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## 1995 Antitrust Guidelines for the Licensing of Intellectual Property: Harmonizing the Commercial Use of Legal Monopolies With the Prohibitions of Antitrust Law

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# **1995 ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY: HARMONIZING THE COMMERCIAL USE OF LEGAL MONOPOLIES WITH THE PROHIBITIONS OF ANTITRUST LAW**

## **I. INTRODUCTION**

That ideas should freely spread from one to another over the globe, for the moral and mutual instruction of man, and improvement of his condition, seems to have been peculiarly and benevolently designed by nature, when she made them, like fire, expansible over all space, without lessening their density in any point, and like air in which we breath, move and have our physical being, incapable of confinement or exclusive appropriation.<sup>1</sup>

More than 150 years ago, Thomas Jefferson's private letter to Mr. Isaac McPherson foreshadowed the contemporary, ongoing struggle between antitrust law and intellectual property law regarding the legal protection and regulation of intellectual property.<sup>2</sup> Historically, antitrust and intellectual property law have coexisted uneasily, with lawyers and the courts often treating the disciplines as directly conflicting.<sup>3</sup>

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<sup>1</sup> Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1813), in *THE PORTABLE THOMAS JEFFERSON* 525, at 530 (Merrill D. Peterson ed., 1975).

<sup>2</sup> That Thomas Jefferson would foresee the contemporary struggle between intellectual property law and antitrust law is not surprising. Scholars know Jefferson as the Father of the Patent System because he shaped the birth of America's patent scheme, including authoring the 1793 Patent Act, and sat as the nation's first Commissioner of Patents. Levi N. Fouts, *Jefferson the Inventor, and His Relation to the Patent System*, 4 J. PAT. OFF. SOC'Y 316, 322 (1921-22). As the Supreme Court has noted, Jefferson, like the law, struggled with the tension between America's aversion to monopolies and the need for economic incentive to encourage innovation via intellectual property protection. *Graham v. John Deere Co.* of Kansas City, 383 U.S. 1, 7-11, 148 U.S.P.Q. (BNA) 459 (1966).

<sup>3</sup> *Intellectual Property Guidelines Help Further Goals of Antitrust Law*, 67 Antitrust & Trade Reg. Rep. (BNA) No. 1686, at 523 (Oct. 27, 1994); Charles C. Hsieh, Case Note, *Professional Real Estate: The Line Between Patent and Antitrust*, 7 HARV. J. LAW & TECH. 173, 173 (1993); Ramsey Hanna, Note, *Misusing Antitrust: The Search for Functional*

This tension remains an issue for those who practice law in the areas of antitrust and intellectual property, and the contemporary prevalence of the conflict has attracted the attention of federal antitrust enforcement officials. Last year, Anne Bingamen, Assistant Attorney General and head of the Antitrust Division of the Department of Justice, discussed the antitrust/intellectual property law conflict in a speech at Stanford Law School; the subject of Ms. Bingamen's speech is the subject of this paper, the 1995 Federal Trade Commission (hereinafter "FTC") and Department of Justice (hereinafter "DOJ") Antitrust Guidelines for the Licensing of Intellectual Property (hereinafter "Guidelines").<sup>4</sup> The Guidelines are designed to reconcile these two areas of law; it appears that the intention of the FTC and DOJ is both to minimize the conflict between these two areas of law and to maximize effective law enforcement by emphasizing the common underlying goals of both antitrust prohibitions and intellectual property protections. This paper hopes to explain how the DOJ and FTC will harmonize their antitrust enforcement with the policies of intellectual property protection by first exploring the theoretical goals of each area of the law, then highlighting the historical background of antitrust enforcement in the context of intellectual property, and finally delving into both the meat of the Guidelines and their potential, real effects on the intellectual property marketplace.

## II. THE THEORETICAL GOALS OF ANTITRUST AND INTELLECTUAL PROPERTY LAW

The superficial tension between antitrust law and intellectual property law is obvious upon first glance. In the most rudimentary sense, antitrust law prohibits monopolies while intellectual property law grants legal monopolies to producers of creative or useful works. The language of the Sherman Act, the statutory source for Antitrust enforcement, specifically prohibits "[e]very

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*Copyright Misuse*, 46 STAN. L. REV. 401, 410-411 (1994).

<sup>4</sup> *Bingamen Emphasizes Sound Enforcement to Reinforce Policy Favoring Innovation*, 67 Antitrust & Trade Reg. Rep. (BNA) No. 1685, at 473 (Oct. 20, 1994); *Antitrust Guidelines for the Licensing of Intellectual Property* (April 6, 1995), reprinted in 4 TRADE REG. REP. (CCH) ¶ 13, 132 (hereinafter "Guidelines").

contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce.”<sup>5</sup> Similarly, the Clayton Act states,

It shall be unlawful for any person engaged in commerce, . . . to lease or make a sale or contract for sale, of goods, . . . whether patented or unpatented, . . . where the effect of such lease, sale or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.<sup>6</sup>

Alternatively, the Constitution of the United States plainly states that Congress shall have 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.”<sup>7</sup> This textual incongruity at the foundational level drives the initial wedge between these two areas of the law. The courts, through subsequent case law, have only added to the confusion by specifically noting that intellectual property protection is not a per se violation of antitrust laws,<sup>8</sup> while using the anti-trust laws in other cases to circumscribe the power possessed by owners of intellectual property rights.<sup>9</sup>

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<sup>5</sup> Sherman Act, 15 U.S.C. § 1 (1988 & Supp. V 1993) (emphasis added).

<sup>6</sup> Clayton Act, 15 U.S.C. § 14 (1988). The Clayton Act was passed in 1914, 24 years after the Sherman Act, to supplement the Sherman Act. While the Sherman Act prohibits monopolies generally, the Clayton Act attacks anticompetitive practices even though such practices may not involve efforts to monopolize.

<sup>7</sup> U.S. Const. art. I, § 8, cl. 8 (emphasis added).

<sup>8</sup> *United States v. Crown Zellerbach Corp.*, 141 F. Supp. 118, 126, 110 U.S.P.Q. (BNA) 399 (N.D. Ill. 1956) (addressing patent rights and subsequent licensing agreements allegedly used to exploit monopoly power in paper towel industry, court said, “[a]ntitrust considerations are not to override the limited monopoly conferred by a patent”); *United States v. Line Material Co.*, 333 U.S. 287, 309, 76 U.S.P.Q. (BNA) 399 (1948) (holding licensing of patent rights for electrical fuses not violative of antitrust laws and noting “[t]he Sherman Act was enacted to prevent restraints of commerce but has been interpreted as recognizing that patent grants were an exception”).

<sup>9</sup> *See, e.g., Timken Roller Bearing Co., v. United States*, 341 U.S. 593, 599, 89 U.S.P.Q. (BNA) 462 (1951) (“A trademark cannot be legally used as a device for Sherman Act violation.”); *United States v. Singer Mfg. Co.*, 374 U.S. 174, 197, 137 U.S.P.Q. (BNA) 808 (1963) (facing alleged violation of antitrust laws through licensing of patent rights over sewing machines, court confirmed “[t]hat Act [the Sherman Act] imposes strict limitations

This legal tension notwithstanding, the fact remains that antitrust law and intellectual property protection have common policy goals; in the broadest sense, both hope to maximize consumer welfare.<sup>10</sup> In the context of regulating intellectual property, both areas of law purport to maximize consumer welfare by promoting investment in innovation and thereby facilitating the introduction of new inventions, discoveries, and creations into the marketplace.<sup>11</sup> Intellectual property law achieves this goal by protecting exclusive property rights in innovation<sup>12</sup> while antitrust law seeks to ensure a vigorously competitive market structure.<sup>13</sup> Guided by these big picture policy objectives, the DOJ and FTC now recognize that the commercial usage of exclusive intellectual property rights is often procompetitive; and the agencies are conforming their enforcement policies to fit this reality.<sup>14</sup>

The 1995 Guidelines juxtapose the common policy goals of antitrust and intellectual property law as follows: intellectual property rights provide incentives for businesses, artists, entrepre-

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on the concerted activities in which patent owners may lawfully engage").

<sup>10</sup> *Guidelines*, *supra* note 4, § 1.0.; see Hanna, *supra* note 3, at 419; Paul Goldstein, *The Competitive Mandate: From Sears to Lear*, 59 CAL. L. REV. 873 (1971).

<sup>11</sup> *Atari Games Corp. v. Nintendo of Am., Inc.*, 897 F.2d 1572, 1576, 14 U.S.P.Q.2d (BNA) 1034 (Fed. Cir. 1990); *Justice Department Seeks Comments on Draft Intellectual Property Guides*, 67 Antitrust & Trade Reg. Rep. (BNA) No. 1676, 182, 183 (Aug. 11, 1994) (Anne K. Bingaman, Assistant Attorney General for Antitrust Division commenting); see *Loctite Corp. v. Ultraseal Ltd.*, 781 F.2d 861, 876-77, 228 U.S.P.Q. (BNA) 90 (Fed. Cir. 1985) (discussing patent system's and antitrust law's complementary goals of promoting innovation and consumer welfare).

<sup>12</sup> See, e.g., *Computer Assocs. Int'l, Inc. v. Altai, Inc.*, 982 F.2d 693, 711 (2d Cir. 1992) (noting that purpose of copyright law is "[to advance] public welfare through rewarding artistic creativity"); *Twentieth Century Music Corp. v. Aiken*, 422 U.S. 151, 156, 186 U.S.P.Q. (BNA) 65 (1975) (stating that aim of copyright protection is "to stimulate artistic creativity for the general public good"); *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970, 974, 15 U.S.P.Q.2d (BNA) 1846 (4th Cir. 1990) (stating "[t]he rationale for allowing patents for new inventions was and is to encourage their creation for the benefit of society").

<sup>13</sup> Hanna, *supra* note 3, at 420-21; John Flynn & James F. Ponsoldt, *Legal Reasoning and the Jurisprudence of Vertical Restraints: The Limitations of Neoclassical Economic Analysis in the Resolution of Antitrust Disputes*, 62 N.Y.U. L. REV. 1125, 1138 (1987); Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140, 1182 (1981).

<sup>14</sup> Bingaman *Emphasizes Sound Enforcement to Reinforce Policy Favoring Innovation*, *supra* note 4, at 473; *Justice Department Seeks Comments on Draft Intellectual Property Guides*, *supra* note 11.

neurs, etc. to innovate;<sup>15</sup> because the law assures creators of intellectual property that they will possess an exclusive property right in their work product, the market extends to these creators the carrot of supracompetitive profits as an enticement to innovate.<sup>16</sup> The consumer benefits from investments in innovation are self evident; one need only consider how the American consumer has profited from technological advancements in personal computing, medical science, telecommunications, and so on, to come to this conclusion.

Moreover, according to the Guidelines, antitrust law similarly hopes to promote consumer welfare, but through different means.<sup>17</sup> Antitrust strives to guarantee a healthy, competitive market.<sup>18</sup> A market consisting of numerous sellers all vigorously competing for consumers' dollars maintains both price and output at optimal market levels.<sup>19</sup> The competitive market structure therefore enhances consumer welfare by ensuring both that prices of goods and services are not unduly elevated and that output of goods and services is not unnecessarily restricted.<sup>20</sup> According to the DOJ and the FTC, antitrust enforcement in the area of intellectual property licensing agreements will now focus on this common goal of promoting consumer welfare,<sup>21</sup> which suggests that the government hopes to initiate cooperation between these two competing areas of law.

This cooperative mindset prompted the promulgation of the 1995

<sup>15</sup> *Lasercomb*, 911 F.2d at 974 (explaining that laws grant to inventors right to exclude others from making and selling their inventions as means of *encouraging* innovation); *Mazer v. Stein*, 347 U.S. 201, 219, 100 U.S.P.Q. (BNA) 325 (1953) ("The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in 'Science and useful Arts.'").

<sup>16</sup> *Guidelines*, *supra* note 4, § 1.0; *Lasercomb*, 911 F.2d at 974.

<sup>17</sup> *Guidelines*, *supra* note 4, § 1.0.

<sup>18</sup> *Guidelines*, *supra* note 4, § 1.0.

<sup>19</sup> *Hanna*, *supra* note 3, at 420-21; *see also* *United States v. Topco Assoc., Inc.*, 405 U.S. 596, 610-11, 173 U.S.P.Q. (BNA) 193 (1972) (holding territorial sales restrictions imposed on members of supermarket cooperative to be Sherman Act violation because it restricted number of individual competitors); *Brown Shoe Co. v. United States*, 370 U.S. 294, 343-44 (1962) (holding merger of shoe companies to violate Sherman Act because of its tendency to concentrate market towards oligopoly).

<sup>20</sup> *Hanna*, *supra* note 3, at 420-21.

<sup>21</sup> *Intellectual Property Guidelines Help Further Goals of Antitrust Law*, *supra* note 3, at 523.

**Guidelines.** The Guidelines are an attempt to reconcile the legal monopoly provided by intellectual property rights with the principles of antitrust law, consequently ensuring more effective, consistent enforcement of both areas of the law.<sup>22</sup> Officers from the FTC and DOJ are working to publicize the government's cooperative agenda for antitrust and intellectual property law. According to Anne Bingaman, the Guidelines "will ensure that sound antitrust enforcement will continue to serve as a catalyst to technological innovation."<sup>23</sup> Echoing this theme, Willard K. Tom, Counselor to Assistant Attorney General Bingaman and member of the task force that developed the Guidelines, stated in a speech at the Canadian Intellectual Property Law Institute that "without intellectual property rights the incentive to invest and innovate would be greatly diminished. That result would be contrary to the very purpose of the antitrust laws, which is to promote the well-being of consumers by spurring efficiency."<sup>24</sup> Both of these comments acutely capture the government's intention to shape antitrust principles and intellectual property protection into an integrated, cohesive enforcement policy.

### III. HISTORICAL BACKGROUND

Licensing agreements are a common creature in the area of intellectual property law. These agreements link up the creators of intellectual property with entities that possess the resources and know-how to commercialize that property and to extract from it whatever profits result.<sup>25</sup> Although scientists, inventors, poets and the like are the primary creators of intellectual property, these individuals may lack the means for distributing the intellectual property through the market for sale to the public. Instead, the creator typically secures intellectual property protection, be it by

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<sup>22</sup> Richard J. Yurko, *Intellectual Property Guidelines: New, Improved, And . . . Irrelevant?*, MASSACHUSETTS LAWYERS WEEKLY, July 17, 1995, at B9.

<sup>23</sup> *Justice Department Seeks Comments on Draft Intellectual Property Guides*, *supra* note 11, at 183; *Bingaman Emphasizes Sound Enforcement to Reinforce Policy Favoring Innovation*, *supra* note 4, at 473.

<sup>24</sup> *Intellectual Property Guidelines Help Further Goals of Antitrust Law*, *supra* note 3, at 523.

<sup>25</sup> *Guidelines*, *supra* note 4, § 2.3.

copyright, patent, or trademark, and then licenses out his or her exclusive right in the property to a manufacturer, publishing house, or other appropriate means of commercial distribution.<sup>26</sup> The licensee pays the licensor inventor a fee and often royalties from the profits as compensation for the right to market the protected property. These agreements often draw meticulous antitrust inspection because they transfer the legal monopoly over the intellectual property from the hands of the creator to the hands of the commercial licensee. The law has struggled over whether this expansion of monopoly power is consistent with the policies supporting intellectual property protection, or whether it runs afoul of the antitrust laws' desire to maintain an open and competitive marketplace. The courts have not provided consistent, thematic answers to these questions.

During the 1960's and 1970's, the antitrust agencies closely scrutinized intellectual property rights and associated licensing agreements.<sup>27</sup> The courts presumed that the owners of patented or copyrighted works, by virtue of their intellectual property protection, possessed the requisite economic power for antitrust analysis to become relevant.<sup>28</sup> In *United States v. Loew's*, defendants owned copyrights on motion picture feature films and distributed to television stations the right to show these films through licensing agreements.<sup>29</sup> The agreements conditioned the licensing of popular films upon the acceptance of unwanted or inferior films.<sup>30</sup> According to the Court, the mere fact that defendants held copyrights over the films sufficiently proved that they possessed market power which, if improperly used, violated antitrust principles.<sup>31</sup>

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<sup>26</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>27</sup> *Yurko*, *supra* note 22.

<sup>28</sup> *Id.*; *United States v. Loew's, Inc.*, 371 U.S. 38, 44-45, 135 U.S.P.Q. (BNA) 201 (1962); *U.S. Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 621 (1977); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16 (1984).

<sup>29</sup> *Loew's*, 371 U.S. at 40.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 45-46 (citing *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 77 U.S.P.Q. (BNA) 243 (1948) and *International Salt Co. v. United States*, 332 U.S. 392, 75 U.S.P.Q. (BNA) 184 (1947)). Using patent power in violation of the antitrust laws overlaps with the doctrine of "patent misuse," a defense to patent infringement. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917). The patent misuse doctrine is



The law's suspicion and scrutiny of intellectual property rights dissipated dramatically during the 1980s as the FTC and DOJ all but withdrew from antitrust enforcement in the intellectual property arena.<sup>32</sup> Under the Reagan presidency, the executive agencies viewed the economic incentives provided by intellectual property rights as legitimate means of extracting the full economic benefit from innovation. Intellectual property rights acted as a "magic trump card" allowing many previously suspect arrangements to proceed without challenge from the FTC or DOJ.<sup>33</sup>

The courts applied this laissez faire approach to intellectual property licensing.<sup>34</sup> Close consideration of market substitutes replaced the judicial presumption of market power when the property under consideration was patented or copyrighted.<sup>35</sup> According to Justice O'Connor in *Jefferson Parish Hospital District No. 2 v. Hyde*, "a patent holder has no market power in any relevant sense if there are close substitutes for the patented product."<sup>36</sup> By giving weight to the role of market substitutes for the protected property, the courts were able to find that the owners of the intellectual property rights lacked a sufficient share of

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beyond the scope of this paper, but for discussion of the doctrine, see Mark A. Lemley, Note, *The Economic Irrationality of the Patent Misuse Doctrine*, 78 CAL. L. REV. 1599 (1990) and Richard Calkins, *Patent Law: The Impact of the 1988 Patent Misuse Reform Act and Noerr-Pennington Doctrine on Misuse Defenses and Antitrust Counterclaims*, 38 DRAKE L. REV. 175 (1988).

<sup>32</sup> Yurko, *supra* note 22.

<sup>33</sup> *Id.* (referring to 1980's as "anything goes era" for intellectual property licensing agreements).

<sup>34</sup> *Id.*

<sup>35</sup> See *In re Data Gen. Corp. Antitrust Litigation*, 490 F. Supp. 1089, 1112-13 (1980) (stating that presumption of economic power resulting from patent or copyright is not conclusive; market conditions, such as competitors' abilities to develop functionally equivalent products, must be considered); *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 676-77 (6th Cir. 1986) ("[W]e reject any absolute presumption of market power for copyright or patented product."); see *3 P.M., Inc. v. Basic Four Corp.*, 591 F. Supp. 1350, 1359 (E.D. Mich. 1984) (addressing alleged tying of computer maintenance services to trademarked computers and copyrighted software, court said neither trademark nor copyright protection established market power).

<sup>36</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 37 n.7 (1984) (O'Connor, J., concurring). In antitrust analysis, economic substitutes play a critical role in defining the relevant market where competition is allegedly restrained. The presence of substitute goods enlarges the relevant market and thereby decreases the anticompetitive effect that a defendant's actions have on market forces. LAWRENCE ANTHONY SULLIVAN, *ANTITRUST* § 16, at 51-58 (1977).

market power to prompt antitrust concerns.<sup>37</sup> In fact, at the height of the 1980's era, only the rare parcel of intellectual property had no close substitutes so as to possess market power.<sup>38</sup>

The 1995 Guidelines appear to be an attempt by the FTC and the DOJ to temper the extreme stances of these two preceding eras. The Guidelines attempt to strike a balance between the overly suspicious antitrust enforcement of the 1960's and 1970's and the hands-off enforcement of the 1980's.<sup>39</sup> By extending a plan for cooperative efforts between antitrust prohibitions and intellectual property protections, the FTC and DOJ hope to effectively enforce antitrust principles where necessary while simultaneously allowing intellectual property protection to serve its public purpose.

#### IV. THE GUIDELINES

The primary purpose of the Guidelines is to help potential licensors and licensees of intellectual property predict what types of conduct will and will not warrant antitrust investigations.<sup>40</sup> Ultimately, this predictability should assist businesses and their lawyers when making business decisions that carry antitrust implications. The Guidelines follow a highly structured format, first articulating three foundational principles and then moving into more detailed regulations. This section will consider these three principles and will then highlight three of the most unique aspects of the details of the Guidelines: 1) the level of scrutiny the FTC and DOJ will apply when deciding whether to intervene with an antitrust investigation,<sup>41</sup> 2) a safety zone where the FTC and

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<sup>37</sup> This analysis is consistent with most protected intellectual property. For example, Margaret Mitchell's copyright on *Gone With the Wind* does not provide her with monopoly power in the market for fiction novels, nor does 3M's patent on post-IT notes provide the company with monopoly power in the market for note pads. Only the most revolutionary, pioneering patents for which no market substitute exists provide true monopoly power.

<sup>38</sup> Yurko, *supra* note 22.

<sup>39</sup> Yurko, *supra* note 22.

<sup>40</sup> *Guidelines*, *supra* note 4, § 1.0; *Justice Department, FTC Adopt Intellectual Property Guidelines*, 63 U.S.L.W. (BNA) 2654 (April 25, 1995). Yet even with the purpose of increasing the predictability of antitrust challenges, the Guidelines note that "these Guidelines cannot remove judgment and discretion in antitrust law enforcement," *Guidelines*, *supra* note 4, § 1.0.

<sup>41</sup> *Guidelines*, *supra* note 4, § 3.4.

DOJ will not apply antitrust inspections,<sup>42</sup> and 3) a new market where the FTC and DOJ will begin regulating antitrust violations.<sup>43</sup>

#### A. THE THREE CORE PRINCIPLES OF THE GUIDELINES

The Guidelines begin by detailing three core principles that will buttress antitrust enforcement in the intellectual property context. For the purpose of antitrust analysis, the principles are as follows: 1) the enforcement agencies will consider intellectual property to be just another form of property,<sup>44</sup> 2) the agencies will not presume intellectual property rights create market power of the sort that instigates antitrust intervention,<sup>45</sup> and 3) the agencies will recognize the economic benefits of intellectual property licensing agreements, which often work to combine factors of production in ways which are generally procompetitive and benefit the consumer welfare.<sup>46</sup>

By stating that the antitrust enforcement agencies will not treat intellectual property as fundamentally different than other forms of property, the Guidelines are simply clarifying the position that the agencies will not adopt a unique set of antitrust rules specifically for intellectual property. The Guidelines recognize that intellectual property is unique from other forms of property in some respects, such as the "ease of misappropriation";<sup>47</sup> however, the agencies believe that the flexibility of antitrust analysis can account for these nuances without requiring a new or unique strain

<sup>42</sup> *Guidelines*, *supra* note 4, § 4.

<sup>43</sup> *Guidelines*, *supra* note 4, § 3.2.3.

<sup>44</sup> *Guidelines*, *supra* note 4, § 2.0; ABA Section Offers Program on Antitrust and Innovation, 68 Antitrust & Trade Reg. Rep. (BNA) No. 1708, at 477 (April 13, 1995) (noting that Richard J. Gilbert, Deputy Assistant Attorney General, affirmed these three core principles at ABA conference on Antitrust Law and Innovation Industries); *Intellectual Property Guidelines Help Further Goals of Antitrust Law*, *supra* note 3, at 523 (noting Willard K. Tom, Counselor to Ms. Bingaman, confirmed these three core principles in speech at Canadian Intellectual Property Law Institute); *Bingaman Emphasizes Sound Enforcement to Reinforce Policy Favoring Innovation*, *supra* note 3, at 474 (noting Anne Bingaman, Assistant Attorney General for the Antitrust Division of the Department of Justice, confirmed these three core principles in speech at Stanford Law School).

<sup>45</sup> *Guidelines*, *supra* note 4, § 2.0.

<sup>46</sup> *Guidelines*, *supra* note 4, § 2.0.

<sup>47</sup> *Guidelines*, *supra* note 4, § 2.1.

of antitrust law restricted to intellectual property cases.<sup>48</sup>

The second principle reaffirms the judicial position espoused by Justice O'Connor in her concurring opinion to *Jefferson Parish Hospital* regarding intellectual property rights and the possession of market power.<sup>49</sup> The enforcement agencies will not presume market power solely on the basis of intellectual property protection because there often are close substitutes for the intellectual property covered by the patent, copyright, etc.<sup>50</sup> The Guidelines define market power in the antitrust context as the "ability profitably to maintain prices above, or output below, competitive levels for a significant period of time."<sup>51</sup> By considering the role of substitute goods in the consumers' purchasing calculus, the Guidelines expand the relevant product market in a way that reduces the likelihood of intellectual property rights securing monopoly power. For example, if an inventor held a patent on staplers, the agencies would not automatically presume that the inventor possessed influential monopoly power because paper clips, butterfly clips, tape, and other potential substitutes compete with staplers for shares of the paper-fastening market.<sup>52</sup> Additionally, and again to the liking of advocates for intellectual property, the Guidelines state that even where there is no close substitute for the protected property, market power is not offensive to antitrust laws if it is a result of a "superior product, business acumen, or a historic accident."<sup>53</sup> By openly accepting lawfully acquired monopoly power, the Guidelines create ample room for antitrust and intellectual property rights to coexist.

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<sup>48</sup> *Guidelines*, *supra* note 4, § 2.1.

<sup>49</sup> See *supra* notes 36 and 37 and accompanying text.

<sup>50</sup> *Guidelines*, *supra* note 4, § 2.2.

<sup>51</sup> *Guidelines*, *supra* note 4, § 2.2.

<sup>52</sup> This position is consistent with the current legal procedure for determining market power in the absence of intellectual property protection. See *Brown Shoe Co. v. United States*, 370 U.S. 294, 326 (1962) (attempting to define market for everyday footwear); *Tasty Baking Co. v. Ralston Purina, Inc.*, 653 F. Supp. 1250, 1257-58 (E.D. Penn. 1987) (attempting to identify market substitutes for snack cakes and pies).

<sup>53</sup> *Guidelines*, *supra* note 4, § 2.2. This position is also consistent with judicial analysis when intellectual property protection is not involved. See *United States v. Aluminum Co. of Am.*, 148 F.2d 416, 429-30, 65 U.S.P.Q. (BNA) 6 (2d Cir. 1945) (holding that Alcoa had abused its monopoly power, lawfully acquired by patent, in virgin aluminum market, but also noting that mere possession of monopoly power as result of accident or "superior skill, foresight, or industry" does not amount to unlawful monopolization).

Finally, the third core principle states that the FTC and DOJ recognize the procompetitive benefits of some licensing agreements.<sup>54</sup> This recognition will restrain the agencies from challenging licensing agreements that display such attributes.<sup>55</sup> More specifically, licensing agreements often work to combine the factors of production (such as design, manufacturing, distribution and marketing) in a manner that promotes consumer welfare.<sup>56</sup> By allowing creators of intellectual property to integrate their work product with the commercial resources of business entities, the agencies enable the procompetitive benefits of such licensing agreements to rebuff any antitrust involvement. Additionally, intellectual property licensing agreements provide the licensee with the incentive to invest in the license and to develop distribution and commercialization plans without worrying about free riding from competitors.<sup>57</sup> The Guidelines recognize that if inventors lacked the assurance that intellectual property rights would protect their investments of time and ingenuity, intellectual property innovations created through the efficient assimilation with the factors of production might never reach the consumer marketplace at all and, therefore, would not be publicly available.<sup>58</sup> This promotion of innovation, of course, is the primary purpose behind intellectual property protection in the first place.<sup>59</sup>

These core principles demonstrate the receptiveness of the FTC and the DOJ to the purposes of intellectual property protection, yet they also communicate the agencies' refusal to retreat from effective antitrust enforcement. In essence, the core principles strike a balance between the historically divergent areas of antitrust enforcement in intellectual property. With the core principles in place, the Guidelines move into more specific details. As noted earlier, the details that this paper will focus on include the level of scrutiny that intellectual property licensing arrangements will receive, the licensing "safety zone," and antitrust patrol of innovation markets.

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<sup>54</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>55</sup> See *supra* note 46 and accompanying text.

<sup>56</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>57</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>58</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>59</sup> See *supra* notes 10-12 and accompanying text.

## B. UNIQUE ASPECTS OF THE GUIDELINES

First, the Guidelines specifically address the level of scrutiny which the FTC and DOJ will apply to intellectual property licensing agreements when analyzing them for antitrust violations.<sup>60</sup> Antitrust analysis applies either a “per se” test or a “rule of reason” test for finding violations depending on the type of conduct under consideration.<sup>61</sup> In order to succeed in prosecuting conduct under a per se test, the enforcement agencies need only prove that the conduct occurred.<sup>62</sup> Under this test, the courts presume that the offensive conduct undermines the maintenance of a competitive market.

Alternatively, under a rule of reason test, the courts consider the degree of harm that will result to the market if the conduct is allowed to stand.<sup>63</sup> In essence, the courts entertain not only arguments over whether the conduct in fact occurred but also arguments concerning the economic ramifications of the conduct. The Guidelines state that intellectual property licensing agreements will receive rule of reason analysis unless the agreement has “no efficiency-enhancing integration of economic activity.”<sup>64</sup> By

<sup>60</sup> *Guidelines*, *supra* note 4, § 3.4.

<sup>61</sup> 54 AM. JUR. 2D *Monopolies, Restraints of Trade, and Unfair Trade Practices* § 31-32 (1971); *Guidelines*, *supra* note 4, § 3.4. (offering price fixing, output restraints, resale price maintenance and horizontal market division as examples of per se antitrust violations).

<sup>62</sup> *United States v. Trenton Potteries*, 273 U.S. 392 (1927) (holding that naked price fixing of sanitary pottery was per se illegal; reasonableness of fixed prices is no defense); *United States v. Socony Vacuum Oil*, 310 U.S. 150 (1940) (determining that fixing prices of spot market oil was per se illegal; court in fact said that mere attempt to fix prices is per se unlawful, even if attempt is unsuccessful); *see also Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979) (holding that possessing monopoly power is not per se illegal; rather, prosecution must prove monopoly power exists and either unlawful acquisition of monopoly power or unlawful wielding of lawfully acquired monopoly power so as to restrain trade), *cert. denied*, 444 U.S. 1093 (1980).

<sup>63</sup> *See Berkey Photo*, 603 F.2d 263 (applying rule of reason to allow Kodak to change its film in manner that inhibited competitors in photo finishing market, and holding that Kodak had right to benefit from its technological innovations); *Federal Trade Comm'n v. Indiana Fed'n of Dentists*, 476 U.S. 447, 458 (1986) (considering refusal of federation of dentists to cooperate with insurers under rule of reason analysis); *NCAA v. Board of Regents of the Univ. of Okla.*, 468 U.S. 85 (1984) (applying rule of reason analysis to arrangement for TV rights between NCAA and two TV networks); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 23-24, 201 U.S.P.Q. (BNA) 497 (1994) (addressing establishment of licensing fees for music by composers and publishing houses).

<sup>64</sup> *Guidelines*, *supra* note 4, § 3.4.

requiring the absence of *any* efficiency-enhancing effects (presumably a situation occurring only in per se antitrust violations such as price fixing, output restraints, horizontal market division or resale price maintenance<sup>65</sup>) and thereby proclaiming that rule of reason analysis will be the de facto standard, the agencies commit themselves to taking the market and the procompetitive benefits of the license into account before proceeding with an antitrust challenge. This, of course, assures both licensors and licensees of intellectual property that any agreement that is not "unreasonably restrictive of competitive conditions"<sup>66</sup> is safe from antitrust challenges. Obviously, the rule of reason analysis is more lenient than a per se approach. When evaluating activity under the rule of reason, courts typically consider factors such as the economic effect of the activity on the marketplace,<sup>67</sup> the structure of the industry market,<sup>68</sup> the market share or position of the defendant parties,<sup>69</sup> and the purpose of the alleged restraint.<sup>70</sup> Thus the Guidelines themselves ensure that intellectual property licensees and licensors can arm themselves with economic information as a means of warding off potential antitrust challenges.

In order for those party to an intellectual property licensing agreement to benefit from the shelter of rule of reason analysis, they should structure the agreement so as to present the procompetitive attributes the agencies view favorably. For example, the parties can license the intellectual property in a manner that integrates factors of production;<sup>71</sup> creators of intellectual property can license primarily to manufacturers or distributors. This type of arrangement, termed a vertical arrangement,<sup>72</sup> generally promotes consumer welfare and increases efficiency by integrating

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<sup>65</sup> *Guidelines*, *supra* note 4, § 3.4.

<sup>66</sup> *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1, 65 (1911) (White, C.J., introducing rule of reason analysis to antitrust).

<sup>67</sup> WILLIAM C. HOLMES, *INTELLECTUAL PROPERTY AND ANTITRUST LAW* § 5.05 (1992).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Justice Department, FTC Adopt Intellectual Property Guidelines*, *supra* note 40, at 2655.

<sup>72</sup> A vertical relationship exists when the parties play successive roles in the chronology of marketing products or services; for example, wholesalers and retailers or retailers and final consumers. See William S. Comaner, *Vertical Arrangements and Antitrust Analysis*, 62 N.Y.U. L. REV. 1153 (1987); *Guidelines*, *supra* note 10, § 3.3.

successive factors of production.<sup>73</sup> Licensees and licensors can word their contracts so as to promote a procompetitive "purpose" or to display procompetitive intent. Creators of intellectual property can license to mass producers with small market shares, and potential producers of intellectual property products can focus their license purchases on parcels of intellectual property where the manufacturing market has low barriers to entry and exit. Finally, parties to license agreements can concertedly collect economic information about their arrangement so as to advocate the procompetitive effects of their licenses in a court of law. Each of these courses of action increases the likelihood of prevailing in an antitrust challenge against an intellectual property license where the rule of reason provides the applicable analysis.

After addressing the degree of scrutiny that intellectual property arguments will receive, the Guidelines then discuss the first of the two new concepts that will pervade the antitrust/intellectual property relationship, the "safety zone."<sup>74</sup> Regarding the safety zone, the Guidelines state that neither the FTC nor the DOJ will challenge a licensing agreement if, "1) the restraint is not facially anticompetitive and 2) the licensor and its licensee collectively account for no more than twenty percent of each relevant market significantly affected by the restraint."<sup>75</sup> The safety zone effectively establishes a presumption that, barring facial anticompetitiveness, agreements between parties controlling less than 20% of each affected market are not anticompetitive.<sup>76</sup>

One key to understanding the safety zone is grappling with the term "facially anticompetitive." The Guidelines plainly state that this term includes all commercial activities deemed per se violations of antitrust laws.<sup>77</sup> (As noted earlier, per se violations include price fixing, horizontal market division between competitors, output restraints, and resale price maintenance). In addition, "facially anticompetitive" includes other restraints that "always or almost always tend to reduce output or increase prices"<sup>78</sup> even if

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<sup>73</sup> *Guidelines, supra* note 4, § 3.3.

<sup>74</sup> *Guidelines, supra* note 4, § 4.3.

<sup>75</sup> *Guidelines, supra* note 4, § 4.3.

<sup>76</sup> *Guidelines, supra* note 4, § 4.3.

<sup>77</sup> *Guidelines, supra* note 4, § 4.3 n.30.

<sup>78</sup> *Guidelines, supra* note 4, § 4.3 n.30.



not deemed *per se* unlawful. Though the Guidelines provide no examples of such conduct, they do refer the reader back to section 3.4, where the text states that *per se* analysis will apply to licensing only when an agreement fails to provide any “efficiency-enhancing” economic results. This supplemental language to the definition of “facially anticompetitive,” though ambiguous, should not be cause for concern. Reading the language in conjunction with the reference to section 3.4 suggests that the agencies were merely trying to capture unforeseen or unfamiliar arrangements that have yet to acquire a *per se* label from the courts. Two things are certain: first, the requisite standard of proof, “always or almost always tend to reduce output or increase prices,” is an extremely high burden for the agencies to meet; and second, the FTC and DOJ do not use this ambiguous language to back away from their section 3.4 proclamation that rule of reason analysis acts as the *de facto* standard for reviewing intellectual property licenses.

The purpose of the safety zone is to encourage licensing arrangements that the agencies perceive as procompetitive, primarily licensing agreements between smaller market players, because such arrangements promote innovation.<sup>79</sup> The safety zone “seeks to address widespread concern that small businesses and innovators are hampered by antitrust uncertainty.”<sup>80</sup> The agencies’ concern is that small businesses fear a looming antitrust suit following their innovation and subsequent licensing and that this fear stifles their incentive to innovate.<sup>81</sup> The safety zone removes the threat of antitrust challenges from the shoulders, and the budget sheets, of smaller market participants.<sup>82</sup> The agencies recognize innovation as being in the consumers’ best interest; therefore, the safety zone is consistent with the goals of antitrust law.

How the safety zone affects larger firms is less clear. The Guidelines are careful to explicitly state that licensing agreements outside of the safety zone are not, automatically, anticompetitive or

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<sup>79</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>80</sup> *Justice Department Seeks Comments on Draft Intellectual Property Guides*, *supra* note 11, at 182 (Aug. 11, 1994).

<sup>81</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>82</sup> Yurko, *supra* note 22.

in violation of the antitrust laws.<sup>83</sup> Though large market shares will always attract increased antitrust surveillance, under the Guidelines even large market participants will not face antitrust challenges if they can show their licensing agreements are procompetitive.<sup>84</sup> As a result of their size, however, showing procompetitiveness, or an absence of anticompetitive effects, will be more difficult for firms possessing major market shares. While the Guidelines state that “the great majority of licenses falling outside the safety zone are lawful and procompetitive,”<sup>85</sup> large firms will always receive heightened antitrust scrutiny. Nonetheless, the safety zone establishes some concrete parameters within which firms can license intellectual property with a degree of certainty that the antitrust agencies will not interfere.

The second creative concept introduced by the Guidelines, and the final detail of the Guidelines which this paper will discuss, is the notion of the “innovation market.”<sup>86</sup> The Guidelines discuss this newly conceived market class in comparison to two other markets more common to the antitrust lexicon—the goods market and the technology market. As defined by the Guidelines, a goods market, in the context of intellectual property, consists of the products produced by utilizing the intellectual property or other inputs used in combination with the intellectual property to create the final product.<sup>87</sup> The technology market consists of the licensed intellectual property itself and any substitutes.<sup>88</sup> This market categorization separates the market for intellectual property rights from the market for the goods in which the intellectual property is used. Finally, the Guidelines define an innovation market as a market for research and development on goods or processes not yet in existence.<sup>89</sup> In essence, it is in the innovation market where intellectual property rights are developed, which are then sold in the technology market, which are then used to produce goods to sell

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<sup>83</sup> *Guidelines*, *supra* note 4, § 4.3; *Justice Department, FTC Adopt Intellectual Property Guidelines*, *supra* note 40, at 2655.

<sup>84</sup> *Yurko*, *supra* note 22.

<sup>85</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>86</sup> *Guidelines*, *supra* note 4, § 3.2.3.

<sup>87</sup> *Guidelines*, *supra* note 4, § 3.2.1.

<sup>88</sup> *Guidelines*, *supra* note 4, § 3.2.2.

<sup>89</sup> *Guidelines*, *supra* note 4, § 3.2.3.

in the product market.

The novelty of the innovation market is that it is an area previously unwatched by antitrust enforcement. By defining this market class, the agencies are recognizing how intellectual property licensing agreements may affect whether intellectual property is developed at all.<sup>90</sup> The FTC and DOJ will now begin to examine the competitive effects of licensing agreements in innovation markets and will pursue antitrust prosecution if a licensing agreement impedes research and development in a particular area or concentrates research and development in the hands of a few business entities.<sup>91</sup>

### C. THE LEGAL EFFECT OF THE GUIDELINES

To understand the ramifications of the Guidelines, it is vital to note that the Guidelines carry no legally binding power. For rules promulgated by the FTC or DOJ to assert the legal force of statutory law, they must be passed in accordance with the Administrative Procedure Act (hereinafter "APA") which congressionally grants to executive agencies the authority to create legally enforceable administrative rules.<sup>92</sup> The agencies did not draft the Guidelines after the requisite notice and comment periods as required by the APA to create "legislative rules"; thus a primer in administrative law would classify the Guidelines as purely a "policy statement" of the agencies.<sup>93</sup> Policy statements do not bind the courts, the public, or even the agency itself.<sup>94</sup> Because the Guidelines are not legislative rules, the administrative principle from *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, whereby the courts defer to an agency's interpretation of its own enabling statute so long as such construction is rational,<sup>95</sup> does

<sup>90</sup> Yurko, *supra* note 22.

<sup>91</sup> Yurko, *supra* note 22; *ABA Section Offers Program on Antitrust and Innovation*, *supra* note 44, at 477.

<sup>92</sup> 1 KENNETH CULP DAVIS & RICHARD J. PIERCE, JR., *ADMINISTRATIVE LAW TREATISE* § 6.3 (1994).

<sup>93</sup> *Id.* § 6.2.

<sup>94</sup> *Id.*

<sup>95</sup> *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

not apply.<sup>96</sup> In the end, the courts can dismiss the Guidelines when adjudicating antitrust cases; private plaintiffs can reject the Guidelines when deciding whether to initiate suit; and the FTC and DOJ can ignore the Guidelines when considering the initiation of an antitrust prosecution.

Despite the nonbinding nature of the Guidelines, however, they still will have a real effect on antitrust enforcement. Prior sets of antitrust guidelines best display the impact these Guidelines likely will have on antitrust law. First and foremost, earlier antitrust guidelines, such as the 1968, 1982, and 1992 Merger Guidelines, have had the practical effect of channeling the analysis of agency employees and limiting employee discretion, notwithstanding their nonbinding force.<sup>97</sup> In essence, such guidelines establish agency procedures which gain an intra-agency inertia. Furthermore, the courts have viewed the aforementioned Merger Guidelines as an informal source of influence on antitrust jurisprudence.<sup>98</sup> One can expect the courts to treat these current Guidelines similarly. And finally, the Guidelines serve an informative function.<sup>99</sup> Market-place actors will rely on these Guidelines as an accurate statement of agency policy and will incorporate their principles into their commercial activity. Each of these insights suggests that the nonbinding nature of the Guidelines will only mildly limit, but will not erase, the impact of the Guidelines on antitrust law.

## V. PRACTICAL RAMIFICATIONS

Only after applying the FTC and DOJ Guidelines for several years will businesses be able to accurately pinpoint their genuine effect. Yet, their effects will be real. This section will consider how the Guidelines: 1) touch some selected, practical business arrangements between licensors and licensees, 2) shift the big picture

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<sup>96</sup> DAVIS & PIERCE, *supra* note 92, §§ 6.2-6.3.

<sup>97</sup> Phillip Areeda, *Justice's Merger Guidelines: The General Theory*, 71 CAL. L. REV. 303, 306-07 (1983); Marc W. Joseph & Timothy W. Mountz, *The Justice Department Merger Guidelines: Impact on Horizontal Mergers Between Commercial Banks*, 72 KY. L.J. 505, 540-41 (1983-1984).

<sup>98</sup> Areeda, *supra* note 97, at 306-07; James B. Dean, *Agricultural Cooperatives: An Update*, 73 NEB. L. REV. 228, 235 (1994).

<sup>99</sup> *Supra* note 92, § 17.3 (1994).

economic policy perspectives for the FTC and DOJ regarding intellectual property in the marketplace, and 3) signal to businesses what types of arrangements are offensive to antitrust laws.

#### A. EFFECTS ON BUSINESS ARRANGEMENTS

The greatest attribute of the Guidelines is that they give a green light to many licensing agreements which are genuinely procompetitive but which businesses previously feared might compel antitrust intrusion.<sup>100</sup> This section will categorically consider three types of business arrangements where intellectual property protection and antitrust law potentially clash: tying arrangements, exclusive dealing, and cross-licensing.

In a tying arrangement, one party agrees to sell its product, the tying product, only upon the condition that the purchaser also buy a second product, the tied product.<sup>101</sup> Tying arrangements traditionally have drawn antitrust concern when the tied product is protected by intellectual property rights, because this creates the appearance that the seller is using its monopoly power over the tying product to either carve out monopoly power in the currently competitive market for the tied product or to coerce sales of another protected, but unpopular, parcel of intellectual property.<sup>102</sup> Based on this construction, proving an unlawful tying arrangement requires a showing of market power in the tying product's market,<sup>103</sup> and older case law created a virtually irrebuttable presumption of market power if the tying product being sold or

<sup>100</sup> *Guidelines*, *supra* note 4, § 4.2.

<sup>101</sup> *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958).

<sup>102</sup> See *Hanna*, *supra* note 3, at 411; *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942) (considering use of patented salt depositing machines to restrain competition in market for unpatented salt tablets); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948) (holding "block booking" to be violative of antitrust laws as tying arrangement where licensor licenses one film on condition that exhibitor will also buy license for another or several other films); *International Salt Co. v. United States*, 332 U.S. 392 (1947) (tying leases for patented industrial salt machines to purchases of unpatented industrial grade salt was violation of antitrust laws because defendant corporation used patent on machine to garner market power in salt market).

<sup>103</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 18 (1984) (addressing alleged tying of anesthesiological services to general hospital services); *United States v. Loew's, Inc.*, 371 U.S. 38, 45 (1962).

licensed was protected by intellectual property rights.<sup>104</sup> Scholars have criticized this presumption of market power, typically because intellectual property protection grants only a monopoly over the specific product; such protection neither prohibits competing or substitute products, nor does it create consumer demand for the protected property.<sup>105</sup>

The Guidelines retreat from the historic common law position and specifically embrace the scholars' arguments, stating that there is no presumption of market power resulting solely from the intellectual property protection.<sup>106</sup> The Guidelines note that substitutes for products protected by intellectual property rights often prevent the exercise of true monopolistic power in a relevant market, that is, the market that the agencies and the courts consider when analyzing a company's behavior under the antitrust laws.<sup>107</sup> Considering the substitutes to intellectual property squares with more recent case law where courts have, although with some trepidation, allowed evidence of market conditions to enter the judicial consideration of tying arrangements.<sup>108</sup> Now that substitute products and market conditions enter the judicial calculus for evaluating tying arrangements, the Guidelines identify the proper inquiries for the FTC and DOJ to be: 1) whether the seller has market power in the tying product market;<sup>109</sup> 2) whether the arrangement hurts competition in tied product market;<sup>110</sup> and 3) whether the procompetitive benefits outweigh the anticompetitive effects resulting from the tying agreement.<sup>111</sup>

<sup>104</sup> *Loew's*, 371 U.S. at 45-46.

<sup>105</sup> Hanna, *supra* note 3, at 432; William Montgomery, Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements*, 85 COLUM. L. REV. 1140, 1149-51 (1985).

<sup>106</sup> *Guidelines*, *supra* note 4, §§ 2.2, 5.3.

<sup>107</sup> *Guidelines*, *supra* note 4, § 2.2.

<sup>108</sup> *In re Data Gen. Corp. Antitrust Litig.*, 490 F. Supp. 1089, 1112-13 (N.D. Cal. 1980) (stating that presumption of economic power resulting from patent or copyright is not conclusive; instead, market conditions, such as competitors' ability to develop functionally equivalent products, are relevant); *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673, 676 (6th Cir. 1986) (noting "accordingly, we reject any absolute presumption of market power for copyright or patented product"); *3 P.M., Inc. v. Basic Four Corp.*, 591 F. Supp. 1350 (E.D. Mich. 1984).

<sup>109</sup> *Guidelines*, *supra* note 4, § 5.3

<sup>110</sup> *Guidelines*, *supra* note 4, § 5.3.

<sup>111</sup> *Guidelines*, *supra* note 4, § 5.3.

Tying arrangements stand the best chance to avoid antitrust challenges when they exist between parties in a vertical relationship or a relationship where the parties produce complementary products, such as computer software and hardware, as opposed to a relationship where the parties produce competing products.<sup>112</sup> In fact, the Guidelines are designed to promote this type of integration of factors of production by suggesting to businesses that these types of arrangements will not be challenged.<sup>113</sup> The Guidelines recognize that tying between parties in a vertical relationship often does not inhibit competition that would ordinarily occur, and instead is generally procompetitive.<sup>114</sup> As firms are relieved of the threat of antitrust intrusion, they consequently are more free to innovate.

Exclusive dealing arrangements are a second commercial relationship addressed by the Guidelines. Such arrangements exist when a licensor conditions the license of intellectual property on the licensee's agreement not to create, use, distribute, etc., competing products.<sup>115</sup> The Courts have routinely applied the rule of reason analysis when faced with antitrust challenges to exclusive dealing arrangements.<sup>116</sup> Such no-compete clauses plainly foreclose new entry of licensees as competitors in the licensor's market. Yet, with this term in the licensing agreement, the licensor will have to compensate the licensee for the restriction by reducing the price of the license.<sup>117</sup> This creates a cost savings that the licensor can then pass on to the consumers. Reductions in

<sup>112</sup> *Guidelines*, *supra* note 4, § 3.3. This does not mean that the agencies are certain to challenge horizontal restraints.

<sup>113</sup> *Guidelines*, *supra* note 4, § 2.3.

<sup>114</sup> *Guidelines*, *supra* note 4, § 3.3.

<sup>115</sup> See *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961) (discussing where electric utility contracted to purchase all its coal needs for 20 years from one coal producer); WILLIAM C. HOLMES, *INTELLECTUAL PROPERTY AND ANTITRUST LAW* § 8.03 (1992) (discussing exclusive dealing contracts); Scott A. Miskimon, *Intellectual Property: Divorcing Public Policy From Economic Reality: The Fourth Circuit's Copyright Misuse Doctrine in Lasercomb America, Inc. v. Reynolds*, 69 N.C. L. REV. 1672, 1694 (1991) (discussing compensation for restrictive clauses in licensing contracts).

<sup>116</sup> *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 236 (1st Cir. 1983) (addressing contract where user of mechanical snubbers agreed to purchase three year needs from single snubber producer).

<sup>117</sup> *Miskimon*, *supra* note 115, at 1694; *USM Corp. v. SPS Technologies, Inc.*, 694 F.2d 505, 510-11, 216 U.S.P.Q. (BNA) 959 (7th Cir. 1982), *cert. denied*, 462 U.S. 1107.

costs to consumers are exactly the type of proconsumer benefit that the agencies, under the Guidelines, will consider in determining whether to challenge the license as a violation of antitrust laws.<sup>118</sup>

Recognizing such procompetitive effects of exclusive dealing, the Guidelines immediately reaffirm the traditional application of rule of reason analysis to these arrangements, and then establish a two part test for rule of reason evaluation. First, the FTC and DOJ will inquire into any anticompetitive effects of the arrangement, taking into account the overall effect that the contract has on the relevant market, the duration of the agreement, and market structure factors such as barriers to firm entry to or exit from the market and the number of market participants.<sup>119</sup> Second, even upon a finding of anticompetitive effects from the exclusive relationship, the Guidelines state that the agencies will consider countervailing procompetitive ramifications of the arrangement such as promoting the exploitation of the licensed technology, encouraging other innovators to develop new technology or applications for existing technology, or otherwise increasing competition in the licensed product's market.<sup>120</sup> In sum, the agencies are signaling an unwillingness to strike too quickly at exclusive dealing arrangements by asserting antitrust violations.

Finally, the Guidelines address cross-licensing arrangements or "pooling" between creators of intellectual property. The agencies commit to applying rule of reason analysis to some of these relationships and to giving due weight to the procompetitive effects of these arrangements.<sup>121</sup> Under such agreements creators of intellectual property license their product to one another or third parties, thus the term "pooling," in an effort to jointly exploit the property.<sup>122</sup> There are three primary antitrust concerns about

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<sup>118</sup> *Guidelines*, *supra* note 4, § 2.3. This is not to say that no-compete terms in licenses are always acceptable, see *Lasercomb Am., Inc. v. Reynolds*, 911 F.2d 970 (4th Cir. 1990) (discussing anticompetition clauses as misuse of copyright), but the procompetitive effects now enter the judicial analysis.

<sup>119</sup> *Guidelines*, *supra* note 4, § 5.4.

<sup>120</sup> *Guidelines*, *supra* note 4, § 5.4.

<sup>121</sup> *Guidelines*, *supra* note 4, § 5.5.

<sup>122</sup> *Guidelines*, *supra* note 4, § 5.5. HOLMES, *supra* note 115, § 14.01.



pooling and cross licensing.<sup>123</sup> first, that these arrangements may collectivize the market for intellectual property and enable firms to price fix, restrain output, or horizontally divide the market;<sup>124</sup> second, that firms may predatorially use pooling and cross-licensing to eliminate competitors;<sup>125</sup> and third, that dominant firms in an industry will cross-license or pool so as to reinforce their market dominance and to exclude smaller competitors from effectively competing.<sup>126</sup> When firms utilize pooling or cross-licensing to accomplish a per se antitrust violation (the first concern above), courts have applied a per se test prohibiting such conduct. When a per se test or a rule of reason test applies to the second and third problematic uses from above is less clear, but the courts have allowed at least some pooling arrangements under a rule of reason analysis.<sup>127</sup>

The Guidelines both reaffirm the per se rule for pooling/cross-licensing when used to commit per se antitrust violations<sup>128</sup> and also highlight some analytical factors that will assist application of the rule of reason test to pooling and cross-licensing. The Guidelines note that pooling allows the integration of technologies, the reduction of transaction costs, the harnessing of economies of scale, and the avoidance of intellectual property infringement litigation.<sup>129</sup>

Alternatively, the Guidelines label as anticompetitive pooling that occurs where the pool participants have market power in the relevant market such that the excluded firms, by virtue of the

<sup>123</sup> HOLMES, *supra* note 115, § 14.01.

<sup>124</sup> National Collegiate Athletic Ass'n v. Board of Regents of the Univ. of Okla., 468 U.S. 85, 99-100, 114 (1984) (holding arrangement for TV rights between NCAA and two TV networks violated Sherman Act because it enabled parties to fix prices paid to schools and to restrict number of broadcasts); *see also*, United States v. New Wrinkle Inc., 342 U.S. 371, 380, 92 U.S.P.Q. (BNA) 158 (1952) (holding that companies owning competing patents in enamel finish violated Sherman Act by pooling their patents in order to fix prices).

<sup>125</sup> United States v. Singer Mfg. Co., 374 U.S. 174, 175 (1963) (addressing pooling of patents by sewing machine manufacturers in effort to drive out Japanese competition).

<sup>126</sup> United States v. Besser Mfg. Co., 96 F. Supp. 304, 311, 88 U.S.P.Q. (BNA) 421 (E.D. Mich. 1951), *aff'd*, 343 U.S. 444 (1952) (holding as violation of antitrust laws license of patent on concrete block machine granted to industry's two dominant firms and requiring their mutual consent before any small companies could license to patent).

<sup>127</sup> Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1, 23-24 (1979).

<sup>128</sup> Guidelines, *supra* note 4, § 5.5.

<sup>129</sup> Guidelines, *supra* note 4, § 5.5.

exclusion, cannot effectively compete in the marketplace.<sup>130</sup> Furthermore, the Guidelines note that pooling resources in an innovation market creates an incentive for individual firms to free ride on the efforts of their pool partners.<sup>131</sup> In sum, the Guidelines's commentary on pooling and cross-licensing does not eliminate the unclear intricacies of this complicated area of antitrust law, but it does voice government recognition of the numerous procompetitive effects of pooling and commit the FTC and DOJ to account for these efficiency-enhancing effects prior to challenging a pooling or cross-licensing arrangement.

## B. CHANGES IN ECONOMIC POLICY PERSPECTIVES

The Guidelines encourage the agencies and invite the courts to consider a diverse scope of economic factors when reviewing intellectual property licensing. As with most products, consumers of intellectual property make purchasing decisions based on numerous factors, price being only one of them.<sup>132</sup> Intellectual property products, such as computer software, are not fungible and do not compete primarily on price, but rather on product performance, creative content, and functionality.<sup>133</sup> Because computer software and other high tech innovations may have very limited substitutes in the antitrust sense,<sup>134</sup> strict price competition analysis may be inappropriate because the functionality of intellectual property frequently dominates the exclusivity of the property right.<sup>135</sup> The agencies' willingness to weigh a variety of economic factors appropriately reflects the practical realities of the consumer market for intellectual property.

As a more concrete policy goal, the Guidelines attempt to develop an antitrust sensitivity to the importance of innovation in the American economy, a sensitivity that advocates of intellectual property rights have claimed is absent from historical antitrust

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<sup>130</sup> *Guidelines*, *supra* note 4, § 5.5.

<sup>131</sup> *Guidelines*, *supra* note 4, § 5.5.

<sup>132</sup> Hanna, *supra* note 3, at 431.

<sup>133</sup> Hanna, *supra* note 3, at 424.

<sup>134</sup> Hanna, *supra* note 3, at 415-16.

<sup>135</sup> Hanna, *supra* note 3, at 415-16.

enforcement.<sup>136</sup> This criticism of antitrust enforcement typically rests on a belief that the goals of antitrust law and of intellectual property protection are not complementary and remain irreconcilable.<sup>137</sup> According to this argument, intellectual property protection promotes consumer welfare by providing an incentive to invest and innovate, namely the profits from an exclusive property right, while antitrust law seeks to promote consumer welfare by ensuring the dispersal of market power and vigorous price competition.<sup>138</sup> By proffering the Guidelines, the antitrust agencies have attempted to bridge the gap between antitrust's and intellectual property's short-term goals by focusing on the common long-term objective of promoting consumer welfare.<sup>139</sup> Using legal monopolies over intellectual property to promote consumer welfare is consistent with the very source of intellectual property protection, the Constitutional command in Article I, Section 8, Clause 8.<sup>140</sup> For innovation to occur, investors must have assurance, at the investment stage of innovation, that they will have exclusive rights in their work product.<sup>141</sup> The threat of free riders or competitors wrongfully seizing their innovative work product and driving down its price below a level at which the innovator can recoup his investment would undoubtedly chill innovation.<sup>142</sup> Recognizing that innovation advances consumer welfare, the Guidelines display the FTC's and the DOJ's willingness to carefully consider the positive effects of intellectual property rights before applying the bite of antitrust laws.<sup>143</sup>

Accordingly, the Guidelines may refute those critics of antitrust

<sup>136</sup> Hanna, *supra* note 3, at 422; see Rochelle Cooper Dreyfuss, *Dethroning Lear: Licensee Estoppel and the Incentive to Innovate*, 72 VA. L. REV. 677, 724 (1986) (noting competing goals of intellectual property rights—incentive for innovation and public dissemination intellectual product).

<sup>137</sup> Hanna, *supra* note 3, at 420-21.

<sup>138</sup> Hanna, *supra* note 3, at 420-21 (arguing that antitrust goals are not complimentary with intellectual property goals and do not reflect reality of market for developing intellectual property).

<sup>139</sup> Guidelines, *supra* note 4, § 1.0.

<sup>140</sup> [The Congress shall have Power] "To promote the Progress of Science and the useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries" [emphasis added].

<sup>141</sup> Dreyfuss, *supra* note 136, at 679-80.

<sup>142</sup> Dreyfuss, *supra* note 136, at 679-80.

<sup>143</sup> Guidelines, *supra* note 4, § 4.2.

involvement in intellectual property markets who state that antitrust should "consider the long-term dynamic effects of these practices [patent protection] on firms' incentives and abilities to innovate, rather than focus solely on their short term price effects."<sup>144</sup> The Guidelines attempt to make just this sort of adjustment to traditional antitrust analysis. There should be little doubt that patent protection enhances market efficiency and consumer welfare. The incentive of short term supracompetitive profits compels firms to take the risk of investing in research and development of new products, processes, etc.<sup>145</sup> The monopoly profit incentive drives innovation.<sup>146</sup> These supracompetitive profits, however, disappear in the long run as competitors reverse engineer the invention and create substitute products,<sup>147</sup> thereby driving the price to the competitive level.

The Guidelines hope to stifle the debate over what type of market structure is best suited for efficient intellectual property development by focusing on the procompetitive or anticompetitive ramifications of intellectual property licensing agreements rather than strictly looking at market structure.<sup>148</sup> Some commentators have argued that the development of intellectual property, at least the high tech sort, is dominated by economies of scale making an oligarchic market preferable, and more common, than a purely competitive market with numerous buyers and sellers.<sup>149</sup> According to this argument, traditional antitrust analysis is therefore not appropriate for some intellectual property markets because the free

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<sup>144</sup> Hanna, *supra* note 3, at 422.

<sup>145</sup> See Hanna, *supra* note 3, at 422 ("The prospect of these temporary monopoly gains drives competition among market participants to be the first to innovate.").

<sup>146</sup> Dreyfuss, *supra* note 136, at 698-99. Often a first producer of an innovative product can garner supracompetitive profits even without intellectual property protection. The first producer has the benefit of secrecy (other firms often cannot replicate the innovation until it is marketed), the advantage of difficult reverse engineering, a marketing advantage (consumers often prefer to purchase from the first producer, believing duplicates are cheap knockoffs) and the advantage of hesitant competitors who wait to see how the product sells before investing in a competing product.

<sup>147</sup> Hanna, *supra* note 3, at 422; see Dreyfuss, *supra* note 136, at 677 (citing 1980's Presidential Commission on Industrial Competitiveness which reported that U.S. was underinvested in research and development, partially because intellectual property rights had eroded to degree that they no longer provided incentive to innovate.).

<sup>148</sup> *Guidelines*, *supra* note 4, § 4.1.1.

<sup>149</sup> Hanna, *supra* note 3, at 424-25.

market outcome will be a highly concentrated market structure consisting of only a few firms.<sup>150</sup>

Alternatively, some commentators argue that larger firms are not necessarily the most innovative. Though their resources are generally more extensive, small firms are often more suited to innovation because communication costs and bureaucracy costs are lower and there is greater flexibility to take risks.<sup>151</sup> Often small firms have the means to innovate but lack the ability to handle the production, marketing, and distribution of their work product.<sup>152</sup> Therefore, the argument goes, the spectrum of intellectual property rights must provide incentives for small firms and small investors in the business of innovation to participate in the market for invention by allowing them to structure business relationships that will afford monetary profits and will minimize the risk of losing the exclusivity of their intellectual property rights.<sup>153</sup> Small firms rely heavily on licensing their intellectual property rights in order to integrate them with the commercial resources necessary to sell their product.<sup>154</sup> Therefore, tailoring the regulatory system to assist small firms may well promote innovation.<sup>155</sup>

The beauty of the Guidelines is that they respond to both of these arguments by providing a flexible framework that embraces the full spectrum of market types. Presumably both of the forgoing arguments are correct; the creation of some intellectual property products best proceeds in markets dominated by small sized firms, while other types of intellectual property progress most quickly behind the force of major corporations. The Guidelines assure that the FTC and DOJ will consider the procompetitive benefits of licensing agreements whatever, and in fact in light of, the optimal market structure. In the context of small firms, licensing agreements serve two purposes. First, they allow small firms to profit from innovation by selling their marketing rights to businesses with the resources to commercialize the product. They also ensure that the innovation has a channel to reach the consumer. The

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<sup>150</sup> Hanna, *supra* note 3, at 424-25.

<sup>151</sup> Dreyfuss, *supra* note 136, at 726-27.

<sup>152</sup> Dreyfuss, *supra* note 136, at 729.

<sup>153</sup> Dreyfuss, *supra* note 136, at 728.

<sup>154</sup> Dreyfuss, *supra* note 136, at 680.

<sup>155</sup> Dreyfuss, *supra* note 136, at 680.

Guidelines grant firms the flexibility in licensing agreements necessary to achieve both these ends. In addition, promoting diverse participation of small business in the production of intellectual property is wholly consistent with even traditional antitrust analysis. For large firms, licensing agreements enable the product market to ride the wave of economics of scale towards more, and more efficient, innovation.

### C. PROVIDING SIGNALS TO BUSINESSES

The Guidelines not only benefit developers of intellectual property by applying a more flexible antitrust analysis, but they also identify issues that are likely to trouble the antitrust enforcement agencies. Most notably, the agencies will challenge licensing agreements that impede competition that would have occurred if not for the agreement.<sup>156</sup> As a practical matter, this precludes most licensing agreements between parties in a horizontal relationship—parties that actually or potentially compete with one another.<sup>157</sup> Licensing agreements between parties in a horizontal relationship are not anticompetitive per se, just as licensing arrangements between vertical parties are not guaranteed insulation from antitrust concern. Horizontal relationships, however, are more likely to attract antitrust inspection.<sup>158</sup> The Guidelines also preclude licensing agreements that set restrictions on purchasing

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<sup>156</sup> *Guidelines, supra* note 4, § 3.1 (noting agreements that facilitate price fixing or market division, or hinder competition in other markets by closing access to or raising price of components/inputs are likely to draw antitrust attention; this attention, however, will follow Guidelines and will only result in actual antitrust challenge if activity is facially anticompetitive or unreasonably restrains trade); see *ABA Section Offers Program on Antitrust and Innovation, supra* note 44, at 477-78 (quoting Deputy Assistant Attorney General Richard J. Gilbert as he commented that agreements between noncompetitors are less likely to be challenged “even if an alternate licensing arrangement could have created more competition”).

<sup>157</sup> When parties are in a horizontal relationship, they produce economic substitutes; they are actual or potential competitors. When parties are in a vertical relationship, they complement each other by combining factors of production. See *Guidelines, supra* note 4, § 3.1; Yurko, *supra* note 22 (stating that licensing agreements between actual or potential competitors are not per se unlawful, but that they will draw traditional antitrust attention).

<sup>158</sup> *Guidelines, supra* note 4, §§ 3.3, 5.5 (noting that even horizontal licensing agreements may have procompetitive benefits resulting from economies of scale in research and development, production, and marketing).

or using goods other than the licensed technology, as well as agreements that penalize one party for dealing with producers of substitute technology.<sup>159</sup> Such restrictive terms facially inhibit competition that would have occurred were it not for the agreement. Antitrust enforcement agencies will take issue with such impediments to competition occurring in a goods market, a technology market, or a newly recognized innovation market.<sup>160</sup>

Furthermore, the Guidelines offer some additional instruction on the application of the safety zone's "less than 20% of the relevant market" standard.<sup>161</sup> In technology markets, if economic data for determining market share is unavailable, entities nonetheless will get the benefit of the safety zone if certain conditions exist. First, there must be at least four other competing technologies in addition to the licensed technology.<sup>162</sup> In addition, these technologies must be both functionally similar to the licensed technology and offered at a comparable cost.<sup>163</sup> In innovation markets, entities will get the benefit of the safety zone if four or more independent parties possess the ability and incentive to engage in research and development that closely tracks the research and development of the licensing parties.<sup>164</sup> Finally, although license agreements outside of the safety zone are not necessarily offensive to the antitrust laws,<sup>165</sup> the very presence of a safety zone should suggest to businesses that antitrust inspection may well follow such agreements.

## VI. CONCLUSION

The Guidelines do not reform antitrust enforcement in the realm of intellectual property in a manner that effectively shields owners of intellectual property rights from the antitrust laws. Long ago, courts made clear that they would not afford antitrust immunity to

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<sup>159</sup> *Justice Department Seeks Comments on Draft Intellectual Property Guides*, *supra* note 11, at 182-83.

<sup>160</sup> *Guidelines*, *supra* note 4, § 3.2.

<sup>161</sup> See *supra* text accompanying note 75.

<sup>162</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>163</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>164</sup> *Guidelines*, *supra* note 4, § 4.3.

<sup>165</sup> *Guidelines*, *supra* note 4, § 4.3.

intellectual property rights.<sup>166</sup> This remains the case. In fact, requiring those possessing intellectual property protection to adhere to antitrust principles is consistent with at least the statutory authority for patent rights. The U.S. Patent Act states that nothing in the patent laws "shall be deemed to convey to any person immunity from civil or criminal liability, or to create any defenses to actions, under any antitrust law."<sup>167</sup>

Alternatively, the Guidelines do provide some effective tools for harmonizing antitrust enforcement and intellectual property protection. Indeed, the overriding tenor of the Guidelines should encourage intellectual property licensing. By stressing the procompetitive benefits of some intellectual property licensing agreements, the Guidelines display an overt receptiveness on the part of the DOJ and the FTC to some licensing agreements. The more detailed aspects of the Guidelines, such as the "safety zone" and the discussion of the relevance of product substitutes, not only provide concrete, reassuring examples of activities that will not suffer antitrust intrusion, but also offer helpful guidance for businesses trying to avoid or limit the risk of violating the antitrust laws. The Guidelines provide a degree of predictability to antitrust enforcement that will assist the creators of innovation and their commercial licensees.

Most importantly, the Guidelines specifically define the purpose of antitrust enforcement as the promotion of innovation and consumer welfare.<sup>168</sup> The Guidelines are not radical. Rather, they describe a middle-of-the-road, inoffensive level of antitrust enforcement over intellectual property. By synchronizing the ultimate purposes of intellectual property protection and antitrust prohibitions, the Guidelines take a positive step towards ending the tension between these two areas of law. At the very least, the mere promulgation of the Guidelines suggests that the FTC and DOJ will continue to enforce the antitrust laws in the context of intellectual property rights.

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<sup>166</sup> *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 490-91 (1942) (holding that patent, though granting exclusive right to make, use, and vend patented item, "affords no immunity for a monopoly not within the grant").

<sup>167</sup> 35 U.S.C. § 211 (1994).

<sup>168</sup> *Guidelines*, *supra* note 4, § 1.0.



