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3 DEPARTMENT OF JUSTICE ANTITRUST DIVISION

4 and FEDERAL TRADE COMMISSION

5

6 Hearing on:

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8 COMPETITION AND INTELLECTUAL PROPERTY LAW

9 AND POLICY IN THE KNOWLEDGE BASED ECONOMY

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11 Session 1: Analysis of Specific

12 Licensing Practices

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14 Session 2: Practical Issues Encountered in

15 Antitrust Analysis: The Problem of Dealing

16 with Uncertain or Disputed Patent Rights

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20 Great Hall of the U.S. Department of Justice

21 333 Pennsylvania Avenue, N.W.

22 Washington, D.C.

1 MORNING SESSION PARTICIPATING PANELISTS:

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3 Morning Session: Analysis of Specific Licensing

4 Practices

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1 AFTERNOON SESSION PARTICIPATING PANELISTS:

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3 Afternoon Session: Practical Issues Encountered

4 In Antitrust Analysis: The Problem of

5 Dealing with Uncertain or Disputed

6 Patent Rights

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1 MORNING SESSION

2 (9:00 a.m.)

3 MICHAEL KATZ: Good morning and
4 welcome. I'm Michael Katz. I'm the Antitrust
5 Division's Deputy Assistant Attorney General for
6 Economics. My colleagues and I are very glad
7 that you've joined us for what we expect will be
8 another interesting session of the hearings on
9 competition and intellectual property law and
10 policy in the knowledge based economy.

11 And if that weren't long enough,
12 this morning's session goes by the catchy title
13 Antitrust Analysis of Specific Intellectual
14 Property Licensing Practices: Bundling and
15 Temporal Extensions.

16 Those of you who slavishly read
17 the website will notice that we dropped out

18 grantbacks. We may touch upon that, but it's not
19 going to be the focus of what we're talking about
20 this morning.

21 As you're all aware, these hearings
22 are a cooperative effort. And joining me in

7

1 representing the agencies this morning are David
2 Scheffman, director of the Bureau of Economics at
3 the Federal Trade Commission, and Edward Polk,
4 an assistant solicitor at the U.S. Patent and
5 Trademark Office. I'm delighted to be here
6 with them.

7 We're also joined by a distinguished
8 panel of economic and legal experts who are going
9 to address three sets of questions. The first
10 set of questions is going to ask how to treat IP
11 bundling such as package licenses.

12 Now, of course, tying and bundling
13 come up in many other contexts. An important
14 subsidiary question is whether the antitrust
15 treatment of intellectual property bundling
16 should differ from the analysis of other forms

17 of bundling or the bundling of other forms of
18 property.

19 Specifically, I hope this morning's
20 panelists will address what features of
21 intellectual property are central to the analysis
22 and/or distinguish intellectual property from

8

1 other forms of property.

2 The second set of questions concerns
3 temporal extensions. We will address the
4 question of whether, absent trade secret
5 concerns, are there circumstances under which
6 it's appropriate for licensing payments,
7 restrictions, or agreements not to compete to
8 extend beyond the life of the patents being
9 licensed.

10 And we'll also ask whether trade
11 secrets can justify extensions beyond the life
12 even if we think -- the panelists think -- that
13 it may not be the case absent trade secrets.

14 Our third set of issues is a practical
15 one. As for almost any licensing practice,

16 economic theories identify procompetitive and
17 anticompetitive effects. How can the courts deal
18 with the complexity of the issues both to reach
19 the right answers and to give private parties
20 some ability to predict how their licensing
21 practices will be treated?

22 Before we begin, I have to go over a

9

1 few housekeeping details. For security reasons
2 if you're not a DOJ employee, you must be
3 escorted around the building.
4 Antitrust Division paralegals wearing
5 name tags highlighted in green, the ones who
6 escorted you in, are available at the back of the
7 room to escort you out whether you want to leave
8 the building, go to the restroom, or go upstairs
9 to the seventh floor which I'm told is where
10 you'll have to go if you want your cell phone
11 to work.

12 Also, coffee, soda, water, and
13 breakfast pastries are available in the back
14 of the room, and you are to freely eat them

15 without assistance from the paralegals. So this
16 morning's session is going to be a combination
17 of presentations and discussions.
18 We'll spend around two hours
19 discussing IP licensing, principally bundling.
20 Then around 11:00 we're going to take a 15-minute
21 break and then come back for a 45-minute
22 discussion of methods used to extend the lives

10

1 of patents, finishing up the session around noon.
2 Around 1:30 these hearings will resume
3 with a session on how the agencies should resolve
4 uncertain or disputed patent rights in the
5 context of an antitrust investigation.
6 If you have any questions in the
7 audience, please come up to me during the break
8 and hand the questions to me in writing. Time
9 permitting I will pose the questions to the
10 panelists.
11 Now let's turn to the presentations.
12 I'll provide only the briefest of introductions,
13 and I refer you to today's program for the more

14 complete biographies of the panelists that their
15 accomplishments merit.

16 Our first speaker is Gregory
17 Vistnes. He's a vice president at Charles
18 River Associates, Washington, D.C., where he
19 specializes in the economic analysis of antitrust
20 and competition issues.

21 He recently was the Deputy Director
22 for Antitrust in the FTC's Bureau of Economics,

11

1 and before that he was an assistant chief in the
2 Economic Analysis Group at the Antitrust
3 Division. Greg will provide us with an overview
4 of some of the economic theories related to the
5 analysis of IP bundling. Greg?

6 GREGORY VISTNES: What I've been asked
7 to do is give a brief overview of some of the
8 economic theories with respect to bundling.

9 And then what I want to do is in the
10 time that remains after covering the entire field
11 of bundling in I think five minutes, is talk
12 about why IP markets are a little bit special

12 problem is that's not a credible threat. And so
13 how does the monopolist respond?
14 One way it can do that is through
15 bundling. And intuition here is by bundling one
16 of its monopoly products to the product in market
17 B, the one where entry is foreseen, in essence
18 what the monopolist does is the bundle puts --
19 it creates a hostage type situation for the
20 monopolist.
21 In other words, in order to continue
22 selling its highly profitable product A where it

13

1 will remain a monopolist, the bundle forces it
2 to continue making a lot of sales in market B.
3 So once entry takes place, the
4 only way it can continue to make those highly
5 profitable market A sales is by setting a very
6 aggressive price in market B. In essence it's
7 committing itself in order to sell product A to
8 be very aggressive in product B.
9 It's as if the bundle for the
10 monopolist, the monopolist is holding a gun up

11 to its head and saying, stop, don't enter or if
12 you do I'll shoot myself. And in this case it's
13 a credible threat, and the entrant is actually
14 afraid of entry because it knows of the high
15 price.

16 So what the bundling does here is
17 it's a little bit different from my of the other
18 theories in that the bundling is really just a
19 means of achieving a different goal, that is,
20 a means to commit to aggressive pricing.

21 The second model is the one by
22 Carlton & Waldman. And what they do is look at

14

1 a monopolist. But we'll leave it an unnamed
2 monopolist in an operating systems market who
3 again faces some sort of entry.

4 And the entry it fears is competition
5 in the operating systems market. What they have
6 is the way that this entry is going to take place
7 is they fear that a browser is going to provide
8 compatibility between software and between a
9 future operating system.

9 But it's again directed at preventing entry into
10 the monopoly market.

11 The third class is models that are put
12 forth by Nalebuff and these are a little bit
13 different. Let me first of all rather than
14 characterize Nalebuff's model is just quickly
15 run through the results, and then I'll try to
16 get forth the intuitions on it.

17 And Nalebuff's basic premises or
18 basic results are that bundling can result in
19 lower prices. It can increase the profits of the
20 bundler but in fact reduce the profits of single
21 product rivals.

22 And his results show that in fact with

16

1 multiproduct rivals, the first firm to bundle is
2 going to achieve higher profits, whereas if the
3 second firm follows suit and also bundles, that
4 the profits of that firm actually fall.

5 It's a model in which bundling can
6 actually result in extraordinarily aggressive
7 competition if all firms follow through with the

8 bundling. And it's also a unique model in that
9 it's a model in which market power is not really
10 a prerequisite to having any of the effects that
11 Nalebuff finds.

12 And that really is a key distinction
13 with most of the other theories on bundling, is
14 the distinction about do you need market power.
15 Simple intuition in the Nalebuff model you can
16 see with the classic pizza and beer markets.

17 And running quickly through it, if we
18 have four firms out there, two producers of beer,
19 two of pizza, it's there I'm taking into account
20 the externalities involved that if Brutus -- firm
21 one -- lowers its price of pizza it induces
22 demand for beer. But he doesn't really care

17

1 because he doesn't own the beer firms.

2 If you get the merger without
3 bundling, all of a sudden when Brutus lowers
4 his price of pizza he realizes that some of
5 that spillover demand goes to now his own beer
6 producer.

7 And so that's a good thing. That
8 creates the incentive for lowering the price of
9 pizza. And that's a classic elimination of double
10 marginalization. It's a fairly classic intuition
11 with mergers of complements.

12 Unfortunately this merged pizza-beer
13 firm is still recognizing that although when they
14 lowered the price of pizza it increases demand
15 for beer, some of which spills over to their own
16 beer production, it's also increasing the demand
17 for other firms' beer.

18 And that's kind of a frustrating
19 result. And so bundling achieves a goal here of
20 basically assuring that all of that spillover
21 demand from the lower price of pizza goes
22 directly to its own beer producer.

18

1 It's in effect saying that if you want
2 to benefit from the lower price of pizza you need
3 to buy my beer. And so the bundling here can
4 create yet another incentive to lower the price.

5 So it's a model in which the bundling

6 creates what a lot of folks other than Europeans
7 might call an efficiency from the bundling. Also
8 one of the effects of bundling is it can just
9 reduce demand overall for what I've called firm
10 three and firm four.

11 And the intuition there is that
12 once the bundle takes place at a very low price,
13 the only folks who are remaining interested in
14 purchasing either the unbundled firm three pizza
15 or the unbundled firm four beer are those people
16 who care so little for the other product that
17 they are willing to forgo what is really a very
18 good deal on the bundled product.

19 So it causes in a sense harm to the
20 competitors by reducing their overall demand.
21 And the last point about bundling is bundling
22 can in fact affect differentiation of competing

1 products.

2 And what I have here is just a
3 simple illustration that if you bundle together
4 two low quality products and two high quality

5 products, you're in effect increasing the overall
6 differentiation between the competing products.
7 That increased differentiation can result in
8 higher prices.

9 Alternatively, if you bundle together
10 a high and a low quality pizza and beer and the
11 same thing with the other set, in essence your
12 bundled products become less differentiated than
13 they previously were. So in that case the
14 bundling can reduce differentiation and increase
15 competition.

16 So now what's special about IP
17 markets? And one of the differences which has
18 been talked about is clearly there are more
19 efficiency justifications or at least the
20 potential for efficiency justifications with
21 bundling, that there can often be the strong
22 complementarities that motivate the bundling and

1 also issues of reducing double marginalization.

2 Secondly, the question is: Is there a
3 greater anticompetitive potential from bundling?

4 And here I want to quickly discuss, first of all,
5 there is a greater likelihood of market power in
6 markets with IP bundling, the market power being
7 a prerequisite in most cases to having a bundling
8 or a tying theory.

9 Also, is there some notion that
10 what may sometimes be the transitory nature of
11 IP-based market power, does that somehow create
12 an incentive for bundling that might not
13 otherwise occur?

14 And lastly, are there greater
15 incentives to block entry in markets with IP
16 power, as I'll say, mainly because of the nature
17 of costs in those types of markets?

18 So first with respect to IP and market
19 power, I think there's at least a notion that in
20 many cases the existence of intellectual property
21 may in a sense convey some real market power.

22 Certainly with a patent, depending on

1 how strong or how broad the scope of the patent,
2 that may confer some real market power. And if

3 nothing else, does that IP power then somehow at
4 least get you over the first hurdle of most
5 bundling theories?
6 Bundling theory says before we pass
7 go, you need to show market power. The IP may
8 provide that. You pass go and therefore, if
9 nothing else, get a little more justification
10 for concerns with bundling.

2 are characterized by high fixed costs and low
3 variable costs or low marginal costs.

4 And those industries are more subject
5 to when competition takes place for it to be very
6 vigorous, very fierce competition that eliminates
7 much of the rents, again depending on how much
8 differentiation is left.

9 So the issue is that with IP markets
10 is there a much stronger incentive to dissuade
11 entry because there's so much profit effect from
12 entry.

13 And similarly, when entry takes place,
14 if that results in very vigorous competition, the
15 entrant may in fact not have that much incentive
16 for getting in in the first place because it
17 knows most of the profits will evaporate.

18 Those sorts of circumstances may lead
19 you in a situation where even if bundling doesn't
20 have a big disincentive for the entrant, that the
21 effect is relatively small, it may be enough to
22 in essence be the straw that breaks the camel's

1 back.

2 There are huge incentives for the
3 incumbent to dissuade entry, and it may be
4 relatively easy to dissuade that entry in the
5 second place.

6 And many of those bundling theories
7 that I so rapidly went over are in fact focused
8 on exactly this issue, trying to dissuade entry.
9 So that may be one reason why the bundling
10 theories are particularly relevant to some of
11 the IP markets.

12 Secondly, bundling to increase
13 differentiation again may be important. If
14 the bundling markets are otherwise relatively
15 undifferentiated, it goes back to the issue of
16 once entry takes place there's a tremendous
17 amount of competition eliminating most of the
18 rents.

19 So if bundling can achieve the
20 increased differentiation, what I was trying to
21 get at with those pictures of the pizza and the
22 beer, then the bundling may in fact be a very

1 valuable or a very important means by which firms
2 can try to maintain their profits.

3 So in conclusion the theories
4 associated with IP with respect to bundling
5 are really the same theories that apply anywhere.
6 But the facts with intellectual property markets
7 are likely to be a little bit different, and they
8 may justify a little bit more concern.

9 There is certainly greater -- there
10 is certainly a scope for more potential for
11 anticompetitive bundling for the reasons we
12 talked about. The flip side is what we haven't
13 talked about -- there's probably likely to be
14 more scope for efficiencies.

15 It's going to make it different to
16 ultimately do the balancing. It's also going to
17 make it important to distinguish whether or not
18 the bundling is motivated by efficiencies, or
19 alternatively if the efficiencies are really more
20 just a cloak by which to get at some sort of a
21 per se argument on bundling.

22 And lastly, just the caution that

1 ultimately the analysis needs to be fact
2 intensive rather than what sometimes seems to be
3 the case of more theory intensive. Thank you.

4 (Applause.)

5 MICHAEL KATZ: Thank you. And moving
6 right along given the schedule we have, our next
7 speaker is Jonathan Jacobson, a partner in the
8 antitrust practice group of Akin, Gump, Strauss,
9 Hauer & Feld. He has extensive experience in
10 antitrust and commercial litigation and is
11 co-chair of the firm's national antitrust
12 practice.

13 Jonathan I believe will provide an
14 overview of the current state of legal practice
15 and identify some difficulties that he sees with
16 it. Jonathan?

17 JONATHAN JACOBSON: I'm going to
18 talk about the legal analysis of tying and other
19 bundling issues. We're told by the Supreme Court
20 in the Jefferson Parish case that tying remains
21 illegal per se. The scope of the per se rule is
22 unclear.

1 But certainly the Supreme Court has
2 told us that tying remains a per se offense. If
3 tying really were illegal per se, if the courts
4 uniformly applied a per se rule, it would be
5 possible to counsel clients responsibly and
6 clients would have a general idea of what they
7 can do and what they can't do.

8 The rule would be wrong for reasons
9 that we'll explore throughout the day today. But
10 at least clients would be able to understand what
11 they can and cannot do. Unfortunately the rules

1 that tying can be quite harmful. I think the
2 greatest episode where tying was used to cause
3 enormous social harm was back in the 1910s and
4 the 1920s during the period where the motion
5 picture trust having succeeded to the Edison
6 patents on the film projector basically required
7 everyone who was making a movie to join up with
8 them or else they could not get their films
9 projected and exhibited.

10 The result was an enduring monopoly
11 in the motion picture business, a series of
12 antitrust proceedings that extended for decades,
13 and problems that in the view of many have not
14 been solved since.

15 Certainly the Paramount decrees are
16 still outstanding and are creating somewhat of a
17 continued havoc in the motion picture industry
18 even today.

19 But the motion picture patents case
20 and other cases where tying has been shown to be
21 harmful aside, it certainly cannot be said that
22 tying is almost always or always harmful, which

1 is the standard that the Supreme Court says in
2 other contexts should be applied to determine
3 whether a practice is illegal per se or not.

4 There are often, not always, but
5 often strong efficiency justifications for tying
6 arrangements. And a very good explanation of
7 some of the efficiencies can be found in the
8 recent en banc decision of the D.C. Circuit in
9 the Microsoft case.

10 The lower courts have recognized this
11 and have found various ways of rebelling against
12 the per se rule, creating a number of splits on
13 very important issues. And I'm going to quickly
14 run through five of them.

15 First is whether the 271(d) statute
16 eliminates the presumption of market power only
17 from misuse cases or whether it applies to
18 affirmative Sherman or Clayton Act cases as well.
19 DOJ and FTC say no. A number of courts say no.
20 But some courts including the Federal Circuit say
21 yes.

1 still a presumption of market power from the
2 possession of a patent or copyright? Jefferson
3 Parish says yes. A number of cases including the
4 Sixth Circuit's decision in the Root case and the
5 Abbott Labs case from the Federal Circuit say no.

6 Another dispute: Can you assume
7 market power from the mere possession of a
8 copyright? We have a fairly recent decision in
9 the MCA case from the Eleventh Circuit saying
10 that Loew's, the 1962 Supreme Court decision,
11 remains good law.

12 We have the Root decision in the Sixth
13 Circuit saying -- this is somewhat shocking to
14 hear a Court of Appeals say flat out -- that the
15 Supreme Court was just wrong and we're not going
16 to obey what the Supreme Court has told us.

17 Another unresolved issue is the extent
18 to which evidence of justification is admitted.
19 There's a clear conflict in the cases. The Ninth
20 Circuit says the justification is admissible.

21 The Supreme Court has said no in a footnote in
22 Jefferson Parish, and a number of Circuit Courts

30

1 have followed that as well.

2 Yet another unresolved issue is
3 whether anticompetitive effects more than sheer
4 volume need be shown in the tied product market.
5 Again we have a number of courts saying it's a
6 per se offense. You don't have to show actual
7 harm to competition.

8 We have a number of cases going
9 exactly the opposite way. So we have clear
10 conflicts in the courts on five very important
11 issues relating to tying and bundling.

12 The result of this is when the client
13 asks you about what the rules are governing
14 bundling of intellectual property that you cannot
15 give a clear answer. If the client is aggressive
16 and wants to take his or her case up to the
17 Supreme Court, you can say absolutely, yes, go
18 ahead and do it.

19 Most clients are not quite that ready

19 eligible at this point for plenary Supreme Court
20 review.
21 And the prospect of a Supreme Court
22 solution at least in the near term has to be

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1 regarded as poor. The Microsoft case I think
2 would have been a good chance to help. The
3 court in that case instead carved out a platform
4 software exception for the tying rule.

5 Now, if you read the opinion, it's
6 clear that the court's real problem was with the
7 per se rule for tying, with the analysis that the
8 Supreme Court had used in Jefferson Parish.

9 But rather than say we disagree and,
10 Supreme Court, you should fix the mess you've
11 made, the D.C. Circuit instead en banc carved out
12 a new exception, a platform software exception
13 for the per se rule that is questionable under
14 the Maricopa standard for per se analysis.

15 And in any event it makes it
16 difficult -- compounds the difficulty in giving
17 advice to clients. There have been a number of

18 efforts over the years to get Congress to fix the
19 problem.

20 There were hearings in 1996 with a
21 very clear statute that simply said there shall
22 be no presumption of market power from possession

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1 of a patent or copyright, very clean, no
2 amendments. It simply stated what people
3 believed to be correct law, correct economic
4 analysis. The bill never got out of committee.
5 Tad Lipsky, who's on the panel today, testified
6 in favor of it.

7 The Justice Department, who only a
8 year before had joined with the FTC in issuing
9 the 1995 guidelines which clearly say that the
10 agencies will apply no presumption of market
11 power from possession of a patent or copyright,
12 nevertheless opposed the legislation on the
13 general grounds that Justice opposes most
14 legislation, which is that, please, Congress,
15 stay out of antitrust and let the courts fix
16 whatever messes they may have made.

17 That's a general standard that has a

18 lot to commend it. But in this particular

16 bundling. Actively seek out cases involving

17 intellectual property bundling in particular.

15 we're told by Congress not to, so that's at least

16 two people's view on the division of labor

17 between them.

18 Let me start I guess in some sense

19 with a ridiculous question, but that's the beauty

20 of being a moderator. Does anybody think that

14 always or almost always harmful to competition,

15 and therefore has little to commend it.

16 MICHAEL KATZ: Anybody else?

17 DAVID SIBLEY: Continuing in the same

18 vein when you say that tying shouldn't be per se,

13 on was the fact that low marginal cost for
14 intellectual property, even costs that could
15 be zero if you're adding more lines on a CD,
16 suggests that it could well be efficient just to
17 take everything and put it out there on a bundle
18 any way just to avoid the transactions cost.

19 So I was wondering if people would
20 say a little bit about do you think that these
21 problems are bigger problems in IP or less
22 problems. Certainly economists, the first thing

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1 they always say about tying is it's a mess. So
2 what about how is that mess relative to other
3 forms of property? Joe?

4 JOSEPH FARRELL: Well, I think tying
5 and bundling is replete with confusion over two
6 questions. And although I'm sure General Katz is
7 not confused in his own mind, the way he put it
8 might confuse weaker minds.

9 On the one hand in the short run
10 static analysis of demand theory it's usually,
11 not always, but usually true that charging a

12 lower marginal price leads to better allocative
13 efficiency.

14 On the other hand -- and you can do
15 some kinds of analyses of tying and bundling
16 along those lines. And perhaps the pizza and
17 beer example is a case in point.

18 On the other hand I think it's crucial
19 when thinking about tying and bundling not to
20 stop with that level of analysis and to also ask
21 does this practice get in the way of someone who
22 is interested in offering a better long run deal

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1 to consumers.

2 Now, one of the reasons I'm
3 Mr. Rule-Of-Reason and don't like per se
4 treatments of just about anything is that I think
5 that's the key question to ask. And I think it's
6 very unhelpful usually to use a word like tying
7 or bundling to describe a practice in coming up
8 with an answer to that question.

9 But I do think it's important to
10 stress that just the fact that marginal cost is

11 low although it's certainly very relevant for
12 thinking about the effects of putting everything
13 out there on a CD, I don't think it tells you the
14 answer right away.

15 MICHAEL KATZ: To summarize your
16 answer, not only do we have to deal with all the
17 messiness of tying, but we have to deal with all
18 the messiness of predation as well.

19 JOSEPH FARRELL: Unfortunately, yes.

20 DAVID SCHEFMAN: I'm curious about
21 what the panelists think on one thing. If I
22 understood Jonathan right, he advanced the view

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1 that the current state of the law although messy
2 and even moving to per se probably wouldn't
3 sacrifice a lot in terms of efficiencies if I
4 understood you right. Is that --

5 JONATHAN JACOBSON: I think there are
6 a number of cases, and I think it's the vast
7 majority of cases where the efficiencies from
8 tying are relatively small.

9 I do believe, for example, let's

- 10 take Microsoft, that although there are clearly
- 11 efficiencies in bundling the browser into the
- 12 operating system, what are the efficiencies on
- 13 precluding the use of alternative browsers

9 significant position in the market, where the
10 rule can be quite harmful.

11 So is the world going to end if
12 Jefferson Parish is not overruled in the next ten
13 minutes? No. Should it be overruled as soon as
14 we can get a case there? Yes.

15 GREGORY SIDAK: I wanted to make a
16 point about intellectual property being subject
17 to the traditional tying doctrines. I think that
18 an additional economic factor that needs to be
19 considered here is the greater relative
20 difficulty under the separate product prong of
21 the tying test.

22 When you're looking at products that

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1 embody a lot of intellectual property and may be
2 subject to continuing technological innovation or
3 still developing consumer tastes, the very
4 definition of the product may not be particularly
5 fixed. It's easier to talk about beer and pizza
6 being separate products.

7 But for some of these software

8 products it may be harder. And I can imagine the
9 same would be true of pharmaceuticals and some
10 other kinds of patented IP.

11 TAD LIPSKY: Just a short addition
12 which actually segues from the previous two, I
13 mean think about the implications of the last two
14 comments. What's really -- it's a fact that
15 product scoping and combination decisions are
16 ubiquitous.

17 I mean do you buy this single serve or
18 six pack or in a case? Do you buy this just for
19 plastic cups or do you buy all your picnic
20 supplies? This is a ubiquitous kind of decision.

21 And if you agree with what Greg said
22 and agree with what Jon Jacobson said about the

1 potential harmful effects of the tie-in doctrine
2 on a lot of firms without any source of market

7 the choice of the characteristics of your product
8 and the combinations in which they are sold ought
9 to constitute kind of a free fire zone where
10 antitrust analysis and the civil court system
11 doesn't even come into play.

12 And so I think I agree with the spirit
13 of both of these previous remarks, that the
14 principal harm from the tie-in rule arguably is
15 not that it's not the exact right analysis in
16 that exceedingly rare set of circumstances where
17 there might be a problem from tie-in.

18 The real problem is that the rule is
19 potentially applicable to an enormous range of
20 harmless commercial decisions which nevertheless
21 tend to attract involvement with law enforcement

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6 bunch of questions I'd like to ask now because

7 I'm sure we will come back to this.

8 Our next speaker is Gregory Sidak who

9 is the F. K. Weyerhaeuser Fellow in Law and

10 Economics Emeritus at the American Enterprise

11 Institute for Public Research and the president

12 and chief executive officer of Criterion

13 Economics LLC, an economic consulting firm based

14 in Washington, D.C.

15 I understand that Greg is going to

16 talk about some of the difficulties associated

17 with pricing. If you're going to say things have

18 to be unbundled, then you're going to have to

19 talk about what the prices are.

20 And I think he's going to draw on

21 some of his considerable experience in telecom

22 regulation to talk about what can happen when you

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1 try to do that.

2 GREGORY SIDAK: Thank you. I do want

3 to say something very briefly about liability

4 rules before going on to the pricing issues which

5 I regard as more remedial in nature.

6 I think that part of the problem that
7 we observe in the application of traditional
8 tying doctrine to intellectual property is that
9 it's a square peg in a round hole because the
10 traditional explanations for product bundling, as
11 Greg Vistnes was pointing out earlier, don't
12 necessarily fit some of these new kinds of
13 strategic behavior.

14 And I think that the Microsoft case is
15 a good example of this. David Sibley's theory
16 there of partial substitutes where products that
17 were once complements could change in their
18 relationship, a browser could be a close

4 provocative theory for a new cause of action in

5 antitrust since the raising rivals' cost

6 literature a decade or more earlier.

7 But that leads me to my next point.

8 If we want to try to give some additional flesh

9 to that theory, I think there needs to be more

10 formal analysis by the economists of how the

11 process occurs within consumer demand theory that

12 a complement turns into a substitute.

13 And I think that's something that

14 wasn't so clearly articulated in the Microsoft

15 case and something that I think would be useful

16 as a matter of academic research and policy

17 analysis.

18 Having said that, let me turn to the

19 remedy issue. So much of the discussion of tying

20 issues focuses on whether there is or is not

21 liability. But let's assume that you find

22 liability. Then what?

1 Presumably the rule against tying does

2 not mean that a firm cannot offer product A and

3 product B in a bundle. What I understand it to
4 mean is that product A, let's call it the tying
5 product, has to be offered separately from
6 product B.

7 But presumably the firm could still
8 offer the bundle under a different pricing
9 regime. Well, that then introduces the question:
10 What is the price at which the unbundled version
11 of product A, the tying product, what's the price
12 at which it has to be offered in its unbundled
13 state?

14 Or to put it a little bit differently,
15 if you unbundle A and B and you are now selling A
16 separately, when is the unbundled price of A so
17 high as to be unreasonable, as to be -- as to
18 defeat the whole purpose of finding liability or
19 maybe even give rise to a separate antitrust
20 cause of action?

21 Well, this is a question that the
22 Supreme Court and the Federal Communications

2 panel to my right have spent a lot of time
3 thinking about.
4 And in the decision that came down
5 yesterday, Verizon Communications versus FCC, the
6 Supreme Court upheld the pricing rule that the
7 FCC adopted in 1996 called TELRIC, which is Total
8 Element Long Run Incremental Cost.

9 This is a rule that was applied to the
10 local telephone companies when they were required
11 under the telecom act to unbundle their networks.

12 Simplify the facts.

13 Suppose that the network consists of
14 just two pieces, the local loop that goes from
15 your home or office to the central office switch,
16 and then everything else in the network, but we
17 can call that the switch just for simplicity.

18 So the question was what is the price
19 that the incumbent must offer the unbundled loop
20 which is the least easily duplicated piece in the
21 network, to competitors for. Well, the TELRIC
22 approach was one of many different pricing rules

1 being considered.

2 The other kinds of rules that are
3 commonly discussed in a multiproduct regulated
4 industry context are fully distributed cost
5 pricing, Ramsey pricing, something called
6 efficient component pricing, and more recently
7 there's been recommendations for using real
8 option theory to price access to networks.

9 The idea of long run incremental cost
10 and the TELRIC rule was to figure out what that
11 piece of the network would cost to replicate
12 given an efficient design of the network at this

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1 the bundled price and you subtract out the
2 incremental cost of what was the tied product in
3 the bundle. And that would then give you an
4 avoided cost approach to calculating what the
5 unbundled price should be for product A.

6 Another approach -- and that approach
7 incidentally is what's used to price wholesale
8 services in telecommunications. The other
9 approach is called the bottom up approach where
10 you say what is the long run incremental cost of
11 product A, the tying product.

12 And this one, if you were to follow
13 the approach that the FCC has used you would say,
14 well, we estimate that TELRIC and we -- and that
15 includes a competitive return to capital, and we
16 include on top of that some contribution to the
17 recovery of common costs of this multiproduct
18 firm.

19 Now, in principle the bottom up
20 approach and the top down approach should get you
21 to the same answer, but in practice they may not.
22 And if they diverge in practice then there will

1 obviously be strategic decisions made by
2 litigants to advocate one approach or the other.

3 Typically the access seeker argues
4 under a top down approach that just subtracting
5 out the avoided cost of what had been the tied
6 product does not take into account that there are
7 monopoly rents being earned and it does not take
8 into account inefficiencies that this incumbent
9 monopolist has been able to get away with.

10 On the other hand, the access
11 provider, in this case the firm owning the tying
12 product, would argue, well, there are actually
13 additional incremental costs of unbundling my
14 products. That may or may not be a persuasive
15 argument to make.

16 But particularly in the case of
17 intellectual property where you can add that
18 additional piece of software to the CD-ROM at
19 very low cost it may actually be more costly to
20 disaggregate it.

21 Now, I think that if we start seeing a
22 number of cases involving intellectual property

- 1 where there are findings of liability, the TELRIC
- 2 pricing approach is as likely as any to be
- 3 adopted by an antitrust court because it has
- 4 gotten the stamp of approval from the Supreme

1 (Applause.)

2 MICHAEL KATZ: Our next speaker is Tad
3 Lipsky. He is a partner in the Washington, D.C.
4 office of Latham & Watkins. 1981 to 1983 he
5 served as deputy assistant attorney general
6 under William Baxter where he supervised the
7 preparation of the 1982 merger guidelines.

8 Tad is going to offer some insights
9 for improving the litigation process and judicial
10 decision making at home.

11 TAD LIPSKY: Thank you, Michael. And
12 I also had the honor of shooting the nine no-nos
13 in the head. First of all let me say what a
14 great idea these hearings are, how honored I am
15 to be included.

16 And it is a great pleasure to be here
17 with friends and colleagues. And Greg of course
18 is a former student although it's obvious he went
19 overboard in hitting the books after he took my
20 course 26 years ago or 28 years ago.

21 I also want to say for the benefit of
22 the audience that if you picked up a copy of my

1 remarks from the table on your way in, you might
2 be a little confused. That was the just before
3 final version. The final version is available
4 now on the website.

5 And the reason it might be confusing
6 is I want to focus on an idea conveyed by the new
7 title of my remarks: Amateurs in black. The
8 phrase actually comes from a speech that Justice
9 Steven Breyer gave to the American Association
10 for the Advancement of Science back a couple of
11 years ago.

12 And he's actually quoting from Judge
13 Acker, but anyway, I'll explain all that in a
14 minute. But I want to focus my remarks
15 completely on essentially the third question that

22 treated? The history of the evolution of the

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1 per se rule, the tie-in doctrine, is very briefly
2 summarized in my written remarks.

3 Anybody who's interested in how we got
4 to the situation of having a per se rule will
5 want to read the original scholarship by Ward
6 Bowman, both his 1957 Yale Law Journal article
7 and his 1973 book where the whole thing is traced
8 in lurid detail. The per se rule under antitrust
9 law actually originates from patent cases.

10 But at some point the per se rule that
11 had evolved to the point of the International
12 Salt case in the patent field jumped the tracks
13 in the Northern Pacific Railway case so that the
14 source of power under the per se rule didn't need
15 to be intellectual property anymore. But in any
16 event, that's what we got.

17 But what I would like to do in my
18 remarks is assume that all of the per se rules
19 that have plagued the tie-in doctrine and the
20 intellectual property area for so many years will

21 eventually be abandoned. And I think they will.

22 It's true that twenty years ago no

20 acutely aware that the Supreme Court has totally
21 revolutionized the process of evaluating expert
22 testimony in federal civil trials.

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1 There are four cases beginning with
2 a case called Daubert which I refer to as the
3 Daubert quartet which basically completely
4 reversed the premises about the evaluation of
5 expert testimony.

6 It used to be the rule was that
7 testimony on a scientific question was subject to
8 the so-called general acceptance test. But that
9 was totally changed by these four opinions
10 starting with Daubert in 1993.

11 The rule now is that the federal trial
12 judge, the District Court judge must assume the
13 position of gatekeeper and make an independent
14 evaluation subject to review for abuse of
15 discretion of the relevance, reliability, and
16 fit of expert testimony.

17 And it has pretty much totally
18 revolutionized the way that the presentation of

19 expert testimony goes in federal civil trials.

20 And I think one of the remarkable

21 things you'll find is a whole series of decisions

22 in antitrust cases following Daubert that

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1 reject -- where a trial judge sometimes rejects

2 testimony or an Appellate Court -- even more

3 embarrassing, an Appellate Court reverses a

4 decision to admit expert testimony.

5 And these courts are not afraid of

6 economic credentials. As I've pointed out, a lot

7 of the testimony has been rejected under the

8 Daubert rule in antitrust cases coming from

9 people who have tenured positions at leading

10 American universities. And a couple of them have

11 Nobel Prizes in economics.

12 So the courts are not shy about

13 exercising this discretion. But in addition

14 to these rulings -- I should also say it's my

15 personal opinion that the Daubert court was

16 actually -- actually had a precursor in antitrust

17 law, that the origins of the Daubert rule can be

18 found in the decisions of the Supreme Court in
19 Matsushita and in Brooke Group versus Brown &
20 Williamson Tobacco.

21 Both cases hinged very critically --
22 well, completely in the case of Zenith Radio

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1 versus Matsushita and to a significant degree in
2 Brooke Group on the reliability and the fit to
3 the facts of expert testimony.

4 I don't have time to go into that.
5 But I see Daubert as falling very much into line
6 with a trend that was begun in the field of
7 antitrust.

8 So the Supreme Court, all of those
9 Daubert decisions, nine-zero. The Supreme Court
10 was unanimous that federal trial judges, District
11 Courts need to conduct this independent
12 evaluation.

13 If you go over the process by which
14 expert testimony is evaluated in federal trial, I
15 think -- well, I wish I had time to support this
16 but I obviously don't. The federal trial courts

17 I think need some incentive to improve the
18 quality control on expert testimony.
19 I think that is essentially the
20 concern that lies at the heart of the Daubert
21 quartet and the two predecessor rulings. Justice
22 Breyer has actually given some public addresses

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1 on this subject. He's spoken to the AAAS in what
2 are referred to -- the title of my remarks is
3 taken from a quote from that.

4 And basically what Justice Breyer is
5 doing is he is appealing to various organizations
6 and institutions that can evaluate the
7 capabilities of expert witnesses in the hope that
8 by cooperating with the courts and cooperating
9 with the selection of experts in the civil
10 justice system, perhaps even by certifying
11 experts which I think essentially is what he's
12 trying to propose, that the quality of the expert
13 testimony can be improved.

14 And that is really the focus of my
15 point. When we get to the business of actually

- 15 if they were interested in getting into the
- 16 business of determining qualifications for
- 17 experts who might be called upon to testify in

14 In the Microsoft case Lawrence Lessig
15 was employed by the trial court. I suppose the
16 jury is still out so to speak on whether that was
17 a good idea or not.

18 But I really -- my main point is that
19 we should be encouraging some -- we should find
20 some additional new supporting institution to
21 improve the quality of the experts so that we
22 can better evaluate the pro- and anticompetitive

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1 effects for these practices when the per se rule
2 is finally abandoned.

3 And let me just close with a quotation
4 from Justice Breyer which again is taken from
5 Judge Acker.

6 He says that unless and until there
7 is a national register of experts on various
8 subjects and a method by which they can be fairly
9 compensated, the federal amateurs wearing black
10 robes -- by which he means of course the federal
11 trial judges -- will have to overlook their new
12 gatekeeping function lest they assume the

13 intolerable burden of becoming experts themselves
14 in every discipline known to the physical and
15 social sciences and some as yet unknown but sure
16 to blossom.

17 MICHAEL KATZ: Thank you.

18 (Applause.)

19 MICHAEL KATZ: Let's take a few
20 minutes for questions here and start with the
21 second presentation first and ask the panel to
22 what extent do they think that there's actually

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1 some market mechanism that's going to start
2 working with experts.

3 People having Daubert motions brought
4 against them successfully, certainly the legal

12 GREGORY SIDAK: I'm absolutely
13 positive it has. I've had one conversation with
14 a famous economist who was very concerned about
15 the implications of one of the notorious Daubert
16 cases that Tad was alluding to.

17 And it really changed the way he was
18 willing to delegate certain kinds of analysis in
19 a case to support staff. So I think that that's
20 clearly one implication of it. But I think
21 there's already been a market reaction to this.
22 And I'm not trying to make a commercial plug for

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1 any consulting firm.

2 But I think the fact that many
3 academics who wind up being expert witnesses
4 affiliate with a firm that then has a brand name
5 and a reputation that is at risk. That is a kind
6 of bonding mechanism that may be relied upon to a
7 greater extent now as a certificate of quality.

8 DAVID SCHEFFMAN: I think the
9 process -- having been an expert witness a lot --
10 that Daubert has been largely very beneficial.

11 And people are clearly aware and subject -- and
12 experts can assume that they are going to be
13 subject to Daubert challenge no matter what their
14 credentials.

15 The credentialing issue is really a
16 false issue, as you can see from the Nobel Prize.
17 There's plenty of highly credentialed people who
18 according to the judge's opinion didn't really do
19 the necessary work to offer expert opinions. And
20 so their testimony should be rejected if that's
21 right. It's really what's more the content.

22 And I don't know a way to get that

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1 other than the judge seeing what the experts are
2 putting forward and seeing that this guy who just
3 got on a case a month ago obviously couldn't have
4 done enough work to offer a reasoned opinion.

5 Obviously I think as you know in
6 most antitrust issues there isn't metaphysical
7 certainty in economics. You're going to have a
8 hopefully good economist on each side. And I
9 think that's beneficial rather than just having

10 lawyers on each side.

11 It's good to have someone bring in

12 what's really the central content of an antitrust

13 case and have the fact finder wrestle with

14 different opinions. It is a benefit to the

15 system. And I think Daubert is working well and

16 is affecting the process and it will work itself

17 out.

18 MICHAEL KATZ: I'll just throw in my

19 own two cents worth. One thing that actually

20 strikes me as a little peculiar about the entire

21 gatekeeper role is that it seems to be saying

8 really taking place. The question I have -- this
9 may be a question for Greg or for Joe since he's
10 now the recognized authority on TELRIC.

11 You're allowed to gloat for one day
12 after the Supreme Court ruling, Joe. After that
13 you have to go back to being your modest self.
14 But the question is what would TELRIC mean for IP
15 or for software. I was wondering if either one
16 of you could say something about what that would
17 look like if that's the way these go.

18 GREGORY SIDAK: I think the first
19 factor that would be distinguishing is the low
20 marginal cost. So if you're looking at the long
21 run incremental cost of a piece of software,
22 you're getting pretty close to a price of zero.

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1 So obviously there's a lot of thought
2 that has to go into whether something being
3 added to that is monopoly rent or is it just
4 quasi-rent, a return to the legitimate investment
5 in product development and innovation.

6 JOSEPH FARRELL: Well, let's see.

7 Yesterday I had the choice of reading the Supreme
8 Court ruling or preparing for today, and I
9 thought I would prepare for today. I didn't
10 realize that it wasn't a choice.

11 First of all on the point Greg just
12 made, TELRIC is meant to be long run incremental
13 cost which includes fixed costs. And so it would
14 be a misimplementation of TELRIC to not include
15 the development cost for the software.

16 But I don't want to make too much of
17 that because that might be heard as suggesting
18 that you could do this well. And I'd just like

6 I think is not to try to remove the quasi-rents
7 that a firm legitimately has in its intellectual
8 or other property individually.

9 It's to try to do something about
10 possible clever strategies by which it can
11 increase those quasi-rents by tying things
12 together.

13 The goal in the Telecommunications Act
14 was not to leave the Bells and other incumbent
15 LECs with the full monopoly or quasi-monopoly,
16 quasi-rents from their facilities. And that's
17 part of what made it so difficult.

18 And it's part of the reason why as
19 the act said you have to have a cost based rather
20 than, for instance, top down or just structural
21 remedy.

22 So it seems to me -- I hope Greg is

1 wrong. I hope that TELRIC will not be generally
2 applied in antitrust unbundling situations
3 because it seems to me that the
4 Telecommunications Act and TELRIC try to do quite

5 a lot more than we should be trying to do in

6 antitrust unbundling cases.

7 MICHAEL KATZ: Joe, let me put you on

8 the spot. For one thing we talked earlier about

9 marginal cost being zero.

10 And you said -- I took your answer to

11 be well that makes a real problem when you try to

12 use some sort of cost floor to judge whether the

13 behavior should be allowed under the antitrust

14 laws or not because you get a floor of

15 essentially zero.

16 And I thought you were saying that

17 that was too shortsighted a view of what should

18 be allowed. You're saying, I think correctly,

19 that TELRIC would be a mess in the case of IP.

20 Do you think it's just a mistake to try to have

21 any sort of cost standard at all? Or is there an

22 alternative approach you would recommend?

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1 JOSEPH FARRELL: In the case of IP

2 bundling you mean?

3 MICHAEL KATZ: Yes, right.

4 JOSEPH FARRELL: You know, this
5 is sort of what I was going to say in any
6 presentation but we can speed up my presentation
7 if I say it now. Just as a personal matter but I
8 suspect it might be applicable to other people
9 too, I don't know what goes on inside other
10 people's heads.

11 When I face an antitrust case I try to
12 ask how does this behavior or does this behavior
13 really get in the way of rivals or potential
14 rivals offering a better deal in the long run.
15 And from that point on it really becomes
16 fundamentally situational and fact intensive.

17 And I personally don't find it
18 terribly helpful to throw around abstract terms
19 like bundling and tying. I find it's more
20 helpful to ask suppose somebody wants to come in
21 and offer a better product, or suppose a rival
22 wants to cut price; how does this behavior or how

1 does this structure get in the way.

2 So given that I find that initially

3 somewhat unhelpful, I don't find it easy at all
4 to answer a question like should there be a cost
5 standard involved in doing it. You'd really have
6 to ask me at least about a particular set of
7 facts.

8 MICHAEL KATZ: Well, let me do this.
9 Let me tell people who you are and then let you
10 talk about whatever you want for a few minutes
11 and we'll ask you some questions about what you
12 just said since getting you out of order -- for
13 those of you who don't already know, Joe Farrell
14 is a Professor of Economics at the University of
15 California-Berkeley.

16 He's also the Chair of the Competition
17 Policy Center there and an Affiliate Professor of
18 Business. As well as being a coauthor of mine
19 and an academic colleague, he was one of my
20 recent -- or most recent -- predecessors as the
21 DAAG for Economics here at the Antitrust
22 Division.

1 He also was my successor as chief

2 economist at the FCC, which is where he had the
3 role in TELRIC and leading up to yesterday's
4 Supreme Court decision. So Joe is going to offer
5 his thoughts, some additional thoughts on the
6 economics of IP bundling and licensing and
7 whatever else he wants to speak about.

8 (Technical support discussion.)

9 MICHAEL KATZ: Apparently there was
10 some natural order. Originally David was simply
11 scheduled to go first. And I thought I would try
12 reversing the order between Joe and David, but
13 apparently the technical gods do not want that to
14 happen. So if we can we'll have David go first.

15 (Technical support discussion.)

16 MICHAEL KATZ: While the overhead
17 projector is being set up, I'll introduce David
18 Sibley who currently holds the John Michael
19 Stuart Centennial Professorship of Economics at
20 the University of Texas at Austin.

21 He's served as an economic consultant
22 to both the U.S. Department of Justice and the

1 Federal Trade Commission. And I guess we'll have
2 to ask him whether he's ever been a consultant
3 for the PTO. Anyway, we're delighted he's here.

4 And he will discuss situations in
5 which his analysis indicates that certain
6 unilateral licensing practice terms can be
7 problematic. In particular something near and
8 dear to the hearts of all economists is whether
9 certain functions are concave or convex.

10 DAVID SIBLEY: You've heard lots of
11 seasoned advice from other people. Here's some
12 of the unseasoned variety from me. This is a
13 work in process with Simon Wilkie from Cal Tech.
14 For those of you who like to follow comings and
15 goings of economists in Washington, Simon is
16 going to be the next chief economist at the FCC.

17 Now, clearly economists talk a lot
18 about the economic effects of contracting
19 practices of one sort or another. But usually
20 the emphasis really is on what an optimally
21 designed contract would be like or would people
22 enter in on a certain contract.

1 old contract and then sign up with the new one.

2 Now, in a way this is a -- or should

3 be a kind of classic IP issue. Economists all

4 the time talk rather blithely about new

5 technologies coming along, and of course people

6 sign up with the new technology.

7 But there isn't much thought given

8 to how long that takes; does the process of

9 switching customers from the old one to the new

10 one happen in a particularly good way.

11 And that's really what my talk is

12 going to be about. Now, a lot of contracts

13 whether they are IP or otherwise have abrogation

14 clauses. I've read a number.

15 And a lot of them say that if you walk

16 from a contract -- in this case an IP contract --

17 you have to compensate the current IP holder for

18 the direct and indirect harm caused by your

19 withdrawing from the contract which in many cases

20 is an unexceptional sort of idea.

21 But there may be cases in which that

22 leads to unexpected effects. Suppose, for

1 example -- this is the only graph or anything in
2 the least mathematical.

3 Suppose that we have these two
4 licensees and each licensee produces output.
5 And there are some benefits that the current IP
6 holder gets depending on how many units of output
7 are produced with his particular technology.

8 So on this axis we have units of
9 output produced with the current IP. And on this
10 axis we have dollar benefits accruing to the
11 current IP holder. Now, the way I've drawn it,
12 this curve rises as you might expect.

13 That is the larger the number of units
14 of output that embody the current IP owner's IP,
15 the better off he is. This could be through
16 royalty payments, the ability to produce
17 complementary products, perhaps advertising
18 revenues, all kinds of things.

19 But notice the way I've drawn it it
20 rises at an increasing rate. That is to say, as
21 extra units of output are produced using the IP
22 of the currently optimal IP owner, the better off

1 he is at an increasing rate.

2 Now this could come about because of
3 scale economies for example, scale economies of
4 production or advertising scale economies or
5 there are lots of ways it could happen.

6 And as we'll see this actually gives
7 rise to a problem. I'll come back to this.
8 We're going to assume initially that two
9 licensees have signed contracts with the current
10 IP holder and then a newer and better IP comes
11 along.

12 And I'm also going to suppose that
13 holding fixed the other licensee, either licensee
14 could profitably buy his way out of the old
15 contract, i.e. pay off the current IP holder for
16 his lost benefit and switch some or all of his

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1 would say that the two licensees would withdraw
2 output from the current IP and go with the new
3 latest and greatest IP up to the point where the
4 marginal benefit to them of withdrawing another
5 unit of output from the current stuff to the new
6 stuff equals the marginal damage cost to the
7 current IP owner.

8 Unfortunately for the efficient
9 functioning of this process the abrogation clause
10 that I went over a minute ago combined with these
11 economies of scale here gives rise to a problem.

12 Let's suppose that you are the first
13 IP -- or the first licensee to try to in a sense
14 buy you out of this contract. Well, this is the
15 benefit to the current IP owner of having both of
16 you guys signed up with him.

17 Let's suppose that each licensee
18 produces 50 units. So the first one to withdraw
19 has to pay the difference between this point and
20 that point which is quite a lot. Whereas the
21 second one to withdraw only has to pay this much.

22 So there's a coordination problem.

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1 Each licensee wants to be the last to exercise
2 the abrogation clause. Now, this fact has some
3 consequences.

4 Assuming that someone does sort of
5 test the waters, the first licensee to withdraw
6 as I just indicated pays quite a high price but
7 reduces the price that the second licensee has to
8 pay. So there's kind of a positive externality
9 between licensees.

10 That is, the first one confers a
11 positive externality on the second one. However
12 total output withdrawn from the current IP and
13 shifted into the new, latest, and greater IP is
14 less than the efficient benchmark level that I
15 talked about earlier.

16 And furthermore, licensees wait too
17 long to do this. Now, I'm assuming here that
18 each licensee has a positive rate of time
19 discount. So the efficient thing to do is if
20 you're going to withdraw output do it right away.

21 Why wait, because of time discounting.

22 Well, in this case they wait. And in

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1 fact we have examples where they wait a long
2 time. Now, these first three bullet points are
3 in the case where both licensees signed up. So
4 they are sort of waiting each other out, not
5 wanting to go first because they would prefer to
6 go second and pay less for bailing out.

7 The result is they wait a long time.

8 There is another possible outcome to this
9 particular scenario which I didn't put on the
10 transparency. And that is both guys don't sign
11 the contract.

12 You could rationally it turns out have

20 an economic cost because the one who did not sign

21 the contract with the current IP uses a less than

22 currently state of the art technology and until

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1 new IP comes along.

2 And he only does that because of ges that b7gil

19 have to do anything to make it difficult for
20 people to switch from his technology to the new
21 one when it comes along. The coordination
22 problem does that for him.

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1 Now, when new technology arrives,
2 the coordination problem means that a licensee
3 doesn't buy his way out of the current IP even if
4 it were theoretically possible for a third party
5 who would say, Farrell, you go first and,
6 Mr. Polk, you go second or sort of break the
7 coordination problem that way.

8 Even if things would work out fine
9 with a third party refereeing who goes first,
10 that doesn't happen here because of the
11 individual coordination problem.

12 Now, if the current IP owner operates
13 under constant returns where that diagram that I
14 went through sort of just goes up like a straight
15 line, then we don't have a problem. People
16 withdraw the right amount from the current IP,
17 put it into the new IP, and they do it

18 right away.

19 Now, I've tried to think about other
20 ways of designing abrogation clauses that
21 wouldn't give rise to these problems or wouldn't
22 create other problems. And it's actually not

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1 that easy to do.

2 A little later on in the talk I may be
3 talking about a paper by Aghion and Bolton which
4 is a very different paper but it involves an
5 abrogation clause which is a liquidated damages
6 clause.

7 That is to say, you don't really have
8 to pay the current IP owner in my setting the
9 exact cost to him if you're withdrawing output.
10 You just pay a fixed amount, liquidated damages.

17 to re-emphasize that what makes the party go is
18 the abrogation clause itself, not that the IP --
19 current IP owner is doing anything bad.

20 And I'll also I mention I guess that
21 since Michael Katz mentioned concavity as well as
22 convexity that if the diagram showed decreasing

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1 returns to scale for a reason I haven't yet -- I
2 haven't yet come up with a good story for why
3 that would be true.

4 But if it did, then everything happens
5 at the right time, but it turns out then too much
6 of what's withdrawn from the contract, because
7 you always want to be first. Okay. Thanks.
8 That's it.

9 MICHAEL KATZ: Thank you.

10 (Applause.)

11 MICHAEL KATZ: I think all the things
12 I said about Joe Farrell's identity are still
13 true to the best of my knowledge. So take it
14 away, Joe.

15 JOSEPH FARRELL: It's not my fancy

16 background to do the PowerPoint I'm happy to tell
17 you. There we go. All right. Bundling, as I
18 said earlier, is in some sense about two
19 questions. And it's important not to confuse
20 them.

21 In the case of intellectual property
22 bundling, it seems to me that the second question

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1 takes on a slightly different, perhaps very
2 different slant from what it does in generic
3 industries.

4 So the competitive analysis of
5 bundling is partly about how bundling affects
6 users' -- buyers' -- willingness to go without
7 the product, in other words, how it affects
8 demand.

9 And in that part of the analysis you
10 think about the pro-efficiency benefits of
11 reducing the marginal price towards marginal
12 cost. And you perhaps also think about the
13 effects on pricing decisions of existing firms of
14 having the bundling.

15 And that relates to the pizza and
16 beer example, for example, that Greg Vistnes
17 described. So sort of the generic econ one
18 alternative to buying the bundled products is you
19 don't buy the bundled products, you, the
20 consumer.

14 better deal?
15 So in a generic bundling analysis it
16 seems to me -- and I'm treating tying at the same
17 time as bundling here -- you have to ask that
18 fundamental question. Well, of course that's
19 true here too.

20 But there's a particular version
21 of that which I don't think has a very close
22 parallel although it has some parallel in the

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1 generic case.
2 And that is challenging the
3 intellectual property. So is challenge specific
4 to intellectual property? It seems like it.
5 Usually in a bundling or tying analysis you don't
6 think about a competitor coming along and saying,
7 well, you're selling that pizza but it's actually
8 not your pizza.

9 So I'm going to talk more, much more
10 later today about incentives for challenge. But
11 what I want to do right now is just point out
12 that the analysis of tying or bundling needs to

13 deal with both the demand side effect and the
14 competitive effect.
15 And one of the big competitive effects
16 in IP bundling is going to be challenge. So now
17 what about attaching -- by which I mean tying
18 and/or bundling -- intellectual property to
19 intellectual property or other goods?
20 I'm not going to say anything very
21 substantive here partly because, as I said
22 earlier, I don't think my brain works that way in

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1 this coming up with observations in response to
2 these abstract nouns, but also partly because of
3 time.
4 But I think it is widely believed that
5 putting together these products is apt to affect
6 private incentives to challenge the IP. And I'll
7 talk about that right now. Yes, I'll talk in a
8 moment and then more later today about whether
9 that's actually going to be true.
10 But what I want to do now is to just
11 raise very briefly a thorny issue which is in a

12 conventional analysis we have some idea -- we
13 have a pretty good idea actually -- what the
14 correct incentive, economically correct incentive
15 as Professor Sibley would put it, the
16 economically efficient incentive is to enter and
17 compete against an existing product.

18 And you can ask is that incentive
19 affected by the bundling or the tying. In the
20 case of challenging intellectual property, it's
21 not so clear at all I think what the economically
22 efficient incentive to challenge is.

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1 There are obviously effects in
2 this market from a successful challenge to
3 intellectual property. If we want to be hard
4 nosed about it and say you've got to look in this
5 market, well, the effects are rather dramatic and
6 positive.

7 Namely, you get rid of the mark-up
8 attributable to the intellectual property. But
9 that's obviously not a very good analysis because
10 the effect of challenging the IP is partly that

11 you reduce potential innovators' expectations
12 of how much they might collect from IP in
13 the future.

14 So although there's the usual question
15 of do you use a consumer surplus standard or
16 total surplus standard, you also I think have to
17 look at the intellectual property incentives
18 effects of profits.

19 Let me skip over that one and just
20 talk a little bit about a couple of examples.
21 There are potential profit gains and market power
22 gains from attaching intellectual property to

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1 something structural that can give you long
2 lasting market power. Let me just mention a
3 couple of examples.

4 In the telephone industry one of the
5 things that happened early in the industry was
6 the Bell System took the patent which was
7 primarily on the handsets, what non-phoneheads
8 call phones, the things that sit on your desk.

9 And when that patent expired it looked

10 like they were not going to have any market power
11 to speak of anymore because other people could
12 produce these handsets in a pretty similar kind
13 of way.

14 And what happened instead was that the
15 Bell System effectively attached, physically
16 attached these handsets to a network of wiring.
17 And of course a network of wiring is a market
18 asset much less susceptible to rapid, small
19 scale, and easy challenge.

20 It's the original network effect. In
21 the case of Star Pagation it's not so clear
22 that you can physically distinguish the two

1 goods.

2 But it seems to be what's going on
3 there is you have some intellectual property,
4 namely on a rather arbitrary system of page
5 numbering, and it gets in some sense hooked up
6 with the network effects of attorneys wanting a
7 common system to refer to legal documents.

8 And so the intellectual property

9 becomes more valuable by being incorporated in
10 this network product. So is all this a problem?

11 Well, clearly in those examples, and
12 I think in many others, structural features in
13 the market are amplifying the rewards to the
14 intellectual property and amplifying the short
15 run or ex post harm to consumers from the
16 intellectual property.

17 If you think about the foundations of
18 intellectual property policy you realize that
19 what you're saying is that in some circumstances
20 based on market structure features you're giving
21 much more market power if you like as a reward to
22 the innovation than in other circumstances.

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1 Well, is that good or bad? Economic
2 theory answers with a resounding yes. It is good
3 or bad. There may be some presumption there if
4 you have a particularly big amplification where
5 the network effects are a lot bigger than the
6 network independent increase in value. But then
7 there's a problem.

8 And I've referred to this elsewhere as
9 the difference between V which is the increase in
10 value from having the superior product available
11 holding fixed network effects, so comparing the
12 world versus a but-for world in which you have
13 the same network but with the less developed
14 technology.

15 That I call V . V can be a lot less
16 than the full reward to implementing your IP and
17 thus gaining control of a network industry which
18 I refer to as V plus N where N is the value of
19 the network effects themselves.

20 And this possible presumption that I
21 refer to in the last line but one is the idea
22 that if N is a lot bigger than V then there's a

1 competitive problem here, that the market power
2 attributable to the innovation is not
3 commensurate with V but is perhaps a lot bigger
4 than V .

5 That doesn't tell us what to do. It
6 certainly doesn't tell us in what circumstances a

7 feasible unbundling policy is going to be the
8 answer to what to do. But I think it does pose
9 a version of the question. That's it.

10 (Applause.)

11 MICHAEL KATZ: Actually, Joe, let's
12 start with a somewhat technical question.

13 Your last point you were making about the
14 amplification of the returns to IP because of
15 various first mover advantages, what about the
16 counterargument that says, look, if V is small,
17 then the rivals ought to be able to do something
18 like just lower their prices.

19 Is there some other way of offering
20 value? And basically the point is, sure, someone
21 ends up being the dominant network, but they had
22 to compete to get there.

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1 And so you need to have a theory that
2 explains why a small change in a certain part of
3 the technology early on changes the entire path
4 of the industry, and not only that but the rents
5 over the life of the industry change

6 dramatically. In a lot of cases it wouldn't

7 actually work.

8 JOSEPH FARRELL: In some cases it

9 wouldn't work that way. That's right. Actually

10 let me put in a plug, not for my own work here,

11 but for the journal that I used to edit. In the

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5 depending on how big a cohort is.

6 If the quality difference is that big
7 and that may be quite small, then the superior
8 technology in effect doesn't have to fight for
9 its win. That is, the rents it gets include the
10 network benefit.

11 On the other hand, if you have a
12 smaller quality difference then what Professor
13 Katz, 2002, said is right. And the network
14 benefit gets dissipated from the seller's point
15 of view or transferred to consumers through the
16 ex ante competition.

4 about two parts to that as well.

5 One is you were talking about if

3 some sort of penalty to being the first one to
4 leave.

5 I suppose it's -- this represents
6 thinking beyond what I've done. But in a court
7 setting one might find that claimed economies of
8 scale were sort of claimed basically to create
9 this coordination problem and in fact may be
10 rather slight.

11 It could also be the case that perhaps
12 if we wanted to look for possible malignant
13 intent by the owner he might do things which
14 would create those economies of scale whose only
15 intent would be to create this particular
16 coordination problem.

17 Apart from a particular wrinkle on
18 exit from contracts that I was talking about
19 today, I should point out that a lot of contracts
20 I've read do have other disincentives to people
21 leaving.

22 For example, if you were licensing a

1 technology to someone and you said that the basic

2 license rate is \$10 billion a unit but I'm going
3 to give you a discount so that after the discount
4 you'll only have to pay a tenth of a cent per
5 unit, but of course if you abrogate the contract
6 then retroactively we apply the original price.
7 So that would be creating a huge sunk cost to
8 exiting the contract.

9 MICHAEL KATZ: Would you see there
10 being an antitrust prohibition of something where
11 someone had a contract that, say, reflected the
12 economies of scale so they really are just
13 charging the marginal loss to them?

14 DAVID SIBLEY: I think I would only
15 see an antitrust prohibition if I could think of
16 an abrogation clause that wouldn't give rise to
17 this problem and was otherwise a good one.

18 MICHAEL KATZ: Joe, you wanted to say
19 something.

20 JOSEPH FARRELL: Maybe this gets to
21 that. You said you had done some thinking about
22 potential other ways to do abrogation. In the

1 model you described I think the abrogation
2 penalty was calculated as if the second licensee
3 was not going to abrogate.

4 But then in fact he did. So you might
5 think that would solve it. Actually I wonder
6 whether that actually could make it worse if the
7 effect of -- true effect of the first abrogation
8 is that both parties leave. So then in a causal
9 sense the first party should pay the whole, not
10 just the big half.

11 DAVID SIBLEY: There are these
12 externalities between licenses. And actually in
13 the modeling I'm assuming that if you -- I think
14 I said this, that if you dictated who was going
15 to go first, they would both find it privately
16 rational to bail the old contract.

17 It's simply that because of this
18 coordination problem if you leave it -- let them
19 do it in a decentralized way -- they won't do it
20 1eryfeticirallyAndYleald makalso ftherthithis

1 you pay.

2 MICHAEL KATZ: I have another question

3 for Joe. Joe is a young man. He has not learned

4 the lesson in life that one shouldn't mess with

5 the moderator. So, Joe, I'll ask you a question.

6 It seems like you have enunciated an

7 antitrust principle today or a policy basis which

8 is if you see something you don't like then we'll

9 do something about it, but you're not going to

10 tell anybody in advance what that is.

11 So let me ask how people would advise

12 their clients in that world. And obviously the

13 serious question is you have identified some of

14 the problems that have this sort of cost based

15 rule that clearly has a problem.

16 You've talked about how it makes a lot

17 more sense to look at the specific facts, to have

18 a welfare standard, to ask does the practice harm

19 welfare or not.

20 But the serious issue as you know of

21 course is if things are that fact intensive and

22 that detailed, is there any way for the parties

1 to predict what the outcome of say a Justice
2 Department analysis would be? How will they know
3 what they can and can't try doing?

4 JOSEPH FARRELL: Yes. I think there's
5 no really good answer to that. The best answer
6 I can give is for corporate counsel or outside
7 counsel not to ask, well, are you tying; are you
8 not tying; is this price below cost or above
9 cost.

10 But to ask why are you doing this;
11 what are the efficiencies, are there other ways
12 to achieve the efficiencies; do you expect it to
13 block competition.

14 And for the advice to be based on the
15 counsel's good -- excuse me -- on the client's
16 good faith answers to those questions rather than
17 on answers to what might be perhaps more
18 mechanical questions but less relevant questions.

19 MICHAEL KATZ: Jonathan, could you add
20 something?

21 JONATHAN JACOBSON: I think Justice
22 Brandeis actually addressed this in the hearings

1 that led to the Clayton Act and the FTC Act. And
2 basically what he said is if you want me to tell
3 you where the line is, I can't tell you where the
4 line is.

5 I can tell you how close you might
6 approach the line so that you can be safe. And
7 the real policy question that raises is what is
8 the efficiency loss between what is safe and
9 where the ultimate line is.

10 It's my -- this goes back to the
11 question that David asked earlier. It's my sense
12 that at least in the case of bundling practices

1 not lose an awful lot of efficiency. You're not
2 going to be able to tell where the line is. But
3 that's not as serious a problem as you may think.

4 MICHAEL KATZ: Greg Vistnes?

5 GREGORY VISTNES: I just want to
6 follow up on what Joe was saying. I think
7 there's -- it's a little bit of a strange thing
8 for an economist to be saying.

9 But I think Joe's approach to
10 assessing bundling problems is actually a very
11 good one in that it's a lot easier to tell from
12 how a firm is operating what their intent is.

13 Are they really pursuing bundling to
14 help themselves to make themselves more efficient
15 competitors or is it more directed at harming the
16 rivals? I think a firm itself will often have
17 a very good feel as to what this bundling is
18 motivated or directed at.

19 And in practice as far as, well, we
20 have a lot of economic theories; we can try to
21 impart them; we can try to tell does the
22 theory work.

1 In practice what I've often seen is
2 that the, quote, theory behind a case is really
3 driven by the facts that the folks in the agency,
4 perhaps more the attorneys than the economists,
5 are going to be looking at the documents.

6 The documents and the interviews, all
7 this non-, quote, pure economic evidence will be
8 reflecting the intent of the parties. And if the
9 antitrust agencies see the intent of causing harm
10 to the rivals, I think nine out of ten times they
11 will find a theory to buttress that sort of
12 intent type story.

13 It may not be a very rigorous economic
14 theory. But I think it's a theory that will make
15 the attorneys sufficiently comfortable to often
16 take that to court or at least significantly get
17 in the affairs of the parties and make them wish
18 they had never done it.

19 DAVID SCHEFMAN: Let me respond to
20 that. I think we clearly need more clarity on
21 what Greg just said. I'd add the predicate as I

22 think he would that no agency for a long time

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1 would pursue that sort of case on a per se --

2 simply per se basis.

3 They would think that they had a

4 bona fide monopoly and a bona fide theory of

5 anticompetitive effects. And then intent

6 evidence is certainly of some relevance.

7 Jonathan, I'm curious when you talked

8 about counseling you didn't talk about who were

9 the likely plaintiffs here. Bringing an

10 antitrust case is very expensive.

11 So I presume one of the discussions is

12 who would be likely to mount an effort to sue us,

13 and isn't that -- doesn't that to some extent

14 cure the problem. That is, if you are not

15 forcing or you are not excluding in an overt way,

16 you're probably not going to get sued.

17 Now, there are instances certainly of

18 those others where you are going to get sued

19 where per se is inappropriate. But doesn't that

20 question solve a lot of the problem or not?

21 JONATHAN JACOBSON: Absolutely.

22 Absolutely. The rules on antitrust injury and

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1 standing limit the set of plaintiffs in the

2 outset. The number of cases where the federald

20 aspect that has elicited so much scholarly
21 criticism over the years, is counseling in the
22 context where you are about to bring an

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1 infringement suit.

2 And the question is not in the open
3 field would you expect a Department of Justice
4 complaint for this conduct or would you expect a
5 private complaint attacking this conduct.

6 The question is to what degree are you
7 willing to put your intellectual property at risk
8 with the notorious overbreadth of the misuse
9 doctrine where your misuse does not necessarily
10 have to be in connection with the behavior that
11 you're challenging in your infringement suit.

12 And the penalty for misuse is you're
13 completely deprived of any ability to enforce
14 your intellectual property.

15 And it's just a fact that for as long
16 as I have been a lawyer it's per se malpractice
17 to fail to advise a client who is considering an
18 intellectual property infringement suit that he

19 must be prepared to litigate any manner of crazy
20 antitrust or misuse counterclaim -- or misuse
21 defense.
22 MICHAEL KATZ: Let me ask you a

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1 question about it. I certainly agree with what
2 you're saying. I have in fact been involved in

18 contexts, at least that have been advised by

17 safety net for the client is reasonably tight.

18 MICHAEL KATZ: So does that suggest in

19 fact for intellectual property that bundling is

20 in a big safe harbor and as long as you're

21 careful to have it all realistic looking or

22 reasonable, whatever word one wants to put to it,

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1 for the individual prices that then you're home

2 free?

3 JONATHAN JACOBSON: Maybe not all the

4 way, but it also raises the point of what's the

5 efficiency in really insisting that the entire

6 package be taken as opposed to offering the

7 ability to take lesser included of the entire

8 package.

9 TAD LIPSKY: This is a comment and

10 also a question for Jon. For many years I think

11 the key precedent on this bundled pricing issue

12 has been -- for plaintiffs anyway -- the

13 SmithKline case in the Third Circuit which now

14 that 3M LePage's -- I think it is subject to a

15 petition for rehearing -- I can't remember

16 whether it has been granted. So are you really
17 as confident as you sound in advising clients
18 that they are essentially home free on bundling
19 pricing where intellectual property is involved?

20 JONATHAN JACOBSON: The LePage's case,
21 whichever side you're on, is a fairly extreme
22 case where there's also a lot of evidence that

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1 what 3M was trying to do was basically put
2 private label tape out of business.

3 And the number of cases that rise to
4 that level of potential antitrust defense again
5 are relatively small.

6 My point is that the difficulty of
7 proving that the pricing bundle is sufficiently
8 coercive to withstand a claim given the expense
9 of bringing an antitrust case I think deters an
10 awful lot of plaintiffs, doesn't give you a
11 complete safety zone, but gives you a measure of
12 comfort that you can be -- achieve your business
13 objectives without an undue threat of being
14 hauled into court.

15 Can lightning strike and you'll get
16 sued for these practices? Absolutely. It does
17 happen. It just doesn't happen that often.

18 MICHAEL KATZ: Let me ask a final
19 question of the panel, and it's whether people
20 make this distinction or not. Some people
21 distinguish between a tie-in and a tie-out, one
22 being the requirement that you purchase the

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1 product; if you want to get A from me, you also
2 have to purchase B from me.

3 The other requirement is it that if
4 you want to buy A from me, you can't buy B from
5 anyone else.

6 And there is certainly an intuition
7 that suggests that second one could be more of
8 a problem, particularly if you think about
9 something like a package license where in the one
10 case you might say, look, you have to buy all if
11 you take our whole package it's a low price but
12 that gets us over transactions costs.

13 And, Joe Farrell notwithstanding, the

14 marginal costs of throwing the extra intellectual
15 property is zero. Some people think it is a very
16 different situation than when you say, okay, you
17 have to take our IP and guess what you have to
18 agree not to use other people's.
19 I wonder if people make a distinction
20 there or not or you think that those -- either
21 you need symmetrical treatment or they both are
22 hard or does anyone on the panel want to jump in

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1 on that?
2 TAD LIPSKY: I can jump in. Mike, I
3 wouldn't say my thoughts have completely spun out
4 on this. But I think the considerations are
5 somewhat different. In many respects the
6 question of whether to impose a tie-out ought to
7 be addressed almost in terms of merger law.
8 If we don't want to create distorted
9 incentives for downstream vertical integration,
10 we're going to have to appreciate that there are
11 a lot of valid reasons why an intellectual
12 property owner would only want to enlist help.

13 And whatever the purpose of the
14 license was, whatever the purpose of the sale
15 was, be it distribution or manufacturing or some
16 other complementary activity or some other
17 activity in the chain of commerce, if you will,
18 there are going to be a lot of circumstances
19 where the intellectual property owner should be
20 entitled to in a sense the complete loyalty of
21 the partners -- of the other partner.

22 It's very similar to the rationales

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1 you find for exclusive dealing in the ordinary
2 vertical context apart from considerations of
3 intellectual property, although I think the
4 problems probably have a better relationship than
5 is widely appreciated.

6 There are corner solutions. There are
7 situations where you're basically facing a Lorain
8 Journal type of situation.

9 But there's also one other important
10 problem that I think should at least be noted.
11 And that is there is a kind of schizophrenia I

12 think in the way that antitrust has tended to
13 treat these kinds of relationships and the use of
14 this kind of restriction.

15 Picture if you will a situation where
16 somebody has come up with a real breakthrough
17 innovation, something that is really going to do
18 a lot of competitive displacement in the
19 industry.

20 On the one hand efficiency seems to
21 suggest that the intellectual property ought to
22 be licensed to everybody, that the technology in

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1 a sense ought to take over the world.

2 But on the other hand if you go ahead
3 and get that solution, then you're going to have
4 cases like Microsoft where there are going to be
5 monopolization-type allegations against the
6 process of taking over the world.

7 But what's the alternative? You say,
8 well, half the world is allowed to have this
9 intellectual property, and the other half is not
10 in the hopes it will preserve some potential

11 competition and the opportunity to invent around.
12 And I remember when the Microsoft
13 case first started I found myself standing on a
14 platform in Palo Alto arguing to an audience much
15 like this one that maybe what the government
16 ought to do is be forced to state at the outset
17 of the case, you know, will you require that some
18 of the hardware manufacturers be disabled from
19 licensing the Microsoft operating system to leave
20 them out there as a competitive fringe so that
21 they can take Apple's operating system or some
22 other future competitive operating system.

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1 I think that is one of the problems
2 at the raems

10 MICHAEL KATZ: What we're going to
11 do up until noon for the remainder of this
12 morning's session is talk about patent extension.
13 And the format is going to be that
14 Rebecca Dick is going to make a presentation and
15 then David Sibley and Joe Farrell are each going
16 to have some comments from economists'
17 perspectives on these issues as well.
18 Rebecca practices antitrust law at
19 Swidler Berlin where she handles both merger and
20 civil conduct matters and specializes in the
21 intersection between intellectual property and
22 antitrust.

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1 Prior to entering private practice
2 two years ago she served for twenty years in the
3 Antitrust Division where she held a variety of
4 positions including director of civil non-merger
5 enforcement. We're very pleased to have her
6 today. Rebecca?

7 REBECCA DICK: Thank you, Michael.
8 I'm going to touch on a number of ways in which

9 IP holders have tried to extend the value of
10 their rights.

11 The variety though is infinite and
12 as David Sibley's talk illustrated in terms of
13 long-term contracts, that's one way. There are
14 many, many others. But I would like to go
15 through some of the main categories at least.

16 The value of a patent or copyright can
17 decline for either of two reasons. Either its
18 term expires or new competitive IP becomes
19 available that diminishes any market power that
20 the earlier IP may have commanded.

21 Companies use a variety of techniques
22 to try to extend the useful life of their

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1 intellectual property. But their ability to
2 do this is really quite limited in most
3 circumstances.

4 Most patents and copyrights expire on

8 But nevertheless companies have
9 devised a number of schemes to try to extend the
10 useful life of their IP. And some of the schemes
11 have been quite inventive. A number of them
12 really are only applicable in a particular set of
13 circumstances, either a particular industry or a
14 particular regulatory scheme.

15 One is the use of trade secrets which
16 has no term instead of a copyright or patent.
17 One is incentive sales schemes. I'll discuss a
18 couple that have been the subject of litigation
19 recently. Another is restrictions built in a
20 joint venture can limit the innovation from at
21 least certain other parties to the venture.

22 Package or pool licenses which we've

1 discussed some this morning already, acquisitions
2 under some circumstances, and Hatch-Waxman is a
3 sort of specialized area unto itself where
4 there's been particular problems.

5 And finally seeking legislation, which
6 has been popular recently. First we can look at

7 trade secrets. It has no fixed term of course,
8 and it operates entirely outside the
9 patent/copyright regime.

10 This was thought to be true for many
11 years, and finally the Supreme Court said so
12 definitively in 1974. The benefit obviously of
13 relying on trade secret information is that
14 there's no expiration of the rights as long as
15 they are not disclosed into the public domain.

16 The Uniform Trade Secrets Act provides
17 some guidance about what constitutes know-how and
18 how rights to it can be enforced. But there are
19 variations in the various state schemes and some
20 states haven't adopted the act in any form.

21 Coca-Cola is really the firm that has
22 been able to use trade secrets as successfully as

1 anyone. It has protected its secret formula for
2 over a century through the use of trade secret
3 protection. But it has done so at the cost of
4 eternal vigilance really to keep that formula
5 secret.

6 Very few other firms have been able to
7 protect their trade secrets to such an extent and
8 for such a period of time. Usually the trade
9 secrets leak out into the public domain over
10 time. And this was the defendant's problem in
11 the Pilkington case.

12 Pilkington had once held patents on a
13 process for making flat glass. It was called the
14 float process. So you hear the case referred to
15 either as the float glass case or the flat glass
16 case. Either way is correct.

17 During the life of the patent they set
18 up a worldwide licensing regime with exclusive
19 territories. Each licensee had a particular area
20 that was exclusively theirs to practice the
21 patent.

22 The principal U.S. patents however on

1 the process had expired by the early 1980s. And
2 nevertheless Pilkington continued to enforce
3 worldwide licensing schemes with exclusive
4 territories now based solely on the licensing of

5 know-how.

6 The Department of Justice in 1994
7 challenged this scheme. Interestingly enough, it
8 did not allege that the know-how was completely
9 gone, that there was no secret know-how that
10 Pilkington still held.

11 It did allege, however, that to the
12 extent secrets remained, they consisted of
13 engineering solutions with no substantial value
14 over equally efficacious engineering
15 alternatives.

16 Essentially the Department argued that
17 the scheme had become -- the licensing of the
18 know-how had simply become a device for
19 implementing a cartel.

20 So one of the issues when you look at
21 a possibly anticompetitive use of trade secrets
22 is whether or not trade secrets are genuine, is

1 the claim that the trade secrets are being
2 licensed -- is that really a sham.

3 And then a second question certainly

4 raised by the Pilkington case is whether or not
5 you're going to ask is the strength of secrets
6 weighed against the anticompetitive effects of
7 the licensing agreement.

8 Since the Pilkington case was settled,
9 this issue wasn't litigated. There is no
10 precedent for this notion of weighing the
11 strength of the IP versus the competitive effects
12 of the licensing scheme.

13 There's no precedent for it in trade
14 secret law. There is some related precedent in
15 copyright law which can look under certain
16 circumstances to how thin or strong copyright
17 rights are.

18 And I think it's possible to develop
19 policy arguments both for and against the notion
20 that there should be such a weighing process.
21 It's hard to imagine how it would be done except
22 in extreme circumstances, and certainly how it

1 could be predicted in terms of counseling
2 clients.

3 But when you have a situation like the
4 Pilkington case where there were -- the markets
5 involved were enormous. The markets both for
6 constructing the plants to build the -- to
7 manufacture the glass and then the markets for
8 the glass itself, the markets were 600 million
9 and 15 billion respectively annually.

10 To have an international cartel of
11 unlimited duration based on such flimsy IP is
12 certainly something that was a competitive
13 concern. And I think you can certainly
14 understand why the Division looked for a way
15 to try to attack that.

16 Are there other Pilkington cases out
17 there, or is this really an unusual situation?
18 My own view is that there are not a lot of other
19 Pilkington cases out there. I understand that
20 patent holders frequently try to insert
21 provisions for licensing of know-how in their
22 proposed license agreements.

1 But where the patent has already

2 expired its separate royalties for know-how are
3 almost always dropped in the course of
4 negotiations over the agreements.

5 The next device I'd like to talk about
6 are incentive sales agreements. One of the cases
7 currently in litigation involving this issue is a
8 lawsuit against Monsanto which has held the
9 patent on the active ingredient in the herbicide
10 Roundup which has been an enormously successful
11 product for them.

12 A competing herbicide company,
13 Chemical Products Technologies, filed a lawsuit

1 of the patent into the months and even years
2 beyond the expiration of the patent.

3 And allegedly under the incentive
4 sales arrangements distributors could earn
5 credits depending on the volume of Roundup they
6 purchased. But they wouldn't actually be paid
7 for the credits unless they continued to buy high
8 volumes after the expiration of the patent.

9 And if they failed to do so during the
10 post-patent period, they could actually forfeit
11 some of the credits they had earned prior to
12 expiration.

13 There are elements of this case that
14 are reminiscent of the LaPage's versus 3M case
15 that was mentioned earlier this morning but with
16 sort of an IP twist. This litigation is in its
17 early stages. Not much of the issues have been
18 addressed substantively by the court yet.

19 And of course the issue raised
20 directly by the case is does calculating a total
21 discount based on purchases both pre-and post
22 expiration improperly extend the term of the

1 patent.

2 And because the court has not begun to
3 address this, there are a number of factors you
4 can imagine the court weighing, the existence of
5 competing IP.

6 If Roundup was one of five affected
7 herbicides out there all going around trying to
8 get dealers' loyalty, some kind of incentive
9 sales arrangement like this might be of
10 significantly less concern.

11 And then just weighing the amounts,
12 what is the amount of pre-expiration credit
13 that's at risk if the post-expiration sales fall
14 below volume levels.

15 And what are those volume levels;
16 how large are they? And then are there any
17 efficiencies in this licensing scheme?
18 Presumably Monsanto will have a story to tell
19 there that it will present.

20 I'd like to talk next about joint
21 venture restrictions. Of course joint ventures
22 frequently involve agreements between the parties

- 1 to the venture that they will not compete against
- 2 the venture, that they will devote all -- in the

1 tomato, but the partners in this joint venture
2 could not get along and the venture dissolved.
3 But in the course of their disputes with one
4 another during the brief life of the venture,
5 they signed a perpetual non-compete.

6 This was permanent. It had no term.
7 It continued post the termination of the joint
8 venture and then was going to continue forever.

9 The Department's complaint alleged
10 that the two former partners had divided the
11 world between them with each agreeing never to
12 engage in the development of any type of long
13 shelf life tomato seeds for sale or use in the
14 other party's exclusive territory.

15 The agreement of this kind wasn't
16 necessary to protect against infringement because
17 you can do DNA testing of a tomato and if one of
18 the former partners was marketing a tomato that
19 the other suspected infringed on the joint
20 venture's IP they could test the tomato and get
21 a definitive answer about their suspicions.

22 And in any event the non-compete as

1 written allegedly survives the expiration of the
2 patent on the joint venture's IP on the joint
3 venture's tomato.

4 The Department's complaint alleges
5 that the party that's foreclosed from selling in
6 the United States, developing seeds for tomatoes

1 appropriate market definitions.

2 The court dismissed with prejudice
3 the portion of the complaint that addressed the
4 agreement's restriction on development of seeds
5 for use in Mexico with the notion in the
6 complaint that the resulting tomatoes would
7 be imported into the United States.

8 And the court held that that provision
9 had no direct substantial and foreseeable effect
10 on competition on the sales of tomatoes in the
11 United States citing the statutory standard.

12 The Department has now asked the court
13 to dismiss the entire case with prejudice so that
14 it can appeal although it hasn't definitively
15 said it will appeal. Presumably that's what's
16 coming next. And that motion is pending.

17 If you look at a joint venture
18 agreement I'd like to emphasize that most of
19 these non-competes are going to be perfectly
20 legal. One issue though to look at is is the
21 competitive restriction really ancillary.

- 1 to effectuate the purposes of the joint venture.
- 2 Are there less restrictive, effective
- 3 alternatives?

21 incorporate in a pool unnecessary but later
22 running patents. Assume a company obtains a

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1 patent for a new product, develops standards for
2 that product, and licenses the rights freely and
3 it becomes widely used.

4 And then as that company develops
5 standards for later generations of the product,
6 it incorporates newer patents that it owns with
7 later expiration dates even though it could have
8 chosen alternative unpatented technology.

9 And the effect of this is to
10 artificially extend the period of time during
11 which it can earn royalties from the firms that
12 use its standardized products.

13 In the late 1990s the Department
14 issued a series of three similar business review
15 letters relating to patent pools. And these
16 letters addressed a variety of issues. But one
17 element of them was the Department approved the
18 use of an independent expert to verify the
19 essentiality of the patents in the pool.

19 are not, refuses to give licensees a list of what
20 those patents are, and in fact even refuses to
21 tell licensees which Gemstar affiliate holds the
22 rights to particular patents.

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1 And Echostar alleges that the
2 practical effect of this is that licensees have
3 to expect to pay royalties forever because they
4 will never know when the patent that they really
5 need has expired.

6 One question in this whole area is the
7 intractability of this issue to litigation. Does
8 asking the questions about which patents are
9 included in a pool really involve courts in
10 product and process design decisions that they
11 are not qualified to address? On the other hand,
12 does not asking create an unwarranted exemption?

13 I think one conclusion you can draw is
14 that as a practical matter courts are only going
15 to be willing to look at this kind of issue in
16 fairly extreme and rare situations because it
17 is to some extent intractable in terms of the

18 litigation process.
19 It's somewhat outside the scope of
20 this talk, but several of the cases I'm
21 mentioning here did involve in addition to the
22 other claims, claims that the defendant had

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1 acquired additional patents to augment or extend
2 rights over a particular process or product.

3 Acquisitions of IP are generally
4 treated like other acquisitions. If the H-S-R
5 levels are met and it's an exclusive license,
6 it's H-S-R reportable. And agencies will
7 consider what are the alternatives and the
8 likelihood that someone could enter the market
9 by inventing around.

10 Both the Gemstar case that I just
11 mentioned and the Biovail case which I'm going to
12 mention in a moment contain claims that there was
13 anticompetitive acquisition of patents, in the
14 EchoStar case allegedly a pattern of acquisitions
15 of a lot of patents, and in the Biovail case
16 allegedly anticompetitive acquisition of a single

17 strategic patent.

18 It's the standard merger analysis if
19 the transaction rises to the level that it's
20 reportable and if it involves IP for which there
21 are few substitutes, you define the market. You
22 look at competitive effects, and you look at the

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1 possibility or likelihood of entry.

2 One of the issues that's often raised
3 is in terms of grantbacks. Does acquisition of
4 improvement patents enable the patent holder to
5 leverage expired core patents into control of
6 later generation product standards?

7 Again I think this is a difficult

16 Hatch-Waxman cases. These really are to some
17 extent a creation of the -- well, to a complete
18 extent a creation of the statutory and regulatory
19 scheme governing the marketing of generic -- new
20 generic drugs.

21 The Hatch-Waxman Act was intended to
22 promote development and sale of generic drugs.

15 a waiting period of up to 30 months while the
16 parties litigate the infringement issue.

17 After 30 months if it's unresolved
18 the FDA goes ahead. And if the litigation is
19 resolved prior to the 30 months -- it obviously
20 depends who wins the infringement litigation. If
21 the generic wins, it's free to go ahead and sell
22 once it has FDA approval.

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1 Then there is a second period. Once
2 the 30 months has passed, the generic is able to
3 proceed and it has received FDA approval, it
4 then as a reward for having gone through the
5 infringement litigation in part is entitled to a
6 180-day head start.

7 And the economics of sales of generic
8 drugs is that a significant part of the profits
9 that are made are made in the days immediately
10 after a generic is introduced in the market. The
11 price starts high at the patent level, at the
12 monopoly level, and declines.

13 But it doesn't drop in a straight

14 line. It drops at an angle. And so the first
15 generic captures a lot of the higher part of the
16 price decline. And so the 180-day period really
17 does provide something of an incentive.

18 And after the 180 days other generics
19 that get permission can go and sell, and the
20 price normally continues to decline
21 significantly.

22 In the first cases the FTC brought

13 applied for FDA approval, it was first in line
14 under the Hatch-Waxman scheme. But because under
15 these agreements it didn't start selling its
16 product in the market, the 180-day head start
17 period never started.

18 So by virtue of this agreement the
19 first in line generic and the monopoly and the
20 patent holder were able to prevent any other
21 generics from entering the market, not
22 indefinitely, but for a period of potentially

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1 many months.

2 And the FTC in the year 2000
3 challenged two of these arrangements. Both cases
4 settled, one I believe right away and the other
5 somewhat later. The FTC in 507s(A3 Tn6 0g5nf pTw 30 -30 TDext4Tw n4 4 p h6isp4Tj T* f this a
8 for three things which it's looking at these
9 infringement settlements in cases involving a
10 patent holder and generic.

11 First of all, it looks for reverse

12 payments, payments from the patent holder to the
13 generic. One of the issues that's difficult for
14 defendants to answer in this situation is why the
15 patent holder who has claimed infringement is
16 suddenly paying money to the alleged infringer.

17 Normally you would expect the payments
18 to be going the other way if there had been any
19 merit whatsoever to the infringement claim. And
20 it's difficult to understand the basis on which
21 the patent holder would be paying -- a legitimate
22 basis on which the patent holder would be paying

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1 the generic.

2 And then the FTC also looks for
3 limitations on the generic's ability to sell
4 non-infringing products. Typically these
5 agreements prohibit the generic from selling so
6 that the 180-day period will not start.

7 And then simply the FTC looks for
8 limits on a generic's ability to waive or assign
9 its rights to the 180-day period which it
10 otherwise can contract away.

11 The second generation cases involve
12 the FDA's Orange Book. I'll just allude to
13 these. These have to do with listing of drugs
14 in the FDA's Orange Book. If a drug listed there
15 has blocking potential over other drugs, the FDA
16 will not approve it.

17 And the FTC has recently alleged that
18 Biovail and other companies have filed -- have
19 knowingly filed and falsely listed products in
20 the Orange Book to prevent generic entry.

21 The issue of whether or not this
22 constitutes protected conduct under the First

1 Amendment has been just litigated in the Southern
2 District of New York which held that it was not
3 protected.

4 And FTC chairman Tim Muris has
5 recently testified on the Hill about all of these
6 cases. And his testimony is on the FTC website
7 and is very useful on this issue.

8 And then finally I'd like to mention
9 legislation. Certainly the safest from an

10 antitrust perspective way to try to extend

11 copyrights and patent rights is to get a law

12 passed that does that.

13 The Disney Company recently heavily

14 lobbied in support of the Sonny Bono Copyright

15 Extension Act which extended rights -- certain

16 rights for an additional twenty years. Otherwise

17 Donald Duck and some other familiar characters

18 would have gone into the public domain.

19 There is however a Constitutional

20 issue with this statute. It's been upheld in the

21 District Court and Court of Appeals levels. But

22 cert. has been granted.

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1 The grounds really had to do with

2 whether or not this is rewarding original works

3 or is it rewarding works that have already been

4 rewarded, are no longer original, and is it

5 really rewarding progress in the useful arts or

6 the status quo.

7 In terms of the future, certainly more

8 cases to come. And I think particularly because

9 IP is becoming an increasingly important part of
10 our economy, our increasingly technology driven
11 economy, some IP has become enormously valuable.

12 Because none of these cases have been
13 litigated fully as yet, there really is not yet a
14 consistent theoretical framework for analysis and
15 we haven't seen really the full development of
16 the kinds of defenses that I think are likely
17 ultimately to emerge. But I do think this will
18 be an area for the future. Thank you.

19 MICHAEL KATZ: Thank you.

20 (Applause.)

21 MICHAEL KATZ: Without further ado,
22 David Sibley has offered some comments, and I've

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1 asked him to cut his comments down considerably.
2 So I will apologize to him for that, but thank
3 you for agreeing.

4 DAVID SIBLEY: I'll talk a bit
5 about long-term contracts, something that Becky
6 mentioned but not in detail. This by the way I've

8 cases.

9 Suppose there is an incumbent and an
10 entrant may be due in the future but an incumbent
11 signs buyers up to contracts which extend past
12 the point where its patent expires and entry then
13 becomes possible.

14 And suppose that entry involves a
15 fixed cost or some type of economy of scale where
16 the entrant has to sign up enough customers in
17 order to make entry viable.

18 Now, in this setting, a long-term
19 exclusive contract or partially exclusive
20 contract, by limiting the number of customers
21 available to the entrant, might possibly be
22 anticompetitive.

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1 Now, this is kind of like the argument
2 made in United Shoe and Posner and Bork and
3 others have made the excellent counterpoint that
4 they don't see anticompetitive harm here because
5 in order for the incumbent to sign up a customer
6 to a contract going past the patent expiration

7 date presumably he would have had to give the
8 customer a good enough deal to make it worth the
9 customer's while to not wait.

10 Now, this view, although it's
11 certainly part of the truth, ignores a factor
12 that's gotten a lot of play in the recent
13 economics literature, the fairly recent paper
14 by Aghion and Bolton in 1987 and the much more
15 recent paper by Segal and Whinston in the
16 March 2000 AER, pointing out that there are
17 externalities between buyers which can cause
18 problems here.

19 That is, if I sign up to a contract
20 perhaps as a result of a great inducement by the
21 IP monopolist, my signing up means I am excluded
22 from being a customer of the entrant.

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1 Thereby my doing that, by making entry
2 less likely, I'm imposing a negative externality,
3 and negative effects on customers that have not
4 been signed up. As a result other buyers will
5 have to accept higher prices.

6 And a seller in fact can exploit this
7 negative externality to extract more from other
8 customers. To give an example, suppose there are
9 fifteen buyers. The monopolist makes a profit of
10 three dollars per buyer without entry. The
11 gain to a customer of having entry would be
12 five dollars.

13 And let's suppose that the entrant
14 has -- let's suppose that the incumbent if he
15 signs up five of the fifteen can exclude entry.

16 Now, in this setting is exclusion profitable?

17 Well, yes.

18 The incumbent makes three dollars
19 profit for the fifteen buyers. That's
20 forty-five. He has to get five of the them to
21 sign up for a long-term exclusive contract. And
22 to do that he has to pay them five dollars each

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1 which is there prospective gain from entry.

2 He ends up making a profit of twenty.

3 Now, exclusion won't always be profitable. We

4 can cook up cases where it wouldn't. But note in

5 this case the five who signed long-term contracts
6 did exactly what Posner and Bork said they should
7 do.

8 They got paid off enough to make it
9 worthwhile their signing up and forgoing the
10 possibility of dealing with the entrant.

11 However, this buyer versus buyer externality
12 comes into play here because the ones that didn't
13 sign up then have to pay higher prices without
14 this payoff as a result of the first five having
15 signed up.

16 Anyway, there are several papers that
17 go over this sort of story in a general way. And
18 it's clear that in principle long-term contracts
19 extending past patent expiration date can be
20 anticompetitive.

21 MICHAEL KATZ: Joe?

22 JOSEPH FARRELL: Well, I think a lot

- 4 literature by my colleagues Rich Gilbert and Carl
- 5 Shapiro that argues -- they argue this in the
- 6 context of intellectual property design rather

3 And without taking the time to give
4 all the links, I will step to my second point
5 which I assure you is related.

6 Professor Shapiro more recently has
7 suggested in the context of settlements to
8 IP litigation that a good rule is to allow
9 settlements if and only if they leave consumers
10 unharmed relative to the but-for world in which
11 the litigation continues.

12 And from an antitrust point of view
13 that seems like a very natural proposal. But
14 let me suggest a slightly different perspective
15 coming back to this IP extension question.

2 statutory period plus.

3 Well, if you treat that as of the date
4 of agreement, which I think is what Carl's
5 suggestion would encourage you to do, then it's
6 basically creating an, if you like, monopoly.

7 I think in those cases it would be a
8 monopoly for an additional X years. That's
9 pretty clear I think how a competition agency
10 ought to view that.

11 However, there is a different way of
12 viewing it which I hinted at in my earlier
13 presentation. And this perhaps relates to the
14 questions about the Sonny Bono act.

15 Suppose you view it not as an isolated
16 incident unforeseen by anyone, but as an instance
17 or the beginnings perhaps of a general tendency
18 whereby the life of certain categories of
19 intellectual property is extended from the
20 existing statutory period to the statutory period
21 plus X years.

22 Now, if you think that's going to be

1 taken into account by potential innovators, then
2 that's equivalent not just to the creation of an
3 additional X years of some sort of monopoly.
4 It's equivalent to Congress having made a
5 somewhat different choice in its choice of the
6 statutory IP period.

7 And if that is taken into account
8 enough to have the effects on innovation
9 incentives as well as on ex post market power,
10 then you're really asking would it have been bad
11 for Congress to make that alternative choice
12 instead.

13 And one view is, well, Congress made
14 the choice it did for a reason, so, yes, it would
15 have been bad. And I think that may be about the
16 best view we can take although certainly easily
17 attacked.

18 But economists are fond of pointing
19 out that hills are flat on top. And so if you
20 have a relatively modest extension of IP rights
21 that is fully foreseen at the time of potential
22 innovation, the overall social losses from that

1 extension are not measured by the ex post

2 increase in market power.

3 They are measured by what to an

4 economist is at least for a modest increase a

5 second order variation in the basic IP policy

6 trade-off.

7 And I don't really now how to resolve

8 this. I think there are elements of both the

9 ex post X years of unnecessary monopoly, and the

10 ex ante change in the IP policy trade-off.

11 And I think it's going to be very

12 important for the consumers of these hearings to

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1 things -- perhaps not as much a summary as my
2 view on some of the economics of this issue and
3 then just summarize the day which will be very
4 brief indeed.

5 The following view I think is an
6 oversimplification. But I think if you're going
7 to start somewhere it is probably the right
8 oversimplification which is a lot different than
9 the way a lot of people think about these things.

10 But I think it is what we've heard
11 from the economists which is throwing extra
12 things in a package of licenses or IP that's not
13 needed or an agreement to extend the royalty
14 payments beyond the life of the patent.

15 None of those things increase the
16 bargaining power of the patent holder vis-a-vis a
17 single licensee. Now, I think that's important
18 because of an awful lot of at least complaints
19 one hears. And I suspect the private litigation
20 is that a single licensee claims that somehow
21 this has disadvantaged that licensee.

22 They are forced to pay for things they

1 licensor and the licensee are competitors in a
2 downstream product market, then the fact that
3 you're charging this running royalty is going to
4 elevate the price to the ultimate consumers
5 because even -- one reason is fairly obvious.

6 The licensee of course is paying the
7 royalty and that's a cost and that's going to
8 tend to raise their price.

9 But also the licensor is going
10 to recognize, at least if it has economists
11 somewhere nearby, that it should raise its price
12 too because it's competing with someone to whom
13 it's selling its intellectual property and it
14 should take that back into account that if it
15 wins sales away from the licensee it's actually
16 forgoing some license revenue.

17 So both of those effects will tend to
18 push then both firms' prices up and consumers
19 will be harmed. So there are good reasons to be
20 concerned here, and there are issues to address.

21 But I think they typically are not the
22 ones that are the most widely stated, the notion

- 1 that somehow the single buyer is being exploited
- 2 or forced to buy things it doesn't want.
- 3 And even in the case where it's

1 There is an appreciation for the
2 efficiency benefits of sophisticated licensing
3 practices including bundling which has been
4 developed over the years.

5 And certainly the IP guidelines issued
6 by the two agencies, you know, if nothing else
7 they were putting down a marker to say, look,
8 rule of reason is the way to think about these
9 things because there clearly can be efficiency
10 benefits.

11 But also recognize that there can be
12 harms. For better or worse it seems that we're
13 largely stuck in a world of rule of reason. And
14 I'll finish on an upbeat note which is to say
15 these are difficult problems and there are
16 certainly times when all of us have made a mess
17 of them. But I think there is reason to believe
18 we are getting better at muddling through.

19 And the thoughts of the people such as
20 on this panel and the other panels we have had in

20

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1 AFTERNOON SESSION

2 (1:30 p.m.)

3 WILLIAM STALLINGS: Good afternoon and

4 welcome. We're very glad that you have joined

5 for what we expect will be another interesting

6 session of these hearings. My name is Bill

7 Stallings. I'm a trial attorney here at the

8 Antitrust Division.

9 We're here today to discuss how to

10 handle antitrust analysis when dealing with

11 disputed or uncertain intellectual property

12 rights. This subject is particularly important

13 to the agencies as IP issues are arising in

14 antitrust investigations with more and more

15 frequency.

16 As Professor Shapiro stated, a

17 compelling case can be made that intellectual

18 property disputes are increasingly important in

19 determining just which firms can compete in which
20 markets and on what terms.

21 At the agencies we often find
22 ourselves faced with difficult issues about

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1 whether and how to take into account the quality,
2 strength, or scope of underlying IP right when is
3 making decision about a transaction's competitive
4 effects.

5 These issues arise from many contexts.
6 For example, imagine a relevant market where only
7 two firms compete. Firm A says that its patents
8 block the field and that its rival, firm B, is in
9 the market only because it is illegally
10 infringing these patents.

11 A is suing B for infringement, which B
12 defends by claiming that the patents are invalid
13 or that it simply does not infringe. Now, let's
14 say that the two firms decide to merge. How
15 should the agencies analyze the competitive
16 effects of such a transaction, especially those
17 effects that arise from disputed patent rights?

18 A will likely argue that competition
19 is not lessened because the only competition
20 taking place was illegal competition that the
21 antitrust law should not protect. Yet B was
22 competing notwithstanding the infringement

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1 allegations. How should the agencies value
2 such competition?

3 As another example, patent license
4 agreements often contain terms restricting
5 competition between the parties. Such restraints
6 may as the guidelines state serve procompetitive
7 ends by allowing the licensor to exploit its
8 property as efficiently and effectively as
9 possible.

10 Yet they may also raise antitrust
11 concerns if they harm competition that would have
12 occurred absent the license. How should the
13 agencies assess competitive relationships between
14 the parties with the strength of the underlying
15 patents in dispute?

16 The agencies may be concerned that the

17 parties are agreeing to terms that fall outside
18 the scope of the patent right or that a, quote,
19 unquote, weak patent, if there is such a thing,
20 is being used to justify a cartel arrangement.

21 Definitional issues also arise in
22 patent pooling arrangements where a key fact is

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1 whether the pooled patents are blocking patents.
2 This is important to ensure that the pools
3 contain complementary IP rights and not
4 substitute IP rights.

5 It seems clear that a mere assertion
6 the patents are blocking should not indemnify a
7 combination for antitrust scrutiny. The question
8 though is how far must the agencies go in
9 conducting a full scale review of scope and
10 validity to assess antitrust risk from combining
11 patents.

12 In analyzing these types of
13 transactions several common questions arise that
14 warrant discussion today. For example, when
15 should parties to a license, merger, or other

16 agreement be treated as horizontal competitors if

17 IP rights are in dispute?

18 How should the agencies take into

15 Now for some brief introductions of
16 the members of our panel in order of their
17 appearance. I refer you to the handout that
18 provides complete biographies. I'll just give
19 abbreviated ones.

20 Doug Melamed is a partner in the
21 Washington, D.C. office of Wilmer, Cutler &
22 Pickering. He serves as cochair of the firm's

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1 antitrust and competition practice group.

2 Prior to returning to Wilmer,
3 he worked in the Antitrust Division for
4 four-and-a-half years, serving first as principal
5 deputy assistant attorney general and then as
6 acting assistant attorney general.

7 Joseph Kattan is a partner in Gibson,
8 Dunn & Crutcher's Washington, D.C. office. His
9 practice focuses on antitrust litigation,
10 counseling, and agency representation.

11 Molly S. Boast is a litigation
12 partner with Debevoise and Plimpton in New York.
13 Ms. Boast served in the Bureau of Competition of

14 the FTC from 1999 through 2001, first as senior
15 deputy director and then as director.

16 Joseph Farrell is professor
17 of economics at the University of
18 California-Berkeley where he's also chair of the
19 competition policy center and an affiliate
20 professor of business. Professor Farrell was
21 recently deputy assistant attorney general for
22 economics in the Antitrust Division.

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1 Gregory Vistnes is a vice president
2 at Charles River Associates in Washington, D.C.
3 where he specializes in the economic analysis of
4 antitrust and competition issues.

5 He recently was the deputy director
6 for antitrust in the FTC's Bureau of Economics.
7 Before that he was an assistant chief in the
8 economic analysis group at the Antitrust
9 Division.

10 M. J. Moltenbrey is as of today a
11 partner in the Washington, D.C. office of
12 Freshfields, Bruckhaus Deringer. Until March

13 2002 she was director of civil non-merger
14 enforcement at the U.S. Department of Justice
15 Antitrust Division. She was at the Antitrust
16 Division in a number of capacities before that.
17 Salem Katsh is a partner with
18 Shearman & Sterling in New York where his
19 practice involves counseling and litigating

12 Antitrust Division paralegals who are
13 wearing name tags highlighted in green escorted
14 you into the Great Hall and they are available at
15 the back of the room to escort you back out of
16 the building should you need to leave the
17 session, to the restroom, or upstairs to the
18 seventh floor where you can make a phone call if
19 you need to.

20 To compensate for the inconvenience we
21 do have coffee, soda, and water at the back of
22 the room.

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1 This afternoon's session will be a
2 combination of presentations and discussion.
3 We will hear presentations from each of the
4 panelists in groups of two with discussion
5 periods following thereafter. We'll also have a
6 fifteen-minute break in the middle of the

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10 mindful of course of the particular factual
11 differences because all antitrust investigations
12 and inquiries obviously have to be attentive to
13 factual differences.

14 I know there's a dispute about whether
15 that similarity between IP and other kinds of
16 property really applies in the case of
17 unconditional unilateral refusals to deal. But
18 with that possible exception I think it does
19 apply.

20 The difficult issue, the really novel
21 issue in my view that the intellectual property
22 poses for antitrust enforcement arises however in

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1 the increasingly frequent circumstances in which
2 there is a bona fide dispute about the scope or
3 validity of the intellectual property that is
4 material to the competitive analysis.

5 And as Bill pointed out correctly,
6 this can come up in a variety of ways. It can
7 come up in contracts, litigation settlements,
8 joint ventures, mergers, pooling arrangements,

9 cross license arrangements, and you name it.

10 And it has the common feature that if
11 the intellectual property is what the holder of
12 the property claims it to be, then there is no
13 lawful competition being eliminated by the
14 horizontal agreement.

15 If however the intellectual property
16 is not what it is claimed to be because it has a
17 problem of validity or a problem of scope, then
18 under many circumstances there would be
19 competition that could not lawfully be prohibited
20 by the intellectual property, and if the
21 agreement serves to eliminate that competition
22 it obviously raises competitive questions.

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1 The problem is exacerbated by the fact
2 that often the parties to the agreement have an
3 anticompetitive incentive to prevent the
4 resolution of the underlying question or
5 uncertainty about the intellectual property.

6 They have that because if let's say
7 the party who is calling into question the

8 validity or scope of the intellectual property
9 is somehow unusually or uniquely situations to
10 do so, either because it has unique access to
11 information that might enable it to challenge the
12 patent or copyright, or because in, for example,
13 the Hatch-Waxman circumstances, it has unique
14 incentive by reason of being a unique opportunity
15 to compete.

16 Then it and the intellectual property
17 holder have a common interest in preventing a
18 resolution of the underlying uncertainty because
19 if the intellectual property is found to be
20 invalid or so narrow in scope as not to block
21 the field, then not only the challenger but
22 potentially numerous other challenges could

1 compete, and there could be no supercompetitive
2 profits for anyone to take in that particular
3 market.

4 If on the other hand the intellectual
5 property is not challenged and is deemed to be
6 valid, there may well be supercompetitive profits

7 to be earned, and both the putative challenger
8 and the intellectual property holder might agree
9 it is in their interest to share those profits
10 and put an end to the intellectual property
11 dispute.
12 So I think it's a conceptually serious

6 more competition than could have been lawfully
7 prohibited even assuming the validity of the
8 intellectual property claimed.

9 In that case of course one could
10 argue using analogies to traditional antitrust
11 doctrines that the agreement is more restrictive
12 than necessary to achieve whatever legitimate
13 purposes one might think there is to repose and
14 settlement of intellectual property disputes.

15 And one could condemn the agreement
16 on that ground without having to grapple with the
17 hard question of was the intellectual property
18 holder entitled by reason of his IP to prevent at
19 least some of the competition that was prevented
20 by the private agreement.

21 Another case that may be easy if the
22 facts are right is a case in which the fact

1 finder can comfortably conclude that in the
2 absence of the private arrangement between the
3 parties there would have been competition,
4 pending some resolution of the intellectual

5 property claimed either because the putative
6 infringer sort of dares the IP holder to bring a
7 lawsuit, or because in fact there is pending
8 litigation and they would have litigated it.

9 But in the meantime, they would have
10 competed. In that situation it seems to me it's

4 dispute about the facts where the parties are
5 really saying, no, there wouldn't have been
6 competition in the absence of this agreement.

7 And again if you assume that the fact
8 finder concludes there would be competition, it
9 seems to me there's little justification to let
10 the parties by a private agreement eliminate that
11 competition on the ground that maybe they were
12 entitled to eliminate it because of the
13 intellectual property.

14 To state this however does not it
15 seems to me give much comfort that there's a way
16 to solve many of these problems because I think
17 it's going to be an unusual case where one can
18 prove there actually would have been competition

3 under the cloud of the IP dispute and before
4 therefore there is a sufficient factual basis to
5 make a confident prediction that if the IP
6 dispute stayed clouded competition would
7 nevertheless ensue.

2 to be sufficiently broad to entitle one of the
3 parties legally to prevent the competition from
4 the other party.

5 I think that's an unsatisfactory
6 solution because in that situation the parties
7 who probably have the best information and the
8 best incentive to know the truth of the matter
9 about the underlying intellectual property would
10 be aligned against the government.

11 They would be the IP claimant and the
12 putative infringer who now have a common interest
13 to defend their agreement and argue that the IP
14 is valid because it seems to me that you are now
15 making an antitrust plaintiff prove not only an
16 antitrust case but a challenge to a patent or a
17 copyright at well.

18 And that strikes me as raising the
19 bar to effective antitrust enforcement very high.
20 Another way to do it is simply to say we're going
21 to deem the intellectual property to be valid.
22 After all it is presumed to be valid in the case

1 of patents under the patent law. End of the
2 matter.

3 That has the obvious disadvantage of
4 course of allowing weak, flimsy, barely plausible
5 intellectual property claims to escape scrutiny
6 because the IP holder can pay off the would-be
7 challengers with some kind of a transaction which
8 enables them to share in the market power.

9 And the third party like the
10 government would not be able to challenge it.

11 The alternative of course would be to say
12 intellectual property is never deemed to be valid
13 until it's upheld in a court.

14 And the premise of this of course is
15 that our intellectual property system as everyone
16 knows to some extent depends on litigation for a
17 final resolution of the validity of patents, and
18 it assumes that the initial grant of the patent
19 will be no more than a presumption of its
20 validity.

21 The problem with this of course is
22 that it prevents legitimate settlements and

1 legitimate transactions whether there is an
2 intellectual property cloud. It probably tilts
3 too far away from the interests of repose and
4 efficient marketplace transactions.

5 Let me suggest then as my final
6 unhappy resolution of all this an approach that
7 may help in some cases to navigate through this
8 what I regard as a difficult conundrum.

9 I would imagine an antitrust rule that
10 might say that an agreement that eliminates a
11 real prospect in a potential competition sense or
12 in the sense of materially basing entry barriers,
13 a real prospect of competition would be illegal
14 even if there were a claim that the electric --
15 that there were intellectual property that
16 entitled the parties to eliminate their
17 competition, if the following three conditions
18 are met.

19 First, the other elements of an
20 antitrust claim are satisfied. That is to say,
21 there was injury to competition in the market as
22 a whole and so forth.

1 Secondly, one of the parties to the
2 transaction, the one I called here the putative
3 infringer, is in an almost unique position to
4 challenge the intellectual property.

5 So the resolution not only eliminates
6 the prospect of that they will compete, but
7 materially reduces the likelihood that invalid
8 intellectual property will in fact be found to
9 be invalid.

10 And here as I suggested earlier there
11 might be a circumstance where someone has a
12 unique ability to challenge it because of its
13 position in the industry, or a unique incentive
14 to challenge it because of its uniqueness in the

1 And the third element is that you
2 examine the agreement between them rather than
3 the underlying IP which the premise of this
4 proposal is the agencies aren't equipped to
5 evaluate IP even in a probabilistic sort of
6 Carl Shapiro-like sense.

7 Instead you look at the agreement
8 between the parties and you ask the question do
9 we have reason to believe that this agreement
10 between the parties entails a sharing of
11 supercompetitive profits.

12 The easy case here is where the IP
13 holder pays the infringer to go away. One would
14 not expect under very unusual situations -- I'm
15 sure Joe Farrell with some game theories can
16 imagine. One would not ordinarily expect in that
17 situation at least where the payment exceeds the
18 expected litigation or transaction costs.

19 One would not expect to see that
20 happen unless the IP holder were in effect
21 acquiring insurance against the fact that its IP
22 claim would be found to be invalid.

1 And ordinarily of course parties
2 can't buy off potential competitors as insurance
3 against their rivalry. Now, it's easy to state
4 in the so-called wrong way payment cases
5 like that.

6 It's harder to know how one would
7 determine by examining an agreement whether it
8 involved the sharing of supercompetitive profits
9 from this particular market if the agreement
10 were more complex and there were a variety of
11 situations going ways or if it were a merger and
12 one were trying to extract from the complete
13 aggregation of assets the particular overlap
14 involving the IP.

15 But it seems to me that asking that
16 question and focusing on that issue might at
17 least enable the antitrust agencies to bring a
18 coherent antitrust case in some instances without
19 the necessity to prove -- resolve the underlying
20 intellectual property claim. Thank you.

21 WILLIAM STALLINGS: Now we'd like to
22 hear from Joe Kattan.

1 JOSEPH KATTAN: Like Doug I think
2 that we have a problem for which we only have
3 unsatisfactory solutions. I think that there
4 are solutions that are more satisfactory
5 perhaps though then the solution -- or the
6 non-solution -- should I just go down there?

7 WILLIAM STALLINGS: It would probably
8 be easier.

9 JOSEPH KATTAN: But I think there are
10 solutions that are less unsatisfactory than the
11 ones that we've opted for as a default matter.
12 And that's what I'd like to discuss. So I'm
13 going to skip the slide about the problem because
14 I think Doug has described it.

15 And I'll talk about the non-solution
16 that we live with today. And the non-solution is
17 that we assume that any two parties that compete
18 are legitimate competitors, and that until an
19 injunction has been issued that stops the
20 infringer from continuing with the infringement
21 the two parties ought to continue to compete.

1 same antitrust analysis process to which we
2 would submit any two parties. And there are two
3 rationales for that. There is a typo there. A
4 is the one that should be getting enjoined,
5 not B.

6 There are two basic rationales for
7 that. One is we say, look, antitrust is already
8 complicated enough without getting it bogged down
9 with IP issues; the antitrust agencies don't have
10 the expertise to deal with the complexities of IP
11 disputes after all.

12 A patent case may last many, many
13 years, and how do you compress a patent case into
14 the life span of a short antitrust case? And
15 this is particularly true in the context of
16 mergers where how do you take a five-year patent
17 case and compress it to the four or five months
18 of the Hart-Scott-Rodino review period?

19 And second of all, consumers should
20 have the benefit of competition until we get the

21 injunction. And I guess I fundamentally disagree
22 with those premises.

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1 The notion that we don't have the
2 institutional expertise and therefore shouldn't
3 get bogged down in IP disputes reminds me of the
4 joke about the economist who is looking for a key
5 under a street light when in fact the key was
6 misplaced somewhere else where it's a little
7 bit darker.

8 And the economist is asked why are
9 you looking for the key here, and the answer is,
10 well, because I can see better over here. So the
11 fact that we can see the antitrust issues better
12 than the IP issues doesn't mean that we can just
13 sidestep them.

14 We do a lot of other things in
15 antitrust analysis that are very complicated. We
16 do very complicated econometrics, particularly in
17 merger cases in recent years.

18 So I don't think that that's an
19 answer. And giving consumers the benefit of

20 competition until final resolution of the IP
21 dispute assumes that there is an entitlement to
22 competition.

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1 I think if we take the extreme case of
2 the people who will sell you a copy of Windows XP
3 for two dollars on the streets of Hong Kong, I
4 think everybody would agree that that is not
5 legitimate competition. And that's not the
6 competition that we ought to give consumers the
7 benefit of until there's an injunction issued.

8 Obviously the cases which the
9 antitrust authorities are called to act upon are
10 a little bit more complicated than that. They
11 are not as clearcut as that.

12 But if we believe that there is a type
13 of competition which is not legitimate because
14 it's founded on misappropriation of somebody's
15 trade secrets or infringement of fundamental
16 patents -- and obviously the importance of the
17 patent itself is another complicated factor --
18 then I think it's a copout to say, well, let's

19 just give consumers the benefit of competition.

20 Now, the fact is that there are

21 different dynamics in merger and non-merger

22 cases. I think in non-merger cases the parties

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1 have a much better chance to try to turn the --

2 or to bring the IP case into the antitrust case.

3 I know that when we litigated the

4 Intel case against the FTC we wanted to bring in

5 some patent issues because the FTC was taking the

6 position that certain patents were valid and

7 infringed.

8 And we ultimately got a stipulation

9 from the FTC that we would not litigate the

10 patent issues if they would not take the position

11 that certain patents were valid and had been

12 infringed.

13 I think in merger cases it is a lot

14 harder to force the agencies to deal with the IP

15 issues. You're racing against the clock. And

16 if the agencies don't want to deal with the IP

17 issues and are not going to be persuaded by them,

18 then your next stop is a District Court.
19 And it's pretty hard to convince the
20 District Court judge that a PI hearing under
21 Section VII should now also be turned into a
22 minitrial on patent issues.

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1 But having been there, having told --
2 clients who have said to me but they've built
3 their business around my stolen trade secrets or
4 on my patents, it's very frustrating to say to
5 the client, well, I see your point, but it's very
6 unlikely that you will be able to persuade the
7 agencies.

8 There is another complicating issue
9 here because the alleged infringer isn't going to
10 be willing to come in to say to the agency, well,
11 I admit it; I really infringed; it's a valid
12 patent and I know that I infringed it.

13 They know that if the deal goes south
14 even if there was a claim that there was
15 intellectual property that the patent is invalid.
16 So the parties can't even present the united

17 front.

18 The one practical suggestion that I

19 have -- and it's worked once. Who knows if the

16 It's ironic because judges just absolutely hammer

17 litigants to settle their disputes.

18 And then they come before the

19 agencies, and the agencies evince hostility

20 toward any kind of resolution that enables the

21 parties to share in the value over which they

22 are fighting.

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1 And my bottom line is this.

2 Particularly in merger cases the agencies are

3 engaged in a predictive exercise. And it's a

4 predictive exercise that has many unambiguously (two) Tj T* -0.5 dimensions AnB

15 understand patent cases, who know how to litigate

16 patent cases, know how to evaluate patent claims,

17 part of the predictive exercise can be evaluating

14 But the current non-solution which is
15 to say we're not even going to concern ourselves
16 with the IP issues I think is something that
17 needs to be looked at. And by augmenting the
18 agencies' resources with IP counsel, perhaps we
19 will get a better handle on the problem than we
20 have today.

21 (Applause.)

22 WILLIAM STALLINGS: Thank you. During

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1 the discussion period if panelists want to make a
2 point, just raise up your tags like that and we
3 can recognize you. Probably to lead it off
4 I think that both Doug and Joe mentioned
5 probabilities and predictive exercises.

6 I think a lot of you know that
7 Professor Gilbert and Professor Shapiro earlier
8 in these hearings have put forth models trying to
9 look at the probability of patents being held
10 valid and the agencies relying on that type of
11 theory. I was wondering if there was any
12 reaction to how such type of theories work in

12 JOSEPH FARRELL: I think Doug
13 obviously has a point. It's not going to be easy
14 to get probability based on assessment into the
15 Judge's head or into the record if you can't get
16 a decision.

17 I think there are circumstances where
18 you can get evidence about the parties' beliefs
19 about the probabilities out of their behavior.
20 And you can then put those probabilities into
21 some sort of rule of reason.

22 Sometimes you can do that. Sometimes

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1 you can't do that. I suspect more often you
2 can't. But I don't think we should give up on
3 the possibility you can. But subject to that I
4 mean I think agree with Doug's core point there.

5 WILLIAM STALLINGS: Are you thinking
6 that you would look at some type of evidence of
7 intent of what the parties subjectively --

8 JOSEPH FARRELL: No. I'm thinking
9 partly of the kind of situation that I've seen
10 where a party continues to compete in the

- 11 marketplace despite claims of infringement and
- 12 is willing to indemnify its customers.
- 13 Or perhaps that's not an essential
- 14 element if the customers are aware of the claim.

10 where they are.

11 If you prevent the settlement from

12 going through, then where are you? The defendant

13 in many, many cases wants to settle because he

14 can't afford the cost of litigation, because he's

15 not in a sufficient -- his cost of capital is too

16 high. He does not want to litigate.

17 And one of the problems I see in the

9 opinion that's been written in history.

10 There is no such thing as a written
11 opinion given to a putative defendant that tells
12 him he's in a dangerous position of infringement.

13 And the reason for that is that those opinions
14 are always written to ward off the possibility
15 of willful infringement.

16 They are always written that there's
17 no infringement, that there's no invalidity. If
18 they can't find a grounds for saying that it's
19 not valid, they will leave it out of the opinion.

20 And if they can't find anything to say, they
21 won't say anything.

8 evidence, conduct evidence in my experience is
9 very probative. And I completely disagree with
10 the Federal Circuit's treatment of the pretext
11 issue in the Kodak case.

12 I think that the way a company
13 comports itself with respect to its intellectual
14 property rights says a lot about how it thinks
15 about those in the ordinary course of business
16 and how it talks to investors and how it views
17 it in terms of its shareholders and its
18 capital value.

19 And when you have a flip-flop on that
20 suddenly in the context of litigation, I think
21 that's worth examining and may be probative.

22 WILLIAM STALLINGS: One thing I forgot

1 to mention to the panelists, if you can make sure
2 you pull a microphone towards you, the acoustics
3 here are not very good, and especially with some

7 about the difficulties of dealing with this in a
8 merger context and then throw a question back
9 to him.k

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6 might not work in every instance. But it's at
7 least one more approach to consider putting in
8 your tool bag when you're dealing with a merger
9 with disputed intellectual property rights.

10 Moving away from the practical, the
11 question back to Joe is that as I understand it
12 in the case of the pirate infringer the patent
13 holder will be made whole through the damages
14 system.

15 I mean that is theoretically what
16 happens. Why under those circumstances is it
17 not appropriate -- what is the social cost
18 of permitting what you label the legitimate
19 competition if the patent holder is made whole at
20 the end of the day in the face of the pirate?

21 JOSEPH KATTAN: Well, I think that the
22 assumption that the patent holder will be made

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1 whole at the end of the day is not necessarily a
2 valid one. There are lots of companies whose
3 business is built around other people's IP and
4 who go out of business without being able to make

5 the other party whole.

6 The other thing that you are avoiding

7 is years of litigation. And there is a social

8 value in avoiding the years of litigation.

9 I understand that the agencies take

10 the position that they would -- the agencies

11 would like certainty on the antitrust side of

12 the ledger. And that is something that is a

13 legitimate consideration for an enforcement

14 agency.

15 On the other side of the ledger the

16 parties themselves value certainty, the ability

17 to go about your business knowing who your

18 competitors are, whether you're going to have to

19 confront this party that you think is a pirate

20 which may or may not be a pirate, or whether

21 you're going to have the what you thought was the

22 twenty-year monopoly that the patent granted you,

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1 assuming again that we are talking about a

2 fundamental patent.

3 There's a huge value in certainty

4 to parties that are in the business world. And
5 that's what they are seeking when they enter into
6 settlement. That's the main driver for
7 settlement.

8 MOLLY BOAST: I would have thought
9 you might have also been concerned about reduced
10 incentives. If you really have a pirate and they
11 are allowed to compete for an extended period of
12 time, what does that do to innovation incentives
13 over the long term?

3 and be almost a little pedantic if I might about
4 Joe Kattan's Windows example. He mentioned
5 Windows offered for two dollars on the streets of
6 Hong Kong. And, first of all, let me say of
7 course I agree assuming that happens it is
8 illegitimate competition.

9 But I think the question for the
10 enforcement agencies is not so much is it
11 illegitimate competition, because that one is a
12 case in which that's easy to see. And there are
13 a lot of cases where that's hard to see.

14 So it seems to me the question might
15 be given that you have -- you can't really
16 condition the rule on whether it's easy to tell
17 that this is illegitimate or not, is it okay for
18 Microsoft if its attempts to enforce its
19 intellectual property in other ways fail to go
20 to these street vendors and pay them off to stop
21 competing.

22 That would be something that given our

1 knowledge of this illegitimate competition we

2 would think I assume would be okay. But that
3 would raise hackles based on the extrapolation to
4 cases in which it's a little less clear that the
5 competition is illegitimate.

6 And it seems to me the panel's
7 reaction to that slightly harder case -- or let's
8 take -- you know, I don't know what a slightly
9 harder case still would be.

10 But imagine that you are not quite
11 100 percent sure that the competition is
12 illegitimate and you see the dominant firm
13 going to these competitors which it claims are
14 illegitimate and doing something, let's say, that
15 would be nakedly illegal such as paying them to
16 shut down were it not for that.

17 If that makes us uncomfortable, then I
18 think it's difficult to say the rule should be,
19 oh, you should shut down or not try to preserve
20 that kind of competition once you step outside
21 the street vendor hawking an illegal copy. And
22 I wonder if you have a reaction to that or

1 to be correct, and that's the nature of a
2 prediction.
3 So I don't know why you would exclude
4 something which is fundamental to the analysis.
5 It is a central part of the analysis. Why would
6 you exclude that from the analysis simply because
7 we say, well, it's too hard to do and we don't
8 know how to do it very well, therefore let's bury
9 our heads in the sand?

10 WILLIAM STALLINGS: I think we're now
11 going to hear a presentation from Molly Boast.

12 MOLLY BOAST: Thank you, Bill. Well,
13 this entire intersection, if you will, is an area
14 of keen interest obviously within the Bar, but
15 to me personally as well since the Commission's
16 Hatch-Waxman settlement challenges were developed
17 and brought during my tenure there.

18 And since I've been away from the
19 government for slightly under a year, I've had
20 the opportunity to consider some of the arguments
21 that were made surrounding those cases that I
22 think have broader applicability and have finally

1 come up with some tentative thoughts.

2 I will give myself the protection of
3 saying that I'm not sure I even agree with what
4 I'm about to say. But at least for purposes of
5 this discussion what I'd like to do is raise some
6 of the questions that were -- that we considered
7 internally and some of the arguments that were
8 made to us and give you my responses as of today.

9 And as I said, I think these are
10 applicable outside the Hatch-Waxman context. So
11 the points should be considered general points
12 unless I narrow them.

13 The first is a question that I think
14 can be readily disposed of, and that is do the

1 between a licensor and licensee or between
2 licensees as horizontal when they would have been
3 actual or likely potential competitors in a
4 relevant market in the absence of a license.

5 And this is thrown up often as a
6 statement that agencies really must go out and
7 prove the infringement or non-infringement,
8 validity or invalidity of the patent.

9 First of all, this pasTj T* -0.3813 Taubee81013813ad 6 statement that agencies really must go out

1 just by mere placement of where the passage
2 occurred.

3 Secondly, the language by itself
4 speaks to probabilities. The section says the
5 parties will be treated as likely potential
6 competitors.

7 There is no suggestion that this
8 should impose some rule of certainty on the
9 agencies in the guidelines themselves. And it
10 would be a mistake I think to elevate it to
11 something more than that.

12 And the third thing is the guidelines
13 are what they purport to be. They are
14 guidelines. They don't and they shouldn't trump
15 actual facts.

16 I think everyone who has been heard
17 on the point at this point agrees that actual
18 conduct, what we see in the parties' behavior,
19 what we see in their recorded records of their
20 behavior, is much more valuable than abstracting
21 some -- elevating some kind of principle like
22 this into the analysis as dispositive.

1 And they certainly -- the guidelines
2 shouldn't be used to cabin prosecutorial
3 discretion in this area, particular where
4 there's a large potential for consumer harm.

5 A second question that was confronted
6 and alluded to again by others is what role in
7 the agencies' antitrust analysis should be played
8 by the presumptive validity of a patent. And my
9 answer to that is almost none.

10 The presumption applies in
11 infringement lawsuits. It is a procedural
12 device. It is not evidentiary in the courts.
13 It's simply a burden shifting tool and by no
14 means provides a final answer about patent
15 validity or not.

16 And there is no presumption of
17 infringement. Even with the presumption of
18 validity operating in its favor, the patentee
19 still bears the ultimate burden of persuasion on
20 infringement claims.

21 And second suggesting somehow that

22 this judicially derived or now statutorily

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1 derived presumption should require the government
2 to give some additional layer of deference to
3 disputed IP rights when it's making an
4 enforcement judgment really makes no sense to me.

5 It's simply adding a layer of
6 deference where the courts have already done
7 that. And that would I think unduly constrain
8 antitrust enforcement.

9 And I guess we are perhaps also
10 influenced or at least I am in my view here
11 by data that suggests that the significant
12 proportion of issued patents are ultimately
13 determined to be invalid in any event.

14 So the presumption wouldn't actually
15 apply in all instances anyway. The third
16 question and the issue that was confronted is
17 can the agencies challenge a licensing
18 arrangement that takes place within the life of
19 the scope of the patent.

20 Doug made the point at the beginning

21 that the Hatch-Waxman cases were perhaps the easy
22 cases because the conduct or at least a portion

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1 of it really was outside the scope of the patent.

2 And indeed if you look at the series
3 of decisions that have come out in private
4 litigation in this Hatch-Waxman context, you will
5 see that the courts are often very focused on
6 things like the manipulation of the exclusivity
7 that the Hatch-Waxman statute affords.

8 The premise of this argument that the
9 agencies ought not to be concerned about conduct
10 that takes place within the life and the scope of
11 the patent is that the patent gives the power to
12 exclude for the duration of the patent. So
13 anything less than that can't be anticompetitive.

14 And the problem with this approach it
15 seems to me is that it elevates the presumption
16 of validity into certainty or near certainty.
17 The power to exclude -- and this is one of the
18 points that Professor Shapiro has made -- is
19 really no greater than the strength and breadth

19 license its intellectual property but does not
20 give it the right to insulate a horizontal
21 agreement on the timing of entry, for example,
22 whether that takes place within or without the

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1 scope of the patent.

2 It seems to me that the analytical
3 process ought not to change even if the agreement
4 is reached within the scope of the patent.
5 And the fourth question is in some respects a
6 variation on this and again one that others have
7 alluded to: does the antitrust plaintiff have to
8 prove the but-for world.

9 This is the argument of course that
10 the plaintiff must litigate the patent case to
11 prove that a competitive relationship existed.
12 Or put otherwise, it must show that the agreement
13 was more anticompetitive than the outcome of the
14 litigation would be.

15 Now, in the Hatch-Waxman cases this
16 is made relatively easy because the statutory
17 framework essentially treats the pioneer firm and

18 the generic firm as competitors by requiring that
19 bioequivalency be shown before the generic firm
20 can pursue the abbreviated new drug application.

21 Outside that context I would readily
22 concede it can be more difficult. But from a

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1 litigator's point of view frankly the argument
2 doesn't make practical sense and I don't think
3 that courts -- they haven't and I don't think
4 they are likely to embrace it.

5 By definition a settlement or
6 license means that there will be no judicial
7 determination on a validity or infringement
8 situation.

9 So to impose this requirement post hoc
10 on an antitrust plaintiff is a very circuitous
11 judicial route to evaluating an agreement.
12 And as I said, the courts have not done this
13 thus far.

14 The several decisions that have come
15 out surrounding the pharmaceutical cases, every
16 court that I am aware of that has been asked to

17 address this question straight up has either
18 rejected the argument or found another way to
19 analyze the problem that prevented it from having
20 to move in that direction.

21 In a settlement context the parties
22 often argue that the settlement in fact reflects

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1 their assessment of litigation risk and therefore
2 the plaintiff must prove the but-for world. Show
3 us why this isn't in fact appropriate given how
4 we assess the litigation. This is just a
5 variation on this same point.

6 But at least in the cases where
7 monopoly profits are being shared I would
8 suggest that the negotiating incentives can be
9 sufficiently skewed that there is really no
10 reason to assume that the settlement in fact
11 reflects an assessment of litigation risk.

12 It's not necessarily a proxy for that.
13 And I think that it would be very risky to
14 operate from that assumption and indeed the
15 agencies haven't.

16 This also raises of course the
17 practical problem of how to read behind the
18 parties' motives when internal assessments of
19 the strengths of their patents except for Joe's
20 waiver of attorney-client privilege are likely
21 to be withheld under privilege claims.

22 And this is something that in a merger

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1 setting I think is more likely that you would
2 counsel considering, parties considering sharing
3 a privileged assessment.

4 Once you are outside the merger
5 setting I dare say it would never happen because
6 there is almost always going to be private
7 litigation following non-merger government
8 litigation. The plaintiff's bar tends not to
9 pursue the mergers.

10 In any event from the government's
11 point of view I think it is also risky to think
12 that access to counsel's opinions would
13 necessarily give you any greater degree of
14 certainty about the likelihood that the

15 settlement accurately reflected the outcome of
16 the litigation if you believe as some seem to
17 have suggested that these opinions could be
18 capable of manipulation.

19 If you believe that there are
20 anticompetitive incentives that can drive toward
21 a settlement, why wouldn't that trickle down into
22 positioning the opinions in the same way?

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1 So those are my practical year old,
2 year later thoughts on some of the tough
3 questions we addressed, and I look forward to
4 people's responses.

5 WILLIAM STALLINGS: Thank you.
6 Professor Farrell?

7 (Applause.)

8 JOSEPH FARRELL: I want to talk about
9 an issue that came up several times this morning
10 and that I think is central to the whole
11 IP/antitrust issue, not by any means the only
12 question, but I think it is a central question
13 and it is a very difficult question.

14 And that is the question of incentives
15 to challenge intellectual property. So, for
16 example, Carl Shapiro, as someone has already
17 mentioned this afternoon, has put forward the
18 view I'm sure others have talked about too that
19 intellectual property and patents in particular
20 are not really rights to exclude; they are
21 tickets to sue.

22 This perhaps is particularly crucial

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1 if we suspect as many do that there may be a lot
2 of weak and invalid intellectual property rights
3 granted in the sense of -- given at an earlier
4 stage.

5 My colleague, Mark Lemley, has a paper
6 where he engages in some back of the envelope
7 cost/benefit analysis and suggests that when you

13 challenge, intellectual property challenge and
14 defense, and resolution is really an important
15 part of the system, that it's completely wrong to
16 think about it as taking place essentially at the
17 Patent Office and after that it's just fighting.

18 My colleague Rich Gilbert suggested
19 earlier here that antitrust agencies might take
20 it upon themselves to challenge intellectual
21 property in a few cases and yet suggested that
22 those cases should be the ones where spillovers

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1 are most marked and therefore where the private
2 incentive to challenge intellectual property is
3 most likely to be inadequate.

4 Following along the same idea that
5 there may be inadequate private incentives to
6 challenge intellectual property, Joe Miller
7 suggests in a paper that was circulated for this
8 meeting that perhaps there should be some kind of
9 bounty system for successful challenge to
10 intellectual property.

11 So all of this is just some -- these

12 are just some of the reasons why it seems to me
13 that challenge is essential to understand.

14 And just to give you a very brief --
15 or at least my understanding of why one might
16 well think and I tend to think that private
17 incentives to challenge intellectual property may
18 be badly inadequate.

19 End users, final consumers typically
20 benefit in the ex post sense, that is once the
21 invention has already been made, typically
22 benefit from a successful challenge to

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1 intellectual property, but are relatively
2 unlikely to be in a position to bring a
3 challenge.

4 More often a challenge is brought
5 by somebody downstream from the intellectual
6 property holder but not in fact an end user.

7 And in those circumstances where
8 there are a number of competing such potential
9 licensees if one of them successfully challenges
10 the intellectual property then the intellectual

11 property is invalid as to all potential
12 licensees.
13 That as I understand it is the
14 Supreme Court decision in the *Blonder-Tongue*
15 case. And what that means is since competition
16 is largely a relative performance scheme that the
17 successful challenger reaps only a part and quite
18 possibly only a small part of the benefits.

19 Other parts go to its rivals and
20 perhaps the biggest parts goes to final users or
21 to downstream participants.

22 So even leaving aside anticompetitive

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1 incentives to settle, there are reasons to think
2 that incentives to challenge are a lot less than
3 the incentive to challenge that you would think
4 arises if you think of a single licensee who in
5 economic incidence terms, that is really -- and
6 not just according to the checkbook is paying the
7 licensees.

8 However, that does not necessarily
9 mean as we might think that the private

10 incentives to challenge are too low because
11 in order to understand whether the private
12 incentives to challenge are too low you have to
13 not only understand whether they are lower than
14 you might think.

15 You also have to understand what the
16 right incentives to challenge are. So how would
17 an economist set about understanding what is the
18 correct, what is the right, what is the efficient
19 incentive to challenge a disputable piece of
20 intellectual property?

21 Well, the natural way for an
22 economist to set about thinking about incentives

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1 to challenge is to ask what's the benefit, the
2 net benefit from a successful challenge, because
3 if you can say what the net benefit from a
4 successful challenge is both to the challenger
5 and to society as a whole, then you'll get the

9 take an invention as given, if we take the
10 invention as having been made, then the social
11 gain from successfully challenging a piece of
12 intellectual property -- and let's look at just
13 the simple case where it's a single product, the
14 patent does confer monopoly, and there's no
15 cumulative investment incentives or anything
16 like that.

17 The social value is either you
18 save the loss of the deadweight loss from that
19 monopoly. That's if you take a total surplus
20 standard. Or if you take a consumer surplus
21 standard you save the deadweight loss plus the
22 monopoly profits.

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1 And it's possible to stop there. And
2 you could compare that against the benefit which
3 any individual licensee might get privately from
4 a successful challenge.

5 And then I think you would find very
6 often that the private incentive to challenge is
7 too low. However, my main point for today is

8 that that may be the wrong place to stop because
9 on the one hand you can't take the view that,
10 look, here's this invention whether correctly
11 patentable or not. It's been made.

12 The patent system has some rules for
13 whether it's appropriate to reward that with a
14 period of exclusivity. And it turns out that the
15 answer is, no, it doesn't. It isn't appropriate.
16 And discovering that seems like a good thing, and
17 how good a thing.

18 Well, you're saving this monopoly
19 power that otherwise was being gratuitously given
20 to the intellectual property holder. That's one
21 point of view. I think it's got something to it,
22 but I think it's not completely right.

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1 And the other point of view that I'd
2 like to put forward for consideration has
3 something to it as well. And that's the
4 following: that any colorable claim to
5 intellectual property, if that's rewarded there's
6 likely to be some effect on innovation

7 incentives.

8 Maybe more, maybe less. That's going
9 to depend on a lot of things. But there's likely
10 to be some effect. And if there's some effect,
11 then there's going to be some effect on future
12 innovation.

13 And that ought to be taken into
14 account too. So if a piece of intellectual
15 property or a piece of asserted intellectual
16 property is successfully challenged, on the one
17 hand you save what you might call the overcharges
18 for this product.

19 On the other hand, inevitably
20 you're going to influence future innovators'
21 expectations to some degree about how much reward
22 they're going to get from their innovation.

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1 And so the second, different
2 contracting approach -- the first approach,
3 remember, was, well, this invention has happened,
4 and now the question is, is the IP holder
5 illegitimately extracting exclusivity.

6 The second approach is to try to
7 integrate it more with intellectual property
8 policy as a whole and to ask not only what's the
9 effect given the invention that's happened, but
10 what's the effect on investors' expectations of
11 future rewards to future innovation.

12 And I think it's important that this
13 has to operate through expectations. Obviously
14 this invention has already happened whether it
15 was patentable or not. So the question is if you
16 challenge -- if you successfully challenge that
17 and the patent is overturned what happens to
18 future expectations.

19 Is this challenge to intellectual
20 property linked in the minds of future innovators
21 to the treatment of their efforts? And that's by
22 the way a different question potentially from can

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1 lawyers distinguish and say, no, no, this was
2 decided on this grounds and that's not going to
3 apply to your more legitimate invention.

4 It seems to me that competition policy

5 needs to take on as a job conveying to potential
6 innovators as well as others what's going on. So
7 if innovators are mistaken as to the link, you
8 know, that's something that needs to be taken
9 into account.

10 So what potential intellectual
11 property is weakened by a decision that removes
12 claimed intellectual property?

13 So one special case which might be
14 interesting to think about is can there be cases
15 where there's no innovation effect, where the
16 original approach of saying, no, the social
17 benefit to overturning this weak intellectual
18 property is just that you save the deadweight
19 loss or the deadweight loss and the profits.

20 Well, basically what you're saying
21 here is there needs to be no spillover from this
22 successful challenge to future innovative efforts

1 and thus no effect on future innovation. This is
2 a pretty strong condition.

3 Invalidity or certain forms of

4 invalidity are really not enough for this. So
5 suppose you take an invention that has -- where
6 there was some contribution but not a large
7 enough contribution to rise to the level of
8 patentable.

9 What does that say? Well, it says
10 that Congress thought or the Congress and the
11 courts have thought that the trade-off between
12 giving and not giving protection to this
13 innovation should be resolved in favor of not
14 giving it.

15 But that doesn't mean that there's
16 no contribution, and it doesn't mean that in
17 thinking about a program of innovation somebody
18 won't be influenced by the treatment of this kind
19 of innovation.

20 So the special case where there's no
21 innovation effect is going to be I think fairly
22 special. A second, perhaps more provocative

1 special case is where there's a uniform
2 innovation effect. What do I mean by that?

3 What I mean by that is think about
4 a successful challenge as causing potential
5 innovators to think, okay, the probability that I
6 can successfully sustain intellectual property
7 has just gone down a bit.

8 And it's that same bit for all future
9 potential innovators. So of the long history of
10 intellectual property policy and decisions, this
11 is a part. It fractionally reduces that
12 probability.

13 Now, fractionally reducing the
14 probability that you can sustain an intellectual
15 property claim, it turns out if you write down
16 the economic formulae to be a lot like
17 fractionally reducing the lifetime of
18 intellectual property.

19 And so just like patent extension
20 techniques, including perhaps settlements,
21 certain settlements, you can think of it as
22 varying the effective lifetime away from the

1 statutory lifetime.

2 In the case of successful challenges,
3 varying it by reducing it. In the case of
4 successful extensions, varying it by increasing
5 it. So what about things that are like changing
6 patent life? So here is where I want to combine
7 two of economists' favorite tools, a diagram and
8 an assumption.

9 I'm going to assume a diagram which
10 actually should be over there, and then I'm going
11 to give some thoughts by comparing what's going
12 on to Congress's judgment.

13 I apologize if it's not very readable.
14 I tried to do this in PowerPoint, but I haven't
15 yet figured out all the twists and turns in
16 there.

17 So in this picture on the horizontal
18 axis I've put the effective length and strength
19 of intellectual property. And on the vertical
20 axis is the total social benefit of the
21 intellectual property system as a whole.

22 And what I have here is an inverted

1 U-shaped curve. And the goal of intellectual
2 property policy should be to choose a length
3 and/or strength to put us at the peak of that
4 curve.

5 Now, if you think about some technique
6 of patent life extension that increases the
7 effect of patent life from the statutory life --
8 call it A -- to something a little longer -- call
9 it A-prime -- if A is indeed at the peak, then
10 A-prime by definition is lower but only a bit
11 lower because if you're at the peak things don't
12 fall off very quickly as you move away from the
13 peak.

14 It's true that if Congress had chosen
15 too strong an intellectual property protection
16 system so that we were not starting from A but
17 from B here on the right of the curve where it's
18 already falling, then extending to B-prime would
19 be seriously bad.

20 But it's also true that if we were on
21 the left part of the curve starting at C where
22 the curve is still increasing, then extending

1 from C to C-prime is actually good. So what do
2 we do given that we don't really know where we
3 are on this curve?

4 Well, I don't know, but in some sense
5 it's not clear that we can do much other than
6 assume that Congress didn't predictably get it
7 wrong, in which case a patent extension of this
8 kind involves a loss.

9 But the loss is not the whole
10 deadweight loss or deadweight loss plus profits.
11 It's rather the trade-off between that and the
12 increased intellectual property protection.

13 So this, remember, is the case where
14 we have uniform effect, not the case where we
15 have no effect. And of course it's not a more
16 complicated case because I can't handle that.

17 If we think about a successful
18 challenge, that's running in the other direction.
19 So a successful challenge takes us perhaps from
20 A-prime to A, perhaps from C-prime to C, or
21 perhaps from B-prime to B. And depending on
22 where we think we are on the curve, that's going

1 to give you different effects.

2 So my bottom line here is in thinking
3 about the incentive to challenge which as I say
4 I think is a very important challenge in this
5 intersection of antitrust and intellectual
6 property, it's not clear that we're getting
7 enough of the picture if we just look at the
8 ex post effect in the market that we're
9 talking about.

10 It's not clear that we shouldn't try
11 to integrate this with intellectual property
12 policy. Unfortunately if you do that the results
13 are a lot less clearcut. So let's step back and
14 say do we really have to do that integrating.

15 We don't have to do the integrating
16 if we're willing to say in some rather absolute
17 sense that we had the right intellectual property
18 policy and so marginal extensions may be marginal
19 but they're still bad.

20 You don't have to do it if you think
21 that there is no effect, as you might think if
22 this is an unpredictable extension of patent.

1 Or perhaps most interestingly you don't have to
2 think, well, all of these curves are all very
3 well. But they don't really deal -- and I think
4 this is right.

5 They don't really deal with the fact
6 that this is not a change in overall policy. And
7 an increase in effective intellectual property
8 protection as a change in overall policy might be
9 one thing. This is not that.

10 It's the private parties deciding that
11 they are going to grab more protection in this
12 particular case. So I think that's an appealing
13 argument, but I also don't know -- you know,
14 suppose it is that. But suppose you have a
15 pattern that allows that to happen.

16 In what substantive way exactly is
17 that different from policy change? Or to put it
18 another way, the policy change might itself be
19 rules onsets, on other policies that allow
20 this kind of thing to happen.

21 So like Doug I have a lot more
22 questions than answers here. It just seems to me

1 that, A, we need to think more about incentives
2 to challenge. And, B, I think it's a good idea
3 to think about it in an integrated context rather
4 than separately.

5 (Applause.)

6 WILLIAM STALLINGS: Thank you. I
7 think right now we'll take a short break, and
8 then we'll pick up on the other presentations and
9 some more discussion after the break. If we
10 could, reconvene at 3:10. Thank you.

11 (Recess.)

12 WILLIAM STALLINGS: I think we'll
13 start back up with a presentation from Greg
14 Vistnes.

15 GREGORY VISTNES: Normally I don't
16 like to speak after so many others have spoken on
17 the same subject in a panel like this because I'm
18 afraid they will have taken all the good
19 questions and good issues.

20 But fortunately on a panel talking
21 about practical problems in IP there are
22 certainly enough problems to go around for

1 everyone. So I think there will hopefully be at
2 least some new things for me to be talking about.
3 What I want to talk about is -- and
4 I've been evolving very much since I started
5 trying to put together. To put it in the context
6 of what Joe was saying earlier with the economist
7 searching around for the keys, I am very much
8 thinking that with some of these IP problems

22 get more expertise at the agencies to be able to

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1 better evaluate IP issues, that's got to

2 be better.

3 But at the same time I think that

4 that's going to be a pretty dim candle at the

5 end of the day and that somehow we need to be

6 worrying about how can we search more effectively

7 in the dark to try to get at some of the answers

8 for the IP issues.

9 Clearly the uncertainty having to

10 do with IP affects all different manners of

11 antitrust investigations whether we're talking

12 about patent pools, whether we're talking about

13 mergers between firms that may or may not be

14 rivals depending on the validity of their

15 patents, having to do with likelihood of entry,

16 all sorts of patent/IP type issues.

17 What I want to be discussing and far

18 less today than when I first started out to be

19 advocating a move towards rules, but to be at

20 least discussing the possibility of implementing

21 additional rules to try to help us find some

22 light in this dark area.

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1 I guess my basic tenet is that having
2 been through at least a few of these both on the
3 side of the government and on the other side
4 although of course still with the government's
5 end goals is that I don't think the agencies are
6 well situated to determine the status of IP
7 claims.

8 And that has nothing to do with the
9 skills or the tenacity or the abilities of agency
10 individuals. But it's simply that the agencies
11 are responsible for far too many industries to be
12 able to build up sufficient skill in this area.

13 I think that there far too often
14 especially in the context of mergers substantial
15 time constraints which preclude any significant
16 light being shed on some of these issues.

17 And there are obviously going to be
18 some significant information constraints which
19 will prevent them from coming to the best

20 determination on IP issues.

21 Clearly at the end of the day an

22 agency decision is going to require some very

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1 subjective determinations. And as others have

2 pointed out, everything the agencies do has some

3 subjectivity about it.

4 But I think looking forward in the

5 area of patent or -- I keep calling it patent,

6 but IP validity involves much more subjectivity

7 than usual. Current IP status is not always

8 relevant even to what's going on depend on the

9 type of case.

10 It may be important to figure out what

11 the parties thought at the time they entered into

12 an agreement which could have been two or three

13 years in the past and try to figure out

14 information on that. That old information

15 will be even more difficult to do.

16 Some of the issues regarding the

17 agency determinations on IP status is any agency

18 decision about status on IP is going to pose

19 some problems. First of all, any decision, any
20 determination the agencies come to is very
21 clearly going to be subject to future challenges.
22 Any IP determinations on even private

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1 contexts outside of the agencies coming to a
2 decision is often subject to challenge. It's
3 even more likely that what the agencies do will
4 be subject to challenge when they have to do it
5 under such time and information constraints.

6 Certainly once the agency makes its
7 decision as time marches forward more information
8 will come to light that additional information
9 will likely affect the decisions that would be
10 made which makes the challenge of an agency
11 determination even more ripe. It makes it almost
12 certain that challenges will come about.

13 I'm not so sure that those subsequent
14 challenges of agency determinations on IP are
15 necessarily good things for the agencies to the
16 extent that their decisions on IP if they are
17 continuously challenged and often overturned,

18 I think that takes away a certain amount of
19 legitimacy of the agencies when they are acting
20 in this area, especially if they are trying to
21 break new ground.

22 And finally the question emerges how

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1 will agency determinations on IP status affect
2 any parallel litigation that's going on outside
3 the agency context, being in private litigation
4 or in the patent dispute. Certainly decisions
5 can be made on what I'm calling here expected
6 values or probabilistic values.

7 Basically, hey, we take the best
8 information we have and sort of you pay your
9 money you take your chances. We figure that the
10 patent validity is maybe 40 percent.

11 And we've put it into, whether
12 explicitly or not, some sort of a probabilistic
13 perspective. Yeah, we can do that. But there's
14 so much barrier that's going to be associated
15 that I don't think that's going to solve many of
16 the problems.

17 So what I was at least thinking
18 originally is to what extent can we be
19 substituting rules for individual IP assessments.
20 And clearly that's easier said than done.
21 There are clearly certain benefits of
22 rules. It reduces cost; it's for everybody.

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1 It increases certainty about the process. It
2 increases speed of resolution. And hopefully it
3 will avoid some parallel litigation of IP issues.
4 Again there are also costs associated
5 with implementing rules. Sometimes you are going
6 to get an ex post bad call. That's clear under a
7 per se type rule even. You always have to admit
8 the possibility of a bad call.
9 The rules will generally not even

16 implement a rule.
17 And one is recognizing the rules
18 involve significant trade-offs, basically trying
19 to balance the harm from allowing bad conduct
20 versus preventing the blockading of preventing
21 good conduct.
22 You need to balance those two types of

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1 errors. The other balance that's going to be is
2 in timing of any type of decision on how the rule
3 works in that the longer you defer a decision the
4 greater the information that you're likely to
5 have. And that will more likely let you achieve
6 a better decision.
7 A deferred decision is not necessarily
8 a better decision overall though. Justice
9 delayed is justice denied I think is the saying.
10 The question arises is market power more likely
11 in markets with IP. And this goes towards how
12 you want to be setting up a rule and what sort
13 of things should rule be focusing on.
14 There is a question that if you think

15 that anticompetitive mischief is more likely,
16 perhaps in designing a rule you want to be more
17 conservative or more aggressive. I'm not sure
18 what the right adjective is. But you want to be
19 more inclined towards blocking behavior because
20 you think it's simply more likely.

21 You may want to focus on rules that
22 somehow reduce the uncertainty associated with

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1 IP issues. And that is, as you think of rules
2 having two possible end results. One is you can
3 either go for the grand slam and try to get the
4 rule that gets the right answer every time or at
5 least most of the time.

6 Alternatively you can try to come up
7 with rules that basically reduce the uncertainty,
8 in essence sort of focus the area of searching
9 underneath the street lamp.

10 And maybe the best example I can think
11 of here is when we're talking in the context of
12 Hatch-Waxman cases where one of the rules is, for
13 example, we don't like reverse payments.

14 Well, if you implement a rule we don't
15 like reverse payments, then one way of getting
16 around that rule is to say, well, let's sort of
17 cloud the whole issue by having all sorts of

13 obvious is that I'm afraid often not fully taken
14 into a context, a rule has been to resistant to
15 gaming. Any rule you can come up with, there are
16 going to be some huge incentives to get around
17 that rule.

12 greatest. Try to use the rules to again -- back
13 to the street lamp example. Use the rules to
14 push you to where you're then most likely to be
15 able to find things using the candle that you
16 have left available to you.

17 So in summary, the agencies I think
18 should very much try to limit their role as much
19 as possible in determining individual IP status.
20 Again the more they can do to figuring it out the
21 better. But I just don't ultimately have that
22 much confidence they will get too far.

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1 And then try to design rules that

22 to t, tkets.ain the anticipy heet y hgic responso

11 Thank you.

12 (Applause.)

13 WILLIAM STALLINGS: M. J. Moltenbrey?

14 M. J. MOLTENBREY: I find myself in

15 large agreement with a fair amount of what Greg

16 said. But I'm going to try not to repeat it too

17 much. I think we've already had this afternoon

18 a pretty good explanation of what the likely

19 problems are that we are looking for

20 solutions to.

21 Since this is supposed to be a panel

22 that focuses on the practical side of things, I'm

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1 just going to make a few points about what I see

2 as approaches that make sense for the agency

3 drawing mostly on my experience as an enforcer

4 and looking at some of these problems and trying

5 to figure out where resources should go and how

6 we should approach the problem.

7 The first thing I want to say is

8 that because we're looking at least in part for

9 practical responses, there doesn't have to be a

10 single answer. The question whether there should
11 be -- for example, whether there should be rules
12 that can be applied to simplify the analysis may
13 make sense.

14 I don't think that -- I actually
15 believe that there are some rules that can be
16 applied that will simplify the analysis in some
17 circumstances. But I don't take from that that
18 the agency should never undertake their own

9 Often times what we have in other
10 areas of law where we have a public policy we
11 want enforced, a private party's incentives
12 aren't going to line up perfectly as we have a
13 public agency that's responsible for stepping
14 into consumers' shoes and doing the enforcement.

15 Certainly that's what we have on the
16 antitrust side with respect to at least certain
17 problems. We know that private enforcement is
18 not going to be a substitute for public
19 enforcement.

20 To the extent the agencies can do it,
21 can get the expertise, can get the resources and
22 can challenge IP that is -- IP claims that are

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1 unduly restrictive to competition, I think they
2 should do that and are perhaps in the best
3 position right now of any agency or any system we
4 have to have someone speak on behalf of consumers
5 and represent their interests.

6 But recognizing that that's not an
7 immediate and perfect solution, the next step is

8 to think about how antitrust rules and how -- how
9 we should analyze certain agreements among IP
10 holders and other parties, recognizing what their
11 private incentives are, and trying to find a way
12 to maximize those incentives towards serving the
13 public good and deterring use of IP for
14 anticompetitive purposes.

7 parties being in settlement of a lawsuit in terms
8 of what the competitive effects are, what the
9 incentives are, and what the analysis is.
10 If I come up with evidence that I
11 believe -- and decide that I'm in a position to
12 perhaps enter a market by challenging either the

6 agreement might be reached in settlement of a
7 lawsuit and the other might be reached -- the
8 same agreement might be reached before the
9 dispute really becomes choate doesn't seem to
10 be that important to me.

5 to do is do we need to ask the but-for question:

6 But for this settlement would there

7 be competition in the end, with the notion being

4 infringers, on potential challenges, on new
5 entrants to require them to challenge patents, to
6 require them to challenge validity to say, no,
7 you're not allowed to decide you're going to duck
8 this particular problem and not take on the
9 burden of defending consumer interests.

10 If you want to have a rule that
11 says -- so that means that you don't want to
12 ever have a rule that says you can't settle
13 litigation; you're not allowed to get out of this
14 litigation.

15 The question you then want to ask is
16 why are they getting out of this litigation.
17 If the only reason they are getting out of the
18 litigation is because they are being compensated
19 with a share of monopoly profits and that but for
20 the sharing of those monopoly profits the answer
21 continue the plight.

22 What the public agencies want to do

1 is say you can't have that payment, not you can't
2 have that settlement. And so what you want to do

3 is separate those two out.

4 I agree with Greg that that buys a

5 whole different set of practical problems. Yes,

6 it is often going to be hard to determine whether

7 or not a payment has taken place.

8 We've had some very obvious examples,

9 and everyone is probably learning from those even

10 as we speak that if you're going to pay an

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2 than doing the full-blown patent analysis

3 would be.

4 So where that leads me is that with

5 respect to agreements that are between parties

6 that lessen competition where you have disputed

7 IP rights is I'd ask a series of questions.

8 The first is: Is this an area where

9 we have market power? If there's no market power

10 involved, obviously whatever types of settlements

11 go on we should assume are not being motivated

12 for anticompetitive purposes and are in the

13 public interest.

14 The second is one that Doug mentioned:

15 Are there relatively few challenges. I would

16 probably broaden that somewhat simply to point

17 out that when you decide how many challenges are

18 out there in a market I think it's important to

19 bear in mind the realities of IP litigation.

20 And even if you have multiple parties

1 be temporally equivalent.

2 If you have someone who's on the verge
3 of going to trial who settles a case and there
4 are three pending cases by -- three challenges by
5 other parties out there but they are years away
6 from resolution, I think there's a lot of
7 potential harm there, notwithstanding the fact
8 that the issues may ultimately be litigated.

9 And so I would look not only at who
10 is a challenger but who is a challenger in the

1 analysis is a little different.

2 And I think a lot of it leads you to
3 exactly that type of inquiry, which is do you see
4 two parties who have an incentive to monopolize
5 this market, and is that what this agreement is
6 about, or is it really simply an agreement to
7 avoid litigation. Those are my practical
8 thoughts on some of the issues that came up
9 today.

10 (Applause.)

11 WILLIAM STALLINGS: Well, I've heard
12 from four panelists. I'd like to just open
13 up the floor for discussion based on the
14 presentations we heard earlier, if anyone has
15 any comments.

1 decides to exploit it by sharing it with a

2 licensee on terms and conditions that are

3 acceptable to the patentee.

4 He may lack some capacity. He may not

5 other things. Why would that -- why is that a

6 solution rather than a sort of circular kind of

7 problem

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1 have any concern whatsoever about it.
2 I don't mean to be too dismissive
3 of the difficulties of making those factual
4 determinations in any given context. I just
5 think that they may be easier determinations to
6 make than the ultimate validity or scope of
7 patent determinations.

8 WILLIAM STALLINGS: Joe Kattan?

9 JOSEPH KATTAN: The thing that worries
10 me about rules is that they tend to be mechanisms
11 by which enforcers shift the burden of proof to
12 defendants.

13 When the IP guidelines talk about
14 agreements raising antitrust concerns when they
15 eliminate or reduce competition that would have
16 taken place in the absence of the agreement, I

1 showing that the agreement has created
2 anticompetitive effects.
3 If one wants to look at a rules regime
4 in the IP context, one can look at the technology
5 transfer block exemption the European Commission
6 has adopted.

7 And I would ask the panelists here,
8 particularly those who have spoken about rules,
9 whether a regime like that which to me seems
10 unduly rigid and has a lot of results that I
11 think most people at this table would at least in
12 some cases question as preferable to the rule of
13 reason approach that we use here.

14 WILLIAM STALLINGS: Doug?

15 DOUGLAS MELAMED: I have a brief
16 comment on what Joe said and then I want to go
17 back to answer the question that was put to M. J.
18 in a way that probably violates the subject of
19 this conference which is to be practical.

20 I agree with Joe about rules. I think
21 that if rules, whatever that means, are going to
22 be attractive in this area what they should be

1 are ideas about how to think about the facts, to
2 draw appropriate inferences from the facts in a
3 rule of reason context.

4 They should not be formalistic rules
5 for the reasons Joe has said. But I don't think
6 that, you know, a rule or a notion that says if
7 you identify parties that have -- to pick up on
8 what M. J. said, parties that have market power,
9 there is a bona fide uncertainty about the
10 intellectual property.

11 And there's something fishy -- I'll
12 come back to what that means in a minute -- about
13 the nature of the deal between them that you
14 can't from that infer that there is a sufficient
15 harm to competition that you meet the
16 requirements of the rule of reason.

17 I don't think that's a rule. I think
18 that's simply a way of thinking about the facts.
19 Now, for whatever it's worth it seems to me one
20 way of looking at M.J.'s notion or at least my
21 understanding of M.J.'s notion of is there market

22 power being shared is to think of the agreement

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1 whether it be a merger or a settlement agreement
2 or a license agreement or whatever between the
3 IP claimant and the putative infringer.

4 To think of it almost as an
5 exclusionary agreement of the type in which a
6 party with market power either induces an input
7 supplier not to furnish that input to anybody
8 else -- and here the analogy would be to pursue
9 the IP litigation in a way that reduces entry
10 barriers to everybody, and if you strike down or
11 reconstrue the scope of the patent.

12 Or simply bribe them not to compete,
13 you know, a BRI kind of case, kind of agreement.
14 And it seems to me what you do there is you ask
15 does this agreement have efficiency enhancing
16 properties. Here you'd be saying did it simply
17 economize on litigation costs.

18 Or you would be asking did it in fact
19 increase the efficiency of the exploitation of
20 the intellectual property because the licensee

21 really is much better able to build the machine

22 or to distribute the product or whatever it

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1 might be.

2 And then you ask the other question or

3 maybe it's the default to say maybe it doesn't

4 increase efficiency. Maybe all it does is bribe

5 the input supplier not to facilitate entry by

6 others or the would be rival not to compete.

7 And you identify that bribe by saying

8 we don't think efficiencies could possibly

9 explain the consideration in this contract after

20 And by analogy to these vertical
21 exclusionary cases or potential entry cases or
22 market allocation cases, you can say that's an

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1 illegal agreement.
2 SUZANNE MICHEL: Let me ask a
3 question. If one were to accept this conceptment.

19 what you are answering there is the question of
20 whether there's an efficiency in the agreement.
21 That is to say, is the licensing
22 arrangement on whatever terms, you know, more

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1 efficient than the outcome of the litigation?

2 SALEM KATSH: I would answer it this
3 way. If you get in a position of asking that
4 question, I think you're asking the wrong
5 question because it can't be answered.

6 SUZANNE MICHEL: And by that question
7 do you mean the question on the outcome of the
8 particular litigation?

9 SALEM KATSH: Right. The ability to
10 quantify or on a qualitative basis assess the
11 outcome of a patent case is impossible. Now, you
12 can get a feel for it. Sure.

13 But I think to go back to Doug's point
14 and M.J.'s, if you have an agreement that appears
15 clearly to be in restraint of trade whether
16 because it falls within the category of sharing
17 market power or otherwise is subject to some

18 traditional antitrust principle, that is where --

19 that is the question that should be asked it

20 seems to me.

21 And then I would say that although the

22 division does have the burden of proof I think

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1 that to say that a but-for -- I think that's more

2 in the way of an affirmative defense than it is

3 an element of the government's claim.

4 And I think that in that respect this

5 entire discussion of presuming competition to be

6 illegal, and that's some2 Ts8ernmmtve defef5p that hat hoenyoe1t

17 of going up and down and how many years it's
18 going to take, where the industry is going to go,
19 what other products are going to come in.
20 Right now you have an agreement.
21 Now, if the agreement is distributing -- private
22 agreement distributing incentives for production

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1 and marketing and it's being justified on the
2 basis of the defendant is an illegal competitor,
3 I just find that something that would be
4 inherently suspicious to me. And I'd want
5 really convincing proof.

6 WILLIAM STALLINGS: M. J.?

7 M. J. MOLTENBREY: I guess I would
8 answer the question about what is it that
9 you're -- what is the but-for world to say it
10 might in different circumstances be any one
11 of those.

12 But what happens is that your relief
13 is different. The relief that you are seeking
14 and that you would be entitled to get is going to
15 be different.

16 I can imagine circumstances where you
17 would be able to show -- and just to take an
18 extreme, simple example, that a patent holder
19 goes out and pays -- simply goes out and pays one
20 of the few other firms that has underlying
21 technology in the area and just walks in and says
22 we're going to pay you a lot of money and you

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1 agree that you'll never challenge our patents.

2 And as long as you do that we're
3 going to pay you a lot of money. And if that
4 circumstance I can imagine challenging that.

5 There the challenge is to the payment, and it is
6 to the agreement not to challenge.

7 And you're not making any
8 determination about the validity or scope of the
9 patent. I can imagine circumstances -- they may
10 be rare -- where in fact you could not only as a
11 theoretical -- on a theoretical level but on a
12 practical level get evidence of the likely
13 outcome of a particular case.

14 It may be very difficult and it might

15 depend a lot -- just to draw on some practical
16 experience, it's a little harder to do that when
17 you are looking at the early stages of litigation
18 with years of discovery yet to go than it is when
19 you're looking at a case that's been briefed on
20 appeal and the issue that is raised on appeal is
21 a very narrow legal one.
22 You may very well be able to make a

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1 determination about the likelihood of success
2 there. And in that case again if you challenge

14 difficult case.
15 But I don't think there is any reason
16 to narrow it down and say there's only one way
17 to get at it. I think you just -- you are
18 challenging something slightly different and
19 you're seeking slightly different relief in each
20 case.

21 SUZANNE MICHEL: If our goal is to
22 take on the -- or to try to show the likely

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1 outcome of particular litigation, to what extent
2 then do we need to get into factors like who are
3 the lawyers and who was the judge and what were
4 his propensities and is this really a doable
5 thing?

6 SALEM KATSH: Why is this different
7 than where the defendant raises the defense of a
8 natural monopoly, that nobody else can exist in

13 fair amount of skepticism. Now, I would modify
14 my prior remarks by saying if the patent has a
15 history of being successfully enforced and, you
16 know, that would be a factor.

17 And in this connection, the so-called
18 secondary consideration under the patent law, you
19 know, long felt need, penicillin, breakthrough
20 discoveries, commercial success, prior judgments,
21 sure. You know, that kind of case is different.

22 But if you're talking about untested

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1 patents, then I think you're in a very difficult
2 situation to ask the but-for question up front.

3 WILLIAM STALLINGS: I recognize
4 Ed Polk.

5 EDWARD POLK: I guess I agree with
6 what was said there as far as the situation where
7 it's just a payment itself and not so much where
8 the underlying patent needs to be challenged.

9 But if you have a situation where it
10 is about the underlying patent and you are in a
11 case where maybe but for that patent there

12 wouldn't be a market there, it seems to me that
13 if you are just putting in rules where you don't
14 want to undertake that analysis you're trying to
15 get a speedier result possibly at the cost of the
16 truth of what really are the facts of that
17 situation.

18 Maybe it would be a good thing to
19 actually go with that analysis, to come with the
20 truthful result rather than the quick result.

21 WILLIAM STALLINGS: Joe Kattan?

22 JOSEPH KATTAN: It seems to me that to

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1 answer your question you need to ask the ultimate
2 question which is what is the question we're
3 trying to answer in an antitrust case, and that
4 is whether the agreement creates, maintains,
5 upgrades, preserves, or -- creates or preserves
6 market power, and not whether the agreement is
7 contributing to efficiency.

8 And the only way that you can
9 determine whether the agreement is creating or
10 maintaining market power is to look at what the

11 but-for world would have been like. And if in
12 the but-for world you would not have had two
13 parties competing with each other, I don't see
14 how you can get to that ultimate result.

15 Now, it just so happens that a lot
16 of patent cases get settled after you have had
17 a Markman hearing. And after you have had the
18 Markman hearing you frequently have a pretty good
19 idea, not a dispositive idea, not something that
20 you can take to the bank.

21 But you have a pretty good idea of
22 where the case is going to wind up because the

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1 Judge has basically told you now here's how I'm
2 going to be interpreting the claims of the
3 patent.

4 And once you've got the claims of the
5 patent interpreted, the rest of it is relatively
6 speaking fairly mechanical. So it's a difficult
7 issue.

8 But I think if we begin by saying are
9 you contributing to efficiencies, then you're

10 saying defendant prove to me that you have had
11 a good reason for entering into this agreement
12 rather than, plaintiff, prove to me that this
13 agreement creates market power, preserves market
14 power, prevents its erosion.

15 WILLIAM STALLINGS: Doug?

16 DOUGLAS MELAMED: I think Ed's comment
17 and maybe Joe's as well implicitly surface a
18 critical premise in this discussion. I say
19 premise. We can disagree about the premise.

20 Both of those comments it seems to me
21 assume the correctness of a pitch that was made
22 by a lawyer who came before the Division when I

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1 was there with a merger in which the acquiring
2 firm had a passel, to say the least, of patents
3 and bought a competitor, a firm where the two
4 were actually competing.

5 They claimed that one or more of all
6 of this mess of patents entitled it to prevent
7 the acquired firm from continuing to compete with
8 it. And the lawyers said, look, if the patents

9 are valid there's no lawful competition here. If
10 the patents are invalid, there's no other entry
11 barrier. There's no competitive concern.

12 So either way you guys should go away.

13 And if one accepts the notion that a patent is
14 either valid or invalid and that the matter --
15 the increase should be as to the truth of the
16 matter, I think there's something to that
17 analysis.

18 There's another way of thinking of
19 patent law which I think has been alluded to by
20 several people this morning but I think it ought
21 to be surfaced.

22 And that is that the truth of the

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1 matter is that a patent gives you certain
2 presumptive rights to act as if you own property.
3 But you don't own that property until after the
4 litigation process if any is completed and it is
5 determined what the proper scope and validity of
6 that patent is.

7 And if that -- if therefore the truth

8 of the matter is that you don't own a patent
9 prior to the resolution of the litigation -- I
10 mean you don't own a definitive right to exclude
11 would-be rivals prior to the end of the
12 litigation, then the but-for world or the truth
13 of the matter that is pertinent o57 T

7 being shown on a PC.
8 I want to run through the slides
9 because I want to make sure I pick up on the
10 points that may not have been covered. The first
11 point I wanted to make -- and this goes to the
12 question of whether we should start with a
13 but-for test -- is to consider historically the
14 relative importance and weight given to the
15 patent laws and the antitrust laws.

16 And I think to the extent the agencies
17 are waking up to this field today, they may well
18 benefit from looking at what was considered
19 axiomatic law when I started practicing sometime
20 during the pendency of the IBM/Government case.
21 I don't want to tell you exactly how old I am.

22 The patent clause in the Constitution

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1 doesn't say anything about licenses. It doesn't
2 say anything about assignments. All it says is
3 that the owner shall have the exclusive right to
4 his discoveries.

5 The antitrust laws and the FTC act are

6 broad based commerce laws, powers, that were
7 enacted to regulate contracts. The patent laws
8 contain no provisions for balancing the relative
9 innovative value of a patent to its competitive
10 costs.

11 Every patent is of equal validity once
12 it issues from the Patent Office regardless of
13 whether it meets the margin of patentability by
14 an inch or by fifteen yards.

15 The degree to which it passes the
16 bar of patentability may be completely out of
17 proportion to the amount of market power it
18 lends itself to.

19 I'm not going to read these, but if
20 you look at the Kodak/Goodyear case of the
21 Federal Circuit, the SEM/Xerox case, and the
22 FTC/DOJ guidelines, you'll see a completely

1 different philosophy of enforcement theory.

2 The Federal Circuit was saying it
3 didn't matter who owned the patent. The fact was
4 that if the patent had not been transferred it

5 still could have been used to exclude

6 competition.

7 So they were assuming a hypothetical

8 infringement action that would have been brought

9 that would have been successful whether or not

10 that would in fact have been the case.

11 I think that -- and I've tried to

12 carefully look at the cases since these chestnuts

13 back in the forties. I don't think the law has

14 changed in terms of Supreme Court pronouncements

15 about the relative status of the antitrust laws

16 and the patent laws.

17 The contract which M. J. may have

18 alluded to comes before the court. If it does in

19 fact lend itself to the interpretation that it's

20 in restraint of trade, it comes -- the patent

21 aspect is subject to that principle of general

22 law and does not override it.

1 So there are many cases where the

2 Supreme Court has struck down pooling

3 arrangements, cross-licensing arrangements

4 without regard to whether the patents were valid
5 or invalid.

6 It is true that as a matter of relief
7 or subsequently the patents could have been
8 enforced. But that would have been on their own
9 merits. The agreements that parties reach
10 privately should not be subject to the control of
11 a subsidiary body of jurisprudence.

12 Now, I used that little clip art thing
13 to try and illustrate what to me is a practical
14 reality that many may not completely understand.
15 The black spider-type thing up with the little
16 red dots, if you can make them out, going into
17 the funnel is meant to represent the patent.

18 Now, there's been a lot of discussion
19 about patents conferring market power. But in
20 reality it's a firm that will have market power,
21 a firm with plant, property, equipment,
22 employees, know-how, trade secrets,

1 relationships, and so forth.

2 A patent is one component of the

3 firm's overall assets. And it is, as has been

4 mentioned, simply a cause of action. One can

- 2 situations beyond the patent case where defenses
- 3 have relied upon private property rights, that
- 4 the government was attempting to reallocate
- 5 private wealth.

1 and does present a unique opportunity for the
2 United States as a plaintiff, or the Federal
3 Trade Commission, to take action so that their
4 cases will not come before the Federal Circuit
5 for review.

6 And I think this is a point that the
7 Federal Circuit has basically adopted the
8 syllogism that because the patent gives you the
9 right to exclude, almost any condition that you
10 attach to giving a license is immune from
11 antitrust attack.

12 No weighing, no attempt to look at the
13 but-for. The license agreement is per se valid
14 unless you meet the requirements of Professional
15 Real Estate and sham litigation, unless there is
16 an enormous fraud on the Patent Office, or unless
17 there is a tying arrangement.

18 Why the court threw in tying
19 arrangement I'm not sure. It was in one portion
20 of its opinion and it's not in many other
21 articulations by the Federal Circuit where
22 they've allowed only sham and fraud as the two

1 grounds for challenging a patent suit or a patent
2 agreement.

3 Think about how the Supreme Court
4 would have treated the argument in Aspen or
5 Lorraine Journal if in Aspen they put forward as
6 a defense that the ski company had a patent on
7 the chair lifts used on Highlands Mountain.
8 Anybody who thinks that the result would have
9 been any different I think is wrong.

10 Aspen owned the three mountains and it
11 was obliged to open its -- it was obliged to
12 waive its right to sue for trespass. That is
13 what antitrust courts do when there are found to
14 be serious antitrust violations even in a single
15 firm context.

16 In Lorraine Journal, the Journal
17 established a policy of not carrying the
18 advertisements of anybody who advertised with the
19 new entrant, the radio station. Suppose the
20 Journal had gotten a business method patent on
21 how it ran advertisements?

22 So but for the infringement of the

1 patent -- in other words, they would have the
2 absolute right to refuse to license their patent.
3 And that would be somehow different from what
4 they did which was to refuse to deal and share
5 their property.

6 Now, the antitrust laws have always
7 had difficulty regulating single firm conduct.
8 It's no different today than it was in the days
9 of the IBM cases that involved access to trade
10 secret or copyrighted interface data.

11 The U.S. gave up on that. The
12 European Commission did require certain
13 compulsory licensing of vertical integration
14 cases where a single firm takes action that has
15 the potential of excluding competition in the
16 primary market because it will require other
17 competitors to vertically integrate into two
18 markets.

19 In most of the Supreme Court cases
20 involving patents -- and one of the last of the
21 string was *Blacksaw* -- the Court again did not
22 pay attention so much to the issue of patent

1 validity as to what the agreements were intended

2 to do.

3 And when the Xerox court in the

4 Federal Circuit says it's not going to consider

5 scienter, it's not going to consider an objective

6 intent, it's not going to consider the memos

1 I really wanted to get to this -- there is a big,
2 big problem which nobody's mentioned. And maybe
3 I'm missing something. But Professional Real
4 Estate does say that if you bring a lawsuit you
5 cannot be accused of violating the antitrust laws
6 unless it's shown to be objectively baseless.

7 Now, that's going to be a very hard
8 thing to show in virtually all cases. A
9 settlement that is based on wanting to resolve a
10 presumptively valid lawsuit is going to be hard
11 to challenge it seems to me, despite whatever the
12 settlement agreement says, if the defendant wants
13 out of the litigation.

14 And the court is bound to find that
15 the litigation was proper exercise of the patent
16 owner's First Amendment rights. And I find this
17 a real curve ball. In terms of examining license
18 agreements there could be litigation. And then
19 you'd be into a direct PRE situation where there
20 is litigation, and you're in that.

21 So I think this is an area where a
22 lot of work and thought needs to be devoted to

- 1 overcoming that if some of these agreements are
- 2 to be challenged. Thank you very much.

22 where you can avoid entirely looking at the

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1 merits of an underlying assertion about the
2 scope of patent rights including validity or
3 infringement, whichever is more important in
4 any particular case.

5 I think it's true from first
6 principles. The guidelines seem to suggest
7 this is the case.

8 And I think more importantly the
9 Business Review letters that people have alluded
10 to that have dealt with patent pool issues, all
11 three of which emphasize the importance of the
12 role of an independent patent expert who is going
13 to pass on the essentiality of patents, of given
14 patents for the pool technology, emphasizes an
15 acknowledgement that the merits of patent claims
16 are important at some very basic level.

17 The good news is that patent law
18 isn't merely a big pain in the neck for antitrust
19 enforcement authorities. Patent law actually I
20 think contains some important principles that the

21 antitrust enforcement agencies could use to their
22 advantage when they are examining and perhaps

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1 then challenging certain patent license
2 arrangements.

3 I've thought about two in particular,
4 but I don't mean to suggest that these are the
5 only two. I'm sure there are many more that
6 people more creative and intelligent than I am
7 will think of later.

8 I do think it's worth spending some
9 mental energy on this though to try and come up
10 with as many as one can. Let me mention the two
11 that occurred to me.

12 One is the presumption of validity has
13 been alluded to many times today. And Molly
14 Boast quite correctly emphasized that the
15 presumption of validity is merely a procedural
16 device. And it's a procedural device of somewhat
17 limited utility.

18 An important instance where it does
19 not apply is when a patentee is seeking

20 preliminarily to enjoin rather than permanently
21 to enjoin someone from competing with them in the
22 marketplace.

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1 So when a patentee wants peremptorily
2 to remove someone from the marketplace, they bear
3 the burden showing that their patent will be
4 sustained against the attacks that the defendant
5 has signaled might be in the offing.

6 It seems to me that the antitrust
7 agencies can and should be able to make the case
8 that they ought to be no worse off with respect
9 to someone who wants peremptorily to remove a
10 competitor with a license than they would be if
11 the person sought peremptorily to remove a
12 competitor with a preliminary injunction.

13 There has also been a lot of talk
14 today about shifting burdens. And I sense a
15 distaste for it in certain respects, shifting the
16 burden onto the parties who come forward with
17 these arrangements.

18 But I do think they need to bear a lot

19 more of the burden, especially if they want to
20 forestall much more drastic measures, about which
21 more in a moment.
22 The other procedural principle that

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1 I think is worth considering is the adverse
2 inference that is drawn in patent infringement
3 cases when a party who has been found to infringe
4 is defending against the charge that their
5 infringement was willful, that it was done with
6 reckless disregard for the other person's
7 patents.

8 Of course, when the person's intent
9 about the patent rights becomes an issue, the
10 natural thing for them to rely on is advice of
11 counsel: I had a good faith basis for believing
12 I didn't infringe or that the patent was invalid,
13 therefore I did not act with reckless disregard;
14 I acted with appropriate regard; I had good
15 advice; it happened to be wrong, but don't sock
16 me with treble damages.

17 It seems to me that there is an

18 argument to be made and it has several steps. I
19 would commend the paper to you for it in detail.
20 But there is an analogy to be made
21 here through the failing firm defense that the
22 accused infringer who says, look, I had to give

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1 in; I had to give my independence to the patent
2 holder because I couldn't possibly compete
3 lawfully, ought to be forced to disclose the good
4 faith basis for that belief or suffer the same
5 adverse inference, that they had no good faith
6 basis for that belief.

7 Now, the point has been made that
8 these legal opinions if they are negative
9 opinions, if they are opinions that suggest that
10 someone would be held liable for infringement
11 of a valid patent, that they will not be
12 written down.

13 My experience as a patent litigator
14 indicates the truth of that statement that's been
15 made by others. It almost certainly wouldn't be
16 written down.

17 That doesn't mean it can't be
18 disclosed. Conversations I'm sure would be had.
19 They have to be had because companies need
20 competent legal advice on how to proceed given
21 the circumstances they are under.
22 And the substance of those

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1 conversations could be relayed. Again if someone
2 decides they don't want to, there is always an
3 adverse inference to draw and I would recommend
4 heartily that it be drawn.

5 Again, these are two procedural rules
6 from patent law itself that I think the antitrust
7 authorities could usefully deploy. I'm sure
8 there are others.

9 But the complaint could rightly be
10 made when one talks about these sorts of ideas
11 that -- pick whichever cliché you like, nibbling
12 around the edges, rearranging deck chairs on a
13 sinking ship.

14 And I take those criticisms to heart.
15 I think they have great merit. The reason that I

16 think they have great merit is because they don't
17 attack the fundamental structural difficulty that
18 we're confronting that Joe Farrell has alluded
19 to, that Doug Melamed has alluded to and I think
20 others have as well.

21 And that is the consequence of the
22 legal rule that's been with us since a Supreme

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1 Court case called *Blonder-Tongue* that once a
2 patent has been held invalid as to one person
3 it's invalid as to the rest of the world.

4 That means that patent challenges have
5 a public goods quality much like innovation
6 itself. So if we're convinced that innovation
7 needs patents because it will be undersupplied
8 otherwise, we're probably equally likely to be
9 convinced that patent challenges need some sort
10 of boost or they're likely to be undersupplied.

11 I need to think a lot more about Joe
12 Farrell's very, very provocative and important
13 remarks here today about whether we can
14 confidently state that the level of patent

15 challenges really is below the place we need it

16 to be according to some particular social wealth

17 or standard.

18 What I'm not going to wait to say

14 invalidates a patent.

15 That would be particularly appropriate
16 when they do so on grounds that the patentee
17 could have avoided if he or she only took a
18 little bit more time and care in figuring out
19 whether the invention was patentable in the first
20 place.

21 But what might you do that's even more
22 bold than that? I think we have a laboratory for

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1 what you might do. It's the Hatch-Waxman Act.

2 Now, the Hatch-Waxman Act is not popular.

3 It's especially not popular in a room
4 full of antitrust lawyers, for good reason,
5 because it has a lot of pernicious aspects to it
6 that have been manipulated with real abandon on
7 the part of the main pharmaceutical
8 manufacturers.

9 But it also has this very, very
10 interesting suggestion for a device that might
11 work quite well.

12 The 180-day semiexclusivity period,

13 this is a period that allows the first person who
14 steps up to challenge the drug patent a six-month
15 period after they succeed where they will be able
16 to sell into the market and their only competitor
17 will be the name manufacturer.

18 The other generics will have to wait.
19 Now, the problem with this procedure as
20 Hatch-Waxman enacted it was that it allowed the
21 first generic to put a cork in the bottle and
22 trap every generic behind it and sit around and

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1 wait and not really even enter.

2 If that got fixed -- and it seems that
3 it is being fixed in some ways and might be fixed
4 even more dramatically with some legislation
5 that's on the Hill right now. If that were fixed
6 I think what we'd see is here is a bounty being
7 paid to the first challenger and only the first
8 challenger.

9 Why is that important? Because it's
10 a benefit that they will get that their
11 competitors, who will also reap some benefits

12 from the invalidation of an invalid patent, will
13 never get.
14 So they get a reward that others won't
15 get that's an incentive to undertake the
16 challenge. It's sounding a lot like the patent
17 regime itself, right? You reward someone in a
18 way that won't be appropriated by people who are
19 similarly situated.

20 So I think we have to think seriously
21 about bounties that we give to people who
22 successfully challenge invalid patents. I

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1 propose at the end of my paper an especially
2 outrageous bounty. So I like to think big,
3 right?

4 So my outrageous bounty is that the
5 accused infringer receive the disgorged profits,
6 all of them, that the patentee has earned under
7 the patent to date.

8 This really evens the playing field
9 considerably and it eliminates the very mechanism
10 which people have referred to repeatedly here

11 today, this structural defect where the patentee
12 can co-opt the accused infringer, align its
13 incentives with the patentee's against the
14 public.

15 If the accused infringer may be able
16 to get all the profits, you offering to cut them
17 in on a third or a half doesn't sound so great.
18 They might decide, well, you know what, I'd
19 rather shoot for the moon and get all your
20 profits.

21 And so I think we need to think about
22 a bounty system, how that might correct this

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1 market failure in patent challenges as a way to
2 really attack central problems at the
3 IP/antitrust intersection rather than sort of
4 nibble here and nibble there with this or that
5 procedural innovation.

6 As useful as those might be, I think
7 they're not nearly as satisfying as something
8 like the bounty proposal would be. Thanks.

9 (Applause.)

10 WILLIAM STALLINGS: Some reaction out
11 of Professor Farrell?

12 JOSEPH FARRELL: Well, I think if one
13 decided to take the view that one shouldn't
14 incorporate incentives to innovate into the
15 calculations of the gain from overturning invalid
16 IP -- and as I discussed, it's not clear whether
17 one should decide that.

18 But if one did decide that, then far
19 from being outrageous your bounty would perhaps
20 be inadequate because it only includes the
21 profits and not the deadweight loss which is also
22 harm caused by the illegitimate monopolization.

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1 And that of course in addition to
2 getting the incentives to bring the suit, to
3 bring the challenge a little higher, probably
4 only a little higher, would also make it even
5 more impossible for someone to offer part of the
6 profits in return.

7 Let me take the opportunity to make a
8 couple of general comments in response to

9 Mr. Katsh's observations. It seems to me that
10 there are two fallacies floating around that he
11 kind of mentioned I think in the spirit of
12 attacking, but I would like to hear attacked more
13 vigorously, and so I'll do it myself.

14 The first is that if there's no
15 obligation to do X, then there shouldn't be
16 limits on how you do X. I think this is a pretty
17 well understood fallacy.

18 I don't have to hire an employee, but
19 if I do hire an employee there are limits on what
20 I can do, even things I can do that are disclosed
21 to potential employees up front.

22 I don't have to enter a market, but if

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1 I do enter a market I'm not allowed then to
2 collude with incumbents. There are lots of ways
3 in which the syllogism you don't have to do X,
4 therefore the law can't limit how you do X, is
5 rejected.

6 The second widespread fallacy is in
7 dismissing too quickly intent evidence. And this

8 is something I think antitrust practitioners are
9 particularly fond of. It's certainly true that
10 middle managers and perhaps others like to make
11 loose statements about crushing the competition
12 and so on.

13 And it's certainly true that we
14 shouldn't base antitrust enforcement on those
15 kinds of loose statements.

16 On the other hand, if you want to know
17 what the real expected effects of a practice or a
18 merger or a settlement are, I think it's likely
19 to be pretty informative to find out the best
20 considered opinion of those in the firm who know
21 the most about that aspect of the business.

22 And just because we want to throw out

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1 cases based on these inflammatory kill the
2 competition memos does not mean and shouldn't
3 mean that we throw out the use of evidence about
4 the most careful thinking within the firms, who
5 know a lot more about it than we do.

6 JOSEPH MILLER: I've rarely been

7 accused of not sufficiently aggressively stating

8 my position. I accept your additions.

9 JOSEPH FARRELL: Thank you. I've

10 rarely been accused by the way for those who have

11 been here this morning of being to the right of

12 Greg Sidak. But he mentioned that.

13 DOUGLAS MELAMED: This is a

14 small comment maybe only in the nature of a

15 clarification about the bounty proposal. But I

16 wanted to note something and maybe ask a question

6 So my question or clarification is
7 this: I take it you do not mean by your bounty
8 proposal to require forfeiture of all profits
9 from the patentee's exploitation of the
10 technology putatively covered by the patent, but
11 rather simply those profits attributable to his
12 now in turns out in hindsight wrongful assertion
13 of a patent right to exclude rivals.

14 Otherwise it seems to me that you
15 would be deterring procompetitive conduct if your
16 bounty is paid by the patentee rather than the
17 Treasury.

18 WILLIAM STALLINGS: Joe?

19 JOSEPH MILLER: I think I would agree
20 with the second characterization that the profit
21 would be the profit attributable to the wrongful
22 reliance on the patent. I suspect however that

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1 in practice that the first would be the proxy for
2 the second.

3 It would be difficult to disentangle
4 the profit attributable to the misassertion of

5 the patent from profits attributable merely to
6 practicing the technology.

7 The reason I went to patentee profits
8 in the first place -- perhaps that would be
9 helpful to lay on the table -- is a problem you
10 confront in designing any bounty system, which is
11 how big shall the bounty be.

12 That's just a design problem, right?
13 And it seems to me that fixing any sum certain --
14 let's make it 100,000, let's make it 5,000 -- is
15 always going to have real underinclusive and
16 overinclusive problems. So the better thing to
17 do is to try and calibrate it directly to the
18 value of the technology at issue in the case.

19 And so that's why I think you have to
20 go to patentee profits measured somehow. But I
21 accept your clarification. And it relates in a
22 sense to Joe Farrell's comment about whether or

1 not we want to include the incentive to innovate
2 in the way we think about whether these things
3 are over- or underencouraged.

4 I certainly think we ought to try to
5 incorporate the incentive to innovate in the way
6 we think about whether these things are under or
7 oversupplied. I would say this however in
8 addition, that we should also try to incorporate
9 all ways that people can protect their
10 investments in innovations.

11 It is not merely the case that you
12 have patents or copyrights or nothing at all.
13 Many firms don't ever get any patents or have any
14 copyrights. What they do is they rely on their
15 lead time in the marketplace.

16 And there's been quite a bit of
17 research about the different ways that firms
18 recoup their investments in innovation. And I
19 think that if a bounty proposal were employed in
20 the patent system it might reduce the amount of
21 patent seeking but I don't think it would reduce
22 innovation seeking that is protected by other

1 mechanisms.

2 So that would also need to be part of

3 this very complex story that we should try to
4 work out for the reasons that you stated earlier.

5 WILLIAM STALLINGS: Molly?

6 MOLLY BOAST: This is a little off
7 point, the bounty point. But just as I sit and
8 listen to this entire conversation and a fair
9 degree of unanimity -- certainly there are people
10 who don't agree.

11 But there's a growing number of people
12 that seem to share a consensus that if we let too
13 many abstract rules get in the way we will engage
14 in underdeterrence in antitrust enforcement in

2 It is better to take those to the
3 courts. That's where the rules get made in this
4 system. That's what antitrust enforcement is in
5 this country. It's not a regulatory regime.
6 It's a law enforcement regime. And we ought to
7 be encouraging agencies to go forward.

8 WILLIAM STALLINGS: Salem?

9 SALEM KATSH: I just had one thought
10 in listening to Professor Farrell. I'm wondering
11 how he deals with that.

12 And this is the fact that before the
13 Federal Circuit in '82 under the exact same legal
14 standard, which is the Graham test of the Supreme
15 Court in '65, between '65 and '82 somewhere
16 around 70 percent of patents that came before the
17 various Circuit Courts of Appeals were held
18 invalid or not infringed.

19 After 1982 again under the same legal
20 standard the percentages have reversed. And one
21 of the problems I think that everybody here is
22 confronting in terms of whether the system can be

1 tinkered with or whether some truly structural
2 reform is necessary, is the question of how to
3 deal with the uncertainty that now pervades the
4 system when you're dealing with one court that
5 will get every patent case if it has a discrete
6 patent claim, and not only will it in general at
7 the end of the day uphold 70 percent of the
8 patents, but it will in the interim reverse
9 almost 50 percent of the Markman determinations.

10 Which to Joe's point prevents the
11 parties from relying on the Markman determination
12 to get certainty before -- because if that were a
13 real final resolution of the claim construction
14 in 90 percent of the cases it would have a
15 tremendous impact, a procompetitive impact.

16 But with the Court it's a brand-new
17 ballgame, almost 60/40. So it's impossible for
18 you to tell a client, look, you've lost in the
19 District Court; now you better fold it in. It's
20 quite the contrary.

21 WILLIAM STALLINGS: Joe, do you want
22 to respond?

1 JOSEPH FARRELL: Well, to be honest
2 I'm not quite sure what the question is here. I
3 mean one thing I would say about the fraction to
4 winners on each side is that's very apt of be a
5 feature of the set of cases that get brought to
6 that tribunal.

7 And so although I assume you can infer
8 something from a big shift like that you have to
9 be very careful about what you're inferring; that
10 is, you're looking at a very selective sample.

11 I think what you're saying is
12 settlements are made more difficult by the
13 uncertainty that goes along with a dramatic
14 change in policy, assuming there is such a
15 change, and made more difficult also by the
16 disrespect that's given to the Markman results.

17 I think it's true there's probably
18 discouraged settlement. But I'm not sure what
19 you're asking beyond that.

20 JOSEPH MILLER: I guess I was thinking
21 out loud for a minute to M. J.'s point about
22 profit sharing. If the uncertainty is so great,

1 confronting both parties as to what the final
2 outcome will be, doesn't that just complicate the
3 antitrust enforcement decision in terms of
4 whether the way the case is settled is a fair
5 allocation of risk even though it may amount a
6 certain amount of profit or power sharing?

7 JOSEPH FARRELL: Yes. I think it
8 does. I've never been an advocate for the
9 antitrust agencies trying to judge whether a
10 settlement is fair. I think one way to phrase
11 what you're saying though is it makes it harder
12 still to find triggers for thinking that a
13 settlement is really a division of monopoly
14 profits rather than a true settlement of the
15 litigation risks.

16 I suppose it does because it does tell
17 you that there is a bigger spectrum of agreements
18 that might look good to both sides if they are
19 taking different views about uncertainty.

20 The uncertainty in itself by the way
21 has very little to do with difficulty of reaching
22 settlements or any of those things. It's

1 the context of re-examination procedure -- and
2 now we're really getting into some finer points
3 of Patent Office administration which is what
4 we're think about, because as I said, I think we
5 need to as antitrust enforcement people -- or
6 people who are involved in antitrust issues need
7 to start thinking in a much more detailed way
8 about substantive patent rules and procedural
9 patent rules.

10 And so thinking about PTO procedure is
11 a good way to start to do that. In the context
12 of re-examination it is the case that the
13 commissioner of the Patent Office is statutorily
14 authorized to request re-examinations.

15 In fact it might even be to direct
16 that there be a re-examination. I would have to
17 go back and look. So re-examination is not
18 merely something that a private party can
19 instigate.

20 Now, it's true that the statute also
21 creates a standard. There has to be a, quote,
22 substantial new question of patentability. So

1 it's not like this is something you can just go
2 do because you feel like it on a whim. You have
3 to have a reason to do so.

4 But I think that if the agencies or
5 one of the agencies went to the commissioner and
6 said in this context there's all sorts of
7 evidence that would suggest a substantial new
8 question of patentability here; do you think that
9 there is some ground for re-examination.

10 And if in the antitrust enforcement
11 context it seemed to be useful and beneficial to

1 question that the agencies have to answer. And
2 if the agency had an unlimited number of patent
3 lawyers and made a determination on the scope and
4 validity of the patent, how should that play into
5 the antitrust analysis? Does the agency's own
6 determination become the final determination?

7 I think the really hard question is
8 the uncertainty of the IP rights, and in fact the
9 nature of the IP rights and the but-for question
10 presented. And is it even possible to get at
11 those questions rather than solely a lack of
12 patent lawyers?

13 WILLIAM STALLINGS: Salem?

14 SALEM KATSH: As somebody who's cut my
15 teeth on patent law and technology without a
16 technical background, which is why I infuriate
17 the patent bar so much, the Federal Trade
18 Commission and the Antitrust Division
19 unquestionably can come to a qualitative decision
20 about a patent within a matter of days or a

21 couple of weeks, having on staff appropriate

20 M. J. MOLTENBREY: Salem, I think an
21 interesting question that we have been trying to
22 get at then is: Is in that case, that

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1 acknowledgement that we can't get at that but-for
2 world, is where does the antitrust analysis go
3 from there?

4 And that's the hard question I think
5 when people talk about the agency not being able
6 to come to a determination, that that's really
7 more the heart of the matter than the inability
8 to make the qualitative analysis that you talked
9 about.

10 SALEM KATSH: But again, why is that
11 different from being confronted with a natural
12 monopoly defense or a failing company defense or
13 some efficiency defense?

14 M. J. MOLTENBREY: Well, I think
15 that's an interesting question in the sense that
16 those defenses place the burden on the parties
17 and not on the agency.

18 And much along the lines of what Joe

19 was talking about, the question might come down
20 to who carries the burden because no one's going
21 to be able to meet it anyway. And it becomes a
22 default rule, which may be just the answer. I

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1 don't know.

2 WILLIAM STALLINGS: Doug?

3 DOUGLAS MELAMED: It seems to me
4 there's a legal problem too here. If you accept
5 the premise of the last couple of minutes that
6 the but-for world that we might be having to
7 investigate -- it involves a resolution of the
8 question is the patent valid.

9 If the antitrust laws require the
10 resolution of that question, there's no way it
11 seems to me to decide the antitrust question
12 without resolving that question in a patent
13 litigation because if the antitrust rule says
14 patentee is entitled to exclude the competition
15 if the patent is valid, then you have to make a
16 determination.

17 It doesn't matter what the antitrust

18 agency thinks. It doesn't even matter what the
19 antitrust court thinks, unless it has proper
20 jurisdiction over the patent issue.

21 It seems to me that unless you want
22 antitrust to have to resolve all those issues in

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1 a proper patent case, that's another reason to
2 look for decision tools, antitrust modes of
3 analysis, that enable you to resolve a lot of
4 competition questions without having to resolve
5 that but-for world.

6 WILLIAM STALLINGS: Joe Kattan with
7 the last comment?

8 JOSEPH KATTAN: I think that a very
9 wise person said that a lot of antitrust law gets
10 made not by litigation or doctrine these days,
11 but by prosecutorial discretion.

12 And in the exercise of that
13 prosecutorial discretion, it seems to me that the
14 agencies can make the qualitative judgments that
15 at least in certain cases and certainly in the
16 merger context we're not going to bring a case,

17 which is based on a prediction of what the world
18 would look like if the merger were to go forward
19 or what the world would have looked like absent
20 the agreement, when we have ability to make the
21 qualitative judgment as to whether competition
22 would have existed between the parties,

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1 legitimate competition given the patent position
2 that has been asserted.

3 WILLIAM STALLINGS: Well, you've heard
4 a lot today. The last thing, we've asked Joe
5 Miller to try to wrap it up and put it all in
6 context.

7 JOSEPH MILLER: And talk about
8 dreaming the impossible dream. How would we
9 summarize this? I think that some themes have
10 emerged.

11 The notion that there is a particular
12 structural problem with the very nature of patent
13 challenges that sets off certain dynamics and has
14 certain conclusions, that we need to think more
15 about and try to struggle with because that may

16 be where the big payoffs are for increasing the
17 amount of competition that should be taking place
18 in the marketplace.

19 I think the theme that figuring out
20 what the but-for world is, how to analyze it
21 correctly, is a daunting challenge. You've heard
22 a lot of different views about whether it's even

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1 something that's necessary to do.

2 And I'm probably at the other end of
3 the spectrum which is I don't see how one can
4 avoid doing it frankly. So this is still very
5 much a contested question.

6 But I think what's not contested is
7 that economic theory honed by experiences like
8 the Hatch-Waxman Act cases are indicating to us
9 plenty of contexts where even if we assume the
10 patents are fully valid and fully infringed by a
11 particular party, that the arrangement in
12 question is anticompetitive and we need to push
13 the forefront of that boundary, get it back as
14 far as we can, so that we reduce the number of

15 instances where we do have to take on the merits

16 of the underlying patent issues.

17 And also again, to sort of plug my own

18 idea since I have the floor, is that we do have

19 to start to think through on the assumption that

20 we will not be able to eliminate the need to look

14 summary.

15 WILLIAM STALLINGS: Joe, thank you

16 very much. I'd like to thank all the panelists.

17 I appreciate your time and effort. Thank you all

18 for coming.

19 (Adjournment.)

20

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