INTELLECTUAL PROPERTY AS MARKET POWER

Talha Syed[*]

The relation between intellectual property (IP) rights and antitrust has bedeviled courts and commentators for over a century. At the heart of the difficulties lie two distinct confusions, one on the IP side and the other in antitrust. Dispelling them results in overturning the prevailing wisdom in both fields, to issue in the conclusion that IP rights should, indeed, presumptively be taken to confer market power in the sense relevant to antitrust. But this does not mean that such rights should presumptively be taken to raise anticompetitive concerns. It is precisely the conflation of what are two distinct issues—namely, the role of IP rights in conferring market power, and the role of market power in raising anticompetitive concerns—that has been a key source of trouble in this area.

Disentangling them is the beginning of wisdom. Once we do so, we see that, first, IP rights must *confer supramarginal pricing power if they are to serve their incentive function within IP policy. Second, what this means within antitrust policy is that such rights should presumptively be taken to confer "market power," since supramarginal pricing power* is *the relevant antitrust notion of market power. Third, however, this is not to say that IP rights should presumptively be seen as anticompetitive. Whether the market power deriving from IP rights should be seen to raise anticompetitive concerns requires a separate analysis, of the distinct roles played by market power in antitrust scrutiny of horizontal agreements, vertical restraints, and unilateral conduct.*

Carrying out that analysis results in significant revisions to existing doctrine with large policy implications. First, it reestablishes heightened antitrust scrutiny for "leveraging" uses of IP rights in both vertical and unilateral cases. Second, it clarifies which horizontal agreements involving IP rights should be held per-se anticompetitive and which given rule-of-reason review. Third, it abolishes the common "scope of the patent" doctrine as question-begging, unworkable, and unnecessary in all cases. Finally, it removes antitrust scrutiny for the mere presence of even very strong IP rights.

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INTRODUCTION

The relation between intellectual property (IP) rights and antitrust has been fundamentally misunderstood over the past century. During the "New Deal era" of the 1930s-1970s, a common view among courts and commentators was that (a) IP rights often conferred "monopoly" power[1] and (b) as such were in "inherent tension" with the goals of antitrust.[2] Enshrined in a host of antitrust doctrines—from the analysis of tying[3] to that of horizontal agreements[4] and unilateral conduct[5]—the upshot of this view was a skepticism toward IP rights that tended to see them as presumptively anticompetitive. But after decades of scholarly and judicial attack in the "Neoliberal era" from the 1980s to today, that view was ultimately displaced by a rival conventional wisdom, which took (a) IP rights to be simply "property" rights like any others, ones typically not conferring monopoly power,[6] and (b) as such inherently compatible with the goals of antitrust, so long as the exercise of the rights did not exceed their formal "temporal or physical" scope.[7] The upshot of this view, then, tends toward seeing standard exercises of IP rights as presumptively procompetitive.

Both views are deeply mistaken. At the heart of the misunderstanding lie two different confusions, one within the field of IP and the other within antitrust. Dispelling them results in overturning the prevailing wisdom in both fields, to issue in the conclusion that IP rights *should*, indeed, presumptively be taken to confer market power in the sense relevant to antitrust. Yet this does *not* mean that such rights should presumptively be taken to raise anticompetitive concerns. It is precisely the conflation of what are two distinct issues—namely, the role of IP rights in market power, and the role of market power in raising anticompetitive concerns—that has been one key source of trouble in this area. Disentangling them is the beginning of wisdom.

Once we do so, we can see that a first basic source of confusion stems from a persistent, yet deeply misguided, debate within IP: whether IP rights are best seen as "monopoly" or "property." This debate is misguided because nothing hangs on it. Even if IP rights *never* enabled a "monopoly" in the sense of a dominant position in a market for a product, and *always* only conferred "property" rights, in the sense of exclusionary rights over a resource, the concern with IP rights would remain entirely unaffected. This because it is precisely conferral of exclusionary rights over a *nonrival resource* that raises the relevant concern.[8] If such rights are to provide an incentive to innovate, they *must* confer supramarginal pricing power.[9] Both the defenders of strong IP rights who claim that they are "property, not monopoly,"[10] and their critics who reply that they

1. *See, e.g., United States v. Loew's Inc.*, 371 U.S. 38 (1962) (holding that patents and copyright confer "monopolistic" power).

2. For a leading scholarly statement of this view, see Louis Kaplow, *The Patent-Antitrust Intersection: A Reappraisal,* 97 HARV. L. REV. 1813 (1984).

3. *International Salt Co., v. United States*, 332 U.S. 392 (1947).

4. *United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952).

5. *United States v. Loew's Inc.*, 371 U.S. 38 (1962).

6. For the leading statement of this position, see Edmund Kitch, *Patents: Monopolies or Property Rights?, in* 8 RESEARCH IN LAW AND ECONOMICS 31, 32 (John Palmer & Richard O. Zerbe, Jr. eds., 1986).

7. *See Illinois Tool Works Inc. v. Independent Ink, Inc*., 547 U.S. 28 (2006).

8. *See* Oren Bracha & Talha Syed, *Beyond the Incentive-Access Paradigm? Product Differentiation & Copyright Revisited*, 92 TEXAS L. REV. 1841, 1850-51 (2014).

9. *Id.* at 1852-53.

10. *See, e.g.,* Kenneth W. Dam, *The Economic Underpinnings of Patent Law,* 23 J. LEGAL STUD. 247, 249–50 (1994); Frank H. Easterbrook, *Intellectual Property is Still Property*, 13 HARV. J.L. & PUB. POL'Y 108, 109 (1990); Edmund Kitch, *Elementary and Persistent Errors in the Economic Analysis of Intellectual Property* 53 VAND. L. REV. 1727, 1729–38 (2000); Sven Bostyn & Nicolas Petit, Patent=Monopoly: A Legal Fiction (December 31, 2013) *available at* http://ssrn.com/abstract=2373471.

are at least "sometimes monopoly"[11] have missed this. Their debate is largely beside the point. It is precisely the conferral of *property* rights over nonrival resources that is the source of concern.

Compounding the problem has been a second confusion, now within antitrust. Since IP rights must confer supramarginal pricing power to perform their incentive role in IP policy then, for purposes of antitrust, it makes sense to adopt the presumption that such rights confer market power. Yet this has been obscured by an oscillation within antitrust between two distinct notions of "market power": the possession of supramarginal pricing power versus the realization of supernormal profits from such pricing power.[12] Yet the view that the latter is relevant here stems from a failure to distinguish between the existence of "market power" and the existence of "anticompetitive" concerns. Dispelling that confusion, we are led to adopt the one and only notion of market power relevant here—supramarginal pricing power—and thus to adopt the presumption that IP rights *do* indeed confer such power. But, again, this does *not* mean that they automatically raise anticompetitive concerns.

Whether the market power conferred by IP rights raises anticompetitive concerns requires analysis of the distinct roles of market power in antitrust scrutiny of conduct under sections 1 and 2 of the Sherman Act. Carrying out that analysis results in significant revisions to existing doctrine with major policy implications. First, it reestablishes heightened antitrust scrutiny for "leveraging" uses of IP rights, be in the context of vertical restraints such as tying or unilateral refusals to deal. Second, it abolishes the common "scope of the patent" doctrine as question-begging, unworkable, and unnecessary. Third, it suggests that the exercise of IP rights in some horizontal agreements, such as those involved in pharmaceutical reverse-payment settlements, are not only presumptively anticompetitive (as opposed to meriting "rule of reason" review, as current doctrine holds[13]), but, indeed, *per-se* anticompetitive (meaning illegal without recourse to rebuttal via case-specific procompetitive arguments). Finally, and perhaps most controversially, the analysis also holds that the mere existence of even very strong IP rights does not, by itself, raise any antitrust concerns.

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I. IP RIGHTS AND MARKET POWER: THE BASIC ANALYTICS

The present Part develops two sets of arguments, one analytic and one diagnostic, for each of the two fields of IP and antitrust. Within IP, the analytic claim is that IP rights must, if they are to perform their incentive function, confer supramarginal pricing power. The one cannot be achieved without the other. This basic analytic point has been obscured, however—and this is the

11. *See, e.g.*, James Boyle, *Cruel, Mean, or Lavish? Economic Analysis, Price Discrimination and Digital Intellectual Property*, 53 VAND. L. REV. 2007, 2018 (2000) ("The question of whether a monopoly exists is one that is determined by the availability of substitute goods, not the shape of the legal entitlement."); Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799, 1811 (2000) ("Although a copyright does not necessarily guarantee market power, many information goods lack perfectly fungible substitutes."); Fisher, *supra* note 14, at 1702–03 (stating that copyright holders' market power "vary considerably," and stating that some copyright works are "considered irreplaceable" while for others "there are readily available, nearly perfect substitutes.").

12. *See* HERBERT HOVENKAMP ET. AL, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW 4-2 ("Market power is the power to profit by charging more than marginal cost, which is the competitive price for a good or service."); 4-7 ("In general, the technically correct way to measure whether a patent, copyright or other intellectual property right produces returns above cost would be to compare all development costs with all profits generated by the right during its reasonably anticipated marketable lifetime.")

13. *FTC v. Actavis, Inc.,* 570 U.S. 136 (2013).

diagnostic claim—by a confused yet persistent debate in IP (bleeding into antitrust): regarding whether IP rights are best seen as "monopoly or property." This debate is misguided because nothing hangs on it: even if IP rights *never* enabled a "monopoly" in the sense of a dominant position in a market for a product, and *always* simply conferred "property" rights, in the sense of exclusionary rights over a resource, the concern with IP rights would remain unaffected, because it is precisely the conferral of exclusionary rights over a *nonrival resource* that raises the concern. And such rights, if they are to provide an incentive to innovate, must confer supramarginal pricing power. Both the defenders of IP rights as "property, not monopoly" and the critics who suggest that they are at least "sometimes monopoly" have missed this. Their debate is beside the point.

What follows from this, in antitrust, is that since IP rights must confer supramarginal pricing power to perform their incentive function, then it makes sense to adopt the presumption, for antitrust purposes, that such rights do confer market power. Yet this point has been obscured in antitrust analysis by, first, the same misguided "property or monopoly" debate and, second, by a further confusing oscillation between two distinct notions of "market power": the possession of supramarginal pricing power or the realization of supernormal returns from such pricing power. Yet the view that the latter is relevant here stems from a failure to distinguish between the presence of "market power" and the presence of "anticompetitive" concerns. Dispelling that confusion, we are led to adopt the one and only relevant notion of market power here—supramarginal pricing power—and thus to adopt the presumption that IP rights *do* indeed confer such power. But they do not, thereby, automatically raise anticompetitive concerns. Whether and how they do is a matter requiring separate analysis of the specific anticompetitive theory at issue.

A. *IP Rights* do *presumptively confer market power*

(1) The IP source of confusion: the misguided "property versus monopoly" debate

The basic economic function of intellectual property (IP) rights of copyright and patents is to enable the creator of an informational good to charge a price for accessing that good that recoups some of the sunk costs incurred in developing it. Any such price will be higher than what, in static terms, is the economically efficient price, namely the marginal cost of disseminating the good (the cost of producing and distributing a physical or digital embodiment of said good). And the economic value represented by all the uses of all the consumers willing and able to pay the efficient price, but not the one charged by the IP rights-holder, constitutes the measure of "deadweight loss" associated with that degree of IP protection.

This cost associated with IP rights has been sometimes described as deriving from the conferral of "monopoly power" on the rights holder.[14] That in turn has led defenders of broad IP rights to attack the premise that IP rights do confer monopoly power, necessarily or commonly.[15]

14. *See, e.g.*, S.J. Liebowitz, *Copyright Law, Photocopying, and Price Discrimination*, 8 RES. L. & ECON. 181, 184 (1986); Ian E. Novos & Michael Waldman, *The Effects of Increased Copyright Protection: An Analytic Approach*, 92 J. POL. ECON. 236, 243 (1984); William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 HARV. L. REV. 1659, 1700 (1988) ("Granting an artist or inventor a property right in his creation may make him a monopolist . . . .").

15. Kenneth W. Dam, *The Economic Underpinnings of Patent Law,* 23 J. LEGAL STUD. 247, 249–50 (1994); Frank H. Easterbrook, *Intellectual Property is Still Property*, 13 HARV. J.L. & PUB. POL'Y 108, 109 (1990); Edmund Kitch, *Elementary and Persistent Errors in the Economic Analysis of Intellectual Property* 53 VAND. L. REV. 1727, 1729–38 (2000) [hereinafter Kitch, *Elementary and Persistent Errors*]; Edmund Kitch, *Patents: Monopolies or Property Rights?, in* 8 RESEARCH IN LAW AND ECONOMICS 31, 32 (John Palmer &

Information goods, they explain, often have substitutes.[16] For example, a film under copyright protection or a drug under patent have to compete with many other films and drugs on the market. Thus, there is no reason to view IP holders as monopolists in the sense of "fac[ing] a demand curve with a negative slope" that allows them to raise prices above competitive level without losing all customers.[17] Consequently, apart from exceptional cases, IP rights do not confer monopolies but rather simply ordinary "property" rights. And, as such, they pose no special cost or policy problem.

The reply from commentators more wary of broad IP rights has been to concede that such rights do not *always* create "monopolies," but insist that, nevertheless, in some cases they do, when the goods they protect have no close substitutes.[18] This entire debate, however, is beside the point. Proper understanding of the economic framework dispels the idea that the main question is "whether the patent as monopoly is an important case that occurs frequently."[19] *Property*, not monopoly, *is* the heart of the problem. This is because what differentiates IP rights from other property rights are the "goods" or *resources* over which they provide protection, as explained next.

(2) Property rights over nonrival resources = supramarginal pricing power

IP rights such as copyright and patents confer on their holder entitlements to exclude others from using, without the holder's permission, the protected informational good in certain ways for certain periods of time. The grant of such rights converts, that is, what are relatively nonexcludable goods into relatively excludable ones.[20] For resources that are rivalrous in consumption, this grant of exclusionary or property rights is generally considered salutary, or at least not troubling, from an economic point of view, since preventing or excluding use by one is necessary to enable use by another.[21] However, for goods that are nonrival in consumption, of which informational goods are a paradigm instance, exclusionary rights may function inefficiently, wastefully preventing uses that would not detract from simultaneous use by others. The justification for incurring this potential inefficiency is, of course, that without it some informational goods may fail to be developed in the first place. Lacking the ability to exclude others from accessing the good, creators of valuable informational goods may not be able to appropriate enough of that social value to recover their costs of creation, thereby discouraging future innovators from engaging in such activity.

To repeat, then, the basic economic function of copyright and patent protection is to enable the creator of an informational good to charge a price for accessing that good that recoups some

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Richard O. Zerbe, Jr. eds., 1986) [hereinafter Kitch, *Monopolies or Property*]; Douglas A. Smith, *Collective Administration of Copyright*, *in* THE COLLECTIVE ADMINISTRATION OF PATENTS AND COPYRIGHTS 137, 139 (1986). *See generally* Sven Bostyn & Nicolas Petit, Patent=Monopoly: A Legal Fiction (December 31, 2013) (unpublished manuscript), *available at* http://ssrn.com/abstract=2373471.

16. Kitch, *Monopolies or Property*, *supra* note 15, at 33; Christopher S. Yoo, *Copyright and Product Differentiation*, 79 N.Y.U. L. REV. 212, 217-19 (2004).

17. Kitch, *Monopolies or Property*, *supra* note 15, at 32.

18. *See, e.g.*, James Boyle, *Cruel, Mean, or Lavish? Economic Analysis, Price Discrimination and Digital Intellectual Property*, 53 VAND. L. REV. 2007, 2018 (2000) ("The question of whether a monopoly exists is one that is determined by the availability of substitute goods, not the shape of the legal entitlement."); Julie E. Cohen, *Copyright and the Perfect Curve*, 53 VAND. L. REV. 1799, 1811 (2000) ("Although a copyright does not necessarily guarantee market power, many information goods lack perfectly fungible substitutes."); Fisher, *supra* note 14, at 1702–03 (stating that copyright holders' market power "vary considerably," and stating that some copyright works are "considered irreplaceable" while for others "there are readily available, nearly perfect substitutes.").

19. Kitch, *Monopolies or Property*, *supra* note 15, at 33.

20. Goods are excludable to the extent to which, once created, they can be provided to some while withheld from others. Informational goods are among the most highly nonexcludable of goods, in the absence of legal exclusionary entitlements.

21. Goods are rival to the extent to which use by one does not degrade simultaneous like use by others. Informational goods are a paradigm nonrival good, perhaps more so than any other resource.

of the sunk costs incurred in developing it. Any such price will be higher than what in static terms is the economically efficient price, namely the marginal cost of disseminating the good. And the economic value represented by all the uses of all the consumers willing and able to pay the efficient price but not the one charged by the copyright holder constitutes the measure of "deadweight loss" associated with that degree of IP protection.

At this point, two opposing but equally erroneous assumptions must be safeguarded against. On the one hand, it is not necessary for their effective operation that the conferral of exclusionary rights over an informational good result in conferring an economic "monopoly," where that is taken to mean the kind of power over price and quantity that a firm enjoys when there exist no rival substitutes for its product on the market.[22] Monopoly power in this sense may be present in some cases of IP protection, but it is neither an inherent byproduct of such protection, nor a necessary or sufficient condition of this protection providing effective incentives. On the other hand, it *is* necessary for IP protection, if it is to achieve its incentive function at all, to confer some supramarginal pricing power. In the absence of any degree of pricing power, there will be no added ability to recoup the fixed costs of development and no added incentive.[23] Supramarginal pricing power, then, is the necessary concomitant of an effective IP incentive: the possibility of securing the latter without incurring the former is as plausible as a perpetual motion machine.

To illustrate, consider the following three possible scenarios for a firm developing an expressive product—such as a movie—that is potentially eligible for copyright protection, or a functional product—such as a drug—that is potentially eligible for patent protection.

Scenario (1): The product does not receive any IP protection, rendering it vulnerable to uncompensated "free riding" by consumers or "corrosive" competition by replicating producers that may undermine the firm's ability to recoup its capitalized costs of development. Result: no static inefficiency from IP barriers to access, but also no provision of dynamic incentives to create.

Scenario (2): The firm obtains IP protection for its product, and the good has no, or at best very imperfect, substitutes, conferring on the firm "monopoly" power in the relevant market. The firm will use its pricing power to charge a profit-maximizing markup price over marginal cost. How much total revenue is generated by the marked-up price will depend on the size of the market and the elasticity of demand for this type of good. Where the revenues generated do not exceed the sunk costs of development, they are understood to be only "quasi-rents" that simply go to cover the costs of development, with the firm ultimately not realizing any supernormal returns or "rents." Where revenues do exceed the costs of development, then the firm realizes "rents" proper, or "supernormal" profits. Further, in the latter instance there is some amount of deadweight loss over and above that strictly necessary to generate the information good using IP protection.

Scenario (3): Finally, consider a third case, where the firm's product faces competition from the IP-protected product of a rival firm—suppose, for instance, they are both competing in

22. To be sure, this traditional notion of "monopoly power" is itself somewhat ill-conceived, since all firms' products will face some downward competitive pressure from alternative uses of consumer resources, whether or not such uses are seen as "substitutes." But we may put aside this nuance here.

23. To be sure, in many contexts efficiency will not require any IP incentive. These involve cases where alternative mechanisms such as first-mover advantages or alternative business models allow innovators to capture enough of the social value of their innovation to cover their private development costs. In such cases, IP right serve no incentive function and, absent other possible justifications, there is no reason to incur the costs associated with them.

the blockbuster summer action movie market or the blockbuster therapeutic drug market for SSRIs. Assume further that while consumers significantly prefer either of the rival IP-protected products to the next-best alternatives vying for their dollar, they are indifferent between the two IP variants. Thus, neither firm enjoys a "monopoly" in the relevant market. The price and quantity effects of such duopolies are of course subject to various plausible outcomes. For present purposes, assume that one possible (but by no means necessary) outcome prevails: prices approach their competitive level.[24] The question, for our purposes, is what that "competitive level" will be. Consider two possibilities. In one, the firms compete all the way down to marginal cost, thereby undermining each other's ability to recover development costs, resulting in a net loss for both. In the other, the firms price compete again, but now down only to average cost, so that each firm is able to recoup development costs and thus realize a "normal profit," but no rents, while charging a price that will incur some deadweight loss.[25] The first possibility, thus, parallels scenario (1): no deadweight loss but also no incentive benefit. The second possibility illustrates how, even in the absence of *any* technical monopoly power or its corresponding supernormal returns, the grant of IP rights can result in *some* deadweight loss, and indeed must, if it is to serve its incentive function.

But, it might be asked, what would be the problem in the second case, where the IP rights result in only enough pricing power for the innovator to recoup their innovation costs, such that they enjoy quasi-rents but not rents proper (or supramarginal pricing power without supernormal returns)? Said quasi-rents being necessary to induce the creation of the good in the first place, they arguably should not be described as a cost, since without them we would incur the greater loss of having to forego the good altogether. This objection, however, betrays a new and distinct misunderstanding of the analytical framework that properly guides IP policy. It does so by supposing that the policy tradeoffs associated with IP rights are internal to a specific innovation or good. Under that supposition, little could be improved over a situation where the deadweight loss is limited to that necessary for incentivizing the creation of the good. A world with a good and the minimal deadweight loss necessary to incentivize its creation is better than a world with no good at all. But the basic premise of this argument is misguided. Internal to any given innovation, there is *no* tradeoff between "access" and "incentives": either (a) we provide just enough IP protection for the good to be generated, in which case the access restrictions from those rights are not a "cost" to be traded off against incentive benefit—absent the rights and hence their incentive, there would be no good to begin and hence no "access" to speak of; or (b) we provide more IP protected than is needed to generate the good, in which cases there is no added incentive "benefit" from the stronger rights to be traded off against their greater access costs—since with weaker rights we still would have generated the good, there is no added "incentive" from strengthening the rights. In other words, the IP tradeoff between incentives and access—between the value of new innovations and deadweight loss—takes place *across* different innovations, *not* internal to any one of them.

To see the point, consider how IP rights work in practice. When IP rights are made available they are to a considerable extent made are *generically* available, in the sense that a relatively standardized set of entitlements are made equally available for various distinct goods or classes of

24. In fact, most product differentiation models *do not* ordinarily assume that the competition between two entrants would suffice to bring prices down to competitive levels. Rather, the common assumption is that each additional entrant will bring about only a measure of price reduction. The number of entrants and the extent to which price at equilibrium will remain above the competitive level is a function of the ratio between the fixed costs of each entrant and the total available surplus in the market. *See* DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 211 (4th ed. 2005).

25. We assume here, as a further simplification, that the development costs for each rival IP-protected variant were the same.

innovation.[26] Thus, at any given level of IP protection, some informational goods will enjoy more protection than is needed for their generation, meaning the revenues enabled by the IP-conferred pricing power will exceed their capitalized costs of development. Put another way, the share of these innovations' social value that this level of IP protection enables innovators to appropriate exceeds their private costs of development. As a result, these innovators will enjoy supernormal returns, and there will be some unnecessary deadweight loss. Another category of innovations will enjoy (roughly) just enough protection for their generation. Finally, some valuable innovations may not be generated because not enough of their social value can be privately appropriated to justify their private costs of development. Thus, although this point is often overlooked, the core tradeoff at the heart of IP policy is between the effect of IP rights *across* these *different categories* of innovation; it is *not* internal to a given innovation.[27] Specifically, the tradeoff concerns whether the benefits of extending protection to enable the generation of some more of the third category of innovations (those "supramarginal" to the current level of protection) will be worth the costs of increasing the unnecessary deadweight loss incurred with respect to the first two categories of innovations (those "inframarginal" to the current level of protection). Or, alternatively, whether the benefits of curbing protection to decrease the unnecessary deadweight loss associated with the first category is worth the cost of foregoing innovations in the latter two.

To sum up: in order to incentivize the generation of informational goods, IP rights necessarily come with inefficient restrictions on access to such goods. Irrespective of whether such rights are deemed to confer "monopoly power," to achieve their incentive function they must confer supramarginal pricing power. This tradeoff between providing incentives and curbing access does not operate internally to any one innovation, but rather across different classes of innovations, which vary in their ratios of private costs to social surplus appropriable by a given level of generic IP protection. With each increase in such protection, we may induce the creation of heretofore "supramarginal" goods, but at the cost of curbing access to "inframarginal" ones.

B. IP Rights do not *thereby become presumptively anticompetitive (AC)*

26. In contrast to the theoretical possibility of a regime in which each IP right were tailored to each specific work. In such a theoretically possible—but administrably unrealizable—case, there would be no "incentive-access" tradeoff posed by IP rights, since protection in each case would be finely-tuned or tailored to each innovation to be just enough to generate it, no more or less, so as neither to provide insufficient incentives nor incur unnecessary access costs. In reality, both patent and copyright regimes are fairly, but not fully, universal, in that alongside generic rules they also include some arrangements that are more industry- or subject-matter, and hence tailored to distinct classes of innovation. Copyright, it is commonly observed, is somewhat more tailored than the patent regime. For discussion of the policy tradeoffs involved in setting the level of tailoring versus uniformity in an IP regime, compare Dan L. Burk & Mark A. Lemley, *Is Patent Law Technology-Specific?*, 17 BERKELEY TECH. L.J. 1155, 1159–60 (2002) (discussing drawbacks caused by uniformity in patent law), Michael W. Carroll, *One for All: The Problem of Uniformity Cost in Intellectual Property Law*, 55 AM. U. L. REV. 845, 849–50 (2006) (explaining that uniform IP rights necessarily incur deadweight loss); Michael W. Carroll, *One Size Does Not Fit All: A Framework for Tailoring Intellectual Property Rights*, 70 OHIO ST. L.J. 1361, 1389 (2009) (describing the "*uniformity cost*[s]" that "one-size-fits-all" IP rules impose on society), William Fisher III, *The Disaggregation of Intellectual Property*, HARV. L. BULL., Summer 2004, at 24, 29 (2004) (noting that IP regimes have begun to fragment into more customized treatment), with ADAM B. JAFFE & JOSH LERNER, INNOVATION AND ITS DISCONTENTS 203–05 (2004) (advocating for uniform as opposed to tailored treatment in IP), and R. Polk Wagner, *(Mostly) Against Exceptionalism*, *in* PERSPECTIVES ON PROPERTIES OF THE HUMAN GENOME PROJECT 367, 379–82 (F. Scott Kieff ed., 2003) (cautioning against adopting distinct legal rules across different technologies).

27. This belies, then, the view that it is an "internal paradox" of the incentive–access framework—one resulting in its general indeterminacy—that "a work's desirability will indicate both the need to ensure the work's creation *and* the need to secure its widespread distribution," because greater desirability of a work means a greater need for both its creation and its wide dissemination, and "[therefore] incentive and access will always oppose each other with exactly equal force." Glynn S. Lunney, Jr., *Reexamining Copyright's Incentives-Access Paradigm*, 49 VAND. L. REV. 483, 486 (1996); *See also* William M. Landes & Richard A. Posner, *An Economic Analysis of Copyright Law*, 18 J. LEGAL STUD. 325, 326 (1989) ("Copyright protection . . . trades off the costs of limiting access to a work against the benefits of providing incentives to create the work in the first place.").

From the foregoing analysis within IP emerges the following point of central relevance to antitrust: since IP rights must, if they are to perform their incentive function for IP policy, confer supramarginal pricing power, it is sensible, within antitrust policy, to adopt the presumption that such rights *do* confer such pricing power. Consequently, then, IP rights do presumptively confer *market power* in the sense relevant to antitrust. In other words, the relevant notion of market power in antitrust is precisely supramarginal pricing power. But this has been obscured by an oscillation within antitrust between two very distinct notions of "market power": supramarginal pricing power or supernormal profits resulting from the exercise of such power.[28] This oscillation, in turn, stems from a conflation of "market power" with "anticompetitive" (AC) concerns: since not all forms of market power give rise to AC concerns, commentators have sometimes been led to redefine market power more narrowly, as referring only to those cases that *do* raise AC concerns, which are taken to involve supernormal returns.[29]

But both the heightened conception of market power—as restricted to cases of "supernormal returns"—and the conflation of market power with AC concerns more generally, are triply misguided: (1) first, there are cases of AC concerns without any market power (so that heightened market power is not necessary for AC concerns); (b) second, even the redefined conception of market power does not always raise AC concerns (so that heightened market power is not sufficient for AC concerns); and (c) finally, the lower standard of market power—as broadly covering any case of supramarginal pricing—may well be enough by itself to trigger AC concerns. The upshot? Market power can and should be delinked from AC concerns. Doing so, we see that there is no reason to redefine market power in the narrower sense of supracompetitive profits—the broader sense of supramarginal pricing is the right one for all occasions. And once we see *that*, then we see that IP rights *do* presumptively confer market power in the sense relevant to antitrust even though they do *not*, thereby, automatically raise AC concerns. Whether the market power associated with IP rights raises AC concerns requires a distinct analysis, one that varies by the different contexts of antitrust scrutiny—in particular, whether the impugned conduct is an agreement between parties, under s. 1 of the Sherman Act, or unilateral, under s. 2.

[…]

(1) Supramarginal pricing power = market power but ≠ anticompetitive conduct

(2) Antitrust course of confusion: oscillation between two views of "market power"

II. IP RIGHTS AND ANTITRUST: THE HISTORICAL CONFUSIONS

The present Part bridges the theory of Part 1 and the policy implications of Part 3, by tracing the historical emergence in antitrust law of the confused analytics critiqued above and their embodiment in the mistaken doctrines and polices that will be revised in Part 3.

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28. *E.g.,* HERBERT HOVENKAMP ET. AL, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW 4-2 ("Market power is the power to profit by charging more than marginal cost, which is the competitive price for a good or service."); 4-7 ("In general, the technically correct way to measure whether a patent, copyright or other intellectual property right produces returns above cost would be to compare all development costs with all profits generated by the right during its reasonably anticipated marketable lifetime.")

29. *E.g.,* HOVENKAMP ET. AL, *id.* at 4-6 (Courts "have sometimes found that the mere possession of an intellectual property right is sufficient to create at least a presumption that the defendant had sufficient market power to warrant antitrust condemnation.")

In broad strokes, the story is of a two-stage "rise and fall" of antitrust suspicion toward IP rights, with both phases fueled by crucial analytic errors. In the first stage, the 1930s-1970s era of (1) antitrust suspicion toward "bigness" and (2) IP suspicion toward patents as "monopolies" saw the consolidation of the view of *IP rights as presumptively anticompetitive*. This took place in three steps. First, *within IP*—specifically, within "patent misuse" cases—hostility emerged to the practice of tying, i.e., to a firm conditioning access to its (patented) product A (the "tying" product) to buying also (typically, an unpatented) product B (the "tied" product). Defendants in patent infringement suits started successfully pointing to this practice by patentee Plaintiffs as an example of "patent misuse," with the effect of that the P would lose their right to enforce the patent against this particular D (but not, it should be noted, against other potential Ds in other lawsuits). This internal-to-patent hostility to tying then migrated over into antitrust analysis—i.e., was invoked by parties not Defendants in a patent suit, but by challengers to the practice in general, with the patentee (now the D) facing more severe antitrust penalties. Moreover, what was initially taken over as a hostility toward IP-based tying became a more generalized hostility toward tying in general, which came to be treated by the antitrust law of this period as at least "presumptively" and perhaps even "per-se" anticompetitive. Then, finally, came step (3): from (1) IP hostility toward patent-based tying, (2) to antitrust hostility to (a) first, patent-based tying and (b) then, tying *simpliciter*, (3) came antitrust hostility toward patents *simpliciter*, increasingly seen as "monopolies" with an "anticompetitive" potential in "inherent tension" with antitrust.

The fundamental point to underline about this New Deal suspicion toward patents is that it is based on an analytic error, indeed two: (a) first, all talk of patents as "monopolies" is misguided, both because wrong (since many patents are not over products that face little competition in a market) and irrelevant (the IP concerns raised by patents have nothing to do with monopoly); and (b) second, all talk of IP as in an "inherent tension" with antitrust is also misguided, both because wrong (antitrust has its own version of the tradeoff between static-allocative and dynamic-productive efficiency that parallels IP's incentive-access one) and irrelevant (talk of "monopolies" does not get you very far in antitrust, where the relevant issue is *illegitimate* "monopolization").

Unsurprisingly then, when the ideological winds shifted from the New Deal era to Neoliberalism in the 1970s, opponents of the existing consensus were able to make short work of its analytical flaws in the course of installing a new one, of *IP rights as presumptively untroubling.* Put in place now was a two-fold neoliberal consensus that formed a mirror-opposite of its New Deal predecessor: (1) from IP skepticism to boosterism, based on "property" fundamentalism for some, and "market-based" incentives for others; and (2) from antitrust maximalism to skepticism, based on protecting "competition not competitors" (i.e., not shielding small firms from their more successful "bigger" rivals). Thus, the neoliberal critics were, rightly, able to argue that (a) all talk of patents as "monopolies" is misguided—these are just "property" rights; and (b) all talk of an "inherent tension" between IP and antitrust is misguided—both recognize that static efficiency may need to yield to dynamic incentives to innovate (and integrate, etc.). Of course this new view was itself marred by fatal analytic errors: (a) yes, of course IP rights are "property" but that's precisely the problem—exclusionary rights over nonrival resources necessarily come with pricing power and its inefficiencies if they are to perform their incentive function; and (b) yes, of course in antitrust we cannot simply say "pricing power, boo!"—but that's not because "market power" is something other than pricing power, but because market power does not equal "anticompetitive."

In a nutshell, then, we have gone straight from the mistaken New Deal view of *IP rights as presumptively anticompetitive* to the mistaken Neoliberal view of *IP rights as presumptively untroubling*, without ever once touching down on the correct view: *IP rights do presumptively confer market power, but that does not mean that they are presumptively anticompetitive.*

In doctrinal terms, the Neoliberal transformation was itself also worked out in three steps: (1) First, the general hostility toward tying was subjected to fierce attack by the "single monopoly profit" theory that, by the late 1970s, had made considerable doctrinal headway, with the Supreme Court in 1978's *Jefferson Parish* dropping per-se illegality for tying in all but name. (2) This then spread to IP law, where patent-based tying was legislatively immunized from attack as "patent misuse" by a 1988 amendment to the patent statute. (3) Finally, in a return to origins, the Congressional 1988 patent amendment was invoked within antitrust by the Supreme Court in 2006's *Illinois Tool Works* as part of its case for generalizing a new view of IP rights even beyond tying contexts, by declaring the presumption of market power from IP rights as dead.

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A. The Rise of Patent Suspicion: mistaken conflation of market power and AC concerns

(1) The Original Tying Context

(2) Generalizing beyond Tying

B. The Fall of Patent Suspicion: mistaken rejection of presumptive market power

(1) Critique of the Generalized View

(2) Return to Origins: Critique in the Tying Context

III. IP RIGHTS AND MARKET POWER IN ANTITRUST: POLICY IMPLICATIONS TODAY

To distill the lessons of the foregoing two Parts in a nutshell, the beginning of wisdom in the antitrust analysis of IP rights is two-fold: (1) First, such rights *should* presumptively be taken to confer market power in the sense relevant to antitrust. (2) Second, however, such rights *should not* presumptively be taken to be anticompetitive. We must, in other words, delink analysis of the market power conferred by IP rights from analysis of their anticompetitive potential. Doing so requires greater clarity than is often exhibited by courts and commentators concerning *the distinct roles of market power* in the analysis of potentially anticompetitive (AC) conduct or results when scrutinizing agreements and conduct under ss. 1 and 2 of the Sherman Act.[30]

[30] Clayton Act: (1) applies to vertical restraints such as tying and exclusive dealing; (2) was felt to impose a more stringent standard owing to it legislative origins as a correction to judicial dilution of Sherman Act enforcement; (3) but when the latter subsided during the New Deal era, many took the two to converge; (4) but this has recently come in for revisitation, with the Act's language of "*may* substantially lessen competition" being pointed to as the basis for a revived more stringent standard in cases that it governs. The discussion below will attend to this where it may make a possible difference in the outcome.

Under s. 1 of the Sherman Act, for tying and related vertical agreements (such as exclusive dealing and bundling and loyalty discounts), the role of "market power" depends on the AC theory: (a) for "foreclosure effects" under exclusive dealing, we need market *share*, not market power, analysis; (b) for "price discrimination" effects under tying, it is market power not market share that is relevant and market power of the first, supramarginal pricing, sort and not of the second, supernormal returns, sort (indeed, the second supernormal returns sort turns out never to be the relevant focus of antitrust analysis); (c) finally for "leveraging" theories under tying, it is again market power that is relevant (along with foreclosure), and again of the supramarginal pricing sort.

Thus, in tying and its related contexts the above analysis, that patents should be taken presumptively to confer market power, has significant revisionary bite. But this does *not* mean that tying arrangements should then be taken presumptively to be anticompetitive—*that* is a separate issue that has historically been entangled with the former but needs to be delinked. While it is probably right that tying should not be given "quasi per-se" or even presumptive AC treatment, but rather either abbreviated or simply full rule-of-reason (RoR) treatment, that is a separate point from the previous one. What this separate point means is that in the case of either of the latter two alternatives—i.e., where tying is not taken to be per-se or presumptively AC—we need an analysis of the tie's possible procompetitive benefits. In other words, although IP rights in the tying product *should* presumptively be taken to confer market power, it should remain open for the defendant to show that such use of market power is *not* (presumptively or otherwise) anticompetitive. In sum, the upshot of this analysis is to rehabilitate the Supreme Court's 1978 *Jefferson Parish* decision in its treatment of the role of IP rights as presumptively conferring market power[31]—such that the Court's 2006 *Illinois Tool Works* decision is seen to be mistaken[32]—while rereading that case to give tying a form of structured, abbreviated RoR treatment that may in theory become full RoR.[33]

Under s. 2 of the Sherman Act, for unilateral conduct of "monopolization," matters stand very differently. First, the role of "market power" in such analysis is very distinct. Indeed it is almost irretrievably confused, playing three distinct roles that are often not even noticed much less kept properly separate: (1) Formally speaking, the entire structure and point of s. 2 analysis is not to prohibit "monopolies" *simpliciter*—i.e., the acquisition of monopoly power through legitimate means (such as historic accident or superior business acumen) or the normal enjoyment of such power (raising prices and lowering outputs to enjoy rents)—but rather "*monopolization*"—i.e., the *illegitimate* pursuit of monopoly power through means of "exclusionary" or "anticompetitive" conduct. Within that formal structure, then, the role of monopoly power is (a) *not* as a form of impermissible means, (b) but rather the impermissible result itself from said means. (2) However, given courts' notorious difficulty in distinguishing between "legitimate" and "illegitimate" forms of engaging in zealous competition against rivals—i.e., in specifying what precisely are "exclusionary" versus acceptable forms of competitive conduct—they have, to avoid this inquiry as much as possible, come to use "monopoly power" as a kind of "filter" in the analysis, whereby if the D can show they do not possess the illegitimate result, the court can be saved from inquiring into whether they deployed illegitimate means. (3) Finally, however, market power may *also* play a role in some theories of the illegitimate means—those involving the D leveraging (legitimately-

31. *Jefferson Parish Hospital v. Hyde*, 466 U.S. 2, 16 (1984) ("if the government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power.")

32. *Illinois Tool Works Inc. v. Independent Ink, Inc*., 547 U.S. 28 (2006).

33. *See* Einer Elhauge, *Rehabilitating* Jefferson Parish, 80 ANTITRUST L. J. 463 (2016).

acquired) market power in one (upstream/downstream) market to attain such power (now illegitimately-acquired) in another (downstream/upstream) market. In a nutshell, then, an inquiry into the D's "market power" may either (a) serve as the final stage of a two-part analysis of means and results; (b) an initial filter to avoid the formally prior, but administrably more difficult, first stage; and (c) as a key component of that first stage! No wonder no one knows what's going on.

Once we carefully separate out these three roles, we see that the relevance of IP rights varies dramatically depending on context: (1) For both (a) the end-result and (b) initial filter roles, IP rights as market power are *not* relevant, and for the same reason: the market power *obtained* via IP rights is precisely of the "legitimate" rather than "illegitimate" sort not germane to s. 2 analysis. (2) But for the illegitimate-means analysis, IP rights as market power *are* relevant, because the *exercise* of market power obtained via IP rights as leverage to acquire market power elsewhere is precisely the sort of illegitimate rather than legitimate means relevant to s. 2 analysis. And the relevant notion of market power here is, again, precisely the sort of supramarginal pricing power conferred by IP rights when they are effective in performing their incentive function. This is most germane to "refusals to deal," the analog in the unilateral context to the case of tying in agreements, but may also be indirectly relevant to "essential facilities" cases.

Finally, we turn to horizontal agreements under s. 1 and to the formalist and unnecessary "scope of the patent" doctrine. Being a Neoliberal replacement of the New Deal "inherent tension" view of the relation between IP and antitrust, this holds that patents pose no antitrust concerns so long as their rights are not being extended beyond their proper "temporal and physical scope." Urged by a Roberts dissent in 2013's *Actavis* (against a Breyer majority that misfired in trying to revive the confused "inherent tension" view),[34] fully to appreciate the limits of this doctrine it helps first to situate it historically. The doctrine has undergone three main phases: it first arose within IP itself, then migrated to antitrust, and then finally returned to have its wings clipped even within IP. It initially arose in the context of "patent misuse" claims where, as a defense in patent infringement lawsuits, "misuse" was defined to include, *inter alia,* (a) tying; (b) refusals to deal; (c) improperly procured patents, such as via fraud; and (d) licensing terms that extended royalty payments—and hence the period of effective exclusionary power—beyond the patent term. The doctrine then carried over into antirust, where a similar suspicion toward IP-based tying practices was adopted. Finally, first within antitrust and afterwards more broadly, both the suspicion of tying and of IP rights more generally came under reconsideration, with the result that in 1988 legislative reform to the patent statute effectively eliminated the first two categories of patent misuse. The effect of that legislative reform, then, was to limit "patent misuse" doctrine to, in effect, licensing-type efforts to extend "the temporal or physical" scope of the patent.

Even strictly within patents, it bears noting that this doctrine is riddled with terminological infelicities and conceptual and substantive difficulties: e.g., (a) there is no "physical" scope to a patent but rather a scope or size of the *intangible* "space" of technological knowledge that is being covered; (b) what is the "proper" scope vs an "illicit" extension thereof? But the important point here is that these difficulties may to some extent be handled *by patent law*, using its doctrinal and policy tools (e.g., claim scope, enablement, etc.). But it is entirely hopeless to seek to handle them within the frame of an antitrust suit, using antitrust tools. And it is also completely unnecessary: the doctrine arose, and finds its proper place within, patent law, as a patent-specific way of dealing

34. *FTC v. Actavis, Inc.,* 570 U.S. 136, 161-2 (2013).

with patent-specific problems. It has no business migrating into antitrust law, where its problems are not raised nor its solutions viable.[35] That is, only confusion as to the *actual relation* between IP and antitrust—i.e., that IP rights *do* presumptively confer market power, but they do *not* thereby presumptively raise anticompetitive concerns, with the latter requiring a separate analysis of the distinct roles of market power in antitrust scrutiny of different kinds of agreements and conduct—generates the illusory need for the importation of such a doctrine from outside, so as to replace the misguided "inherent tension" view with an equally misguided "inherent compatibility" one.

Sound antitrust analysis of horizontal agreements begins, then, by simply bracketing the relation of patents to antitrust and asking instead under what category the impugned agreement falls. Proceeding from there, we stick with the cogent three-step analysis of per-se AC categories, the productive joint-venture exception, and the five-part rule-of-reason analysis, in which the role of IP rights is put in its proper place as relevant only when market power as illicit means is relevant.

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A. *Vertical Restraints: market power as pricing power*

(1) Tying

(2) Exclusive Dealing

B. *Unilateral Conduct: market power as AC means, not result*

(1) Refusals to Deal

(2) Standard-Essential Patents and the Essential Facilities Doctrine

C. *Horizontal Agreements: abolishing the "scope of the patent" doctrine*

(1) Per-se Categories

(2) Rule of Reason Analysis

CONCLUSION

35. *See also* Herbert Hovenkamp, *The Rule of Reason and the Scope of the Patent*, 52 SAN DIEGO L. REV. 515 (2015).