1 FEDERAL TRADE COMMISSION

2 I N D E X

3

4 SPEAKER: PAGE:

5 STEPHEN A. STACK 6

6 GEORGE S. CARY 16

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1 FEDERAL TRADE COMMISSION

2

3 In the Public Hearing on:)

4 COMPETITION AND INTELLECTUAL)

5 PROPERTY LAW AND POLICY IN)

6 THE KNOWLEDGE-BASED ECONOMY.)

7 ------------------------------)

8

9 MAY 2, 2002

10

11 Room 432

12 Federal Trade Commission

13 6th Street and Pennsylvania Ave., NW

14

15 The above-entitled matter came on for hearing,

16 pursuant to notice, at 9:02 a.m.

17

18 WORKSHOP CHAIRPERSONS:

19 GAIL LEVINE, FTC

20 ROBIN MOORE, FTC

21 WILLIAM COHEN, FTC

22 WILLIAM STALLINGS, DOJ

23 MAGDALEN GREENLIEF, PTO

24

25

1 PANEL ON: A COMPETITION VIEW OF PATENT SETTLEMENTS

2

3 PANEL MEMBERS:

4 GEORGE S. CARY, Cleary, Gottlieb, Steen & Hamilton

5 STEVEN A. STACKS, Dechert

6 THOMAS O. BARNETT, Covington & Burling

7 JOSEPH F. BRODLEY, Professor, Boston University

8 School of Law

9 ROBERT N. COOK, Drinker, Biddle & Reath

10 JAMES J. EGAN, Novirio Pharmaceuticals

11 RICHARD A. FEINSTEIN, Boies, Schiller & Flexner

12 PHILLIP A. PROGER, Jones, Day, Reavis & Pogue

13 CARL SHAPIRO, Professor, Haas School of Business,

14 University of California, Berkley

15

16

17

18

19

20

21

22

23

24

1 P R O C E E D I N G S

2 MS. LEVINE: Good morning.

3 I'm Gail Levine. I'm the Deputy Assistant General Counsel for
4 Policy Studies here at the FTC, and I'm joined today by two of my
5 colleagues, Robin Moore, who's an attorney in the General Counsel's
6 office in Policy Studies, and by Bill Cohen, who is the Assistant General
7 Counsel for Policy Studies here at the FTC in the General Counsel's
8 office.

9 I would also like to introduce the representative
10 from the Justice Department, Bill Stallings, and we may be
11 joined as well by a representative from the United States
12 PTO, Magdalen Greenlief, but I want to take a brief moment
13 before we jump in to the substance today just to introduce
14 our panelists.

15 I want to introduce our panelists and have themselves
16 give a quick summary of what you've been doing in the patent
17 area, to put your thoughts in context for us. So let me get to our
18 panelists.

19 We have with us today Tom Barnett, from Covington &
20 Burling; Professor Joe Brodley from Boston University School
21 of Law and an alum of my office, so we're glad to have him
22 back for a short while today; Phil Proger from Jones, Day;
23 Rich Feinstein, another alumni of the FTC, now of Boies,
24 Schiller & Flexner.

25 We also have with us today James Egan, senior vice

1 president of Novirio Pharmaceuticals; Robert Cook from
2 Drinker, Biddle & Reath; Carl Shapiro of the Haas School of
3 Business, University of California at Berkley; George Cary of
4 Cleary Gottlieb, and Steve Stack from Dechert.
5 Just a couple housekeeping matters for the day.
6 We're going to start the day with a couple presentations by
7 Steve Stack and by George Cary. We've asked them to make
8 some short presentations, just to kickoff the issues for us.
9 Steve is going to present on the cross currents of
10 policy in the patent settlements area, and then George Cary is going to
11 be making a presentation on some other key issues that have come up in
12 the patent settlement area.
13 Then we're going to have a panel discussion. We're
14 going to open it up to the entire panel for conversation, and
15 basically we'll be covering three areas. The first area will
16 be, why do firms settle patent litigation? What are the pro-competitive,
17 efficiency-oriented reasons that firms settle
18 patent litigation?
19 After that, I thought we would take a little break
20 from about 10:00 to 10:15 and then we'll get into the real thorny
21 questions of, When do patent settlements pose antitrust concerns, if they
22 do, and finally, when does Noerr pose a defense to an antitrust challenge
23 to a patent settlement?
24 With no further ado, let's turn to those PowerPoint
25 presentations. Steve, would you kick us off, please?

1 and the fall-out from litigation. We're talking about
2 obviously the expenses of a trial, but there are other
3 expenses as well or at least other costs as well.
4 We're talking about management distraction, adverse
5 publicity. The analysts, if it's an important product, will
6 follow the litigation. That tends to depress the shareholder
7 value, and they want to avoid that adverse effect as well.
8 Also as they go through the course of a litigation,
9 there's a dynamic factor at work. Litigation has its ups and
10 downs, battles lost and won, and as the parties go through
11 that process, they may begin to question whether they're
12 likely to get what they hoped to get at the outset of the
13 litigation.
14 As litigation expectations shift, other things are
15 shifting as well. The market for the patented product may be
16 changing. The parties' patent portfolios may be changing. A
17 patent that's deemed to be very important at the outset of a
18 litigation may, as further innovation is done by the patent
19 owner, become less important. The strategic value of the
20 patent in suit, therefore, may be changing as well.
21 As a result, business solutions that might have been
22 unthinkable when the complaint was filed suddenly begin to
23 look a lot more attractive, and as these factors begin to
24 line up, the result is often a settlement agreement, and it's
25 frequently brokerage by a judge or a magistrate or a court-

1 appointed mediator.
2 Turning now to the policies that come into play. I
3 don't intend to offer my own opinion on the relevance of the
4 merits of each of these, but I'm just going to lay them out
5 as policies that at least deserve some consideration.
6 I'll start with the obvious one since we're in an
7 antitrust forum here, and that is preserving competition. It
8 may not be quite as simple as it sounds. As we've seen from
9 the outset of these hearings, maximizing consumer welfare
10 requires some balance between short-term benefits from
11 competition, uninhibited by patents or unimpeded by patents,
12 and long-term benefits from innovation, which may be enhanced
13 by patent protection.
14 That leads to the second related policy concern, the
15 effect of patent settlement rules on innovation. The point
16 here is that harsh or uncertain rules may deter settlements.
17 That may lead to more uncertainty over the value of patent
18 rights in general, which may in turn lead to less innovation,
19 at least in those industries where patents form an important
20 role in fostering innovation.
21 Another policy consideration, again central to
22 antitrust, is efficiency. Two of the most obvious
23 efficiencies I've mentioned before are eliminating risk and
24 avoiding legal expenses. Here I want to suggest really a
25 third one.

1 Litigation produces a lot of information about the
2 patent and about the importance of the patent. The parties
3 don't have that information in a normal licensing context.
4 If you believe that better information leads to more
5 efficient transactions, you might conclude that licenses
6 negotiated in a settlement context are more efficient than
7 licenses negotiated outside of litigation when you don't have
8 that information that you get during litigation available to
9 you.
10 So, to the extent that antitrust rules discourage
11 settlements, they may drive the parties to do more licensing
12 transactions outside of litigation before the suit is filed.
13 They have less information there, and you might conclude that
14 those transactions might be less efficient than the
15 transactions you would get in a settlement context.
16 Another policy that comes into play obviously stems
17 from the role of the courts in the patent system. To put it
18 bluntly, they're the ultimate determiners of the patent
19 validity, so it is their role, along with obviously the PTO
20 and the processes of the PTO, to weed out invalid patents.
21 And it's for this reason that many of the antitrust
22 and patent law doctrines that you see have been shaped by an
23 explicit policy of encouraging challenges to patents.
24 Settlements obviously run counter to this policy
25 since they take the issue of validity away from the court, so

1 again you might say that strict antitrust rules that
2 discourage settlements are a good thing, a good thing because
3 force more cases to trial where invalid patents can be
4 eliminated, but there's also a double edge to this sword as
5 well.
6 If you force patent litigation into a dual to the
7 death with no exit possible, you may deter patent challengers
8 from entering risk in this the first place. The result would
9 then be fewer patent challenges.
10 Last, but certainly not least, we have the judicial
11 policy favoring settlement of litigation. There are really
12 two dimensions to this policy. There's a general social
13 policy that says compromise is better for the social fabric
14 than a regime of what I'll call pistols for two, coffee for
15 one, and far importantly, a strong need to clear the courts
16 of disputes that do not need to be there.
17 I'll turn back to this policy later, but let me say
18 that it's one that antitrust cannot afford to ignore because
19 simply the plain reality is that judges are going to give it
20 very great weight, and it's going to enter into their
21 decisions whether antitrust purists would like that result or
22 not.
23 Finally, let me just take a couple minutes to tee up
24 some of the issues that are raised by settlements. I'll be
25 focusing here on issues that are peculiar to the settlement

1 context. There are obviously a lot of issues that come up
2 with settlement agreements that are the same as issues that
3 would come up in licensing agreements and would be treated in
4 the same way that they would be treated in a licensing
5 context, but what I'm going to focus on are agreements where
6 the settlement context adds a dimension to the problem that
7 isn't there in other contexts.
8 Without a doubt, the most difficult issue in the
9 settlement context, at least in my view, is what credit you
10 give to the patent itself and the power of the patent to
11 exclude competition.
12 Settlement agreements very often contain licenses
13 that limit the licensee's activity operating within the scope
14 of the patent. They may restrict the licensee to a specific
15 territory, to a specific field of use or to a particular time
16 frame within the patent term. How you approach the
17 exclusionary patent power of the patent will give you very
18 different results when you consider those kinds of
19 restrictions.
20 It seems to me there are basically three options.
21 You can presume that the patent is valid. You can ignore the
22 patent all together, or you can treat the patent's power to
23 exclude as a fact issue, something that you litigate ab initio
24 in each case.
25 If you assume that the patent is going to be valid,

1 several things flow from that. The relationship is vertical,
2 not horizontal. There's no anti-competitive effect that can
3 be attributed to the settlement agreement because the
4 restriction it's operating within the scope of the patent,
5 and therefore there's no effect beyond the scope of the
6 patent.
7 And thirdly, the 1995 IP guidelines and the case law
8 analysis provides a rich source of authority for analyzing
9 the licensing agreements because a great deal of it depends
10 on the assumption that the patent is valid.
11 You can also ignore patent rights. In that situation
12 the parties' relationship very often, if they're competitors
13 or would be competitors otherwise, is horizontal, and many of
14 the common licensing restrictions could be per se illegal. I
15 mentioned before territorial restrictions, field-of-use
16 restrictions and restrictions on time within the patent
17 currently.
18 Finally, there's the possibility of treating the
19 patent exclusionary power as a fact issue, something that the
20 courts and the agencies really haven't tried to do so far, at
21 least to any great degree. The key question under this
22 approach is, What do you have to prove, and how do you go
23 about proving it?
24 Must the antitrust plaintiff relitigate the patent
25 case and prove that the patent is, in fact, valid, which

1 would in a sense be a retroactive kind of determination? How
2 would this square with the policy that I mentioned earlier
3 favoring judicial economy, or can the plaintiff prove perhaps
4 from the evidence of the parties' own assessments at the time
5 they entered into the settlement, that below a certain
6 probability of success, the exclusionary power can be
7 discounted or even ignored all together?
8 If so, is this a workable standard? Why wouldn't you
9 then apply the same analysis to ordinary licenses because
10 when you think about it, a license really is a settlement
11 agreement of a dispute that hasn't ripened into litigation
12 yet.
13 Another issue: what is the relevance of intent? Can
14 we use intent to separate good settlements from bad
15 settlements? The first question there is, What kind of
16 intent are we talking about, an intent to exclude
17 competition? Isn't this why people get patents in the first
18 place, to exclude competition? How reliable, therefore, is
19 that as a criterion?
20 How about the intent to avoid a determination of
21 patent invalidity, which is a factor in some of the older
22 cases? Again isn't this always why people settle cases, to
23 avoid an adverse decision? So how reliable is this as a
24 criterion that would separate a good settlement from a bad
25 settlement, or are there other forms of intent that might be

1 relevant as well?
2 Next big issue, Is the per se rule appropriate in the
3 settlement context? It seems to me this raises several
4 subsidiary questions. What about the efficiencies we
5 mentioned earlier? Don't these take you out of the per se
6 category? Can we say that settlement agreements are
7 anti-competitive in an overwhelming number of cases, which is
8 another criterion for per se treatment?
9 If you think that the patent owner might win a
10 significant number of cases that settled, then maybe
11 settlements can't be illegal per se because they don't have
12 that overwhelming statistical probability that they would be
13 anti-competitive.
14 And finally, what about the judicial policy favoring
15 settlements? Isn't this a redeeming virtue that in and of
16 itself precludes per se treatment?
17 That leads right into the next significant issue.
18 How in an antitrust analysis do you factor in the judicial
19 policies favoring settlement? Is this a make weight? Is it
20 a trump card? Is it something else?
21 One difficulty with this is it really operates
22 outside the antitrust value scale. There's no competitive
23 variable coming from this policy that you can balance with
24 the other competitive variables that you usually turn to in a
25 rule of reason analysis.

1 How then can you account for it since there's really
2 no common unit of measurement that embraces all of these
3 policies? How do reverse payments affect the analysis,
4 obviously a big issue these days?
5 As you know, reverse payments are payments that run
6 from a patent-holder to the alleged infringer. Normally you
7 would expect the payments to run the other way. Given the
8 suspicion that these payments may represent a sharing of
9 monopoly rents, should they be presumed unlawful?
10 Is that presumption stronger when the amount of the
11 payment exceeds any reasonable expectation that the alleged
infringer would realize in the [illegible]

1 has been, for good or for ill. My background comes first
2 from representing patent challengers in the high tech
3 context. I also have background at the FTC working with
4 patent issues and approaching it as an enforcement agency
5 might.
6 I was involved initially on behalf of generics in
7 challenging some of the agreements whereby generics and
8 branded pharmaceutical companies settled patent disputes in a
9 way that resulted in the generics not coming to market, but
10 I've also advised branded pharmaceutical companies in terms
11 of what kind of settlement agreements would pass antitrust
12 muster, what kind of licensing agreements would pass
13 antitrust muster, so I've been on both sides of that issue,
14 counseled on both sides of that issue.
15 I've also been involved in the high tech area from
16 the point of view of challengers who are asserting patent
17 rights against monopolists. We represented Stack Computer,
18 for example, when it was challenging Microsoft for a patent
19 infringement, and I've been on the side of defendants who are
20 also challengers to a monopoly position who have IP rights
21 where the monopolist is in essence trying to put the
22 competitor out of business by asserting IP rights against the
23 smaller rival.
24 So my presentation is going to be a little less
25 direct in focus than Steve's was, and I'm going to try to hit

1 the issues from both sides, from all sides, just identifying
2 what the issues are and talking a little bit about why firms
3 settle and what the antitrust implications of that are.
4 Again, like Steve, I'm not necessarily going to take
5 any firm and fast positions. Any position I take is going to
6 offend somebody, so I'll lay them out there, and people can
7 bat them down or applaud them as we go through.
8 So why do firms settle patent litigation? They
9 settle because the gains from settlement in their judgment
10 outweigh the costs of settling. That seems like a pretty
11 bland and unobjectionable statement.
12 The question is, What are those gains, and how do
13 those gains affect the antitrust analysis, and who's gains
14 ought to be relevant in the antitrust analysis?
15 There are really several interested parties here, not
16 only the plaintiff and the defendant, but there are also
17 customers of each who have a vested interest in how the
18 patent litigation is resolved, so I'm going to assess the
19 question of what the gains from the settlement are from the
20 perspective of all three of those interested parties.
21 First of all, both sides to a litigation benefit by
22 reducing litigation risks and uncertainty, and as Steve
23 pointed out, that can be, depending upon the value of the
24 patent, a very, very important issue for the economics of the
25 firm and for its position in the equity markets.

1 An important factor that contributes to that
2 significance is the all or nothing nature of patent
3 litigation. The patent holder wins and the competitor is out
4 of business, or the defendant wins and the patent holder
5 loses any return on whatever investment it made on the
6 innovations that it's trying to vindicate. So the stakes are
7 high, and without a compromise, there is very little room for
8 anything but an up or down decision.
9 The settlement will avoid litigation expense, which
10 can be considerable, especially for a challenger, a
11 challenger to an incumbent with market power monopolists, and
12 it also distracts senior management and senior technological
13 officials within the company, and the value of this cannot be
14 understated.
15 If you have a high tech company, you live and you
16 breathe by virtue of the innovations you're able to develop
17 in the laboratory, and having important officials in the
18 company off worrying about litigation and taking depositions
19 and helping the lawyers, that can be a very, very expensive
20 proposition, again probably more so from the perspective of a
21 challenger rather than an incumbent, but it's important to
22 both.
23 What does the plaintiff get from settling the
24 litigation? First and foremost, it gets compensation for the
25 infringement of intellectual property from its point of view

1 as it sees it. Some compensation is perhaps better than the
2 risk of none, even though the gains of all would probably
3 outweigh that, but from the point of view of a patent holder,
4 they've invested in innovation. They've come up with a
5 patent, and getting return on that patent is important.
6 Oftentimes patent settlements involve sort of
7 clearing the debris. Two firms will have patent portfolios.
8 Those patents portfolio pose a risk to each other. The
9 patent portfolios, therefore, are hanging over each other,
10 and a patent litigation on one or more of those patents may
11 result in a complete cross license, which frees both firms
12 from the risk of future patent litigation, frees both firms
13 to innovate in the most efficient way without worrying about
14 inventing around patents, and can therefore provide values to
15 the plaintiff as well, in this context I suppose to the
16 defendant of clearing the underbrush.
17 Those are sort of the standard business
18 justifications for intellectual property settlements. I'm
19 sure there are others, but there are also strategic
20 implications that go directly to the role of antitrust in
21 this context.
22 One of the benefits of patent settlements can be to
23 raise the costs of the competitor firm. It can also be to
24 limit competition between the plaintiff and the defendant.
25 Raising the cost could result from the structure of a license

1 that's issued, so instead of having, for example, a lump sum
2 payment, you might have a royalty that's paid on sales over
3 time. That affects competition in that it might affect the
4 pricing incentives of the firm, the defendant firm.
5 It limits competition by virtue of restrictions in
6 the licensing agreement, which explicitly state that the
7 license is good for one field of use and not for another with
8 a recognition that competition without the license would be
9 risky and might invite future litigation.
10 It can also limit competition by virtue of a clause
11 in the settlement agreement where the patent is acknowledged,
12 and the scope of the patent is defined, thereby precluding
13 the defendant from entering into another area having admitted
14 that the patent covers that area.
15 Finally, the plaintiff could use the patent
16 settlement to leverage its legitimate monopoly by virtue of
17 the patent in a particular technology into market power that
18 goes to a complete product area, whether or not the patent is
19 relevant or even beyond that in some cases, and this can be
20 accomplished through careful and skillful crafting of the
21 settlement agreement itself, so obviously the last three of
22 these bullet points raise antitrust questions.
23 Finally the combination of the patent positions of
24 the two firms that might be exchanged in a cross license,
25 potentially an exclusive cross license, could also raise

1 barriers to entry to third-parties by creating a patent
2 thicket that deters others from trying to enter.
3 What are the gains from settlement for the
4 defendant? Well, first of all, obviously the defendant
5 potentially gets to remain a competitor in the marketplace.
6 That's typically the case in patent settlements, not always
7 the case as we've seen in some of the pharmaceutical cases.
8 Defendants often have very, very powerful incentives
9 to enter into settlement agreements, not only because it
10 allows them to stay in the specific product market that's at
11 issue by virtue of the patent itself, but also because
12 companies oftentimes have very, very large sunk investments
13 that are related to the patented technology.
14 This can be an important driver because even if the
15 patent itself is not particularly valuable, the investment
16 that the company has around a product that contains that
17 patented technology can be quite substantial.
18 That being the case, the patent defendant would be
19 quite willing to enter into quite onerous settlement
20 agreements, even those that restrict its competitive freedom
21 beyond what one would normally expect in a licensing
22 situation if you're starting from the beginning in order to
23 protect that investment.
24 One of those investments might be the good will of
25 the firm with customers. One of the fallouts of losing

1 and expand output to the benefit of the customers, and
2 consumer welfare can be enhanced relative to litigation
3 alternatives by reducing risk and basically benefitting not
4 only the plaintiff and defendant but also customers in that
5 context.
6 So the question is, are these on balance, these
7 considerations indicate that patent settlements are
8 pro-competitive or anti-competitive? Obviously the gains
9 from patent settlements to litigants can be good or bad for
10 customers as we've seen. Patent settlements can be either
11 anti-competitive or pro-competitive, and the real question is
12 how do you tell the difference?
13 Telling the difference is obviously what we're all
14 about here, and it is an extremely challenging effort from
15 the point of view of the antitrust agencies. The source of
16 the problem is that patent litigation involves competitors.
17 It implicates the ability of one of them to remain in the
18 market.
19 Settlements often involve private agreements between
20 competitors which directly implicate the extent of their
21 competition going forward, so it raises all of the concerns
22 that horizontal agreements would ordinarily raise, and
23 antitrust has historically been quite suspicious of private
24 arrangements governing competition.
25 But more than in other contexts, these kinds of

1 relationship between the value of the patent itself, which
2 maybe in the first instance could have been easily invented
3 around or was not a necessary part of the product, but once
4 it's incorporated in the product, there's a huge investment
5 that is made and is riding on the continued necessity of
6 using that patent.
7 There is a tremendous leverage for the plaintiffs,
8 even with the low probability of success, and combined with a

1 pro-competitive than settlements that preclude competition
2 going forward, which raises the question about agreements
3 that enable future competition in exchange for payments.
4 What happens if the settlement results in an
5 agreement that the infringer can use the patent starting two
6 or three years from now? How do you balance pro and
7 anti-competitive effects in that scenario?
8 Settlements that license without restriction are more
9 likely to be pro-competitive than settlements that confine
10 competition through ancillary constraints. Payments from the
11 infringer to the patent holder are more likely to be
12 pro-competitive than payments from patent holders to the
13 infringers, especially when this is coupled with delayed
14 entry or other restrictions on competition going forward.
15 Cross licenses are more likely to be pro-competitive
16 than patent pools, which combine in one hand the right to
17 license the individual patents of the competitors.
18 Nonexclusive licenses are more likely to be pro-competitive
19 than exclusive licenses. Exclusive patent licenses can
20 prevent third-parties from entering and eliminates
21 competition in licensing.
22 Lump sum royalty is more likely to be pro-competitive
23 than an ongoing royalty based on sales. Again, the
24 assumption is that a variable payment will affect prices more
25 directly than will a lump sum payment upfront. A lump sum

1 payment upfront will more emulate the initial investment
2 which is usually fixed for R&D.
3 The problem is that because these generalizations do
4 not always apply, it is difficult to fashion per se rules.
5 On the other hand, because of the great uncertainty and other
6 limits on the agencies' ability to determine the likely
7 outcome of patent litigation, with its "all or nothing"
8 characteristics, it is difficult for the agencies to perform
9 a rule of reason analysis, thereby creating the problem.
10 MS. LEVINE: Thank you very much. Thanks to both of you
11 for teeing up the hard questions for us.
12 Again, let me sort of go over the ground rules.
13 Please jump in at any time. We'll toss out questions --
14 Robin's going to throw out the opening pitch -- and
15 please turn up your name tents like this if you want any one
16 of us to recognize you so you have a chance to talk. And
17 don't forget, as George and Steve did so well, please
18 introduce yourself and give yourself some background so we
19 know the context of your thoughts this morning.
20 Robin?
21 MS. MOORE: My first question was going to be: Why
22 do firms settle? And focusing on the efficiencies, since both
23 Steve and George gave us a number of reasons that firms might
24 settle, maybe the best thing to do is open it up to the panel
25 for comments and questions.

1 (Discussion off the record.)
2 MR. COOK: Hi. I'm Bob Cook, and I guess for the
3 last three years I've provided counseling on some of these
4 issues. Before that I was at the FTC and was involved in the
5 investigations of the Digital Intel settlement and the Boston
6 Scientific Ciba settlements so that's where I'm coming from.
7 And I think what came out is parties settle these for
8 the same reasons they settle other lawsuits, and so it's
9 efficient between the parties, and the question is whether --
10 and I think Carl pointed it out in his article, whether there
11 are persons who might be harmed by the settlement that make
12 it not efficient in an economic sense, and that's why
13 antitrust comes up.
14 You might have consumers harmed, for example, in ways
15 that are cognizable under antitrust, and that comes up.
16 There might be other parties too. Settlements are not immune
17 from other legal rules or regulation.
18 MS. LEVINE: Carl?
19 PROFESSOR SHAPIRO: Hi. I'm Carl Shapiro. I've
20 actually been working on and writing papers on licensing
21 going back about 15 years. More recently I've been involved
22 in a number of these cases involving settlements, and I've
23 written a paper, economic research paper which was made
24 available I believe.
25 On this question about why firms settle, I guess I

1 might suggest turning it around. Why don't firms only
2 settle? The reason I put it that way is one of the
3 principles from the law of economics, settlement generally,
4 and not just in the patent area, is that since there are
5 costs associated with litigation, that we would think
6 typically there would be some mutual benefit of settling
7 rather than incurring those costs.
8 So, in fact, the academic literature at least has
9 asked, Why do we get disputes that continue, even though it's
10 costly to fight it out?
11 Now, of course, you might just as well ask why don't
12 we always have peace instead of war, but one of answers is
13 the usual reason we don't get settlements is when both sides
14 are relatively optimistic about their prospects, okay, so
15 there's going to be disagreement about, I may think I have a
16 70 percent of chance of winning, and you may think you have a
17 50 percent chance of winning.
18 Well, those are kind of inconsistent, but we may hold

1 this basic principle, both parties are relatively optimistic,
2 and so they want to go forward, and perhaps they learn more
3 in the process that narrows those differences of opinion, and
4 then they can settle at a later point, even if they couldn't
5 settle it prior to entering into litigation.
6 PROFESSOR BRODLEY: I'm Joe Brodley. I'm a professor
7 at Boston University Law School. Just in response to the
8 last thing, Carl, you know, if they always settle, then we
9 would have to subsidize litigation because without the flow
10 of litigation, we wouldn't have any law.
11 So that parties when they litigate, thank God, really
12 do have differing views or opinions about settlement.
13 MS. LEVINE: You don't want to go to a Code system?
14 PROFESSOR BRODLEY: I think that actually runs
15 through some of the topics today, which is the positive value
16 that litigation contributes both through clarifying the
17 law and through the deterrent effect it has on improper patents.
18 So that's getting a little bit beyond the topic right
19 now, but it just seems to connect with the fact that a world in which all
20 cases settled would not be what we're aiming for and is
21 not a legal world I suggest.
22 MS. MOORE: Jamie?
23 MR. EGAN: James Egan. I'm with Novirio
24 Pharmaceuticals. And I would like to come at this from an
25 industry perspective. I recognize the cost of litigation can

1 be considerable in these matters, but in the bio-tech and
2 pharmaceutical industry, at least in my limited experience,
3 litigation costs often more or less is a rounding error.
4 When you're talking about patents that deal with
5 billions a year and the lawyers are costing you ten million a
6 year, for some of the CEOs in this industry, that's bigger
7 than the greens fees, but it's not bigger than the cost of
8 gassing up the G 5.
9 It's a situation where I think it many cases the
10 consumer interest gets lost out in the shuffle. The
11 activities of the legal profession, God love them, are
12 important to us, although I don't know if we should subsidize
13 them or get better laws, but the long and short of it is
14 strong patents don't get litigated against. It's the marginal
15 patents that do.
16 When you get into territories where you have two
17 major players with the wherewithal and the interest to get
18 into litigation, allowing them to come to a settlement and
19 not have greater antitrust agency review on a regularized
20 basis I think is a little bit like sending the goat out to
21 guard the cabbage.
22 I think the consumer interest is best represented by
23 the agencies who are the advocates. One of the background
24 areas here for me is that the business community is an
25 adversary system. That's what competition is really all

1 about, and the legal system is certainly an adversary system,
2 and I don't see strong advocate consumers in most of these
3 settlement negotiations.
4 It's usually after the fact. I don't know for a fact
5 whether people file Hart-Scott-Rodino disclosures when they
6 reach these settlements or anything of that nature. I don't
7 know how regular the communication is to the FTC or the
8 Justice Department. I imagine litigants don't go in and ask
9 the permission of the competition agencies on a regular
10 basis.
11 But speaking more as a consumer, as someone who makes
12 a living from a legal profession or someone that would like
13 to protect patents, I was wondering whether there was any
14 concern among all the citizens located here today, whether
15 there's an interest in the consumer's interest in these
16 settlements today.
17 MR. PROGER: Phil Proger, and let's see. I have
18 represented patent holders in a number of industries,
19 including today pharmaceutical patent holders who have been
20 involved in some of these settlements, but in saying that, I
21 want to round it out by saying I've been practicing antitrust
22 laws for 29 years, and I'm a strong believer in our free
23 market system, and antitrust is the referee of that system,
24 so I think, I hope this can come out with some balance.
25 I think this is a difficult issue, and I think it is

1 a very broad issue. You have a number of competing
2 incentives. There's the incentives and goals for the society
3 to have competition. There's the goal of society to have
4 innovation through a patent and intellectual property
5 protection system. After all that's in our Constitution to
6 have it, and there's the goal of having settlements and
7 judicial efficiency.

8 We've talked about how, in looking at these
9 settlements, your information and your knowledge changes
10 through the settlement. I think there's another factor to be
11 considered here in the risk.

12 We have a very good judicial system to adjudicate
13 these things, but it's not perfect, and the patent area is
14 one area that particularly challenges the judiciary, and one
15 reason why you have patent settlements here is because often
16 the issues themselves are highly complex, highly difficult,
17 take enormous resources to litigate take very long time to
18 litigation, and the judicial system may not be ultimately the
19 best place to properly decide that. If you can have two
20 parties that can resolve the differences in a way that of
21 course is lawful, I think society benefits.

22 One point about consumers, certainly consumers
23 benefit by good settlements and do not benefit by bad
24 settlements, but let's remember, consumers also benefit by a
25 system that rewards innovation and a system that promotes new

1 drugs, new products, new inventions, new technology.

1 the patent.

2 I think there's another element, and maybe this can
3 be wrapped into the optimism point, but sort of a real world
4 litigation point. There are a number of elements. One element
5 is that, as I mentioned before, this whole idea that there is
6 a huge rent to be gained by the patent holder if he can put
7 somebody out of business by doing a narrow patent that
8 intrinsically has very little value.

9 He can extract all that sunk investment that the
10 patent alleged infringer has incurred, and therefore he might
11 demand that kind of a payment, and the infringer night cringe
12 at having to pay that kind of a settlement fee in order to
13 resolve a patent dispute where, in fact, that investment has

1 windshield wiper.

2 So there's a hold up opportunity there if you can
3 grind the whole factory to a halt because you've got a patent
4 on a windshield wiper.

5 Another element that comes into play is just the
6 litigation process itself. Typically if you're talking about
7 important high tech companies, they're going to have patent
8 portfolios. I don't want to say typically but often a
9 challenger is going to be reluctant to take on an incumbent
10 because of a presumed perception that the incumbent might
11 have deeper pockets or greater staying power.

12 The result of that might be that the incumbent sues
13 first, and then there's an all out war on a portfolio of
14 patents, and there might be some reluctance on the part of
15 the plaintiff to settle if it gets a jump in the litigation
16 process and if it can get to judgment before the other patent
17 issues on the cross complaint get to judgment, and it can
18 then leverage that into a disproportionate settlement.

19 So there is some gamesmanship in the litigation
20 process itself, which might discourage settlements and might
21 yield inefficient results well beyond the transaction costs.

22 MS. LEVINE: Is that curable within the litigation
23 process? Is this an argument to be pitched at the Rules of
24 Civil Procedure and to judges?

25 MR. CARY: Conceivably, yes.

1 MS. MOORE: Rich?
2 MR. FEINSTEIN: I'm Rich Feinstein. I've practiced
3 antitrust law for about 25 years. My familiarity with the
4 issues that we're talking about today has been framed almost
5 entirely by a three-year period that I spent at the FTC
6 between 1998 and 2001 in the Health Care Shop, in the Bureau of
7 Competition, where we fought pretty hard on a lot of these
8 issues and sort of picked up -- to use a metaphor, sort of
9 picked up a rock and shown a flashlight underneath it, and
10 lots of different things went off in different directions

1 exclusivity is also an incentive for innovation, and to the
2 extent that settlements may improperly prolong periods of
3 exclusivity, they may be problematic for that reason.
4 MS. LEVINE: I have a follow-up question. I don't
5 want to get into the nuts and bolts on the issues except how
6 do you mean -- what kind of prolonging of the patent term do
7 you imagine happening with patent settlement.
8 MR. FEINSTEIN: Well, it's probably most likely to
9 occur in the setting that involves the Hatch Waxman
10 settlements, which as I said, to the extent I have any
11 expertise in this area, it would be there, and typically
12 those settlements have not involved sort of the patent on the
13 compound, which would in some sense be a blocking patent.
14 It tends to be a patent on the delivery mechanism or
15 sort of the bells and whistles that accompany the basic patent,
16 which typically has expired.
17 In that situation there could be -- you can imagine a
18 settlement which could have the effect of prolonging -- in
19 effect prolonging the period of exclusivity for the product
20 as a whole.
21 MS. LEVINE: Thanks.
22 MR. BARNETT: I'm Tom Barnett. I'm with Covington,
23 and I have advised a number of companies. I probably should
24 confess I'm a bit like Steve. I tend to be on the patent
25 holder side of the issue, so I will confess that up front,

1 largely in the pharmaceutical area, and indeed I had some
2 experience with Rich when he was at the FTC on some issues
3 that at least touch on this.
4 I think there's been a very good summary of the reasons why
5 you settle: the uncertainty, the cost. What I would like to
6 underscore is a lot of the dynamics of what is involved and how
7 difficult it is to take into account all of the factors that come
8 into play, and just two sort of examples is, Why don't people
9 settle?
10 On the one hand, if you are the patent holder, you're
11 defending the patent and you have somebody challenging it,
12 and you settle with this plaintiff or defendant, you may well
13 have a stream of 5, 10, 15, 20 companies following on, and
14 you've set a precedent now, and so the cost of your
15 settlement is more than just the cost of this particular
16 suit.
17 Also I guess on the other side of it is why you might
18 settle, if you take the example of the pharmaceutical
19 industry where you've got a major compound that's a billion,
20 $2 billion a year drug, and a company is trying to decide
21 whether or not to settle this challenge, it's not only the
22 litigation cost, it's not only management distraction. To
23 some extent it goes to the fundamental philosophy and
24 business decisions of the company. Do I have one to two years of
25 this revenue coming in to fund research and development? If

1 MR. PROGER: No. Let's say -- one of the things we
2 haven't talked about here is the distinction between lawful
3 competition and unlawful competition. What the patent laws
4 give you is not a monopoly but rather the right to exclude.
5 Whether it's a monopoly or not is an antitrust issue. But if
6 you have a valid enforceable patent that somebody is
7 infringing, and that someone therefore takes away legitimate
8 returns that are owed to you for your innovation and
9 ultimately you prevail, but if that entity is judgment-proof
10 because they have no assets, where's your remedy? You've lost.
11 Maybe your market has been destroyed and an innovator that faces
12 that as all innovators broadly have to factor that into their
13 R&D, to their other analysis to their decisions of whether
14 they're going to proceed with the appropriate investors.
15 So from a societal standpoint, we need to be
16 concerned about that.
17 PROFESSOR BRODLEY: My comment goes back to James
18 Egan's remarks. I thought that you said something extremely
19 striking. I wonder if other people agree. You said that
20 strong patents don't get litigated and marginal patents do.
21 Now, I think that is -- I would like to know if the
22 rest of you agree. What I'm thinking is that if that's the
23 case, then the losses from litigation would be a lot less
23

1 strong but the scope of the patent is unclear or uncertainty,
2 and that may be what you mean by a weak patent in that
3 context, but that to me doesn't say the patent is weak.
4 There's just a great deal of uncertainty, and that leaves
5 room for parties to disagree as to the probability of success
6 as well as some of the other factors.
7 MS. MOORE: Phil?
8 MR. PROGER: I'll be real brief because I was going
9 to say what Tom said in the Hatch Waxman context, I don't
10 think that's necessarily a true statement.
11 MS. LEVINE: How is that?
12 MR. PROGER: Well, because under Hatch Waxman, the
13 alleged infringer has very little risk because you file the
14 ANDA pursuant to the statute, and that's your act of infringement,
15 so as Tom pointed out you could have a very low probability of
16 success against a very strong patent, but you don't have much at
17 risk, and there might be an enormous reward if you could knock it
18 out.
19 So you may very well want to challenge a strong
20 patent that has a lot of returns.
21 MS. LEVINE: And in the non-Hatch Waxman context?
22 MR. PROGER: I think in the non-Hatch Waxman context,
23 it's a little bit different because there you're allegedly
24 infringing, and you may have a lot more at risk, and I think
25 it also differs a little bit, and we failed to mention that a

1 lot of times people get sued for infringing without realizing
2 that they're infringing.
3 But when you said strong patents do not get
4 challenged, particularly in the Hatch Waxman context, I don't
5 think that's necessarily true.
6 MR. EGAN: I don't know anybody in my industry who's
7 in the habit of challenging strong patents and doing well.

1 today perhaps the law has changed.
2 MS. MOORE: Bob, you've been waiting a long time.
3 MR. COOK: That's okay, I was just going to comment,
4 and it's probably just as apropos now as it was when I was
5 going to make it originally, that when parties are litigating
6 these pleadings and arguing these cases and then settling
7 these cases without thinking ahead of time they're going to
8 have a settlement, that may raise antitrust issues, they
9 often say things that come back to haunt them because you're
10 making really statements applicable to product market issues
11 because you're saying that they infringe, and you're saying
12 you would have gotten all the sales that the other guy got.
13 And that's problematic then when you run into an
14 antitrust review of the settlement because you may have
15 foreclosed some of your issues. That was my comment.
16 MS. MOORE: I actually had a follow-up question to
17 something you said earlier and something that George brought
18 up in his presentation. When we kicked off, Bob, I think you
19 said that you settle in the IP context for the same reason
20 that you settle any sort of litigation, and when George was
21 making his presentation, he brought up the point that in the
22 patent litigation, you're pretty much talking about an all or
23 nothing gain.
24 So I would like to get the panel's reaction. Is it
25 different in the IP context? Are the efficiencies different

1 because of that?
2 MR. COOK: Well, I guess my point was simply that the
3 efficiencies are efficiencies between the parties.
4 MS. MOORE: Okay.
5 MR. COOK: That is, the parties have a view of what
6 the outcome of the litigation is going to be, the cost of
7 pursuing it and the cost of not pursuing it and strategies
8 that may implicate other litigation and how much they're
9 likely to attract or appeal other litigation that in the long
10 run will lead them to make a decision when and how to settle,
11 and that that is not as independent of antitrust
12 considerations which go to consumer value and things like
13 that.
14 That was my point.
15 MS. MOORE: Okay. Rich?
16 MR. FEINSTEIN: I wanted to throw one other thought
17 into the mix on this little debate about strong patents and
18 weak patents and which are more likely to generate
19 litigation.
20 And I'm not a patent lawyer and would always defer to
21 others on the distinction between a strong patent and a weak
22 patent, but it does seem to me again built into the Hatch
23 Waxman regulatory scheme, there's a little bit of a safeguard
24 because that process begins with a certification by the ANDA
25 filer that their product either does not infringe or that

1 their patent in question is invalid.
2 Now, obviously those certifications can be made in
3 bad faith, but that is a bit of a safeguard, and when you add
4 to that the automatic, in effect, preliminary injunction for
5 30 months that follows with that if litigation is initiated,
6 and the fact that that is usually the opening salvo on what
7 can become a pretty expensive battle pretty quickly, it seems
8 to me those are all factors that suggest that the least
9 assailable patents are least likely to be challenged in that
10 situation.
11 And again I say that more as a matter of logic than
12 as a matter of patent expertise.
13 MS. LEVINE: Let me see if I can throw out to the
14 panel a question Professor Brodley raised in the his written
15 statements, and it was a question about the data. Have you
16 all heard of any studies, any empirical evidence that shows
17 what the competitive effects of patent settlements has been?
18 Maybe this is a question for our resident economists.
19 PROFESSOR BRODLEY: I'll defer to him.
20 PROFESSOR SHAPIRO: Well, I may be resident economist
21 but I don't have a good answer. I know there's certainly a
22 bunch of empirical work about sort of the win and loss rates
23 of different cases that get litigated, but in terms of the
24 actual effects of settlements, it's just always seemed to me
25 the big problem for the empirical work is they say, We don't

1 have a database of settlements, we just don't know what the
2 universe is.
3 Again first off, and this is going to come up more
4 this morning, how broad are we defining it in terms of
5 settlement? If somebody has a licensing agreement is that a
6 settlement, or is it only when they get into litigation and
7 then they stop, that's a settlement? So what's the universe
8 to begin with? You could define it quite broadly. A merger could
9 be a settlement of IP litigation as well, so what's the universe
10 you're talking about?
11 And is there a database? Most of these things are private
12 anyhow. A lot of them are not HSR reportable certainly, so -- and
13 I think Joel Klein a few years ago floated the idea of notification
14 of settlement.
15 We don't have that so, I think there's just no good
16 comprehensive databases on settlements or licensing
17 arrangements for that matter, so to my knowledge at least
18 it's more anecdotal and case-based that people talk about,
19 Well, this settlement, the ones we've dealt with.
20 We look at the Intel Digital situation, and that was
21 studied, and there was a consent order and so forth, so it's
22 more case by case rather than any systematic empirical work,
23 and I don't see must prospect moving beyond that given the
24 data that's likely to be available.
25 PROFESSOR BRODLEY: I don't have the answer to the question

1 you posed but let me suggest this. We do have data on the casualty
2 rate of patents that are litigated in the courts, and it used to be
3 overwhelmingly rejecting patentability.
4 Today I don't know the exact data but it's like a
5 third or 30 or 40 percent. I don't know if anybody has that figure
6 -- of the patents that go to the court, how many are ultimately
7 invalidated. Maybe, you know, but anyhow it's really a
8 substantial percentage.
9 Now, so we do have that data set. Is there any
10 reason to think that the group of patents that are selected
11 to go through litigation are not reflective of the
12 totality? You said that, Well, they're optimistic, but both
13 sides are optimistic.
14 Are there any reasons to think those patents are
15 different? If not, then maybe that could be -- could supply
16 some sort of a basis or an estimate for the ones we don't
17 know anything about.
18 PROFESSOR SHAPIRO: I would add I know my colleague
19 Mark Lemley at the Law School of Berkley has done some work
20 on tracking these win and loss rates. That's one of the
21 things we do have sort of systematic data on, and in
22 particular how that changed after the creation of the Federal
23 Circuit.
24 There was a shift, I can't remember the numbers,
25 where I think patent holders were doing better, and then I

1 When do these patent settlements, if ever, pose antitrust
2 concerns? What are the anti-competitive issues that lurk in
3 certain kinds of patents settlements?
4 Professor Brodley, did you want to tee us off with a
5 couple of thoughts on that?
6 PROFESSOR BRODLEY: Okay. I'll open it. Well, I
7 think the first kind of area of concern is when the
8 settlements involve collateral agreements that amount to
9 horizontal restraints; that is to say, they involve
10 competitors or potential competitors in the technology
11 market, the goods market or the R&D market, and the
12 collateral restraint affects competition between them in that
13 market.
14 And it's particularly sensitive if the markets
15 are concentrated. The issue then is whether these
16 collateral restraints are unjustified in view of the
17 efficiencies that they may create and always assuming, of
18 course, that they're based on valid patents.
19 A second kind of restraint would be vertical
20 restraints which ordinarily are not apt to raise grave
21 issues at all, but vertical restraints where the patent
22 owners, patent holders impose restrictions on competition
23 among their licensees that can be injurious, that is to say,
24 they might involve the fixing of output and market share, and
25 that also -- those may be justifiable.

1 They're normal, in fact, in patent arrangements. But
2 it is an area of concern when that kind of arrangement
3 reflects in effect a cartelization or makes the market
4 among licensees highly anti-competitive, and when the patent
5 holder is actually sharing some of its rent in return for the
6 agreements that create this. Then it begins to look like
7 there's a concerted arrangement to gain from cartelizing a
8 licensing market.
9 And a third area is the predatory extension of patent
10 rights. This would be where a patent holder sacrifices
11 present rent in order to extend its market power into another
12 market or its present patent into other time periods, so this
13 really is kind of form of predation which is similar to non-
14 price predation outside the patent market, which is
15 to say that it is a failure to maximize short run profits in
16 return for anti-competitive gains later or in some other
17 market.
18 I actually wasn't there yesterday, but I understand
19 that Doug Melamed testified at the hearings on this issue,
20 not the one we're discussing, but basically the idea of a
21 similarity between what might happen in the patent field and
22 what is the law in the unpatented area.
23 So those are just general comments. Obviously we're going
24 to be going into lots of details about the particular kinds
25 agreements. It seems to me that those three basic situations

1 are of an antitrust concern.

2 MS. LEVINE: Thank you very much, and let me throw out a

3 question to the panel, not only for your responses to Professor

4 Brodley's thoughts because I think we can all benefit from those,

5 but also whether you think whether the risk of anti-competitive

6 agreements embedded within patent settlements is greater in

7 an industry where R&D is a big factor.

8 It's a question that you raised in your questions to

9 the FTC. The chemical industry, agricultural industry,

10 pharmaceutical industry, where industries like these where

11 R&D is a key factor, are we likely to see more

12 anti-competitive risks in patent settlements?

13 PROFESSOR BRODLEY: Can I just ask?

14 MS. LEVINE: Sure.

15 PROFESSOR BRODLEY: The reason I asked that question

16 was because if those are the areas -- pharmaceuticals,

17 agriculture and chemicals -- where patents make the most

18 difference in the company's profitability, then one might

19 think that those are the areas where there would be the

20 greatest concern about these antitrust topics.

21 MR. COOK: Just to jump in. I think that those are

22 really the areas that are factually the most difficult, and

23 this question brings us into really the facts of the

24 individual cases. In a particular case with particular

25 products, how does a particular settlement affect competition

1 in light of what would have happened if these patents were
2 litigated to a final resolution?
3 And the more complicated the product gets, the more
4 difficult it I think gets to really answer that question, and
5 these are really -- I think that question is why we're here
6 and why this problem seems to be so intractable, and that
7 unsatisfactory statement is my input on this subject.
8 MS. LEVINE: We're getting a lot of those, answering
9 questions with questions today.
10 MR. CARY: I'm going to answer the question from a
11 base of very little knowledge, but I'm going to throw a
12 speculation out on the table and see what the response is.
13 I would guess that the risks of anti-competitive
14 agreements and settlement of patent litigation would actually
15 be higher in network industries, high technology electronics
16 industries than it would be in chemicals, pharmaceuticals,
17 agricultural I guess would be the other one, the reason being
18 that it seems to me that's there a closer link to a patent in
19 the chemical area where the result of that patent is that you
20 have a monopoly over a particular product. The patent goes
21 to the product. The product is out there, and there's a
22 monopoly rent to be gained.
23 In the high tech area, one can speculate that you can
24 leverage a patent on one aspect of a product in to market
25 power with respect to a wider array of products that go

1 beyond the product implicated by that single patent by virtue
2 of the network effects or portfolio effects that might flow
3 from being able to preclude competition in a broader field
4 simply by precluding competition in a single product area.
5 So I would say that that's a more fruitful area to
6 look than the areas that you've identified.
7 MR. EGAN: I would say that in the pharmaceutical and
8 agriculture area, yes, you'll have composition of matter

1 In our industry, in pharmaceuticals, you might see
2 the interplay between formulation technologies and
3 composition of matter. You might see that same kind of thing
4 in process chemistry and in chemicals and the like. It
5 really does get down to interplays between patents. I'll
6 leave it at that.
7 MR. BARNETT: I guess I had two comments. One, I
8 think there was an earlier summary about the areas that are
9 most likely to cause concern, and I think that it was a very
10 good summary.
11 Whenever the settlement goes beyond the immediate
12 scope of the patent dispute, I think you're most likely to
13 have concerns. If there's a dispute over a pharmaceutical
14 patent and the settlement is that you will not infringe that
15 patent or make any other form of this drug, whether or not it
16 violates the patent, I think that's going to raise
17 suspicions.
18 The second comment though is in the industries that
19 you identified, the chemical, the pharmaceutical and related
20 industries where patents are important to that industry
21 because innovation is so important to that industry, and so
22 policy changes that undermine intellectual property
23 protection can actually deter innovation, and I think you, in
24 those industries, may have a greater risk of harming consumer
25 welfare in the long run if you're not careful.

1 And so that it's not immediately clear to me that
2 settlements are necessarily more suspect. They may be more
3 beneficial from a dynamic point of view.
4 MS. MOORE: I have actually a two-part question that builds
5 on a discussion we had earlier this morning, and that is consumers
6 not being at the table or customers not being at the table when
7 patent settlements are reached, and the question that I have is:
8 Can we assume that the outcome that the parties are seeking
9 in a settlement is necessarily the social desirable outcome,
10 and how should that impact the antitrust analysis of
11 settlements?
12 Carl? Sorry, Bob was actually first.
13 MR. COOK: I'm much more willing to listen to what
14 Carl has to say than what I have to say.
PROFESSOR SH:a.,dRO TheTj -28.5 0 TD (9) to 0fay than what I

1 two competitors, very uncertain how it's going to come out.
2 There's a good chance the patent will be invalid or non-infringed,
3 in which case there will be a full-fledged competition. Customers
4 will benefit. The companies agree to merge. They agree to merge,
5 okay, obviously avoid litigation costs, eliminate the possibility
6 of that competition either in the future or perhaps competition
7 that's ongoing during the pendency of a litigation.
8 Let's just suppose there are no real efficiencies
9 associated with the merger, to keep the hypothetical simple.
10 Customers get the short end of the stick on that one, again
11 assuming that these companies have let's say a large share of
12 a relevant market.
13 So, in other words, if it was a merger that we would
14 otherwise want to stop, the fact that it happens to be the
15 settlement of the patent litigation is no trump card I would
16 say for the merging parties and should give us no assurance
17 that customers are not injured in fact.
18 So I just -- I would be surprised if anyone at the
19 table thinks that there would be any general reason to
20 believe that settlements, while in a private interest, are in
21 the public interest.
22 MS. MOORE: Bob?
23 MR. COOK: Well, I think that's what I would have
24 said if I were that smart, but I was also going to add --
25 PROFESSOR SHAPIRO: You could have said it more

1 quickly though.

2 MR. COOK: I would have said it more quickly, but

3 since the customers aren't there, there may well be customer

4 or consumer concerns that simply aren't known to the parties

5 settling or suppliers.

6 MS. LEVINE: What do you have in mind?

7 MR. COOK: Well, rather than what I have in mind, if

8 you think about the dynamic process of competition and

9 negotiation, you have two adversaries who are both suppliers

10 of a product, say hypothetically, and they're going to try to

11 work out an agreement that is value maximizing between the

12 two of them.

13 They may well find certain areas of agreement that

14 are agreeable to them but aren't agreeable to their mutual

15 customers or their potentially mutual customers because, in

16 effect, they take value from the customer and share it

17 between the two. Hypothetically, I mean, I'm not thinking

18 specifics, but that's why one couldn't rely on a negotiation

19 between these two parties settling the litigation to protect

20 the value that would be sought by the consumers who aren't

21 part of it.

22 MS. MOORE: Steve?

23 MR. STACK: I think it's hard to disagree with what

24 Carl said. I think the question is, therefore, what

25 antitrust rules are you therefore going to impose on

1 settlements? To the extent that you're talking about
2 restrictions that fall outside the scope of the patents that
3 are in litigation, we have a body of law that deals with
4 that.
5 It's basically no different than the way you would
6 analyze the license, and there are plenty of cases and
7 guidelines in that this area. I think the hard question is,
8 What about restrictions that operate within the scope of what
9 is being challenged as a patent that may be invalid, and I
10 think that's the hard question.
11 And there you have to really balance some other, it
12 seems to me, policies that go to certainty of patents and the
13 innovation benefits that flow from it.
14 MS. MOORE: Phil?
15 MR. PROGER: Maybe in the spirit of the conversation
16 here and with the disclaimer that I have had the judgment to
17 retain Carl on matters, I'm going to the point of saying, I
18 don't find it hard to disagree with him at all, at least to
19 this extent.
20 I think you have to ask yourself the question, What
21 public policy, what public benefit are we talking about?
22 There are other public policies other than competition.
23 There are public policies of encouraging settlements, so I'm
24 not sure that settlements in and of themselves are plus or
25 minus from a public policy standpoint.

1 I think the issue is -- and this is where I was going
2 to go, it's exactly what Steve just said, Tom earlier said,
3 and I think we would all agree, that look, if your settlement
4 goes beyond the scope of the relief you could have obtained
5 in the litigation, I think that is a suspect area, and you
6 have to look at that. It doesn't necessarily mean it's
7 unlawful, but there's a restraint, and you have to apply
8 antitrust analysis.
9 The real tough question, and the question that
10 everyone has difficulty with is, How do you analyze
7

1 you, Tom, because I wanted at that point to turn to the
2 question that you raised earlier, the question of whether
3 going beyond the scope of the patent is an indicator of
4 anti-competitive issues.
5 So, please, Carl? I'm sorry, Bob.
6 MR. COOK: Just bouncing off of what Professor
7 Brodley said about other types of persons who might be
8 affected by a patent settlement, there you have questions
9 that may go, for example, to questions of antitrust standing,
10 but you touched the issue of whether there may be other legal
11 regimes besides the TD (9) Tj des208at are implicated by a
12 patent settlement.
13 For example -- Td then other persons who may be

1 of the patent grant.

2 I would say two things about that. One is that that
3 body of law seems to be on the edges at least eroding to some
4 degree, less clear than it previously was. Second, one could
5 make the case from I suppose an economic or public policy
6 point of view that the argument that the courts have up until
7 now pretty consistently rejected, namely, "But I wouldn't have
8 licensed the patent if I hadn't gotten these out-of-the-scope
9 restraints," is worthy of some pro-competitive weight.

10 The tax that you impose on licensing because the
11 patent holder is unable to restrict its use outside the scope
12 might be something that, in fact, is anti-competitive if, in
13 fact, he would have chosen not to license in the first place,
14 thereby shutting down the competitor. The problem is that's
15 again a very, very difficult judgment to make and probably an
16 impossible one for the antitrust agencies to make.

17 The second problem might be that clear delineations
18 of the limits of the scope and the ancillary restraints might
19 be pro-competitive in the sense that it gives patent
20 innovators a sense of what the value of that patent might be
21 and not a false expectation of maybe greater patent value
22 that otherwise might lead to inefficient investment
23 decisions.

24 So that's an area where I think it's worthy of
25 discussion as to whether limiting the restraints to the scope

1 of the license is, in fact, the best public policy -- I'm
2 sorry, the scope of the patent is the best public policy.
3 Now, going to the other side, going to Phil's point
4 about keeping it within the scope and then having the freedom
5 to do what you want as long as it doesn't go beyond the
6 patent grant, the problem with that is that what you're doing
7 is you're converting the possibility or maybe in the way Phil
8 said it the probability that you would have a monopoly by
9 enforcing the patent to a certainty of a monopoly.
10 And the difference between a probability of a
11 monopoly in an unlitigated patent and the certainty of a
12 monopoly by private arrangement of the litigants can be quite
13 a significant difference and can be quite detrimental to
14 consumers.
15 So both of the kind of general rules that have been
16 laid out I think have some infirmities from the point of view
17 of pro-competitive or consumer welfare.
18 MS. MOORE: Steve?
19 MR. STACK: I just want to back Phil up on this one.
20 I'll ask the question, Why shouldn't we have a rule that says
21 if for those portions of your settlement that fall within the
22 range of potential outcomes of the litigation itself, they
23 ought to be presumed to be lawful, and I come at it for two
24 basic reasons.
25 One reason is I think it's consistent with more of

1 the policies that factor into this issue, and secondly, I
2 think the alternatives to that seem a lot worse to me. I
3 think a rule like that is certainly consistent with the
4 presumption of patent validity that operates in patent
5 law.

6 I think it's consistent with a policy that favors
7 settlements. Remember one of those policies is compromise,
8 and if it falls within the range of outcomes, it is by
9 definition a compromise.

10 It facilitates settlements, and it reduces the
11 uncertainty that is a problem with innovation here. It's
12 consistent with the rules on licensing I think, all of which
13 really are based on the assumption that the patent is valid.

14 And I think it limits the scope of the Noerr issue.
15 It basically says, If you can bring a lawsuit consistent with
16 Noerr, then you ought to be able to settle it within that
17 range of potential outcomes.

18 What are your alternatives? Do you retry the patent
19 case later on, which obviously doesn't promote judicial
20 economy, and also ends up with kind of an armchair, second
21 guessing, Monday-morning-quarterback result where you may
22 have won the patent case had you litigated it the first time,
23 but you're mousetrapped because you've lost it in the
24 antitrust case, or do you adopt some kind of probability
25 approach?

1 And I don't see that working. I don't think that
2 when you -- given the range of error that you have in any
3 probability analysis, I don't think that's a workable
4 solution, and how do you prove it? Do you force the patent
5 owner, for example, to waive its attorney/client privilege in
6 order to be able to defend the assertion that this patent
7 only had a 30 percent chance of success when the patent
8 attorney says, No, it's 60 percent?
9 And at what point in time do you do that because the
10 odds change as litigation proceeds, so that's where I come
11 out, and that's why I come out that way.
12 MR. CARY: Can I respond briefly to that?
13 MS. MOORE: Sure.
14 MR. CARY: I think Steve makes an excellent point.
15 It's a bright line rule that stays within the potential range
16 of the possible outcomes. The problem is, as Steve points
17 out, I think there's a real question as to whether the
18 agencies can do anything other than what he just proposed.
19 You can't relitigate. There have been a number of
20 instances where I think the FTC has looked at that option.
21 There was one where they actually attempted that option, not
22 to great success, and going behind the patent positions and
23 trying to figure out who would have won or what the odds
24 were, with all due respect to the FTC, which is an agency for
25 which I have immense respect, I think it's just intractable.

1 I think it's beyond their -- the administrative
2 competency of the agency to do that sort of thing, so what
3 are you going to do? You've got to set up some kind of
4 bright line, and the one that Steve sets up is not a bad one.
5 Maybe there's some procedural process like a Tunney
6 Act process where the court that is deciding upon whether to
7 accept the settlement has the opportunity to take input from
8 other interested parties.
9 Maybe that helps, maybe it doesn't help, but it's a
10 very tough problem if you're going to rule of reason to
11 figure out what the odds were that the patent would have been
12 upheld and then to figure out whether the settlement extends
13 the monopoly beyond what it should have been extended to.
14 MS. MOORE: Jamie.
15 MR. EGAN: One of the concerns I have here is that
16 the patenting system itself is not adversarial, although
17 people applying for patents will disagree with that. Their
18 examiners argue back and forth, and no third parties can get
19 in there and really argue the points.
20 There is a duty of candor when you're filing a
21 patent. You're supposed to tell all, show all. Oftentimes
22 things come out when other people are looking at it that
23 didn't amount to having told all and shown all.
24 If we're talking about patent settlements between two
25 competitors reaching a conclusion put before a relatively

1 overburdened judge on an issue that turns as to whether
2 consumer interest is being helped or hindered, when our
3 entire system is based upon adversarial process, simply
4 saying that the advocates of the consumer whose job it is to
5 permanently do this are overburdened or incapable, I wouldn't
6 leap to the conclusion that two competitors who might not
7 have the best interest of the consumer at heart are better
8 capable in that setting.
9 And sure, it may be more difficult, but the thing at
10 stake here is the consumer competitive interest, not the
11 interest of the two competitors, and if anything, there are
12 laws about maintaining the competition.
13 And I recognize that patents really support
14 innovation and everything else like that, but at the end of
15 the day, I think competition and free commerce is the
16 preferred public policy goal.
17 Patents are temporary. They are seen as a necessary
18 incentive, but they're not an absolute excuse, and once you
19 have your patent, you're on notice that you must defend it,
20 and I don't think it's too much of a burden for a patent
21 holder to respond in an adversarial setting for the first
22 time before he goes to a settlement with someone who
23 represents a consumer interest.
24 MS. LEVINE: Tom, you were raising the issue before
25 about restrictions that go beyond the scope of the patent. I

1 First, I agree fully that the trying -- the retrying
2 of a patent case in the antitrust arena is an undesirable and
3 ultimately unwieldy undefeating means or instrument, so I
4 agree with all of that.
5 But I don't think that -- I wouldn't agree that it
6 then follows that as long as it's within the scope of the

1 might be used?
2 Well, one that is being used, and as I said we'll
3 come to this later, but as an example of this approach is
4 reverse payments, as an indicator which can be useful, and
5 another one that I gather we may discuss, is the payment of a
6 trivial royalty along with certain other factors.
7 And so then you look at the degree of the collateral
8 anti-competitive restraints and their necessity. That would be
9 part of the rule of reason analysis. You look and see if there are
10 anti-competitive effects, and of course, it would have to be
11 afterwards, but I suppose in assessing whether they're likely to
12 be, and those are often hard to establish.
13 But in certain conditions, I think they would be
14 indicative coupled with, for instance, the payment of a
15 trivial royalty, but it's hard to figure the anti-competitive
16 effects because obviously the restraint, which would be a per se
17 violation in the absence of a patent, will have effects which you
18 might find are anti-competitive, so that's not enough.
19 Well, then the cases in this area have also looked to
20 intent, more so than in other areas of antitrust where that is
21 dropping away a good bit as a factor, so while I think intent can
22 be misused, as some of you have inferred already, but I think
23 we know that we can use it when effects are not clear.
24 The Supreme Court has said so on more than one
25 instance, but it has to be the proper kind of intent, and the

1 kind of intent that one is talking about is not expressions
2 of feelings or animosity or anything like that, but these are
3 corporate documents which illustrate the likely effect of the
4 transactions involved.
5 And finally, there's a business justification, so --
6 well, that's unwieldy. That's the modern rule of reason, and
7 I don't see why we should give up on trying.
8 MS. LEVINE: I want to say thank you for that very
9 thorough and very helpful exposition of a lot of the
10 indicators of -- indicators of what may flag anti-competitive
11 issues within patent settlements. I want to open that up to
12 the panel now actually and get responses to your list.
13 I think a few of the indicators mentioned were
14 restrictions that go outside the scope of the patents,
15 reverse payments and of course a few others.
16 Can I get your thoughts on whether those things,
17 those indicators, when you see them, do indicate any kind of
18 anti-competitive concerns?
19 George?
20 MR. CARY: Yeah. I guess my reaction to that is that
21 my sense of what Professor Brodley just described is not too
22 different from what I heard Steve say in a sense. If you
23 start with a presumption that one of the likely -- or I
24 shouldn't say likely. One of the possible outcomes of the
25 patent litigation is an injunction which precludes the

1 competition that we're talking about here, then you either
2 have to make an assessment in the antitrust context of what
3 the likelihood of that outcome is and put a probability on to
4 it and then compare that probability against the restraints
5 that have been imposed by the settlement, which I think is
6 impossible, or you have to assume that a full stop injunction
7 would have issued, and therefore there would have been no
8 competition within the scope of that patent altogether.
9 If you're going beyond the scope, outside the scope
10 of the patent, reverse payments, those two examples that Gail
11 just listed are examples that I would argue are outside the
12 scope of the possible outcomes.
13 There's not going to be a restriction on competition
14 outside the scope of the patent as a result of the
15 litigation. There's not going to be a payment from the
16 patent holder to the infringer as an outcome of the
17 litigation, so I think Steve's rule captures those examples,
18 leaving you with a question of, Are there antitrust agencies
19 capable of making an assessment about the likelihood that the
20 patent would have been held valid, thereby giving rise to the
21 presumption that injunctive relief automatically flows.
22 MS. LEVINE: Phil?
23 MR. PROGER: I was -- well, one, let me just say that
24 I think that we're in general agreement that it's the right
25 analysis as Joe has set forth when you're outside the scope.

1 It's essentially a rule of reason analysis, and I don't think
2 it is that alien to the antitrust process.
3 When you're within the scope, I think again that
4 raises the difficult questions, and I don't have easy answers
5 for it, and I wasn't suggesting in my earlier comment that
6 it's easy to try the patent issues, but I still don't
7 understand how you get around them.
8 And when you talk about reverse payments, one of the
9 things that troubles me is what makes a payment reverse? I
10 don't fully understand that. Maybe if someone could define
11 that to me, that would be helpful.
12 Certainly --
13 MR. CARY: That's easy. It's a payment from the
14 patent holder to the infringer.
15 MR. PROGER: Why is that reverse, though?
16 MR. CARY: Because typically it's the infringer
17 that's liable for damages, not the patent holder.
18 MR. PROGER: Why do you say typically? Are there
19 situations where it is not?
20 MR. FEINSTEIN: Let's talk outside the patent context
21 for a second. Typically when you have a potential entrant
22 and an incumbent, you would not expect the incumbent to be
23 paying the potential entrant not to enter. To me that's sort
24 of the essence of the reverse payment, stated most starkly.
25 MR. PROGER: What about when you have Hatch Waxman,

1 Rich?

2 MR. FEINSTEIN: If anything, that may make the

3 problem worse in my mind.

4 MR. PROGER: It means just the opposite to me. There

5 you have the -- because of what Hatch Waxman does is

6 essentially create a declaratory judgment process. There you

7 have the alleged infringer as the nominal defendant, really

8 the plaintiff under Hatch Waxman, and the alleged infringer

9 has very little at risk, and the plaintiff, the patent

10 holder, has enormous risks.

11 And I'm not surprised under those circumstances that

12 the party with greater risk, more at stake, might end up

13 paying the party with less in a declaratory judgment context.

14 MR. FEINSTEIN: But what is the source of that risk

15 is I think the next question. Is it the risk of competition

16 on the merits or is it some other risk?

17 MR. BARNETT: But it's more fundamental than that.

18 The patent holder in that Hatch Waxman context has no claim

19 for any damages against the generic company who typically

20 files the paragraph 4 certification.

21 In that bargaining context, it's hard for me to

22 imagine a situation where the generic company would be paying

23 the patent holder anything. You start off where the

24 default -- the best that the patent holder can get is zero,

25 and given that they're the only ones who have something at

1 risk here because a generic company can walk away at any
2 time, you would expect any settlement to involve some flow of
3 consideration from the patent holder to the generic
4 challenger.
5 MR. PROGER: Exactly. I'm sorry. One thing I do not
6 think is helpful -- George is right, it's intractable. I
7 hear people say, Let's not try the patent issue.
8 On the other hand, I cannot believe that we want to
9 set up a series of decision rules or operating rules here
10 based on the percentages and likelihoods because I don't
11 think how you really determine that, and I don't know how you
12 make those standards, and what does that mean?
13 We have two alleged infringers. First one goes to
14 the patent holder and says, I believe I have better than a 50
15 percent chance of winning, but I'm willing to settle if you
16 pay me not to infringe, what do you think? Patent holder
17 says, Sure, okay?
18 Under sort of the handicapping, that looks like a
19 really suspect settlement, and I would agree with people who
20 say that. The second infringer says, I'm not going to pay
21 you, I'm going to trial. You go to trial. You go to the
22 Federal Circuit, Supreme Court, patent is held as valid.
23 What was the right outcome? Was the first settlement
24 anti-competitive? Turns out that they had no right to be in
25 the market in the first place. I mean, we all want to find a

1 rule that avoids the ultimate issue, and I would like to
2 also. I just can't figure one out.
3 MR. FEINSTEIN: Can I -- I'm sorry?
4 MS. MOORE: I'll let you respond, Rich, and then I
5 actually have a question.
6 MR. FEINSTEIN: I wanted to go back to what Tom said
7 because maybe I'm just missing something, but it's not
8 obvious to me why the potential entrant has no risk. I mean,
9 they at some point -- if there's no injunction, they have the
10 opportunity to enter, and that presumably brings with it
11 substantial risk.
12 MR. BARNETT: If I could respond to that. The way
13 Hatch Waxman is set up, it's so that you're entitled to bring
14 the declaratory judgment action before the expiration of the
15 patent that's at issue and during the pendency, at least the
16 way it typically works out, the generic company does not
17 enter, does not have the right to enter, and therefore until
18 you get to the end of that process, there is no prospect of
19 their entering, and the patent holder has no claim for
20 damages.
21 MR. FEINSTEIN: Right, but during that part of the
22 process, what's the incentive then for the incumbent to pay
23 anything to the patent holder, to the generic?
24 MR. BARNETT: The incentive?
25 MR. FEINSTEIN: Yes, what's the pro-competitive

1 that we don't have to get this to the valuation of the patent
2 strengths or weaknesses. At least that's one approach to try
3 to take to see whether that's workable.
4 So I would start with the simplest case, patent
5 license, that is, I sue you. I say you're infringing. We
6 settle. You agree to pay me a certain amount per unit let's
7 say. I would say I think there was in the scope of your
8 question.
9 That obviously is a cost to you of doing business.
10 You're going to compete against me now, let's suppose, but
11 you're going to have this cost. Should we be at all
12 suspicious of that agreement, just a classic licensing
13 agreement? Whether entered into before or after litigation
14 ensued, I don't care.
15 I would say, no. I would say no because there's --
16 you must have a view on sort of maybe you would win, maybe
17 you would lose in terms of the patent litigation.
18 You wouldn't typically agree to pay more, to pay so
19 much and burden yourself with cost unless you thought, Hey,
20 there's a pretty good chance you would lose, and you would
21 actually be out of the market.
22 So there's no inference based on that sort of simple
23 classic licensing agreement that competition has been reduced
24 by this agreement in comparison with what likely would have
25 come about from litigation, which I think is ultimately the

1 I guess my question would be: If you flip that, the
2 second goes to trial and the patent is held invalid or not
3 infringed or actually I guess it would just have to be
4 invalid. What does that do to the first agreement as far as
5 an antitrust perspective?
6 MR. PROGER: I actually think that that's a very good
7 question, something that I have thought about, and you have
8 to take a step back here. This is hard because we're
9 marrying two different means to promote consumer welfare, and
10 the concept that the means aren't necessarily compatible isn't
11 self-evident to me and at least when we talk about something
12 being anti-competitive, that's the wrong place to start.
13 I mean, I'm an antitrust lawyer. I believe in
14 competition, but there is a system of intellectual property
15 rights that grants you the right to exclude something that is
16 infringing. That in its very basis is anti-competitive,
17 and society has made a judgment we want that.
18 And just to an earlier comment, someone has said that
19 competition is the preferred public policy over intellectual
20 property rights, I would like to see where that is, and I
21 don't know who made that judgment. Unfortunately, I think
22 they're kind of equal, and you have to marry them.
23 So here the first thing I think you have to figure
24 out is if the settlement is within the scope of what you can
25 achieve in litigation, I think you have to figure out whether

1 the patent was valid.
2 Then what happens is if subsequently you determine
3 that the patent -- if a patent is valid, I would say it's per
4 se lawful. Maybe that's going too far, but if the patent is
5 valid and you settled within the scope of it and there's
6 nothing else that is restricting, then you have the right to
7 exclude, and the fact that you're going to share whatever
8 returns you get I don't think is anti-competitive.
9 But the question you posed, Robin, is the most
10 difficult, which is what happens if the parties -- let's set
11 it up and eliminate the obvious.
12 If it is a bad faith settlement, they really didn't
13 believe they had a valid patent and this is a sham, okay?
14 MS. MOORE: Okay.
15 MR. PROGER: And I'm not going to put Professional
16 Real Estate Investors in this or that type of standard. I'm
17 just going to say, if it's a sham it's anti-competitive, we
18 shouldn't protect that.
19 What do you do in a situation where the parties
20 honestly believe that they have a valid settlement, reverse
21 it. I go to you and say, Look, I believe you have 90 percent
22 sure that the patent is valid and enforceable, I'm
23 infringing, we'll settle, and then subsequently it turns out

1 Then I think you have to apply the Noerr concepts and
2 some of the standards we do under the rule of reason and look
3 to, Was it a sham? Were the parties in effect trying to
4 engage in what would otherwise be a naked restraint?
5 And I agree with Joe, that it is difficult to get
6 intent here, and I don't think by intent we want to look at in
7 terms of what was the intent of the parties in the sense of
8 ultimately ignoring that to the exclusion of the effect.
9 But here when you're looking at this issue and
10 looking at to determine whether it's a sham or not, I think
11 you're going to have to look behind the curtain and see what
12 the parties were trying to do here, and that gets very
13 difficult.
14 MS. LEVINE: Let me see if I can return our
15 conversation to a question that's come up a little bit, but
16 let's get into the thick of it now, a question of whether
17 patent settlements should be reviewed, when they are
18 reviewed, under the standard review of per se or rule of
19 reason.
20 Are there any types of settlements that should be
21 viewed under the per se rule, and on the other hand, when
22 should an agreement be analyzed under the rule of reason?
23 Rich, I know your views have evolved on this, so
24 you've told me.
25 MR. FEINSTEIN: Yes, they have, and I've moved over

1 the last several years I think more to the point of view that
2 there are certain settlements, and they may be the easiest
3 examples. They may be the ones where they have features that
4 we all would agree are outside the scope of the patent, but
5 where those features are present, I think a strong case can
6 be made for a per se rule.
7 And I think it's important to remember just as -- and
8 I completely agree that settlements are most of the time very
9 desirable, and one of the reasons that they're very desirable
10 is because they conserve judicial resources. They conserve
11 the parties' resources. They conserve society's resources.
12 That's also why we have per se rules, for certain
13 kinds of practices that are so unlikely to have any
14 competitive benefits, we just agreed these should be
15 prohibited, and we're going to move on, and it could be --
16 it's a follow-up on what Bob said. This could be a bump in
17 the road.
18 I don't know. I don't know how widespread the
19 agreements are that have the most problematic features -- and
20 they're not always necessarily settlements, let's keep that
21 in mind. Some of them are agreements that don't settle
22 anything, but it may be that because of the scrutiny they've
23 come under that they're not going to be -- they're not going
24 to be a big problem in the future.
25 I think the study that the Commission is doing right

1 now under [Section] 6b is going to be very informative on the
2 scope of the problem and then perhaps also on the remedy, but
3 I think a persuasive case can be made when you have features that are
4 very difficult to justify as efficiency enhancing or
5 pro-competitive to say they are per se unlawful.
6 MS. LEVINE: Any responses to that?
7 PROFESSOR BRODLEY: Well, yeah, I agree, but I would
8 go a little farther. I mean, I don't know whether you would
9 go this far or not, but I think the reverse payment should be
10 either per se or presumptively unlawful.
11 And let me say just a word about that that replies to
12 something -- some things that have been said earlier about
13 the reverse payments. The vice in the reverse payments as I
14 see it, the underlying vice, is it distorts the incentives of
15 the parties.
16 That is to say, before the reverse payments, you had
17 two parties who were disagreeing about the validity of the
18 patents or the infringement, and one party is in effect
19 trying to open this to competition.
20 I don't say that's good because maybe the
21 patent should be open to competition, but I say that's a
22 force that works in the competitive direction. The patent
23 holder obviously wants to keep its patent and keep it closed
24 to competition.
25 Now, they work that out in a settlement. Generally

1 that may be okay, but with a reverse payment in this field is
2 such that the patent holder can well afford to pay this
3 challenger more than it could ever have earned by coming in
4 competitively.
5 So that means that the dynamic by which we would get
6 a normal, more or less market type solution is broken, and
7 there's nobody left to represent the consumer interest. The
8 two of them are actually sharing the monopoly risk, so -- and
9 therefore you have to go to a regulatory solution if you're
10 going to allow those things to go on and look into validity and
11 all that sort of thing.
12 If you make it either presumptively or per se, what
13 happens? You throw them into another kind of solution which
14 would -- this has been suggested by Commissioner Leary in a
15 paper recently -- by which they would have to trade in terms of the
16 entry date that a generic would come in, and they could also
17 negotiate the royalties.
18 Then the generic would still be in a competitive
19 posture, and the generics would reflect the public interest
20 in competition factored for the strength of the patents, so
21 it seems to me that's the vice.
22 Now, beyond that, I haven't seen it. The only
23 indicator that I'm playing with, and I wouldn't call it a per
24 se or necessarily presumptive, but at least it might be a very
25 useful indicator, is the trivial royalty, but I won't go into

1 that until you want to.
2 MS. MOORE: I actually have a question for the whole
3 panel. We've talked a lot about reverse payments today, and
4 I wanted to find out if you guys are aware of these things
5 existing outside of the Hatch Waxman or if the reverse
6 payments -- if those comments are sort of directed at Hatch
7 Waxman?
8 MS. LEVINE: Keep your signs up for the next question
9 or for the previous conversation, but I guess our question
10 is: Have you seen a reverse payment outside the Hatch Waxman
11 context? Is that a no?
12 MR. FEINSTEIN: Well, I would just say that certainly
13 outside of the time that I was at the FTC, I haven't seen
14 that, and inside the time that I was at the FTC, that was
15 something we were looking for and couldn't find any
16 examples.
17 MS. LEVINE: None to be offered today, right?
18 Hearing none, let's move back on to the discussion.
19 Carl, you had a comment?
20 PROFESSOR SHAPIRO: I wanted to respond to the
21 question about when, if ever, per se treatment's appropriate,
22 and I guess like most economists I tend to move right along
23 to a rule of reason rather than per se, but I do think that
24 with suitable care, certain reverse payments should be --
25 I'll say like either per se or sort of a presumption that

1 they're anti-competitive.

2 What I mean by suitable care is I think first you

3 want to look at the net payment that's involved, so there may

4 be a more complex transaction going on so rather than just a

5 naked cash payment in a reverse direction, if you have other

6 consideration flowing, you would want to look at the net

7 payment, and I would say you would also want to look at net

8 payment in excess of what a litigation costs from the point

9 of view of the patent holder, with the idea being that if the

10 net payment is flowing from the patent holder and exceeds the

11 amount of avoidance of litigation costs, then you ask

12 yourself, What is the patent holder paying for, okay?

13 And I think a presumption -- maybe I would be

14 comfortable with that, a presumption they're paying for some

15 lessening of competition, and maybe that could be rebuttable,

16 I guess, but that's a shortcut at least, some sort of

17 shortcut rather than a full blown rule of reason which seems

18 to be is probably a good idea with that fact pattern.

19 MS. LEVINE: Steve?

20 MR. STACK: Just again going back to the per se

21 question, what are hallmarks of per se violations? One, no

plausible efficiencies, and, two, a statistical probability,

1 think you have either of those in a settlement context.

2 You clearly have efficiencies, and you can't really

3 say that settlements per se are going to be overwhelmingly

1 box. I think it's got to be a payment that's large enough to
2 alter the incentives of the party that's on the receiving
3 end.
4 And I guess in some sense that may take you one step
5 beyond sort of classic per se analysis, but I think another
6 thing that we have to keep in mind here, and again I'm
7 focusing this on the Hatch Waxman context, it sort of ties in
8 things people have said earlier, yes, there are efficiencies
9 as between those two parties, but there are some third
10 parties who are not necessarily benefitting from those
11 efficiencies in the context of the reverse payment.
12 MS. LEVINE: Tom, let me call on you and ask you if
13 you can take the conversation about rule of reason versus per se
14 discussion -- you can certainly address reverse payments, but
15 take it beyond that. How should other practices be
revat

1 particular practice is an agreement that you're going -- the
2 challenger is going to walk away, which is presumably the
3 most threatening to competition, that is still within the
4 scope. I just frankly have trouble seeing the argument for a
5 per se rule within that context.
6 When you go to settlements that go beyond, I think
7 Rich has a much stronger case. I mean, if the settlement
8 involves an agreement that you're going to license your
9 patent and they're going to purchase a separate unrelated
10 product from you, you get into tying issues, as an example,
11 and if the other elements of a tying claim are met, then the
12 settlement may be subject to a challenge under a per se
13 analysis in that context.
14 I do think it's worthy of mention that my
15 understanding of the settlements that the Commission in
16 particular has gone after without exception, and I'm open to
17 being corrected -- but without exception involve something
18 beyond really the scope of the actual patent dispute.
19 I alluded to one earlier, that you wouldn't make the
20 patented product or any other substitute, as an example, and
21 I think it is telling that the cases that the Commission has
22 gone after involve this sort of reaching beyond the dispute,
23 and that for a pure settlement, the hard case that Phil puts
24 forward, I'll be surprised if you find anyone willing to put
25 a per se rule to it, and even under the rule of reason I

1 think it's a very tough case.
2 MS. LEVINE: Phil?
3 MR. PROGER: I think I agree with Tom. I think that
4 in the area within the scope of the patent, I think we should
5 follow rule of reason. Outside the scope of the patent, then
6 while I'm generally not enamored with the per se rule to
7 begin with, I think there are situations where it might
8 apply.
9 Let's go back to what the rule is. If I recall
10 correctly, in BMI and in CalDen, the Supreme Court has said
11 we applied per se that always or amount always injure
12 competition.
13 When you're within the scope of the patent, one of
14 the set of conceivable outcomes could be, as I said, if the
15 patent is valid, so I don't see how we can puts as a standard
16 there that that would almost or always injure competition.
17 That is why I would not favor per se within the scope.
18 Outside the scope I think is a different situation,
19 but we're in an era where the Supreme Court has been
20 narrowing the application of the per se rule, and now to
21 apply it in an area fraught with uncertainties and
22 difficulties I think would be problematic.
23 MS. LEVINE: Steve?
24 MR. STACK: Just one point, one caveat. When we talk
25 about this distinction between using technology that's within

1 or restraints that are within and without the scope of the
2 patent, it's not as easy as you might think because obviously
3 one of the issues is whether the infringing product is, in
4 fact, within the scope of the patent or not.
5 And when parties settle, they want to get some
6 closure on that issue, and they want to get some closure

1 Anything between those that I've missed feel free to
2 bring up to, so --
3 PROFESSOR BRODLEY: What's the question then?
4 MS. MOORE: The question broadly stated is: When
5 does Noerr apply? How much judicial involvement do you need
6 for Noerr to apply to settlement agreements?
7 MS. MOORE: Tom?
8 PROFESSOR BRODLEY: You start.

1 Professor Brodley has to say about this, but it seems to me
2 that the logical extension of what Tom just said is that all
3 settlements are immune from antitrust scrutiny, and I think
4 we're past that point.
5 I don't know where you would draw the line, but what
6 is particularly -- I'll start at the other end of the
7 spectrum that you tossed out at me, where you have a private
8 agreement followed by a stipulated dismissal of a lawsuit.
9 The private agreement settled the lawsuit. All the judge
10 sees under Rule 41 is that the lawsuit is dismissed.
11 I don't see an argument for that being immune from
12 antitrust scrutiny. Obviously the battle is joined in my
13 mind at least somewhere in between. I may have more to say
14 about that, but I'll let some others chime in.
15 MS. MOORE: Joe?
16 PROFESSOR BRODLEY: Well, I agree with what Rich
17 said. Imagine the sweep of the proposition that whatever
18 imprimatur you put on the settlement, that the
19 settlement then makes immune all of the agreement that
20 you've reached.
21 I mean, who would follow any other course but get it
22 into litigation, settle, and if you need a judicial
23 signature, get the signature and now you've got immune
24 transactions? So I think that that isn't enough to make the
25 legal argument entirely, but I think it's something to keep in

1 mind.

2 As far as the legal argument which is basically

3 whether this involves petitioning, I think a clear

4 distinction between the demand for payment and so forth,

5 that's a part of the litigation -- clearly petitioning,

6 that's a part of a litigation process.

7 It would be crazy to say that you can litigate but

8 you can't ask for -- send a demand letter in advance, so the

9 real question is really the bottom questions which is, What

10 if a judge signs it or indeed the last question, What if the

1 a bit, both of whom are eagerly asking him to approve? That
2 doesn't seem to me to be petitioning in any meaningful
3 sense.
4 It would only be meaningful if there's some sort of a
5 hearing, some sort of a presentation. Plus it doesn't involve
6 any presentation to the judge of the interests that he ought
7 to consider if he's deciding in the public interest, and where
8 is he going to get the information as to how to do this?
9 So I would say that petitioning, at the least,
10 involves a process in which the government decision maker is
11 at least open to the presentation of competing views. In a
12 judicial situation this is usually a hearing.
13 And finally there's another doctrine that cuts on
14 this, that there is precedent that says that where the
15 decision maker is receiving information from consistently
16 biased participants, that it's entitled to no immunity. Now,
17 they're biased in the sense that they represent only a single
18 interest, and it's consistent. That's the line of cases, Woods
19 Expiration is one of them, so that also it seems to me supports the
20 idea that this isn't petitioning.
21 Could it be petitioning? Yes. If some kind of a
22 hearing is held that has some meaning, then sure, that could
23 be a procedure, and the presentations and the judge's
24 approval could be a -- could get you into petitioning.
25 Somebody said the Tunney Act proceeding. That would be I

1 suppose along those lines. Whether that's something we
2 should do is another matter.
3 MS. MOORE: Okay. I think Rich was next.
4 MR. FEINSTEIN: I just wanted to echo in some sense
5 what Joe just said. I mean, the point I didn't get to in my
6 first comment, which I suspected someone would, is exactly

1 on an adversary process is pretty troubling.
2 Sure, everybody here says if you're acting in bad
3 faith, nobody's ever going to agree to any of this. On the
4 other hand, allowing Noerr to cloak something like that is
5 going to put a chill on trying to even investigate into those
6 kind of things if you have the presumption that there's a
7 Noeer benefit on it, even if entered in bad faith, and I
8 don't think the courts really want that result.
9 I think there is some immunity, a full hearing, where
10 all the parties and interest including consumers would have
11 to be adequately represented and by their appropriate
12 advocates, and that setting I think would be the competition
13 law advocates in the government.
14 MS. MOORE: Phil?
15 MR. PROGER: I certainly do not believe that every
16 private agreement that settles litigation because it's
17 settling litigation now is cloaked in Noerr, and as a matter
18 of fact, I think I'm a little skeptical about that overall.
19 That being said, I'm a little bit confused about the
20 comments with respect to your question on a consent
21 judgment. If the question is, Does the consent judgment
22 confer Noerr immunity over the private agreement, that's one
23 question.
24 If the question is, Is the consent judgment immune,
25 well, however that judge came to issue that order -- if the

1 judge issues an order, whether the parties put it before the
2 judge or that he or she just signed it, it's an order of the
3 court, and I cannot conceive a basis that that is not
4 protected if the parties obey the court's order.
5 And to say that you now have to have some sort of
6 Tunney Act proceeding for the judge, maybe that's the way
7 Congress may want to change the law, but that's not the law
8 today. That Article III constitutional judge, he or she could
9 use their own discretion.
10 One other point: we say the judge is not informed.
11 In most of these cases, this judge, he or she has been
12 presiding over this proceeding for a number of years, may
13 have made a number of rulings in this case, and I'm not going
14 to just automatically assume that he or she really doesn't
15 know what's going on.
16 MS. LEVINE: Bill, do you want to ask our closing
17 question of the day?
18 MR. STALLINGS: I think we've heard there are
19 definitely some settlements that warrant antitrust scrutiny
20 and that especially consumer interest is not necessarily at
21 the table at the settlement process.
22 I'm wondering how basically the agencies should get
23 involved in terms of how do we get notice? There was a
24 mention earlier today about Joel Klein's proposal a few years
25 ago to have some type of agency notification of settlements.

1 It seems to me we don't have the ability normally to
2 hear about these things, and the parties don't have the
3 incentives. Normally we get a competitor who complains about
4 a practice, but in this case the competitor is silenced
5 through the settlement.
6 So I would like to get the panel's viewpoints on
7 whether there should be some type of notification system.
8 PROFESSOR BRODLEY: I don't want to keep anybody else
9 from -- okay. Yeah, I think that there should be. First of
10 all, the most limited thing which the Department of Justice
11 was engaged in at one time as an attempt was they should have
12 access to the interference settlement before the PTO, which
13 they don't have now, and there's a decision standing in their
14 way of getting it, but I think either that should be tested --
15 it was only in one circuit -- or should be tested again or that
16 they should see if they can get a statutory amendment.
17 So that -- because the PTO according to Klein is
18 unable really to obtain information -- the problem is that the
19 settlement is supposed to include all the collateral agreements
20 which, of course, is what the antitrust -- where the antitrust
21 issues lie, and that the PTO has not been able to enforce
22 that. And in any event, you would want an antitrust agency
23 presence when you get to the collateral agreements that might
24 be anti-competitive, so that's number 1.
25 Number 2, I think that the proposals in the currently

1 deal while the -- before the notification has been acted on?
2 What happens -- and that in turn creates resource issues for
3 the agency that's reviewing it, depending upon what the
4 obligations are for a review, but I think the general concept
5 is one that's worth taking a look at.
6 PROFESSOR SHAPIRO: I would pretty much second what
7 Rich said. I don't know exactly what the costs that would be
8 imposed by such a rule and one limited appropriately, but it
9 seems to me if it's really notification and not pre-approval
10 for starters, it should be hopefully fairly low cost, and it
11 could make some companies think twice before they enter into
12 what might be really an anti-competitive settlement.
13 Just knowing that it would be revealed to the
14 agencies, that seems to me to really have some merit, if it's
15 done carefully.
16 MS. LEVINE: All right. Let me thank our panelists.
17 I must say this has been a truly impressive array of
18 panelists today, and at least for me this has been one of the
19 most vigorous and informative discussions of our whole
20 hearings. It's just been wonderful.
21 Thank you very much. The agency appreciates it, and
22 the Department of Justice and PTO as well, and I think the
23 public record will reflect just a wonderful morning.
24 Thank you very much.
25 (Whereupon, at 12:03 p.m., the workshop was

1 concluded.)
2 - - - - -
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 C E R T I F I C A T I O N   O F   R E P O R T E R
2
3
4 CASE TITLE: COMPETITION AND INTELLECTUAL PROPERTY LAW AND
5 POLICY IN THE KNOWLEDGE-BASED ECONOMY
6 HEARING DATE: MAY 2, 2002
7
8 I HEREBY CERTIFY that the transcript contained herein
9 is a full and accurate transcript of the notes taken by me at
10 the hearing on the above cause before the FEDERAL TRADE
11 COMMISSION to the best of my knowledge and belief.
12
13 DATED: MAY 9, 2002
14
15
16 DEBRA L. MAHEUX
17
18 C E R T I F I C A T I O N   O F   P R O O F R E A D E R
19
20 I HEREBY CERTIFY that I proofread the transcript for
21 accuracy in spelling, hyphenation, punctuation and format.
22
23 DIANE QUADE
24
25