DEPARTMENT OF JUSTICE

THE 1995 ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY: New Signposts for the Intersection of Intellectual Property and the Antitrust Laws

Address by

RICHARD J. GILBERT
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

ABA Section of Antitrust Law
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The 1995 Guidelines for the Licensing of Intellectual Property

It is with great pleasure that I announce today the release of the 1995 Department of Justice and Federal Trade Commission Antitrust Guidelines for the Licensing of Intellectual Property. Intellectual property is an increasingly important determinant of U.S. economic growth and international competitiveness. In 1992, six knowledge-intensive industries (aerospace, computers, communications equipment, drugs and medicines, scientific instruments, and electrical machinery) accounted for 27 percent of total manufacturing output in the United States, up from 15 percent in 1981. Royalties and fees collected by U.S. firms from trade in intellectual properties approached $18 billion in 1991, nearly double the amount collected just 5 years earlier.[1]

Licensing royalties and fees, although considerable, greatly understate the value of intellectual property to the U.S. economy. Technology licensing and related partnerships are essential in today's economy to remain globally competitive and to market the products that knowledge assets help to create. As the world continues to become a more competitive place, and as firms scattered across the globe develop their own technological advantages, licensing plays an increasingly vital role to ensure that America's industries remain at the technological frontier.

The importance to the U.S. economy of the development, use, and exchange of intellectual property led Assistant Attorney General Anne K. Bingaman to appoint an Antitrust Division task force to examine antitrust enforcement priorities in the licensing of intellectual property. The task force published draft Antitrust Guidelines for the Licensing and Acquisition of Intellectual Property for comment in the Federal Register on August 11, 1994. Shortly thereafter, the Federal Trade Commission joined this effort with the objective of developing the unified antitrust guidelines that we release today.

The new Guidelines share the core principles expressed in the section on technology licensing in the U.S. Department of Justice 1988 Antitrust Enforcement Guidelines for International Operations. These include the generally procompetitive nature of licensing arrangements, the absence of a presumption that intellectual property necessarily creates market power in the antitrust context, and the validity of applying the same general antitrust approach to the analysis of conduct involving intellectual property that the Agencies apply to conduct involving other forms of tangible or intangible property.

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[1] *See* National Science Board, *Science & Engineering Indicators* (1993), Appendix tables 6-4 and 6-6. These six industries were selected based on their high research and development expenditures as a proportion of total sales.

These three core principles provide a foundation for the policy statements in the Guidelines. Because licensing often has significant efficiency benefits (for example, by facilitating the integration of the licensed property with complementary factors of production), antitrust concerns that may arise in licensing arrangements normally will be evaluated under the rule of reason. The absence of a presumption that intellectual property necessarily creates market power implies that an antitrust evaluation of licensing restraints such as tying arrangements normally will require investigation of market circumstances to establish anticompetitive effects. The principle that the Agencies will apply the same general antitrust approach to intellectual property does not mean that intellectual property is the same as other forms of property. There are important differences, but the antitrust laws are sufficiently flexible to take these differences into account and should not impose greater or lesser scrutiny for intellectual property than for other forms of property.

Key changes from the 1988 Guidelines

While the new Intellectual Property Guidelines affirm the general approach to antitrust analysis of licensing arrangements described in the 1988 Guidelines for International Operations, there are some differences and refinements. The new Guidelines include a safe harbor for licensing transactions. "Absent extraordinary circumstances, the Agencies will not challenge a restraint in a licensing arrangement if (1) the restraint is not facially anticompetitive and (2) the licensor and its licensees collectively account for no more than twenty percent of each relevant market significantly affected by the restraint." (pp. 22-23) Facially anticompetitive restraints include those that would normally warrant per se treatment under the antitrust laws, such as price fixing and market division, and also agreements not to compete in terms of price or output that the Supreme Court said could be condemned as anticompetitive without an elaborate inquiry into market circumstances.[2]

The new Intellectual Property Guidelines include a section on analysis of competitive effects in research and development and on the use of innovation markets to address such effects. Case 6 of the 1988 International Guidelines referred to the analysis of competitive impacts in a "research and development market" in the context of a research and development joint venture. The discussion of innovation markets in the 1995 Intellectual Property Guidelines, thus, is a refinement of a concept already familiar in antitrust analysis.

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[2] "When there is an agreement not to compete in terms of price or output, 'no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.'" *NCAA v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 109 (1984), quoting *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978).

Using an innovation market to analyze competitive effects is appropriate if the competitive effects of an arrangement cannot be adequately analyzed in conventional product markets. This threshold condition also applies to the use of technology markets. The 1995 Intellectual Property Guidelines state that "[T]he competitive effects of licensing arrangements often can be adequately assessed within the relevant markets for the goods affected by the arrangements. In such instances, the Agencies will delineate and analyze only goods markets. In other cases, however, the analysis may require the delineation of markets for technology or markets for research and development (innovation markets)." (pp. 7-8)

An innovation market can be useful to identify competitive effects that cannot be adequately analyzed in markets for goods and services when the arrangement may affect the quantities, availabilities or prices of products that do not presently exist, as in a research and development joint venture.[3] Innovation markets also may be useful when an arrangement has competitive effects from research and development in geographic markets where product market competition is limited or non-existent. That situation occurred in the proposed acquisition of the Allison Division of General Motors by ZF Friedrichshafen.[4] General Motors and ZF compete in Europe in the supply of automatic transmissions for large trucks and buses and in some but not all relevant product markets in the U.S. The acquisition would have likely affected the development of new transmissions worldwide. In particular, the acquisition would have affected the development of new transmission models for sale in the U.S. by both General Motors and ZF, even if they are neither actual or likely potential competitors in the relevant product markets. The Department of Justice challenged the acquisition, alleging likely adverse effects on competition in the product markets in which General Motors and ZF compete in the U.S., and also in a worldwide innovation market for the design and development of new and improved heavy-duty transmissions for trucks and buses.

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[3] *See e.g.*, *Sensormatic*, FTC Inv. No. 941-0126 (accepted for comment Dec. 28, 1994); *Wright Medical Technology, Inc.*, FTC Inv. No. 951-0015 (accepted for comment Dec. 8, 1994); *American Home Products*, FTC Inv. No. 941-0116, 59 Fed. Reg. 60,807 (accepted for comment Nov. 28, 1994); *Roche Holdings Ltd.*, FTC Inv. No. 941-0085, 59 Fed. Reg. 46,846 (Sept. 12, 1994); *Roche Holdings, Ltd.*, 113 F.T.C. 1086 (Nov. 28, 1990); *United States v. Automobile Mfrs. Assoc.*, 307 F. Supp. 617 (C.D. Cal. 1969), *modified sub nom. United States v. Motor Vehicles Mfrs. Assoc.*, 1982–83 Trade Cas. (CCH) ¶ 65,088 (C.D. Cal. 1982).

[4] *See* Complaint, *United States v. General Motors Corp.*, Civ. No. 93-530 (D. Del., filed Nov. 16, 1993).

When does a licensing arrangement warrant antitrust scrutiny?

The 1995 Intellectual Property Guidelines differ from the 1988 Guidelines for International Operations in their approach to identifying when a licensing arrangement may warrant antitrust scrutiny. The 1988 Guidelines focused on the scope of the intellectual property right and stated that "[T]he owner of intellectual property is entitled to enjoy whatever market power the property itself may confer." (p. 22) The 1988 Guidelines did not provide clear signposts to distinguish market power that is conferred by the intellectual property from market power that is not. As former Assistant Attorney General William Baxter once said, intellectual property may confer the power to license under the condition that the licensee eliminate the licensor's mother-in-law,[5] but that does not cause such power to be legal.

In place of the condition that "[T]he owner of intellectual property is entitled to enjoy whatever market power the property itself may confer," the 1995 Intellectual Property Guidelines state the principle that "antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license." (p.7) This principle is offered as a way to identify when antitrust concerns may arise in a licensing arrangement. It should not be interpreted as a "baseline" against which to measure the economic effects of a licensing arrangement. Specifically, it does not mean that in assessing the legality of a licensing arrangement, the antitrust authorities will compare the benefits of the licensing arrangement to a hypothetical baseline in which the intellectual property is not licensed at all.

If entities affected by a licensing arrangement would not have been actual or likely potential competitors in a relevant market in the absence of the license, the arrangement generally cannot result in harm to the economy and therefore should not be considered to have an adverse effect on competition. This is so even if an alternative licensing arrangement could have created more competition. The principle of "harm to competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license" parallels the Agencies' approach to the evaluation of a joint venture. If the parties to a joint venture would not have been

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[5] "[A] promise by the licensee to murder the patentee's mother-in-law is as much within the 'patent monopoly' as is the sum of $50; and it is not the patent laws which tell us that the former agreement is unenforceable and subjects the parties to criminal sanctions." William F. Baxter, Legal Restrictions of the Patent Monopoly: An Economic Analysis, 76 *The Yale Law Journal* 267, 277 (1966).

competitors in the absence of the joint venture, it is unlikely that the joint venture could adversely affect competition among those parties, although it is conceivable that collateral restraints could harm competition with others who are horizontal competitors to one of the parties, or in other markets.

As an example, suppose a manufacturer of jet engines and a firm that develops advanced composite materials enter into a joint venture to produce a new type of turbine blade. The joint venture could include a cross-licensing arrangement in which the parties agree to exchange rights to relevant intellectual property with the objective of developing the new product. In this hypothetical, the parties to the joint venture are not competitors in any relevant market. Normally, the antitrust authorities would not scrutinize the specific arrangement between the parties to this joint venture, because it does not harm competition that would have existed in its absence. For example, the antitrust authorities normally would not be concerned about the particular structure of the joint venture, such as the number of jet engine facilities in which the composite materials may be used.

Concerns about possible adverse impacts on competition may arise if the joint venture included restraints that harmed competition with rivals who are not parties to the joint venture or that harmed competition in other markets. A plausible example of such a restraint is a requirement that the suppliers of composite materials to the joint venture refrain from supplying similar materials to competing jet engine manufacturers. The Agencies likely would examine such a restraint to determine whether it is likely to have an anticompetitive effect and, if so, would assess whether it is reasonably necessary to achieve the benefits of the joint venture.

The principle of "harm to competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license" is straightforward to apply when a license involves competition in a single relevant market, but what about more complex situations such as vertical restraints in a licensing arrangement? Suppose a particular University licenses a breakthrough technology to miniaturize electronic circuitry and includes terms in its license that prohibit licensees from dealing with the supplier of any other present or future technology that may compete with the licensed technology. I doubt that the Agencies' would conclude that the University escapes antitrust scrutiny because the University itself is not an actual or likely potential competitor of its licensees. The terms in the University's licensing arrangement may adversely affect competition in the market for electronics technology that would have occurred in the absence of the license. The Agencies would likely investigate whether there are other practicable licensing arrangements that the University could use that would be less harmful to

competition in the market for electronics technology, without hindering the University from developing and marketing its technology.

In words that may be more familiar to antitrust practitioners, the 1995 Intellectual Property Guidelines affirm that the Agencies' approach to technology licensing arrangements is, in most cases, a standard application of the rule of reason. Section 3.4 of the Guidelines state that "[T]he Agencies general approach in analyzing a licensing restraint under the rule of reason is to inquire whether the restraint is likely to have anticompetitive effects and, if so, whether the restraint is reasonably necessary to achieve procompetitive benefits that outweigh those anticompetitive effects." (p. 16) In making this assessment, the Agencies will not engage in a search for a theoretically least restrictive alternative that is not realistic in the practical prospective business situation faced by the parties. As in the Agencies' approach to the evaluation of a joint venture, if a proposed licensing arrangement includes restraints that have adverse effects on competition that would have occurred in the absence of the license, the Agencies would evaluate whether those restraints are reasonably necessary to achieve the procompetitive benefits of the arrangement. If not, the Agencies would be likely to challenge such restraints. If they are reasonably necessary, the Agencies would inquire whether the procompetitive benefits of the arrangement outweigh any harm to competition.

The principle that "antitrust concerns may arise when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license" is a refinement of the principle in the 1988 Guidelines that "[T]he owner of intellectual property is entitled to enjoy whatever market power the property itself may confer." It is a useful clarification to identify those situations in which a licensing arrangement may or may not warrant antitrust scrutiny. It is not intended as a new baseline for antitrust analysis or as a replacement for the rule of reason.

Changes since the August 11, 1994 draft

The new Intellectual Property Guidelines released today are changed in several respects from the draft U.S. Department of Justice Antitrust Guidelines for the Licensing and Acquisition of Intellectual Property that were published for comment in the Federal Register on August 11, 1994. Most of the changes are expositional, although a few are more substantive. The word "acquisition" has been deleted from the title of the 1995 Intellectual Property Guidelines to clarify that the Agencies' Merger Guidelines are the operative guidelines for antitrust analysis of acquisitions,

including transfers of intellectual property rights. The new Guidelines include specific language noting that they apply to know-how arrangements as well as to patents, copyrights, and trade secrets. They also clarify that the Agencies will apply the same general antitrust principles to a licensor's grant of various forms of exclusivity to and among its licensees that they apply to comparable vertical restraints outside the licensing context, such as exclusive territories and exclusive dealing.

The 1995 Intellectual Property Guidelines include a more definitive statement of the likely absence of anticompetitive effects from non-exclusive licensing arrangements. They recognize that non-exclusive licenses of intellectual property that do not contain any restraints on the competitive conduct of the licensor or the licensee generally do not present antitrust concerns even if the parties to the license are in a horizontal arrangement. In such a non-exclusive license, each party to the arrangement is free to compete using the licensed intellectual property and therefore the non-exclusive license normally does not diminish competition that would occur in its absence. Note, however, that agreements to cross-license technology prospectively (even if non-exclusive) may reduce incentives to develop new technology because each party to the agreement can free ride on the accomplishments of others. Moreover, certain types of cross-licensing arrangements, even if non-exclusive, may reduce competition that would occur in the absence of the arrangement, for example by levying royalties that increase rivals' costs or by promoting price coordination.

The Intellectual Property Guidelines recognize that a grantback provision in an intellectual property license may have procompetitive effects by promoting the dissemination of new technology, sharing risks, and rewarding the licensor for making possible further innovation based on or informed by the licensed technology, and may be necessary to ensure that the licensor is not prevented from effectively competing because it is denied access to improvements developed with the aid of its own technology. Grantback provisions in licensing arrangements may have anticompetitive effects on total industry innovative effort, however, by reducing incentives to engage in research and development. The new Guidelines note that compared with an exclusive grantback, a non-exclusive grantback, which leaves the licensee free to license improvements technology to others, is less likely to have anticompetitive effects.

Earlier policy statements by the Department of Justice on antitrust analysis of intellectual property licensing arrangements were incorporated in the Department's 1977 and 1988 Guidelines on International Operations. This was appropriate given that the geographic scope of intellectual property licensing is often international. The 1995 Department of Justice and Federal Trade Commission Antitrust Enforcement Guidelines for International Operations focus on the governing

principles of antitrust jurisdiction and comity in the global economy and do not address particular commercial practices such as intellectual property licensing arrangements. Recognizing that licensing is often international, the 1995 Intellectual Property Guidelines include a statement that the antitrust principles described in the Guidelines apply equally to domestic and international licensing arrangements, with appropriate consideration for issues such as jurisdiction and comity that may affect enforcement decisions when the arrangement is in an international context, as described in the 1995 Department of Justice and Federal Trade Commission Antitrust Enforcement Guidelines for International Operations.

The 1995 Intellectual Property Guidelines include more detail on the delineation of technology and innovation markets. As discussed previously, the Agencies will delineate technology or innovation markets only when the competitive effects of a licensing arrangement cannot be adequately addressed within the relevant markets for the goods affected by the arrangement. The Guidelines issued today include an additional example (Example 2) that illustrates a situation in which a technology market permits analysis of competitive effects from a licensing arrangement that cannot be adequately addressed within relevant goods markets.

The new Guidelines state that if the data permit, the Agencies will delineate the relevant technology market following the general approach described in the 1992 Horizontal Merger Guidelines. The Agencies will identify the smallest group of technologies, and goods that may be substitutes for the technologies, over which a hypothetical monopolist of those technologies and goods likely would exercise market power -- for example, by imposing a small but significant and nontransitory price increase. The new Guidelines also recognize that technologies are often licensed in ways that are not readily quantifiable in monetary terms. For example, technology may be licensed royalty-free in exchange for the right to use other technology, or it may be licensed as part of a package license. In those circumstances, the new Guidelines state that the Agencies will delineate the relevant technology market by identifying the technologies and goods which buyers would substitute at a cost comparable to that of using the licensed technology.

If market share data are unavailable or do not accurately represent competitive significance, a licensing arrangement that may affect competition in a technology market would nonetheless qualify for protection under the safety zone if (1) the restraint is not facially anticompetitive and (2) there are four or more independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement that may be substitutable for the licensed technology at a comparable cost to the user.

An innovation market consists of the research and development directed to particular new or improved goods or processes, and the close substitutes for that research and development. The Agencies will delineate an innovation market only when the capabilities to engage in the relevant research and development can be associated with specialized assets or characteristics of specific firms. As in the Agencies's approach to the delineation of goods and technology markets, the Agencies will delineate an innovation market by identifying the smallest collection of research and development efforts, technologies, and goods for which a hypothetical monopolist would have the ability and incentive to exercise market power, for example by retarding the pace of research and development.

Market share data may not be available that accurately reflect the competitive significance of current and likely potential participants in an innovation market. When entities have comparable capabilities and incentives to pursue research and development that is a close substitute for the research and development activities of the parties to a licensing arrangement, the Agencies may assign equal market shares to such entities. The Intellectual Property Guidelines include a new example (Example 4) that illustrates the use of an innovation market in evaluating the competitive effects of a research and development joint venture.

Absent reliable market share data, the market share requirement of the safety zone would be satisfied for a licensing arrangement that may affect competition in an innovation market if four or more independently controlled entities in addition to the parties to the licensing arrangement possess the specialized assets or characteristics and the incentive to engage in research and development that is a close substitute for the research and development activities of the parties to the licensing arrangement.

A concluding note of appreciation

Many people within the Antitrust Division and the Federal Trade Commission have worked hard to provide the best advice we can offer on this complex subject. Their input has been essential to the development of the 1995 Intellectual Property Guidelines and I cannot express enough gratitude for their expertise and dedication to this effort. Among the many in the Agencies who have devoted their time and energy to this project, I would like to call particular attention to the very important contributions made by Will Tom, Greg Werden, Neil Roberts, Mike Tecklenburg, Steve Sunshine, Becky Dick, and David Seidman of the Antitrust Division and by Susan DeSanti, Mark Whitener, Tim Daniel, and Josh Newberg of the Federal Trade Commission. I would also like to

thank the many people from industry, academics, and the bar who commented on the draft Intellectual Property Guidelines published in the Federal Register. We developed these Guidelines by following a process of extensive communication and cooperation with interested parties. This close interaction has made it possible to explore challenging antitrust issues related to the licensing of intellectual property and to develop policies that protect the interests of consumers and the intellectual property community.