (2006). Writing for a unanimous Court, Justice John Paul Stevens recounted how that presumption originated in patent misuse precedents and was imported into antitrust jurisprudence in *International Salt v. U.S.*, decided nearly sixty years before. As Justice Stevens observed: "Without any analysis of actual market conditions, these patent misuse decisions assumed that, by tying the purchase of unpatented goods to the sale of a patented good, the patentee was 'restraining competition'…or 'secur[ing] a limited monopoly of an unpatented material.'" Thus, in antitrust cases such as *U.S. v. Loew's, Inc.*, "the Court relied on this assumption despite evidence of significant competition in the market for the tying product."

In 1988, however, Congress amended the Patent Code to eliminate the presumption of market power in patent misuse cases. In light of the presumption's elimination in the patent misuse context, *Illinois Tool Works* therefore revisited the presumption in the antitrust context. As Justice Stevens acknowledged, "the vast majority of academic literature recognizes that a patent does not necessarily confer market power." Moreover: "It is no doubt the virtual consensus among economists that persuaded the enforcement agencies to reject the position that the Government took when it supported the per se rule that the Court adopted in the 1940's." The Court therefore concluded that future antitrust claims raised against tying arrangements involving patented goods require proof of power in the relevant market instead of presumption.

The reasoning of the Supreme Court's decision in *Illinois Tool Works* was subsequently applied to a tying claim involving copyrighted content in a lower court decision. In *Mediacom Communications Corp. v. Sinclair Broadcast Group, Inc*. (2006), Chief Judge Robert Pratt of the Southern District of Iowa effectively concluded, based on *Illinois Tool Works*, that a copyright does not create a presumption of market power. Instead, antitrust claims raised against tying claims involving copyrighted content must likewise require proof of power in the relevant market.

Illinois Tool Works cited federal agency antitrust enforcement guidelines published in 1995 in support of its rejection of the presumption of market power in tying cases involving patented goods. Indeed, by the time the Supreme Court decided *Illinois Tool Works*, the DOJ and FTC had long since abandoned the Nine No-No's *per se* illegality approach toward licensing contracts. As Gilbert and Shapiro have explained: "In the early 1980s the Antitrust Division began to question the theory underlying the Nine No-No's, focusing on the principle that unconstrained patent licensing increases the value of patents and encourages licensing and innovation." The DOJ's Antitrust Division formalized its new rule-of-reason approach in its 1988 "Antitrust Enforcement Guidelines for International Operations." The DOJ and FTC's 1995 Guidelines built upon the rule-of-reason approach, expressly recognizing the generally-competitive benefits of licensing agreements and rejecting any presumption that IP rights creates market power for antitrust purposes.

The DOJ and FTC's "Antitrust Guidelines for the Licensing of Intellectual Property" (2017), reaffirm the position of the federal antitrust agencies concerning the competitive aspects of tying arrangements involving IP. According to the 2017 Guidelines:

> The Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although the intellectual property right confers the power to exclude with respect to the specific product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power. If an intellectual property right does confer market power, that market power does not by itself offend the antitrust laws. As with any other asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely 'a consequence of a superior product, business acumen, or historic accident' does not violate the antitrust laws. Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others. As in other antitrust contexts, however, an intellectual property owner could illegally acquire or maintain market power. Furthermore, even if it lawfully acquired or maintained that power, the owner could still engage in anticompetitive conduct in connection with such property.

Additionally, in *Leegin Creative Leather Products, Inc. v. PSKS, Inc*. (2007), the Supreme Court overruled its opinion in *Dr. Miles Medical Co. v. John D. Park & Sons Co*. (1911), which held that resale price maintenance agreements are *per se* illegal. Writing for a 5-4 majority, Justice Anthony Kennedy acknowledged that "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance." Supreme Court precedents adopting a rule of reason approach toward other price-restrictive contracts, as well as several pro-competitive justifications for resale price maintenance agreements listed by the Court, led it to conclude that resale price maintenance agreements should be evaluated under the rule of reason. Similarly, the 2017 Guidelines declare: "[T]he Agencies will apply a rule of reason analysis to price maintenance in intellectual property licensing agreements."

In sum, modern Supreme Court antitrust jurisprudence, directed toward the goal of enhancing consumer welfare and informed by neoclassical welfare economics, has vindicated the competitive potentiality of IP licensing practices, including tying arrangements and price-restrictive agreements. The Supreme Courts and federal agencies now recognize that licensing contracts involving IP can create efficiencies and increase output, thereby benefitting consumers. Antitrust jurisprudence and agency guidelines also recognize that concerns can potentially be raised by licensing contracts involving IP – such as those involving acquisition of patents as part of a monopolization scheme, manipulation of private industry technology standards to effectively require the use of patented invention, or horizontal agreements between competitors to refuse licensing of IP rights. But such concerns must be subjected to a reasoned analysis that also takes into account the competitive benefits of IP licensing.

Promoting Creative and Innovative Output: The Common Purpose of IP and Antitrust

Neoclassical or consumer welfare economics – reflected in the Supreme Court's antitrust jurisprudence and the outlook of federal antitrust enforcement agencies – bring into sharper focus how the aims of IP and of antitrust are ultimately consistent. The public and private purposes of the IP Clause are by no means solely reducible to the maximization of consumer welfare. But the promotion of progress of science and useful arts and the securing of exclusive rights in creative works and inventions surely is consistent with the promotion consumer welfare.

Professor Bowman aptly describes the common purposes of antitrust and IP with respect to patents: "Both antitrust law and patent law have a common economic goal: to maximize wealth by producing what consumers want at the lowest cost. In serving this common goal, reconciliation between patent and antitrust law involves serious problems of assessing affects, but not conflicting purposes." Patent law fits with antitrust's central aim of greater output in that "[i]t is designed to provide something which consumers value and which they could not have at all or have as abundantly were no patent protection afforded."

The 2017 "Antitrust Guidelines for the Licensing of Intellectual Property" also recognize the common goals: "The aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are actually complementary, as both are aimed at encouraging innovation, industry and competition."

The obvious differences between IP and antitrust lie in the means by which they facilitate achievement of their shared goal. For IP, the means of increasing output are exclusive rights protections for a term of years to incentivize intellectual labor and investment in new creative works or novel inventions for consumption in the market. As Professor Bowman has written: "Patent law insures that those who incur the costs of inventing will reap its reward if users find the result worth paying for" and is thereby ensures that "the profit-incentive system may operate in the interest of the patentee and in the interest of the community." And for antitrust, the means for promoting competition are prohibitions on output-reducing restraints on trade where the circumstances and economic reasoning warrant market intervention.

Professor Hovenkamp has similarly acknowledged that no inherent conflict exists between IP and antitrust: "Tying arrangements historically provoked most of the conflicts that courts imagined to exist between antitrust and IP rights. Nearly all the conflicts were false." Hovenkamp does maintain that balancing does need to take place between competition and protection for innovation. However, "questions about the duration and scope of the IP laws belong to Congress and to judicial interpretation of the relevant IP statute, *not* to the antitrust laws." Ultimately, it is the constitutional responsibility of Congress to ascertain the terms and conditions of copyright and patent rights protections "To promote the Progress of Science and useful Arts." Congress can advance both the public and private purposes of the IP Clause consistently with the consumer welfare purpose of antitrust.

Conclusion

The dual purposes of the IP Clause reinforce each other. New creative works and inventions further "the Progress of Science and useful Arts" to the benefit of the public. The "exclusive Right" to creative works and inventions provides essential private benefits to artists and inventors. Copyrights and patent rights are unique types of property rights. They are rooted in an individual's intellectual labors, and thus in an individual's natural right to receive the fruits of his or her labors.

Unfortunately, false claims are sometimes made that principles of IP are in conflict with principles of antitrust. A closer look at antitrust law helps to reveal the emptiness of such claims. Antitrust is directed at private actors and private exercises of market power that pose harm to market competition, whereas IP involves federal exercise of power to secure private rights. Moreover, free market competition, private property rights, and liberty of contract are default presumptions in antitrust. The congruence between IP rights and antitrust was widely assumed when the Centennial Congress passed the Sherman Antitrust Act in 1890 and the International Copyright Act in 1891. That basic congruence was reaffirmed by early Supreme Court antitrust decisions. Antitrust may be deemed an exception to the general policy of liberty of contract concerning IP. Yet in this respect, antitrust treats contracts involving IP just like commercial contracts involving other types of property.

The Supreme Court's early respect for the general policy of liberty of contract regarding IP eroded over the course of the 20th Century, fueled by erroneous ideas about competition and conflicting goals that animated the Supreme Court's antitrust jurisprudence. Modern Supreme Court's antitrust jurisprudence has largely reoriented toward maximizing consumer welfare based on economic analysis. This has had important implications for IP. In recent years, the Supreme Court has overruled or limited the holdings of older decisions that expressed skepticism toward IP licensing practices, such as involving tying and resale price maintenance agreements.

Neoclassical or consumer welfare economics bring into sharper focus how the aims of IP and of antitrust are ultimately consistent. The public and private purposes of the IP Clause are by no means reducible to the maximization of consumer welfare. But the promotion of progress of science and useful arts and the securing of exclusive rights in creative works and inventions surely is consistent with the promotion of consumer welfare.

The obvious differences between IP and antitrust lie in the means by which they facilitate achievement of their shared goal. For IP, the means of increasing output are exclusive rights protections over a term of years to incentivize intellectual labor and investment in new creative works or novel inventions for consumption in the market. And for antitrust, the means are prohibitions on output-reducing restraints on trade where the circumstances and economic reasoning provide strong justification for intervention in the market.

Ultimately, it is the constitutional responsibility of Congress to determine the term lengths and conditions of copyright and patent rights protections "To promote the Progress of Science and useful Arts." Congress can advance both the public and private purposes of the IP Clause consistently with the consumer welfare purpose of antitrust.

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