Importance of Protecting Innovation

As U.S.'s basic industries suffer in competition, recognition of role of patents, licensing gains importance

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As the nation's basic manufacturing industries suffer in competition with foreign suppliers, our ability to innovate new products and processes has become of utmost economic importance. The patent system provides an important incentive for innovation. However, antitrust policy in the past limited the patent right, viewing it as inconsistent with the general scheme of competition. A fresh look indicates that patents and their exploitation provide an important force for competition, as well as economic growth.

THE NATURE AND VALUE OF INNOVATION

Innovation is a risky, costly and lengthy endeavor. The search for technological advance requires originality, persistence, money, and manpower. As the process is pursued toward the development of prototypes and then commercialization of salable products, the resources required mount sharply. The risk of failure is ever present.[1]

Studies of American economic growth have identified innovation as a major source of that growth; a much more significant factor than, for example, the intensification of the use of capital.[2] Indeed, in an important recent book, innovation has been identified as the distinctive force stimulating economic growth in the Western world since the Middle Ages.[3]

Innovation, moreover, is an important source of the competition favored by antitrust policy. Technological change can create new products or methods of production that are so superior to existing ones that they completely displace them and create large benefits in the form of new capabilities, lower costs, additional revenues, and new jobs. Less dramatic improvements can create advantages over existing products that win a share of the market in competition with the older products and provide corresponding economic gains. Joseph Shumpeter, in his 1950 book, aptly called the technological change that characterized the American economy a "gale of creative destruction."[4]

Other forms of competition are often more confined. Price competition is restrained by its direct impact on profits. The main arena of competition often shifts to advertising, service and small product differences, with little impact on efficiency or consumer benefit.

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THE PATENT AND ANTITRUST LAWS

The Patent System stimulates invention and commercialization by providing a 17-year exclusive right to the invention.[5] This exclusive right can be exploited to provide financial rewards to patent owners and investors who are able to successfully commercialize their inventions. The patent incentive has historically been regarded as so important that the Constitution itself provided for enactment of patent laws.

The premise of antitrust policy is that competition will yield the best allocation of resources and the lowest prices.[6] The antitrust laws are largely concerned with efforts of individual companies to improperly achieve or maintain monopoly, agreements between competitors which unreasonably restrain competition[7] and mergers that may tend to diminish competition.[8]

Whereas the emphasis of the antitrust laws is on preventing a *reduction* in competition, the Patent System is a vehicle for stimulating innovation which generates *new* competition.

TRADITIONAL NARROW VIEW OF PATENT PROTECTION

Antitrust jurisprudence did not traditionally recognize patents as a means of affirmatively generating the competition that antitrust policy favors.[9] Instead, the exclusive rights given to patentees were treated as a "special privilege"[10] to be "narrowly construed"[11] in a more general scheme of competition basically hostile to any exclusive rights. For example, the Supreme Court created a "patent misuse" doctrine that denied legal relief to a patentee against infringers if he attempted "to extend the scope of his patent monopoly."[12] Regardless of whether the patentee had actually violated the antitrust laws or caused injury to anyone, and even though there was a separate antitrust remedy against him, which the government or an injured party could pursue if there had been a violation of the law, the right to enforce the patent was withdrawn.

Additional bases upon which courts limited patent rights were decisions applying a high standard of invention under the patent laws. While the Supreme Court rejected a "flash of creative genius" as the standard,[13] many courts nevertheless found patented inventions to be not sufficiently new or unobvious in view of information and devices already known. One appeals court observed that more than 80% of patent infringement actions on appeal result in a determination that the patents

tion that the patents sued upon are invalid.[14]

More recently, the courts have evinced a salutary and proper respect for patent rights.[15]

A case in point involved an antitrust attack on Xerox's right under its patents to exclude others from making infringing xerographic copiers.[16] Xerox, in a now classic example of innovation, had acquired certain basic patents on a crude xerographic process and, at considerable risk and expense, developed it over a 13-year period into an office copier. The copier was successfully introduced, revolutionized the business and, with additional improvements, eventually led to a monopoly position for Xerox. The Court recognized the importance of patents in stimulating innovation and upheld Xerox's acquisition of the patents and its refusal to allow others to use them, even though the patents were, for a time, protecting a monopoly in the copier business. The net economic effect of the introduction of the new xerographic technology has been measured as decidedly positive.[17]

There have also been signs of increased sympathy for the viability of patented inventions under the patent law. The recently created Federal Circuit Court of Appeals, to which Congress shifted jurisdiction over patent appeals, has shown its respect for patented inventions by a number of significant changes in emphasis in the law. For example, the Federal Circuit has elevated circumstantial evidence of the non-obviousness of an invention, such as its commercial success, from a so-called "secondary consideration" to more important "objective" evidence. In one case, it reversed a lower court's decision that a patent to the material "Goretex" was obvious in view of the prior art primarily on the basis that, upon introduction, the material enjoyed substantial use and sales.[18] The Federal Circuit has also demonstrated an increased willingness to grant injunctions against infringement[19] and to closely scrutinize the willfulness of an infringement for purposes of increasing damages.[20]

The result of these changes is a greater incentive to engage in research and development and to obtain patent protection. They have also led to heightened concern among potential infringers about the relief available to patentees.

Enhanced patent protection increases both the desirability to the patentee of exploiting its own patent alone, and also of licensing. In either case, competition is strengthened. The patentee who exploits his own invention introduces a new product that competes with the prior products performing the same function.

Licensing — even with restrictions on the licensee — increases competition by expanding the number of sellers utilizing the proprietary technology. Licensing has become more attractive to a potential licensee than the alternative of litigation, since the likelihood of suit on the patent against infringement is greater and the attractiveness of defending that suit is less.

At the same time, antitrust restrictions on licensing are loosening. The Department of Justice has in recent years altered its negative view of licensing restrictions and now argues that many such restrictions are lawful, or at least should be tested under a Rule of Reason rather than a rule of *per se* illegality.[21] Similarly, recent decisions have suggested an elevated standard for the patent misuse defense to patent infringement that would require a showing of anticompetitive effect.[22]

Our capitalist economy works essentially by holding out the chance of financial reward to induce economic effort. The patent system works just that way, by providing an incentive for innovation. As a dynamic force for new growth and new competition, patents deserve the broader respect that the courts are beginning to provide.

NOTES

1. Unlike tangible property, the inventions that are at the heart of innovations are essentially easily transferable knowledge. Unless protected legally as property, they will not benefit their inventors or protect investors who would undertake the risks to commercialize them. Unless legally restrained, a competitor can "free ride" and copy the innovator's technology, diminishing the incentive to innovate in the first place.

2. *See* F.M. Scherer, "Industrial Market, Structure and Economic Performance," 407-08 (2d ed. 1980) (citing Denison, Accounting for United States Economic Growth, 1929-1969, 131-37 (1974); Solow, *Technical Change and the Aggregate Production Function,* Rev. Of Econ. and Statistics, 1957, at 312).

3. Rosenberg and Birdzell, "How The West Grew Rich: The Economic Transformation of the Industrial World" (1986).

4. *Capitalism, Socialism, and Democracy* (3d Ed. 1950) at page 84.

5. *Kewanee Oil Co. v. Bicron Corp.,* 416 U.S. 470, 480 (1974).

6. *Northern Pacific Railway v. U.S.,* 356 U.S. 1, 4-5 (1958).

7. Sections 1 and 2, Sherman Act, 15 U.S.C. §§ 1, 2 (1890).

8. Section 7, Clayton Act, 15 U.S.C. § 18 (1950).

9. *U.S. v. Grinnell Corp.,* 384 U.S. 563 (1960); *U.S. v. United Shoe Mach. Corp.,* 110 F. Supp. 295, (D. Mass. 1953).

10. *Morton Salt Co. v. G.S. Suppiger Co.,* 314 U.S. 488, (1942) ("special privilege"); *U.S. v. Line Material Co.,* 333 U.S. 287 (1948) ("The monopoly granted by the patent laws is a statutory exception to [the] freedom for competition [of the Sherman Act] and consistently has been construed as limited to the patent grant . . . .").

11. *Mercoid Corp. v. Mid-Continent Investment Co.,* 320 U.S. 661, (1944) ("The limited of the patent are narrowly and strictly confined to the precise terms of the grant.")

12. *Morton Salt v. Suppiger Co.,* 314 U.S. 488, 493 (1942).

13. *Graham v. John Deere Co.,* 383 U.S. 1, 15 (1966).

14. *Carter Wallace,* 443 F.2d 867, 872 (2d Cir. 1971), *cert. denied,* 412 U.S. 929 (1973).

15. A first step was taken in *GTE Sylvania, Inc. v. Continental T.V., Inc.,* 433 U.S. 36 (1977), by the Supreme Court when it recognized, in a different area, that a restriction on competition in the distribution of goods could have a *pro*-competitive purpose. The Court upheld a television set supplier's restriction on the area in which its distributor could resell the sets. The restriction encouraged promotion of competition among different brands by encouraging the distributor to promote the supplier's brand; something he might not do if he feared that a neighboring distributor would "free ride" on his promotional effort and use it to take sales away. *GTE Case.*

16. Scherer, *Industrial Market Structure and Economic Performance* (2d Ed. 1979), p. 454.

17. On the subject of patent misuse, for example, two recent cases suggest, in contrast to the earlier cases, that there should be a showing of anticompetitive effects associated with challenged conduct before the patent right may be withdrawn. The Antitrust Division of the Department of Justice also has adopted a view of patents much more sympathetic than its predecessors.

18. *W.L. Gore & Associates v. Garlock, Inc.,* 721 F.2d 1540 (Fed. Cir. 1983).

Similarly, the Federal Circuit has strengthened the statutory presumption that an issued patent is valid, eased the opportunity of a patentee to obtain a preliminary order stopping infringement before a full trial occurs and increased the likelihood that a successful patentee in an infringement suit will be able to obtain a permanent injunction barring infringement.

19. *E.g. Smith International, Inc. v. Hughes Tool Co.,* 718 F.2d 1573 (Fed. Cir.), *cert. denied,* 464 U.S. 996 (1983); *Polaroid Corp. v. Eastman Kodak Co.,* 228 U.S.P.Q. 305 (D. Mass. 1985), *aff'd,* 789 F.2d 1556 (Fed. Cir. 1986).

20. *E.g. Central Soya Co. v. Geo. A. Hormel & Co.,* 723 F.2d 1573 (Fed. Cir. 1983); *Radio Steel & Mfg. Co. v. MTO Products, Inc.,* 788 F.2d 1554 (Fed. Cir. 1986).

21. Andewelt, "Competition Policy and the Patent Misuse Doctrine", 25 BNA *Patent, Trademark and Copyright Journal* 41 (Nov. 11, 1982); Justice Department Vertical Restraints Guidelines, Paragraph 2.4 (1985).

22. *Windsurfing Int'l Inc. v. AMF, Inc.* 782 F.2d 995 (Fed. Cir.), *cert. denied,* 106 S. Ct. 3275, _____ U.S. _____(1986); *USM Corp. v. SPS Technologies, Inc.* 694 F.2d 505, 510-14 (7th Cir. 1982), *cert. denied,* 462 U.S. 107 (1983).