

1 FEDERAL TRADE COMMISSION AND DEPARTMENT OF JUSTICE

2 ANTITRUST DIVISION ROUNDTABLES:

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6 COMPETITION AND INTELLECTUAL PROPERTY LAW AND

7 POLICY IN THE KNOWLEDGE-BASED ECONOMY

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13 Wednesday, November 6, 2002

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9:30 a.m.

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18 Federal Trade Commission

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6th and Pennsylvania Avenue, N.W.

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Room 432

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Washington, D.C.

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FEDERAL TRADE COMMISSION

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TOPIC:

Standard Setting Organization: Evaluating
the Anticompetitive Risks of Negotiating
Intellectual Property Licensing Terms and
Conditions Before A Standard Is Set Page 3

Relationships Among Competitors and Incentives to
Compete: Cross-Licensing of Patent Portfolios,
Grantbacks, Reach-Through Royalties, and Non-
Assertion Classes Page 93

P R O C E E D I N G S

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STANDARD SETTING ORGANIZATIONS

MS. GALBREATH: If we could begin, good morning. Welcome to the DOJ and FTC joint hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy. We are here this morning for the third roundtable discussion. My name is Carolyn Galbreath. I'm an attorney in the Division's San Francisco Office.

Joining me to take on the moderating duties this morning are Tor Winston, he's an economist in the Division's Economics Advisory Group, and Gail Levine. Gail is Deputy Assistant General Counsel for Policy Studies here at the FTC.

We'd like to welcome you all this morning to this panel. We are going to be taking two issues today. This morning we'll look at standard setting organizations: evaluating anticompetitive risks of negotiating intellectual property and licensing terms and conditions before a standard is set. Although our discussion could go much longer than two hours, we will limit it to that amount of time and we will end as close to 11:30 this morning as possible.

This afternoon, the hearings will resume at

1 2:00 and there will be a roundtable discussion of
2 relationship among competitors and incentives to compete
3 and particularly, we will be looking at cross-licensing
4 of patent portfolios, grantbacks, reach-through royalties
5 and non-assertion clauses.

6 Since our time is limited, we are not going to

1 difficulties, both practical and legal, for standards
2 groups, practitioners, intellectual property holders and
3 antitrust enforcers, and one aspect of hold-up, whether
4 ex ante discussion and negotiation of licensing terms
5 within standards organizations would run afoul of the
6 antitrust law seems to merit more focused scrutiny. It
7 is to that that we turn our attention today.

8 And I'd like to turn now to Tor Winston and ask
9 him to introduce our panelists.

10 MR. WINSTON: To help us navigate this
11 analytical and legal thicket, we've assembled a group of
12 distinguished panelists and I'd like to briefly introduce
13 them.

14 We have Joseph Farrell, who is the Professor of
15 Economics at University of California, Berkeley; Joe
16 Kattan, who is a partner at Gibson, Dunn & Crutcher;
17 Scott Peterson, who is Corporate Counsel for Hewlett-
18 Packard Company and Chair of the ANSI Patent Committee;
19 Carl Shapiro, the Transamerica Professor of Business
20 Strategy at the Haas School of Business, University of
21 California, Berkeley; Earle Thompson, who is the
22 Intellectual Asset Manager and Senior Counsel at Texas
23 Instruments; and Paul Vishny, who is a member of D'Ancona
24 & Pflaum and General Counsel of the Telecommunications
25 Industry Association.

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1 kind of formal standard setting that people generally
2 think of in terms of standard setting organizations.
3 These are things that are called SIG or special interest
4 groups, that are a lot more formal and, at least
5 historically, have typically involved royalty-free
6 licensing or reciprocal royalty-free licensing where the
7 basic proposition is, if you want to get a license on a
8 royalty-free basis from everybody else who is signing on
9 to the standard, you also agree to grant a reciprocal
10 license.

11 So, I've been involved in advising people on a
12 broad range of issues having to do with both these kind
13 of informal SIGs as well as the formal standard setting.

14 MR. FARRELL: I'm Joe Farrell. I'm an
15 economist and I've been working on the economics of
16 compatibility and standards since the early 1980s. At
17 first, thinking primarily about de facto standards,
18 bandwagon effects and the like, and then in the mid or
19 late '80s, getting interested in formal standards as
20 well. The feature of the formal standards process that
21 emerged from my discussions with participants and from
22 just thinking about the problem as an economist was
23 primarily the role of vested interests in creating
24 bargaining delays in adoption of formal standards, and I
25 view that as kind of a cousin to hold-up because the more

1 we're going to discuss -- have arisen. They've been
2 extremely infrequent and that increases my interest. The
3 infrequency of the problem increases the interest in kind
4 of a direct proportion to the subject matter of this
5 discussion.

6 MR. THOMPSON: I sort of backed into handling
7 the standards at Texas Instruments. I'm responsible for
8 all of our standards organizations worldwide, our legal
9 aspects of participation, and one of the things that --
10 we had a teleconference on all of this and Scott Peterson
11 had raised an interesting issue with me. It was a
12 perspective issue. Scott and I don't necessarily see
13 eye-to-eye, which I think will come out some today, but
14 it may be because of the way we look at things a little
15 bit differently.

16 You know, from a licensing standpoint, I really
17 view the history of TI as three sort of eras, and
18 basically, it was the pre-'85 kind of era in which most
19 of the semiconductor companies -- and I'm only going to
20 talk about semiconductor licensing today. We've done
21 some others, but I'll just leave it at that. The general
22 feeling was that in the industry it was cross-licensing,
23 basically royalty-free, and it was portfolios. You
24 didn't worry about standards, particularly.

25 Yes, you did standards because you were selling

1 jelly bean parts and they had to all go on the PC boards
2 the same way, but there were not a whole lot of things
3 other than that. Systems were very complex and the
4 system integrators were the ones that were dealing with
5 system level issues.

6 Some of that changed around '85, and the reason
7 being is there were a lot of new entrants into the field
8 that were wanting to play the game without having spent
9 the R&D. In other words, in some cases, it became a
10 national priority for some countries to be in the
11 semiconductor industry and there were massive infusions
12 of cash, and since we were -- the people that were in it
13 had already made large investments, you know, there's an
14 inherent competitive advantage.

15 So, in the mid-'80s, things changed a little
16 bit to where we just tried to level the playing field.
17 There was still the same cross-licensing, it was still
18 basically the portfolio. You weren't so much concerned
19 about the standards issues because you never looked at
20 them. Those weren't part of your licensing strategy.
21 You didn't worry about that. But you did look at how
22 much exposure somebody had and, you know, money exchanged
23 hands.

24 The present generation is a little bit
25 different. Again, we're going through another

1 metamorphosis in the industry. We're looking at most of
2 the IP that we used to not have to worry about, it was
3 the system integrators' IP, is now moving onboard our
4 chips. We're no longer just a semiconductor company. We
5 sell software along with that, the support tools. We
6 provide reference designs. Basically, the end product is
7 basically wrap some plastic around it, put a display on
8 it and some batteries and you're ready to go.

9 Well, that exposes a whole different level of
10 exposure for the semiconductor company. Now, all that
11 system level stuff that we used to not have to worry
12 about because we sold parts that the system integrator
13 put together, all that's migrating down to a single chip.
14 We're having to take on the system level responsibility.

15 The consequence, we've looked very closely at
16 how do we need to change, whether there is something to
17 the ex ante discussions of licensing terms in order to
18 figure out how we handle the indemnification issues.
I'll tell you my bias right up front. Having looked at

1 connection issues for about 20 years. Like Joe,
2 actually, I also really starting thinking in terms of
3 competitive moves preemption, decisions about whether to
4 inter-connect or make your products compatible with

1 with other things I've been studying and working on
2 regarding the patent thicket, the increasing number of
3 patents, the fact that patents often are not applications
4 or pending patents may not be visible. So, these sort of
5 complex of problems that arises not just in standards
6 associated with patents can come particularly into this
7 arena we're talking about today.

8 So, that brings us right to the hold-up, the
9 sort of patent thicket, and how important those things
10 are when there may be a large number of technologies and
11 patented technologies that could read potentially on a
12 given specification or standard.

13 MR. WINSTON: Thank you very much. We clearly
14 have a lot of experience and various perspectives and
15 opinions represented here in the panel.

16 I wanted to just remind people to please speak
17 directly into the microphone, as Carl did an excellent
18 job of doing. And I guess for our discussion today, we'd
19 like to break things down into sort of three main areas
20 of discussion. The first part, we'll talk about whether
21 hold-up occurs and more about how much hold-up occurs and
22 how we can identify those cases. In the second section
23 then, we'll talk about whether these multilateral ex ante
24 discussions may be useful in mitigating hold-up where it
25 might occur and the relating antitrust issues there. And

1 then in the third section, we'll talk more about other
2 mechanisms that might be able to be used to mitigate
3 hold-up where it occurs, other mechanisms that may not
4 raise such antitrust issues.

5 So, moving on to the first section of the
6 discussion today, ascertaining the existence and scope of
7 hold-up in standard setting organizations and for the
8 purpose of this discussion, I think we'd like to assume
9 that we have a standard setting organization that
10 requires a commitment to RAND, to reasonable and non-
11 discriminatory licensing terms. And what we'd like to
12 explore are what potential remains for hold-up once a
13 company has committed to RAND, identify the potential
14 causes of hold-up and try to assess how much hold-up may
15 be occurring.

16 Before we launch into that, Carl Shapiro has
17 agreed to give us a brief definition of hold-up just so
18 that we all know what we're talking about, that we're on
19 a common ground here. For the record, too, he'll give us
20 a definition of what we're talking about with ex ante and
21 ex post in this context.

22 MR. SHAPIRO: I'm glad I get to give the
23 official definition. I guess I'm going to be stuck with
24 this for a long time.

25 **(Laughter.)**

1 MR. SHAPIRO: Hold-up, I think, is associated
2 with commitments or the expenditures of sunk costs. Let
3 me do it by way of example. I was involved in a case
4 relating to modems. Ex ante, we would refer to the
5 situation before the group of companies have fixed or set
6 a standard or committed to it. Ex post, after such a
7 commitment.

8 Ex ante, there may be, in that case apparently
9 were, a number of choices of different technologies or
10 specifications to build into the standard. Ex post,
11 there then may be certain essential patents that are
12 needed, technologies or patents that are needed to comply
13 with the standard. So, the notion of hold-up would be
14 that ex post there are very few choices, and a company
15 that controls an essential patent is in a very strong
16 bargaining position to extract royalties or other
17 concessions from people who want to comply with the
18 standard.

19 Ex ante, the bargaining positions are very
20 different because, let's suppose, there would be maybe
21 lots of choices rather than what later would become the
22 essential patent. In addition to the word "hold-up,"
23 opportunism is a word that's commonly used in the
24 relevant economics literature, at least, which is on
25 transaction cost economics, the notion that somebody

1 might wait, perhaps, until commitments were made and then
2 seek to extract a high royalty or might try to steer
3 things in a direction so that they would have an
4 essential patent but not have made a firm commitment ex
5 ante on the terms on which it would be licensed.

6 MR. WINSTON: Thank you. For the first part of
7 this portion of the discussion, I'd like to throw out
8 some general questions and have people respond.
9 Hopefully the conversation will just steer itself from
10 there.

11 For this first part, if we could talk about, in
12 practical terms, how does an IP holder hold up the
13 potential licensees for a standard, the licensees that
14 may want to adopt a standard? And what sort of
15 investments are licensees making in adopting standards
16 that may be held up?

17 MR. THOMPSON: I guess I'll take the first
18 whack at this. Interestingly, where I see most of the
19 hold-up coming from is from a fair bit of fear,
20 uncertainty and doubt in that somebody -- you know, the
21 rumor will start that somebody has IP in this area and
22 the engineers, who are the ones that are at these
23 conferences, tend to get very concerned because they've
24 heard, oh, this could be a big problem.

25 From a practical standpoint and what I see in

1 my industry and what I basically advise the engineers
2 that we have that go to these things -- we don't send
3 business people, we don't send lawyers -- is don't worry
4 so much about what the IP is that is going into the
5 standard or who has it. To some extent, we'll sort that
6 out at the end. For one thing, you don't know what the
7 IP is going to be. Most of these standards move fairly
8 rapidly. It takes much longer to get through the patent
9 office. So, yes, somebody might say, yes, I've got some
10 IP in there.

11 Sometimes the reason they're doing that is for
12 the counter-reason, it's not actually for extracting a
13 royalty, but to drive the technology in a different
14 direction. That technology may well be something that
15 he's got ready to go into production, and so, it's much
16 better to go drive somebody in the direction of where
17 he's already got a product or about to have a product
18 than into this other area, and the way of doing it is to
19 confuse it by saying, gee, I've got IP in this area.

20 You can play this street on both sides. You
21 can game it either way. As a consequence, I generally
22 tend to tell our people to pretty much ignore that. At
23 the end of the day, what I have to look at is go and try
24 to figure out what's the likelihood that I'm going to
25 have to be hit on a standard. Note that -- you know,

1 this goes back to the perspective issue.

2 When I do out-licensing, I do not even look at
3 standards. In fact, the one thing I don't like is having
4 a patent that covers the standard, which is sort of a
5 different view than most people. And the reason for that
6 is I don't have much bargaining leverage then. I'm
7 limited to, in most cases, a RAND situation. I do not go
8 in immediately for an injunction, which is where you have
9 the maximum leverage. My ideal thing is to have
10 something that's used, it's very good to have and it's
11 not a standard.

12 On the other hand, where I do worry about it
13 from the standard, is coming in. If there are other
14 players that are at the table that are large companies
15 such as myself, I can look at that and go, fine, I can
16 work out a cross-license with them on a portfolio basis.
17 I am not interested in licensing just that standard. On
18 the other hand, if it is an individual, I look at that
19 and go, well, that may be a tax on the industry, and I
20 you know, it doesn't hurt me any worse than anybody else.
21 Sometimes that gets gamed like some of the modem cases.

22 There you will see that game because what
23 everybody thought was happening was a large company --
24 and this was an ex ante discussion. A large company put
25 up, here's our rate. Everybody looked at it and said,

1 it's a large company, fine, we can cross-license. And at
2 the end of the day, that wound up going back to an
3 individual with no exposure, and a certain -- Southern
4 California District Court said, gee, because they had put
5 that out in front, that's good evidence that wasn't the
6 least bit anticompetitive. Totally missed what the issue
7 was. The issue was the fact that you thought it was a
8 large company, you could do a portfolio cross-license,
9 not a license for that individual thing, and it wound up
10 being an individual, no exposure.

11 So, it's a very difficult way of looking at it.
12 That's kind of my approach.

1 which is a somewhat amorphous term because you have to
2 look at the custom of the industry to figure out what's
3 reasonable and non-discriminatory, where if there would
4 have been a contest among people who -- or companies that
5 have competing technologies, you might have had a lower
6 royalty rate result.

7 I think that if you define the problem that
8 way, hold-up does occur. The big question is how often
9 does it occur and how often does it occur within the
10 standard setting body because there are very good
11 examples where the party exercising the hold-up did not
12 participate in standard setting and, therefore, really
13 didn't have any obligation to disclose anything, didn't
14 have an obligation to make patents available on
15 reasonable and non-discriminatory terms.

16 That latter problem is just a practical
17 problem. It's really not a legal issue. Nobody can
18 really do anything about it.

19 I've talked to a lot of people who work in
20 standard setting groups and have asked how often has it
21 been that somebody has come in and said, choose my
22 technology, the other guys aren't telling you what
23 they're going to charge, I'm disclosing to you right here
24 and now what I'm going to charge and it's a pittance, go
25 with me? And that is a context where the antitrust

1 concerns about joint discussions, that we've seen in
2 cases like Addamax or Soundview, simply don't come up
3 because anybody is free to come in and say, choose me.

4 There's a concern about legal exposure, it's
5 about the competitors who are participating in the
6 standard setting discussing, whether or not the terms
7 that are being offered are reasonable, and we can talk
8 about whether that ought to be an antitrust concern.

9 Anyway, the answer to that question is, yes, it
10 has happened, but it doesn't happen very often. And to
11 me, that suggests that maybe the problem is not as
12 pervasive as some people might think. I think that the
13 problem does exist, but companies that are engaged in a
14 contest to have their technology chosen have the
15 opportunity to go in and say, choose me and here are the
16 terms, I'm putting my cards on the table, choose me, and
17 that doesn't happen very often. It does happen.
18 Virtually everybody I've talked to has said, yes, I
19 remember in such and such a case that happened. But
20 that's far from the norm.

21 MR. VISHNY: I don't know if you're going in
22 order. I think what Joe has said would be a good time
23 for somebody who represents a trade association, as such,
24 to say something about hold-up.

25 I guess you can think of hold-up in several

1 ways. You can think of hold-up as being related to time.
2 You know, you hold up the adoption of a standard or you
3 hold up licensing for a period of time in order to
4 extract a fee that you might not otherwise be able to
5 extract. That would be hold-up.

6 I suppose that in every standard setting
7 activity there is a measure of hold-up. In this sense, I
8 mean, hold-up can be 10 minutes and it could be 10 months
9 or it can be one week because there are always delays
10 that arise in any process when two people have to come
11 together and carry on commercial negotiations. I don't
12 think anyone can attribute anything harmful, bad,
13 anticompetitive or wrong in the mere existence of some
14 delay that relates to the fact that somebody has
15 something that somebody else wants.

16 In terms of what actually happens in the
17 standard setting process, for TIA's standpoint, where we
18 have over 600 standards adopted, we have not even -- we
19 could not count the number of controversies we've had
20 over patents on one hand. I've seen problems come up
21 from time to time and they simply get resolved, and they
22 tend to get resolved in a period of delay that is not
23 extreme, not harmful and not difficult.

24 I've asked some other colleagues in the field
25 what their experience has been in terms of patent-related

1 problems that arise out of the adoption of standards. I
2 know that, for example, in the question of what is a
3 reasonable -- RAND terms, that ANSI has said that they
4 have not had any complaints of controversies arising out
5 of RAND. A representative of IEEE told me that they have
6 had no complaints. A representative of ATIS told me that
7 they have had no complaints. So, I guess when I say that
8 we have had less than a handful of complaints, we have
9 more than others, and what we have is indeed
10 insignificant. We have not seen this as a practical
11 problem.

12 MR. SHAPIRO: Yeah, I guess I differ a little
13 bit from what Paul just said in terms of timing and
14 how -- the question was, what are the sources of hold-up.
15 I think there are two. One is timing. It relates to
16 timing, but it's not what Paul said. I mean, of course
17 things are already slow. One of the problems with
18 standard setting is it's slow because it requires
19 consensus and so on and so forth, but I think that
20 relates to -- and, of course, people say, look, this
21 bargaining, there's nothing wrong with that, that takes
22 time. But the problem is, if people hide their
23 intellectual property and then the process proceeds and a
24 standard is set, and then they reveal it, it's not like
25 the whole group can then quickly change course.

1 about prices, there might be a large scale fainting that
2 would arise from the audience. It kind of assumes that
3 there is one kind of product that should be singled out
4 called intellectual property and there should be
5 discussions permitted, which in other contexts are
6 generally considered to be, per se, unlawful.

7 MR. WINSTON: If I could just interject one
8 thing and then we'll move on to Joe. For the purpose of
9 this discussion we're assuming that the intellectual
10 property has been disclosed and there has been a
11 commitment to license on RAND terms. I think we're
12 talking very much about sort of the fee hold-up that you
13 mentioned earlier, Paul.

14 MR. VISHNY: Well, we have, from time to time,
15 had people make commitments to RAND or people say they're
16 not sure they're going to make commitments to RAND. I'm
17 simply trying to say that we have sensed no practical
18 problem in the area.

19 MR. FARRELL: Well, I think -- let me jump in
20 there if I can. Trying to get back to the question that
21 we're supposed to be discussing which, as I understand
22 it, is how much hold-up is there. It seems to me pretty
23 clear that to the extent these standards organizations
24 have a role, it's because coordinating on choosing a
25 standard is difficult, and the fact that they often take

1 a long time and have trouble coordinating on standard
2 pretty much, I think, implies that they're going to take
3 a long time and have trouble coordinating on a switch to
4 something else if the so-called RAND doesn't look so
5 reasonable to them.

6 So, it seems to me that economic logic says,
7 pretty firmly, based on that level of description of the
8 situation, there's the prospect for problems happening
9 quite a lot. And yet, I think we need to take very
10 seriously what Paul Vishny had said, which is, you know,
11 there's a remarkable lack of complaints about these
12 problems.

13 So, how can we understand that? Well, one
14 possibility is there are mechanisms going on that make
15 things work out a lot better than my capsule description
16 says. Another possibility is that excessively high
17 royalties, in the sense that Carl sketched out, do get
18 charged but there's not a lot of complaining about that.
19 So, let's think about that for a moment. Is that
20 possible?

21 Well, what would be the point of complaining?
22 You'd have to think about what happens if somebody does
23 complain. I think it's also relevant to observe that to
24 the extent that the people paying royalties are competing
25 against each other and are all -- or believe that they're

1 happens if complaints do get lodged or what is going on?
2 I don't think we should just start by saying there's
3 obviously a problem, and I don't think we should just
start by saying there's obviously not a problem.

1 SDOs are not forums in which one goes for a resolution of
2 what RAND is, and they've made it quite clear.

3 Joe Kattan was mentioning the "choose me"
4 concept earlier. Why is it that people don't do that
5 more frequently? Well, in fact, there is an established,
6 I would say, almost culture, that suggests that that is
7 not acceptable practice because, in fact, when people
8 participate in an SDO, certainly the more formalized
9 ones, they're discouraged from even thinking about those
10 things. So, the idea that someone would go to the table
11 and say, listen, we think this alternative is the one

1 example, or other rules that could cure hold-up, would it
2 simply lose members, members that would flock to another
3 standard setting organization that had those kind of
4 rules?

5 MR. PETERSON: I think at the present there's a
6 sufficient disincentive for SDOs to adopt rules that
 address this issue more aggressively. There's such a

6

1 MR. THOMPSON: Let me go back a little bit to
2 something Joe was talking about earlier. You were
3 talking about, you know, it takes a long time to develop
4 these standards. Sometimes it does, sometimes it
5 doesn't. Usually the reason it does is because they're
6 developing the technology as they're developing the
7 standard. Hence, you know, having a bake-off of
8 technology on a regular basis or anything like that where
9 you say, okay, here's my technology and here's its price,
10 and the next guy going, here's my technology and here's
11 its price. From a practical standpoint, it doesn't work
12 very well because you're constantly having to make
13 different choices in there, and gee, if I had known this,
14 I would have gone back and done something else.

15 That's assuming that you even know at the end
16 of the day whether or not you're going to have a patent
17 on it. In most cases, because of the time delay, you
18 have no idea whether, A, there's going to be a patent
19 that covers it; or B, just because there's a patent on
20 that specific implementation doesn't mean there's not 50
21 other patents that cover it, and that's where you
22 generally have your problem. That is particularly true
23 in my industry. It's impossible to build a semiconductor
24 device that doesn't infringe 20 other people's patents.
25 You can't do it. Even if you come up with a new widget,

1 you're going to use somebody else's technology that's out
2 there that may or may not be part of it. Frankly, I'd
3 rather deal with the people I know in the room, you know,
4 deal with them later on than try to carefully steer
5 around their technology, because then I'm going to design
6 it squarely into somebody else's IP who wasn't part of
7 it. That happens a fair bit.

8 MR. FARRELL: Can I interrupt for a moment?
9 Where is this going? You say the choice among
10 technologies is time-consuming and difficult, but I'm not
11 sure how it's made a lot more so by including some
12 commitments about licensing terms at the same time.

13 MR. THOMPSON: The problem is, the commitments
14 that you make on the licensing has absolutely no bearing
15 to what you're actually going to wind up with at the end
16 of the day. And you've got a lot of engineers now
17 worrying about --

18 MR. FARRELL: So, you're saying there's no
19 mechanism to make a real commitment.

20 MR. THOMPSON: Right. There's no mechanism in
21 there because you don't know what your IP is going to be.
22 It may or may not cover what you wind up with then in the
23 standard. You say, fine, I'll announce that I'll license
24 this for 2 percent. Well, A, it depends on what 2
25 percent means. Is that 2 percent of the chip, 2 percent

1 of the system price, 2 percent of every time the consumer
2 uses it? Well, that doesn't help a whole lot because
3 everybody's presupposing what's going to happen in the
4 future.

5 You also don't know, at the end of the day, if
6 you've got anything there, and thirdly, there may well be
7 other things you have to trade with that. And so, it
8 winds up not being a practical discussion. And if I
9 start having to do this -- you know, now I've got to have
10 business people in meetings. I've got to have licensing
11 people talking about, gee, what are they going to do.
12 You know, our licensing people are rare beasts because
13 they're, first of all, an engineer, secondly, an
14 attorney, and they're able to handle both worlds. And
15 thirdly, they have to be a business person. That's a
16 rare breed. I don't have those to go around for 300
17 different standards consortia or standards bodies that
18 I'm in.

19 It's a very real cost to me to even consider
20 doing that, and that is going to be a major hold-up in
21 and of itself, trying to have these people available and
22 to factor that in.

23 MR. WINSTON: I think that we've gotten on to a
24 more practical consideration of, how would things like ex
25 ante discussions actually be implemented. For the

1 MR. KATTAN: I think I would agree to the
2 extent that there is a problem that people identify in
3 which -- in circumstances in which there may be a
4 participant in the standard setting process who may be
5 championing an alternative standard or indeed a
6 proprietary standard and tries to hold up the process
7 literally in a temporal sense, to delay the adoption of a
8 standard by raising all sorts of technical objections and
9 trying to slow down the process.

10 Again, I don't necessarily see that as an
11 antitrust issue, but it is a problem that people do
12 encounter in standard setting. That's one of the reasons
13 that people sometimes tend to gravitate toward the SIGs
14 that I talked about earlier, because those types of
15 organizations tend to be less encumbered by the kind of
16 procedure that would allow somebody to hold up the
17 process.

18 MR. THOMPSON: I think it's, you know, similar
19 to what Joe and Scott were talking about here. I think a
20 very real issue there -- and it's one of the reasons the
21 consortia or SIGs, who you're talking to, came about, is
22 a lot of times it's a way for a company to push its
23 proprietary technology. And in that situation, yes, it's
24 very practical to talk about what the economics are going
25 to be ahead of time. Because you know where the IP is.

1 This person has probably developed it and now they're
2 trying to get in implementers of it to further that
3 technology. And everybody looks at it and says, is this
4 a good business deal or not and understands what it is.
5 It makes sense in some of those environments to allow
6 that.

7 But what really happens in there is it's
8 basically set from the beginning. It's not a mutual
9 discussion over what the price is going to be. The
10 company that's pitching in its technology is the one
11 that's going to tell you what it's going to be. You
12 know, here's what I'm going to charge, and gee, everybody
13 else, you know, I want to grantback or I want everybody
14 else to be royalty-free, the way in practice most of
15 those work today.

16 And they work fairly well. I mean, there's
17 nothing wrong with that. But that's already developed
18 technology. Most of the other standards -- and the
19 reason I go back to the timing and not knowing what it is

1 in the state of development, some of which have been
2 developed. But it's not a mechanism for just one company
3 to push its agenda. I don't think that's right.

4 MR. THOMPSON: There are several different
5 types of those, and yes, there are SIGs that operate just
6 like a more formal SDO, have similar policies and those
7 are carefully negotiated policies. I know because I
8 negotiated about two of those a week. On the other hand,
9 you know, there are other consortia that are set up
10 specifically to push proprietary technology, two
11 different things.

12 MR. PETERSON: I want to say something about
13 this complexity of license terms issue. In this problem
14 of licensing a patent that's essential to a standard,
15 fairness among those who are going to participate in the
16 marketplace, I think, is of particular concern. And, at
17 least, fees are a way to more readily make something, I
18 think, fair or at least understand fairness. The
19 opportunity for -- although people may enter into very
20 complex bilateral agreements when licensing patents
21 generally -- when that's the way a patent is licensed --
22 if that was the only way a patent was licensed for
23 practice of a standard, there's all kinds of opportunity
24 for anticompetitive effects to go relatively hidden in
25 these other terms.

1 I mean, so, for example, the grantbacks or non-
2 assert provisions have very widely varying effects
3 depending on the portfolios of the people that are
4 signing up, whereas fees are something that at least are
5 measurable and can be -- so, although I think, in
6 general, licensing can be very complicated, I think that
7 people should be free to enter into those complicated
8 licenses.

9 On the other hand, we should not assume that
10 that's the kind of license which ought to be the baseline
11 for the availability of a patent that's essential to a
12 standard.

13 MR. VISHNY: But I can't imagine imposing the
14 kind of license you think is proper or I think is proper,
15 calling it a baseline and kind of limiting to either
16 discussions or the activity.

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1 license? That makes a huge -- as you just pointed out,
2 that's hugely different for one company versus another,
3 depending on what they would have to give back.

4 What's non-discriminatory? If you have a fixed
5 fee versus a per unit fee? Very large versus small
6 companies? What do we mean by that? Reasonable, of

1 which an IP holder acquires additional bargaining power
2 through the SDO having completed its -- or gone a certain
3 distance in its standard option process. And the exact
4 form in which that bargaining power is then exercised may
5 not be tremendously important for the central point.

6 But let me make a rather fundamental point
7 about reasonable and non-discriminatory. I mean, my
8 instinct is much the same as Carl's, which is that it's
9 going to be very difficult to specify even what that
10 means. But I also think my understanding, at least, of
11 reasonable and non-discriminatory is that it's some kind
12 of an attempt to put a cap on opportunism or hold-up.
13 But I think it's not so obvious that that's the effect
14 it's always going to have.

15 Suppose you could define what reasonable and
16 non-discriminatory means, or more precisely, suppose you
17 could define what non-discriminatory means and you have a
18 hard time saying what reasonable means. It seems to me
19 you would be flirting with what I would identify as the
20 worst case for this kind of hold-up problem; namely,
21 vigorous competition in implementation of any possible
22 standard, so that the pass-through effect I was
23 mentioning before is at its strongest. Final demand for
24 the standardized product, is inelastic; in other words,
25 very little competition against the standard. A slow and

1 MS. GALBREATH: Joe, I really appreciate all of
2 your comments and they are ones that we are going to get
3 back to. But in the interim, I think what we would like
4 to do is to get to the antitrust issues that really are
5 the core of what we are looking at today, and then get
6 the RAND issues at the end of our discussion. So, I
7 really do hope that we will get back to what you've said
8 and get some comments and feedback on that.

9 Before we get there, however, for this part of
10 the discussion, we are going to try to assume that
11 licensing hold-up exists, that a standard has been set,
12 that it includes intellectual property, and that the
13 potential for licensing hold-up, in whatever form it
14 might come in, and, obviously, the fee issue is one of
15 those forms, but Scott has alluded to other types of
16 hold-ups as well in the licensing process.

17 There are, obviously, mechanisms that could be
18 used to deal with that hold-up, and among them are the ex
19 ante discussions, multilateral discussion of terms within
20 the organization. We've heard in our previous hearings
21 that a lot of bilateral discussions may be taking place
22 outside of standards organizations. What we're looking
23 at here today is those multilateral licensing
24 discussions.

25 The question before us, then, is to what extent

1 moral problem about this, but I see both a legal problem
2 and a practical problem.

3 From the standpoint of an organization
4 administering the standard setting process, I shudder to
5 think that we would ask our working group chairs to try
6 and define the rule of reason. I don't know that there's
7 any lawyer who would want to trust that to the people who
8 chair our committees, not because they are incompetent
9 people, not because they are unfair people, but because
10 they are unskilled and not prepared for the task.

11 Are there potential legal problems in a group
12 of purchasers of technology coming together to discuss
13 the terms on which they will purchase the technology?
14 You can also ask, is there any problem in any case where
15 a group of purchasers come together in order to discuss
16 the terms on which they will purchase a product? Is
17 there a difference between this product and every other
18 product in life? And I would suggest there is no
19 necessary difference between this product. It's
20 different, of course, but I can't say that it is
21 necessarily different from every other product in life.

22 I was thinking to myself that if buyers come
23 together to discuss this, the buyers could come together
24 and collude to fix the prices down, to lower the prices,
25 to the harm of the producer, which might benefit the

1 reasonable alternatives that are available to the
2 standard setting body, create the demand for that product
3 or for that patent. And in that context, to talk about
4 per se liability is to disregard the integrative effort
5 that takes place in developing the standard and in
6 creating the demand for the technology.

7 I don't know if it's proper protocol, but Gail
8 Levine wrote a wonderful article on B2B exchanges in
9 which she discussed this very problem. So, I don't think
10 that it's appropriate to talk about per se liability when
11 what you're effectively doing here is potentially
12 creating market power that otherwise would not exist and
13 then seeking to have a discussion that would constrain
14 the market power that you've created.

15 Whether or not standards organizations take
16 advantage of a more relaxed legal rule, I don't know. I
17 tend to think that most will not. But they ought to have
18 the opportunity to do so, at least in those circumstances
19 where it's their actions that is -- their action that is
20 creating the demand.

21 MR. VISHNY: I'm not trying to suggest that
22 there is always a per se liability involved in any kind
23 of a discussion and I'm not trying to say that there are
24 always antitrust risks in every discussion, but I do say
25 there are, at least, antitrust concerns in every

1 discussion because of the potential there for other kinds
2 of discussion, as well, and other consequences.

3 MR. FARRELL: Well, I think there are a couple
4 of things here. I mean, one is a concern that if you
5 stop telling the human participants in the standards
6 organizations, don't discuss business matters, then maybe
7 we'll get temptation to collude on prices downstream,
8 maybe we'll get temptation to do various bad things
9 because we're in this smoke-filled room.

10 I personally am a bit skeptical of that. I
11 mean, it seems to me -- I don't see why it should be so
12 much harder to tell participants -- instead of telling
13 them don't talk about prices and business matters, tell
14 them, don't talk about selling prices, don't talk about
15 market allocation, talk about trying to implement the
16 best technology available as cheaply as possible. But,
17 you know, that's a practical issue on which other people
18 may have different opinions or more experience than me.

19 It seems to me then -- I kind of like Scott
20 Peterson's discussion of the buyer monopsony issue. The
21 traditional monopsony issue of reducing the quantity
22 through depressing the price seems to me probably doesn't
23 arise. Something that does arise, I think in principle,
24 is under-rewarding -- the potential for under-rewarding
25 the innovator of the best available technology by

1 essentially executing a form of price squeeze and saying
2 we'd like to adopt your best technology, but we'll give
3 you a dollar for it rather than the X dollars that it's
4 worth relative to the next best alternative.

5 They could squeeze relative to the appropriate,
6 that is, ex ante reward as well as relative to the
7 inflated ex post opportunistic reward. So, the question
8 then becomes how likely is that kind of -- is that kind
9 coordinated buyer opportunism? I think it's hard to say.

10 My instinct is probably not that likely partly
11 because of this pass-through issue, which suggests that
12 where you have competing producers acting as the
13 negotiator on behalf of consumers, as it were, they have
14 an incentive not to bargain necessarily all that hard.
15 But that's going to vary. It seems to me in principle,
16 this could be a concern. It's going to be a question of
17 trying to judge how often and how large a concern it is,
18 relative to the other concerns.

19 I mean, I don't think we should allow ourselves
20 to stop with the observation that this could be a
21 concern. I think we have to try somehow to weigh it
22 against the other concerns that we're talking about.

23 MS. GALBREATH: Scott?

24 MR. PETERSON: I think that people take cost
25 into consideration when they're selecting standards all

1 the time. I think it's routine to consider that this
2 alternative will be more costly to implement than that
3 alternative. I think taking cost into consideration is
4 commonplace. However, this particular cost is one that
5 is somehow specifically excluded from the discussion and
6 consideration, and I find that curious and I think
7 unhelpful to the end of selecting the right standard. To
8 suggest that people don't take cost into consideration, I
9 think, that's just not my observation of the kinds of
10 standards that I see.

11 I mean, it doesn't come in -- this is a case
12 where the cost has particular kinds of business terms
13 associated with it and, therefore, has gotten special
14 treatment in the sense of being excluded from the
15 discussion and otherwise, I just find it curious that
16 it's excluded when, in fact, other costs are considered.

17 MS. GALBREATH: Scott, could I follow up on
18 that and ask, is it in your experience, and the
19 experience of the rest of the panelists, because the
20 consideration of cost -- and by that I take it you mean
21 all of the various terms and conditions of the license --
22 is something that people are negotiating bilaterally or
14 it because h5laomeenf op eTetAees

1 enforcers think about in terms of price where you're
2 talking about price fixing? Is that a distinction with a
3 difference or not?

4 MR. PETERSON: I'm talking about the concern
5 that one selecting the standard ought to have is how
6 expensive is it going to be for them and others to
7 implement this, and there are dollars that are associated
8 with that. I don't know what the term would be that one
9 associates with that, okay?

10 So, I think of it as inputs to this, and I
11 think of that as cost. So, the costs associated with
12 that are considerations. You might have a standard that
13 might require 10 times as many components and therefore,
14 is more costly, and that's clearly contemplated in the
15 consideration. If you have, as Joe was mentioning
16 earlier, the "choose me" opportunity where something was
17 clearly put on the table with a, yes, there's a patent
18 that's associated with this, the licensing terms will be
19 the following, people could take that into consideration.

20 There is too little of that happening both
21 because the information is generally not available
22 because the discussion stops at RAND without any further
23 detail, and to the extent that could play into the
24 conversation that the participants have among themselves,
25 there are, oftentimes, specific admonitions that they

1 should not take that into consideration.

2 MR. THOMPSON: I think there is nothing that
3 prohibits somebody from making a unilateral declaration,
4 here's what I'm willing to ante up my technology for.

5 MR. PETERSON: I think there are forums in
6 which that's specifically discouraged.

7 MR. THOMPSON: Yes.

8 MR. PETERSON: The aggressive participant,
9 perhaps, could do so, but I think -- for example, the
10 IEEE, I think, is very concerned about that and has
11 resisted being even in receipt of detailed terms. I
12 recall an affair -- this was outside the U.S. -- but ECMA
13 (phonetic), some specific experience with them where they
14 didn't want to see these or have anything to do with
15 them, notwithstanding the fact that the others who would
16 be actively considering this as it came up for vote, this
17 would be information that would be valuable to them.

18 MR. THOMPSON: I question the value of it, and
19 it goes back to what I said earlier. You know, you make
20 a declaration, here's what my costs are, here's what I'm
21 going to extract. Well, that's not necessarily what your
22 royalty is going to be. There's all sorts of other terms
23 in there. It depends on who it is. If the person has
24 absolutely nothing to trade, yes, it may be an upper
25 limit, but that also is not what -- if everybody thinks,

1 oh, okay, here's what this technology costs, that is also
2 not true because you're liable to have four other people
3 come knock on your door as well.

4 So, from a practical standpoint, you know, that
5 information does very little good for me. I look at who
6 is in that general area and I have to go look at -- you
7 know, balance entire portfolios against whoever is there,
8 what my costs might be, what's the potential for
9 litigation, how strong do I think their patents are going
10 to be, that kind of thing, and it all goes into a fairly
11 complex modeling.

12 MR. VISHNY: I don't have the benefit of
13 sitting in on working group meetings at TIA or anywhere
14 else. But from what I'm told, what I hear, is that
15 discussions -- private discussions outside of the setting
16 take place all the time, particularly when some
17 disclosure, however preliminary, is made and a claim of
18 IP, people sit and talk. They want to know what's
19 involved. They approach them and they even begin their
20 negotiations, which are sometimes concluded, sometimes
21 not concluded because you can have applications pending,
22 you don't know if a patent is going to issue. There is
23 so much that is unknown during the course of that
24 process. To treat it as if it were a conclusive
25 arrangement at that point is, again, an impractical

1 thing.

2 MR. PETERSON: But do we want to foster that
3 kind of behavior? I'm not sure that that actually is
4 more desirable. That these private discussions among
5 some of the individual participants is necessarily more
6 pro-competitive than having some sort of discussion that
7 a broader range of people can participate in. I see all
8 kinds of opportunity for participants to cut their
9 private deals on the side, and that isn't necessarily
10 desirable either.

11 So, there are challenges associated with
12 managing people's behavior. I don't think that pressing
13 the evaluation of this to bilateral discussions outside
14 eliminates the problem. I think it's susceptible of a
15 different category of problems.

16 MR. SHAPIRO: It seems to me there's pretty
17 clear consensus that there is a chill on these sort of
18 discussions currently resulting from antitrust fears. I
19 mean, you said that people would faint in the room if
20 they could talk about prices or commercial terms. Okay,
21 that's very chilly.

22 I think that the agencies can really make a
23 difference here by clarifying things so that that chill
24 is not so broad or deep. This, I think, kind of is going
25 to trickle. You know, if the agencies can say things

1 that and sort of a recognition and maybe statement from
2 the agencies, yeah, lower costs, that's a good thing,
3 that's pro-competitive and we do think those will tend to
4 be passed through to final consumers who are ultimately
5 kind of -- you know, who are interested in it.

6 MS. LEVINE: Carl, just a clarification
7 question. Are you talking about lower costs to the firms
8 who are collectively buying the intellectual property?

9 MR. SHAPIRO: Yeah, lower costs ultimately to
10 implement the standard and produce products, as a result,
11 making sure there's no hold-up, that the royalty costs
12 would be lower and, therefore, the marginal cost of the
13 product is lower and hopefully downstream that will lead
14 to lower consumer prices.

15 So, I would start there and nowhere near sort
16 of a per se rule when we're talking about trying to
17 prevent hold-up.

18 MS. GALBREATH: Carl has brought us really to
19 the point that we wanted to go next, which was the pro-
20 competitive or potential pro-competitive aspects of this
21 and to a point that Joe made a while ago about the pass-
22 through. The question that I would pose to the panel is
23 if there are pro-competitive efficiencies from such
24 negotiations, would those pro-competitive efficiencies be
25 passed through to consumers? And, how could we ensure

1 that they would be?

2 We've talked a lot about the possibility of
3 collusion in the last few minutes. Obviously, the flip
4 side of that is exclusion. And so, to begin with, we've
5 heard about how people do or don't participate. I think
6 that's an issue. And then the issue of pass-through.
7 So, I'll throw it open to the panel. Joe Kattan, I'll
8 turn to you.

9 MR. KATTAN: Let me just say one thing about
10 pass-through where I have to disagree with Joe and Carl.
11 Their position is royalties are passed through;
12 therefore, companies don't have an incentive to complain

1 be taken away from the notion that complaints are not as
2 frequent as one might suggest.

3 Now, suppose if you had an antitrust rule that
4 said that you are allowed, in the context of a standard
5 setting, to discuss the terms under which patents would
6 be licensed, or at least that there's a strong
7 presumption that that's pro-competitive, is the position
8 that Carl advocated and I tend to agree with, would it
9 make a difference?

10 I'm not convinced how big a difference it would
11 make because I think some standard setting organizations
12 are very, very comfortable having the antitrust
13 restrictions.

14 If you look at the comments that were filed
15 with regard to the FTC's Dell consent order, standard
16 setting organizations said, oh, my God, are you, FTC,
17 trying to impose on our process a duty of disclosure? If
18 you do that, it's going to drive away a lot of the
19 companies that have IP. So, if you give them that
20 latitude to engage in discussions, to allow disclosures,
21 indeed to require disclosures of IP positions, it is not
22 clear to me how many will take advantage of it and what
23 difference it will make. But clearly to the extent that
24 people do want to take advantage of it and have
25 discussions that result in lower royalties, I think at

1 least in the context of the industries that I'm familiar
2 with, you will have a pass-through to consumers because
3 the entire semiconductor industry is built around selling
4 you something that you already have. By convincing you
5 to buy something that you already have because the new
6 version is just so much cooler.

7 MR. THOMPSON: Well, that's the PC industry.

8 MR. KATTAN: And price considerations drive
9 everything. I mean, that's why we see these \$299 PCs.

10 MR. THOMPSON: Let me address the pass-through
11 and the cross-licenses. At the beginning this morning,
12 when I was going through the history of where licensing
13 had come from in TI, the situation that would be most
14 analogous was in the pre-'85 time frame where everybody
15 basically cross-licensed for very little money. You
16 know, the consumer benefitted greatly, or seemed to,
17 until companies started going out of business because
18 other people were coming in without having to have spent
19 the R&D. You know, yes, it's a new generation. Yes,
20 they have things to contribute in the future, but you
21 lose a lot at the same time. That was why there was a
22 period after '85 where it was leveling off the field, and
23 that's where royalties started being charged for that
24 same technology.

25 Yes, that got passed on to the consumer, but

1 the consumer benefitted because now even the people who
2 wanted to now play in this field were desperately trying
3 to make new inventions of their own so that they could
4 bring their royalty levels back down and that actually
5 encouraged innovation on both sides. So, you know, the
6 consumer, ultimately, benefitted.

7 Technology hasn't stagnated. That's the reason
8 the PC industry can keep selling you a new computer every
9 couple years. Sorry, Scott.

10 MS. GALBREATH: Joe.

11 MR. FARRELL: I think the topic has come up a
12 couple of times, but we haven't really focused on it.
13 There are two dichotomies in the way that royalty is --
14 or terms, in general, for licensing might be negotiated.
15 One is ex ante versus ex post and the other is
16 multilateral or joint negotiation versus bilateral
17 negotiation. The RAND rules seem to try to make it more
18 multilateral and less bilateral. The kind of first order
19 concern about hold-up that at least some of us started
20 out with suggests that there's a problem with doing it ex
21 post multilaterally versus ex ante.

22 The bilateral discussions that Scott was
23 suggesting might be sometimes frowned upon and sometimes
24 problematic are a way of doing it ex ante but
25 bilaterally. And it seems to me there are some real

1 questions, questions that I don't actually know the
2 answer to. What happens if you do bilateral ex ante
3 negotiation? Well, you don't have the hold-up problem
4 due to the commitment or sunk costs. You have this
5 strange negotiation where presumably the parties who are
6 perceived to be pivotal in the standards process get very
7 good terms, and parties who are not perceived to be
8 pivotal get much less good terms. And then you have to
9 think through, well, that generates some reward for the
10 innovator and it generates perhaps a rather asymmetric or
11 ex post lopsided market structure downstream. Is that a
12 good way of doing things? It's not clear to me whether
13 that's a good way of doing things.

14 So, do you want to deal with those problems,
15 which, as I said here, I don't really see how to analyze
16 very convincingly, or do you want to deal with the
17 problems generated by joint negotiation, in which case it
18 seems to me again, you know, still sort of where we
19 started. Logic suggests that ex ante is kind of better
20 than ex post to the extent that you can do it, and Earle,
21 I'm sure, has a good point that it's hard, perhaps, to
22 make these commitments, but you can try, and to the
23 extent that it doesn't generate smoke-filled room
24 problems or technology monopsony problems, which my
25 inclination is not to worry too much about that, but I

1 could be wrong about that.

2 MR. VISHNY: I have one concern, I guess. I
3 realize it's very hard to explain and, perhaps,
4 impossible to explain. First of all, I think RAND rules
5 tend to be -- give rise to bilateral discussions rather
6 than multilateral. RAND rules may impose on the
7 discussions kind of a common culture, if you will.

8 MR. FARRELL: That's what I meant.

9 MR. VISHNY: But the discussions tend to be
10 bilateral. Secondly, there is -- I don't know if I can
11 even define it, but there is reason, I think, to state
12 that RAND rules impose a kind of culture over the entire
13 standard setting process which works, and that the
14 exclusion of commercial negotiations during the process
15 itself also works. At least that's the experience we
16 certainly have at TIA.

17 The evidence that it works is the absence of
18 problems because we have highly competitive companies.
19 We have companies who go at each other with great
20 strength, with great vigor and with an awful lot of
21 ambition, and that's justified and, in fact, it's what we
22 want, I think, in our society and in our own culture.

23 The RAND rules act as an inhibitor in the
24 entire process of negotiations. There is the feeling
25 that somewhere out there there is somebody who can

1 ultimately judge the imposition of terms that might prove
 2 to be after the fact, if you will -- and that's what
 3 happens whenever you go to court, it's after the fact --
 4 that might prove you wrong. I think it has its effect,
 5 which is shown in actual practice.

6 Now, one can theorize that the actual practice
 7 doesn't disclose what is, in fact, taking place and that
 8 maybe something else is taking place, but that remains a
 9 maybe and not a certainty and a maybe which I think does

10 terminate the ND? ~~the ND~~ justify remedial action at this point.

the ND? 11

MR. SHAPIRO: Well, are you saying you tend to

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prefer the R part of RAND without the ND?

11 prey Iwerithe ND? MR. VISHNY: No, no, I prefer both. But noitR. ojuh.

1 that's the people who are negotiating for the
2 establishment for the creation of a standard don't know
3 what reasonable and non-discriminatory mean. But I'm
4 really trying to say, in other words, it's something that
5 Earle said, and that is that the people who populate
6 these committees are not the people who are skilled at or
7 who carry on commercial negotiations and imposing that
8 task on them is probably impossible.

9 At TIA, for example, we have an intellectual
10 property working group that meets from time to time
11 looking at our policies and our standards which are
12 consistent with those of ANSI -- we try to keep them
13 consistent, we think they are -- at all times. But we
14 come across a great deal of difficulty when we talk
15 about: who is it who sits in the room? What is it that
16 that person knows? What is it that that person is in
17 the position to disclose at any given time? To what can
18 that person commit? And we have a great deal of
19 difficulty in trying to find it. I think that becomes
20 even more complex when you go beyond the technological
21 terms of the standard setting process and into the
22 commercial terms.

23 MR. THOMPSON: One other point on is RAND an
24 empty term and what is it you've really agreed to. One
25 thing I mentioned earlier is I'd much rather have a

1 patent that's not part of a standard, and it's because
2 when I commit to RAND licensing, I just gave up my
3 injunctive power for a while, and that's a big difference
4 and a big lever. I have to know what scope of commitment
5 that I have made up front, and that's a very big deal.
6 That's one of the reasons I agreed every type of
7 consortia, SIG agreement or whatever, to know what that
8 scope is that I'm giving up potentially.

9 MR. SHAPIRO: I want to take exception, Paul.
10 I mean, it seems to me you said something about we
11 shouldn't impose the requirement that people have to
12 discuss these terms and conditions, and, Earle, you said,
13 oh, it would be so costly because you'd have to send all
14 these lawyers, I guess, are worth more than engineers or
15 something like that. I don't know exactly.

16 MR. VISHNY: You don't want to be so foolish as
17 to send a bunch of lawyers.

18 MR. SHAPIRO: Well, fine, or licensing --
19 business people who know about licensing. I don't think
20 anybody here is talking about imposing any such
21 requirement. We're talking about removing a bar or
22 taking away a chill. If all the companies say, look, I
23 can't send the licensing people, they're busy doing other
24 things, don't send them, nobody's making you send them.
25 We're just saying if you want to, and if you think it's

1 important, then you won't be prohibited from doing so.

2 So, I think that's just a red herring. I don't
3 buy that at all.

4 MR. VISHNY: I think what you say is, if you
5 want to, it won't be prohibited, provided you do it in a
6 way that's not antitrust, right? Is that what you say?
7 Or do you say that if you want to, it's not prohibited
8 and you can do it on any basis you want? Is that what
9 you say? And if not, what do you say? I have a lot of
10 difficulty with that.

11 MS. GALBREATH: One thing that we discussed in
12 the earlier session having to do with standards was the
13 fact that some of the organizations that we're familiar
14 with have gotten around to this question of RAND terms or
15 licensing terms by really requiring a commitment to open
16 or royalty-free licenses. And I'm wondering if anybody
17 has any comments about that as a fix to this problem. I
18 know it's one that we have explored, but is that
19 something that we should be thinking about as we're
20 throwing the rest of these issues into the mix?

21 MR. FARRELL: Well, I think that raises the
22 technology monopsony concern much more sharply than ex
23 ante negotiation, for example, would. I also think that
24 the way these things are often structured, they're as
25 duties on member participants. And to the extent that

1 that might create an incentive not to join, it seems like
2 that could be a real concern.

3 Now, again, coming back to Carl's observation,
4 nobody, I take it, is suggesting that that be a required
5 rule for all SDOs. So, if an SDO is very worried about
6 non-participation, it might choose not to adopt a policy
7 like that. So, to some extent, that's self-regulating.
8 But I don't think we've really thought through the extent
9 to which that's true.

10 MR. KATTAN: Let me disagree with Joe because I
11 think he's beginning from a faulty factual premise. The
12 way that the organizations that provide for royalty-free
13 licensing work is not by requiring members to commit up
14 front to royalty-free licensing. It is rather by
15 agreeing that there will be a license, which will be
16 royalty-free. If you want to take advantage of the
17 license and get a royalty-free license from all the other
18 members who agree to sign that license, then you have to
19 agree to give them a reciprocal license. So, it doesn't
20 create a monopsony problem, it gives you a choice. What
21 is more valuable to me? Getting a royalty-free license
22 from everybody else or paying everybody else the
23 royalties that they may ask for and at the same time
24 charging royalties for my patents. So, it's
25 fundamentally different from the kind of hold-up that I

1 think Joe is talking about.

2 MR. THOMPSON: I would have to strongly
3 disagree. There are some organizations that operate that
4 way. The vast majority of them do not operate that way,
5 that are royalty-free. It is a commitment the day you
6 sign that thing that any patents you have will be
7 royalty-free. In some cases it goes so far as to give a
8 third party the right to license your patents for you,
9 and that's a particular problem.

10 In my corporation, we have certain policies and
11 procedures and that kind of group requires very, very
12 high level signatures within the management chain. I see
13 those. I've got one on my desk right now I'm writing the
14 routing memo for. So, it is not just the ones that say,
15 gee, if you want to participate and enjoy the fruits of
16 this at the end of the day, then you need to grant the
17 license. Most of the ones I see start from the very
18 beginning.

19 MS. LEVINE: Joe --

20 MR. SHAPIRO: I don't understand the
21 difference. If everybody says they'll be royalty-free,
22 then it's reciprocal anyhow. So, it just seems -- I'm
23 not sure where we're going here. Plus by the way, Joe,
24 if I think I've got really cool stuff and you guys don't
25 have much, it's still a big concession, perhaps, to say

1 I'll offer my royalty for your piece of whatever, may
2 not appeal to me much. So, it's not symmetric,
3 necessarily, if we start with different technology
4 positions.

5 MR. KATTAN: But if you think that your
6 technology position is better than that of everybody else
7 and the value of what you're getting in return from
8 everybody else is not as great as what you've got to
9 offer, you don't sign. It's not an agreement that says
10 you must license your IP on royalty-free terms. It just
11 says, if you want to get a royalty-free license from
12 everybody else, you've got to cross-license them on
13 reciprocal terms.

14 MR. SHAPIRO: I guess it would be helpful if
15 you could participate without signing. That's a
16 question, whether you can't even participate, then you've
17 got a stronger situation where even to come to the table,
18 you have to give up any claims. That gets more into the
19 -- that's the area where, I think, as Joe said, you might

1 just hear what's going on, you have to agree that it will
2 be a royalty-free license.

3 MR. KATTAN: So --

4 MR. THOMPSON: Where you really get a problem
5 is in the -- sometimes what you will see being set up is
6 that that is, for all practical purposes, the buyer of
7 the technology, who may actually have developed something
8 there, but they are the ultimate buyer, it's setting up a
9 consortia or whatever, and if you want to participate in
10 this in order to sell to this buyer, you are agreeing
11 that it's going to be a royalty-free. That lowers the
12 buyer's costs significantly.

13 Now, what does it do as far as whether or not
14 you participate in it? You have to make a decision at
15 that point, are you going to want that business and is
16 giving up your IP worth it? In some cases, the answer
17 will be yes. It's a business call. But that situation
18 does very much exist.

19 MR. PETERSON: So, I think that this idea of
20 royalty-free licensing is, in fact, implemented in a lot
21 of different ways, as is illustrated here.

22 MS. GALBREATH: I think so.

23 MR. PETERSON: And that's my experience, that
24 it actually is implemented in a variety of different
25 ways. I don't think it is a solution to anything in

1 particular. There is the concept of we would like maybe
2 to have free licenses here as something that might become
3 implemented in some kind of a larger plan or policy. It
4 can be implemented in a variety of different ways. Its
5 utility, I think, varies quite radically from technology
6 or type of standard to another.

7 So, I think there are some for which the
8 likelihood that there is an essential patent that you --
9 or a patent to which the standard really would need to
10 have a license for some reason, there's some standards
11 for which that's a much lower probability than others,
12 and for some, where this patent landscape is loosely
13 populated, shall we say, in the sense of likelihood of
14 patents that you're really going to need to be essential,
15 you have a higher -- that would be one indication that
16 maybe there's a higher probability that you should strive
17 for something that is actually RF because in a sense what
18 you're doing is you're trying to look possibly for the
19 unpatented solution or if there are patented solutions,
20 if it turns out that there are unpatented alternatives,
21 it may be that the proponent of that may be just as happy
22 to grant a free license.

23 So, I think there are some patent situations,
24 there are some kinds of technologies where it plays a
25 very useful role and people focus on it, and yet, there

1 doesn't really matter what rule you have because if you
2 have a rule that says they're forbidden, it has the same
3 consequences as if you have a rule that says they're
4 allowed, if they are meaningless.

5 So, we've got to focus on the cases where it
6 does mean something. It seems to me then, in terms of
7 the framework that Scott laid out in his written
8 submission and that Carl and I have talked about, and
9 others have talked about, ex ante makes good sense
10 provided -- and now this is sort of using the stripped
11 down economic theory of the situation -- provided that
12 the standards body doesn't take an aggressive negotiating
13 position, but rather says, let's ex ante compare the
14 terms that are being offered by the different technology
15 proponents and we'll choose the best one. That way, the
16 technology proponent with the best technology can get to
17 choose a RAND corresponding to its technological
18 advantage which is, broadly speaking, the right reward
19 for that innovation.

20 Now, whether there's a good way to implement
21 that in practical terms without allowing too much -- and
22 maybe it's not an issue but maybe it is an issue --
23 without allowing too much of the, well, we're the
24 standards body, we have the power, we'll give you a
25 dollar for your patented technology. It seems to me

1 that's the core issue.

1 think, many around this table agree is desirable, the
2 market will pretty much decide whether that's an
3 efficient solution. And it may not be a one-size fits
4 all solution, it may be a solution that works for some
5 standard setting, it doesn't work for others. My gut
6 feeling is that in the overwhelming of cases, the SSOs
7 will choose not to make use of the freedom that they're
8 given if you lift the antitrust restrictions. But to the
9 extent that some do and it results in negotiated
10 royalties, I think that's all for the good.

11 MS. GALBREATH: Certainly, from the rule of
12 reason perspective we look for innovation enhancement or
13 some kind of efficiencies that are passed on to
14 consumers, and so, those obviously would be things that
15 we would be interested in hearing more about as we go on
16 and finish up the morning.

17 We should turn now to what reasonable and non-
18 discriminatory means. We've had a little bit of a
19 preface to that and I'd like to go back there for a few
20 minutes. In particular, I noted that in the recent
21 Microsoft decision that we, at least, had one or two
22 lines from the judge who indicated that reasonableness is
23 an objective standard, a quotation from a Supreme Court
24 case from 1992.

25 I'm wondering if that is the case or if that's

1 the consensus around this table, that reasonableness is
2 an objective standard, and if it is, what would be the
3 indicia of reasonableness if we're looking at RAND? And
4 then going to the flipside of that, what does non-
5 discriminatory mean?

6 MR. SHAPIRO: Well, far be it from me to
7 overturn the Supreme Court, but come on. Would you agree
8 to buy a house and we'll figure out the reasonable terms
9 later after we move in? I mean, it just doesn't work,
10 okay?

11 Now, it may work because of reputation or it
12 may work because in some cases there are a lot of close
13 examples that give a clear benchmark, but it's -- I don't
14 know what objective means. I mean, to the economist,
15 it's just asking for trouble, I guess, put it that way.

16 Now, again, I'm hearing -- you know, there's
17 some, I guess, lack of -- we're not sure how often this
18 is really a problem. We've heard that there's not a lot
19 of big complaints. We know there are some number of
20 cases where it really gets litigated and it's a big
21 dispute. I know that from personal experience. Other
22 people do, too. But, you know, lawyers may like the term
23 "reasonable," but I think economists less so.

24 Non-discriminatory -- I mean, I mentioned this
25 earlier, maybe I'll slightly repeat myself. You know,

1 it's really not clear what that means. That's something
2 we're more familiar with in terms of, you know, price
3 discrimination and, you know, I've seen situations where
4 the small companies, the small licensees or producers
5 will say, well, you know, it's really discriminatory that
6 everybody pays the same fixed fee because I don't spread
7 that out over very many units. Of course, the big guys
8 say, well, it's really discriminatory I have to pay more
9 in total because it's per unit. So, what do we mean
10 there?

11 Again, grantbacks -- and this does not just
12 come up in standard setting. It was discriminatory to
13 ask everybody to give some sort of cross-license for
14 stuff that reads on the standard when some people have a
15 lot of IP, other people don't.

16 I'm not going to give you some definition.
17 There are economic definitions of discrimination. My
18 point is simpler, which is, these terms don't have enough
19 precision unless we either -- specific standard setting
20 bodies define them. I don't think we should be defining
21 them uniformly for all standard setting organizations.
22 But, we should allow them to do so themselves so they're
23 meaningful in a context that works within the companies
24 and technologies with which they deal.

25 MR. VISHNY: Well, I'm burdened by the fact

1 that I'm a lawyer. But, you know, when something like
2 the U.N. convention and the International Sale of Goods
3 or other codes say that if two parties to a transaction
4 fail to set a price, it should be a reasonable price, and
5 the world manages to live with that. Not only judges,
6 but business people manage to live with that. They know
7 there is potential for conflict, but they manage to live
8 with it.

9 Is it therefore necessary to define it with
10 precision? I think not. I think there is good policy
11 behind the acceptance of the word "reasonable" in certain
12 settings. And I can understand why an economist would
13 have difficulty with it. It lacks a certain precision
14 clearly. But it's used and it's used by reference to
15 community standards, to standards in an industry, to the
16 going rate, if you will, to how something is traded at a
17 particular time on the market. But it can ultimately be
18 defined.

19 Do I think an agency should define it? I
20 really think not because I think what is reasonable and
21 what is not reasonable will vary in many cases in many
22 different ways.

1 panel?

2 MR. VISHNY: I understand the difficulty.

3 MR. PETERSON: The example that you gave,
4 though, about the use of reasonableness, that's an
5 exception case. That's applying this loose term in the
6 case of exceptions. Here, we're talking about
7 reasonableness as being the way that business is done and
8 I think that that's quite different.

9 MR. VISHNY: I think it's not more exceptional
10 than the way business is done because we've had as little
11 trouble with it in the standard setting arena than we
12 have in other commercial transactions.

13 MR. FARRELL: But aren't we talking here not
14 about whether reasonable sometimes work, but about
15 whether it would be okay for a set of parties to a
16 transaction to define things more precisely? And if you
17 look at the world of ordinary commerce, sometimes people
18 will leave prices undefined, but very often they will
19 nail down exactly what the price is. I think we're
20 talking here about whether it's okay for people in this
21 context to do that, not about whether reasonable ever
22 works.

23 MR. VISHNY: I don't think I would want to say
24 that it's never okay for people to sit down and do that.
25 I don't even believe that that's the issue. I think I

1 would support, in our context, in the standard setting
2 with which I'm familiar, I would strongly support the
3 rule that we have because anything else is so highly
4 unworkable and impractical in that setting. I can't
5 speak for others.

6 MR. KATTAN: You know, to my knowledge, there
7 have been only two cases in which a company has sued
8 somebody and said, you promised to license me under
9 reasonable and non-discriminatory terms and your terms
10 are unreasonable. There could be two possibilities here,
11 maybe more than two, but then I'm not sure which they
12 are.

13 One is that the term "reasonable" works
14 reasonably well and that's why people haven't taken a
15 shot at suing somebody, or at least asserting it as a
16 defense, you know, an estoppel defense.

17 The other possibility is that the term is just
18 so amorphous and has such wide latitude that people say
19 it's not worth my time. And I'm not sure which it is,
20 but the paucity of lawsuits that have been brought,
21 particularly given that one of them was quite successful,
22 suggests to me that maybe the problem is not as pervasive
23 as one might think.

24 MR. THOMPSON: I have to agree with that, also.
25 I don't think the problem is very pervasive. If a

1 royalty, at some point, is not considered reasonable by a
2 company, they make a choice at that point, you know, from
3 a practical standpoint. They decide, okay, I won't be in
4 this business or I will pay the price today and find some
5 way of getting it down in the future or changing the
6 standard, and that happens a fair bit. You find
7 standards come and go over time for a variety of reasons,
8 not necessarily because it's better but because the cost
9 of implementing it because of the royalty may have been
10 higher. That's where a lot of these special interest
11 groups that Joe has talked about come from.

12 You have competing things right now. For your
13 wireless laptops, you know, there's about four or five
14 different competing standards. Each one of those would
15 work. Which one will win in the end? I don't know. But
16 some of that is based on the royalty rate, some of it's
17 based on the implementations.

18 I don't really think that, you know, while RAND
19 is a very uncomfortable sound in many respects, in
20 practice, it hasn't worked out to be that big a problem.

21 MS. GALBREATH: Before we finish what I'd like
22 to do is turn it over to the panel and if they have any
23 questions of one another, it would be a good time to get
24 those questions out, and I guess lacking that, what we
25 would like to do is go around and give each of our

1 panelists an opportunity just to sum up what they feel
2 have been the most important and salient points of the
3 morning.

4 MR. KATTAN: Let me just raise one question
5 because I see Danny Weitzner in the room. His
6 organization has a policy, as I understand it, that says
7 we're not going to incorporate anything that's patented
8 into a standard, and that's, in a sense, a policy that
9 says we're not going to pay anything for a technology
10 even if that technology has merit. I think that people
11 are generally comfortable that that policy, which if I
12 wanted to use pejorative antitrust terms I could come up
13 with terms like "boycott" and whatever, it's a reasonable
14 one.

15 And I've never heard a suggestion that that
16 kind of policy -- if we're going to try to go for the
17 lowest cost alternative, which means we're not going to
18 take anything which is patented, is a reasonable one.

19 MR. FARRELL: What was -- I think the ASSE case
20 said that wasn't reasonable.

21 MR. KATTAN: Well, no. What the ASSE cases
22 basically said is that if you have a policy that doesn't
23 enable somebody to comply with a standard because -- the
24 ASSE case was an exclusion case rather than a collusion
25 case. It was not a compatibility standard. Somebody

1 said, I want my product to be certified as safe, and the
2 ASSE said, we're sorry, you have a patent on it, we're
3 not going to certify it. That was exclusion, not
4 collusion.

5 MR. VISHNY: But it's still an antitrust
6 concern, the exclusion, or can be.

7 MR. KATTAN: Yes. But the context of those
8 organizations that say we are trying to adopt
9 compatibility standards, which is really what we've been
10 talking about today rather than safety standards that do
11 not require us to pay any royalties. So, if anybody's
12 got a patent, we're not interested unless we can have it
13 for free. Is that a problem? I don't think anybody --
14 well, I guess I'll pose it as a question. Does anybody
15 think that's a problem? I don't, and if that's not a
16 problem, then why is it that discussing the terms under
17 which you would license becomes a problem?

18 MR. WEITZNER: Could I, just for the record,
19 say we are considering such a policy. We have not yet
20 finally adopted such a policy. But thank you for raising
21 the question.

22 MS. LEVINE: For the record, that speaker was
23 Danny Weitzner of the W3C.

24 MS. GALBREATH: Do any of our panelists have
25 anything more to say about that?

1 (No response.)

2 MS. GALBREATH: Then, perhaps, Scott, if you
3 would like to begin summing up and we'll just let people
4 go in whatever order they wish.

5 MR. PETERSON: I just have one, not really a
6 sum-up, but sort of one point to make, and that is we've
7 struggled a little over what's reasonable, what would be
8 discriminatory and so forth, and also, what's the
9 likelihood that there will actually be pass-throughs to
10 customers, what's the likelihood that there will be some
11 collusive effect that will result in agreement on larger
12 fees that ultimately get passed through.

13 In my view, the best way to attack all of these
14 nettlesome problems is to have broader participation in
15 the group that is looking at and considering and involved
16 in these licensing negotiations or whatever the process
17 is. The broader participation will likely shed light on
18 what is or isn't discriminatory because you will have
19 those people potentially at the table raising the
20 concerns about whether, in this context, that kind of an
21 arrangement is going to have a terrible effect on some
22 particular participant.

23 The pass-through -- we were talking earlier
24 about the difference between perhaps the established
25 players and those who may be new entrants or sitting out

1 on the fringe, and those are the ones whose participation
2 can work to cause the collective result to be a better

1 talking about these things and problems have arisen.

2 I guess in that sense, I would draw a parallel
3 to the discussion 10, 15 years ago about cooperative
4 research ventures, and there was this long discussion,
5 gee, are the antitrust laws preventing people from
6 getting together and doing cooperative R&D, and some
7 people said it wasn't a problem, other people said it was
8 a problem and per se, and legislation was passed and I
9 don't know that it made a big difference, but it seemed
10 to me it helped because to the extent people were worried
11 about it unnecessarily, those concerns were alleviated.
12 And we could do something similar here to let people have
13 these discussions if they choose to do so.

14 MR. THOMPSON: Going back to basically the last
15 question which was, you know, is there a chilling effect
16 by having this. Probably the answer is, at the moment,
17 would be no. If you were allowing ex ante discussions,
18 is there a chilling effect on it? Maybe not. But by the
19 same token, there may be. And the reason why there may
20 be is that, you know, from a corporate standpoint, I'm
21 not wanting to have my engineers going in there.

22 Now, as Carl had said, well, it's your choice,
23 you either make the decision you can go do that or not,
24 well, very quickly, it then becomes, well, we're not even
25 going to let you in the committee until you tell us

1 everything that's going on and you get sort of an
2 inherent peer pressure there where all of a sudden,
3 whether you like it or not, you're going to find out that
4 your people are there and you're going to have to do that
5 or you're not going to play in the business at all. That
6 is what bothers me.

7 At some point, you know, it's either going to
8 add to my cost, which, by the way, gets passed on to the
9 consumer at some point, or it's going to be we don't
10 participate in certain groups. To me, it's a major
11 longer term concern and I'm not sure if the thing that
12 we're trying to fix, which doesn't seem to be a real
13 problem, is worth presenting another problem down the
14 road.

15 MR. VISHNY: I'm grateful for the opportunity
16 by way of being able to come here and exchange views. I,
17 myself, have learned a lot and it's important to learn
18 where you differ, obviously, and why.

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1 anything.

2 I think the process works, it works well, it
3 works as efficiently as human beings can work. I
4 acknowledge that we have delays. I don't think the
5 delays, in general, are related to the problem we've been
6 discussing at all. Unfortunately, they're there, but not
7 because of this.

8 Also, I would not be in favor of a statement
9 that any discussion is automatically a violation of the
10 antitrust rule and exposes you to risk. I don't think
11 that's necessarily true, but I wouldn't be willing, in
12 advance, to lay down the precise circumstances under
13 which it would and would not. I think that's a call
14 that's exceedingly difficult and one which the judges
15 might not accept some day, and after all, they will have
16 the final say.

17 MR. KATTAN: I think it's important to
18 emphasize a point that Carl made earlier, which is we're
19 not talking about imposing anything on standard setting
20 organizations. What we're talking about is giving them
21 freedom to make a decision as to whether to allow
22 discussions of licensing terms. Some undoubtedly will
23 decide not to. Others might decide to do that and if
24 they see people like Earle walking out, decide that
25 that's too high a cost to pay, I think the market is

1 going to sort that out.

2 Now, the point that Paul made about judges, I
3 think, is an important one because it really speaks to
4 how big a difference you can make. I would certainly
5 agree with Carl that the rule that you ought to
6 articulate is one that says rule of reason with some kind
7 of presumption that ex ante discussions are legitimate
8 and pro-competitive. Whether that makes a difference, I
9 don't know.

10 Scott's company was involved in a case that was
11 a rule of reason case, Addamax v. Open Software
12 Foundation, that case lasted --

13 MR. PETERSON: Multiple times.

14 MR. KATTAN: And that case lasted how many
15 years, Scott? Five or six years, and the cost of --

16 MR. PETERSON: The residue goes on to this day.

17 MR. KATTAN: So, the fear of being embroiled
18 even in a rule of reason case, I think, is there.
19 Certainly those companies that don't want to have the
20 discussions take place, for whatever reason, maybe they
21 are more -- their IP halves who would like to collect
22 more royalties, are going to play into that fear.

23 So, you can make a difference, I'm just not
24 sure how big a difference you can make.

25 MS. GALBREATH: Joe?

1 that come out. I can also offer to finish it up on a
2 lighter note, if you'd like that. But people should
3 probably say their serious things first.

4 MS. GALBREATH: Well, I will just say thank you
5 to all the panelists this morning for taking the time in
6 coming and I will let you have the last word.

7 MR. FARRELL: Okay. Well, we've been
8 talking -- I've noticed that nobody has used the term,
9 but I think at some level we've been talking about
10 submarine patents and the like, and there's actually a
11 dispute which is perhaps illuminated by thinking about
12 the word "submarine." Those of you who know me well know
13 that I enjoy messing around with words. So, I'd like to
14 just take a minute to take a look at the word "submarine"
15 in a slightly unusual way.

16 Now, if you look at the word "submarine" it's
17 obvious that the last three letters are just kind of a
18 suffix, so I think we can dispense with those. Now, what
19 are we left with? We're left with this rather strange-
20 looking word "submar" and sometimes in this kind of
21 endeavor when you can't make a lot of sense out of
22 something, it helps to look at it the other way around.
23 So, let's look at it the other way around.

24 **(Laughter.)**

25 MR. FARRELL: Coincidence? I think so.

1 **(Laughter.)**

2 MS. GALBREATH: Thank you all very much for
3 coming and participating with us this morning, and join
4 us again this afternoon at 2:00, please.

5 **(Whereupon, at 11:46 a.m., the morning session**
6 **was concluded.)**

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AFTERNOON SESSION**(2:00 p.m.)**

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3 MR. SCHEFFMAN: Welcome. This is the final
4 session of the FTC-DOJ hearings on Competition and
5 Intellectual Property Law and Policy in a Knowledge-Based
6 Economy. I'm David Scheffman from the Bureau of
7 Economics. I'm joined by Frances Marshall from DOJ, Gail
8 Levine and Sarah Mathias from the FTC Office of General
9 Counsel.

10 Let me say, since I've done no work at all in
11 these hearings other than appear in this thing, the
12 people who did this at the FTC and DOJ really deserve a
13 tremendous amount of credit. This is probably the most
14 important set of hearings that have ever occurred on this
15 topic that are available, as they are transcribed, on the
16 web page. It's greatly contributed to learning, in
general, and to trtosof GeTp2et2

1 have been the critical sub-stand of input. There are
2 biographies available for the people. I'm sure the
 audience knows all the people, but I'll give them a short

1 where he focuses on antitrust issues, on merger and non-
2 merger matters, and biotech, pharmaceuticals,
3 diagnostics, defense, consumer products, and other
4 matters. Mike is an alum of the FTC where he was in the
5 Office of Policy Planning in 1997 to 2000 and also was an
6 Attorney Advisory to FTC Chairman Bob Pitofsky.

7 Barbara McGarey serves as Chief Counsel to the
8 NIH, the National Institutes of Health. Barbara has
9 extensive legal expertise on the funding and regulation
10 of the biomedical research enterprise, having served as
11 General Counsel to the NIH Foundation, Deputy Director of
12 the NIH Office of Technology Transfer, and as a litigator
13 with the Department of Justice representing the U.S. Food
14 and Drug Administration.

15 Janusz Ordovery, of course, is Professor of
16 Economics and former Director of the Masters in Economics
17 Program at NYU. Janusz is yet another alum former Deputy
18 Assistant Attorney General for Economics in the Antitrust

1 Justice.

2 Carl Shapiro is Transamerica Professor of
3 Business Strategy at the Haas School of Business at UC,
4 Berkeley, Senior Consultant to CRA, Charles River
5 Associates. Carl, of course, was also a Deputy Assistant
6 Attorney General for Economics for the Department of
7 Justice.

8 The agenda in these final panels are to clarify
9 some issues that have arisen earlier in the hearings.
10 So, it will be questions asked by the people at the table
11 here and interchange and discussion by the panelists. As
12 a procedural matter, at least what we'll start -- see how
13 well-behaved you are, but we'd encourage you to turn your
14 -- we'd say tent, but turn your name thing on its end if
15 you want to speak, and then we'll see whether that's
16 really necessary or not.

17 We're going to discuss four general topics
18 today, portfolio cross-licensing, grantbacks and non-
19 assertion clauses, reach-through licensing agreements,
20 and issues related to non-vertically integrated IP
21 holders.

22 So, I'm going to start with some general
23 questions about portfolio cross-licensing and I'm
24 interested in this general issue on all the topics, which
25 is, definitionally, what is it we're talking about, which

1 is not so ambiguous in portfolio cross-licensing, but is
2 in some of these others, we'll see if we have agreement
3 on what it is we're actually talking about
4 definitionally, and then what is the business purpose of
5 the practices we're talking about and what do we know
6 about the usage of such practices.

7 So, starting out with portfolio cross-
8 licensing, I put to the panel: what is the business
9 purpose behind portfolio cross-licensing? In what sort
10 of industries does this practice arise? Is this practice
11 becoming more or less common? Does it occur between
12 vertically integrated firms, between rivals? That's the
13 questions I would put to the panel to start off talking
14 about portfolio cross-licensing. So, who would like to
15 begin addressing these general issues?

16 Carl, since you've written about these issues,
17 do you want to start?

18 MR. SHAPIRO: Well, sure. First off, I think
19 it's -- in part, I think there's a pretty clear consensus
20 or understanding that portfolio cross-licenses are widely
21 used in certain industries, semiconductors, perhaps,
22 being the best example.

23 Just to define it and make sure we know what
24 we're talking about then, you know, particularly between
25 some of the large companies in that industry, whether

1 it's Texas Instruments or Hewlett-Packard or Intel or
2 IBM, licenses that go both ways, include a large number
3 of patents, maybe some carve-outs, maybe not, maybe some
4 field of use restrictions or something, maybe not, but
5 pretty broad, and typically apply not just to patents
6 that have been issued but patents that will be issued
7 through or applied for through a certain date. So, just
8 in terms of getting on the table what we're talking
9 about.

10 I mean, my view, I guess to maybe start the
11 discussion is, you know, certainly if you're talking
12 about cross-licensing patents that have already been
13 applied for or issued on royalty-free terms, it's a
14 wonderful thing from a competitive point of view. This
15 kind of allows companies freedom to design their products
16 and manufacture their products without royalty burdens in
17 a marginal cost sense.

18 And so, it can lead to improved product quality
19 and lower costs and less basically patent cloud and so
20 forth. I think that's sort of unambiguous, very
21 straightforward, including patents that haven't yet been
22 issued for some period of time, potentially could raise
23 some issues because you could say, well, if I do some R&D
24 and I come up with this patent, I've got to license it to
25 you, maybe my competitor. You might be worried that that

1 would reduce the incentives to innovate a bit because it
2 would be shared.

3 I think, again, certainly in semiconductors,
4 it's pretty clear that that's not been the effect, I
5 would say. And that because of the lags in patenting,
6 because of the patent thicket problems, the pro-
7 competitive advantages of knowing that you have this sort
8 of patent freedom, at least vis-a-vis a cross-licensing
9 partner, outweigh any possible concerns about stifling or
10 deterring innovation. Maybe other people don't agree
11 with that, but that's my position anyhow. That's what I
12 think I've observed.

13 So, at least before you get to royalty bearing
14 issues, there's a lot to be said, in a pro-competitive
15 sense, for these type of portfolio cross-licenses.

16 MR. SCHEFFMAN: Jeffery, I wonder with your
17 experience working for a major high tech company whether
18 you could share with us your perspective, the business
19 perspective about cross-licensing and the pluses and
20 minuses from a business perspective.

21 MR. FROMM: I certainly agree with Carl. I
22 think, amongst major corporations, it's pervasive in
23 certain industries, not just the integrated circuit
24 business, but the computing business generally has a lot
25 -- most companies participate in some sort of broad

1 portfolio cross-licensing. I think the business aspect
2 is -- certainly, within many corporations, H-P being one,
3 the number one criteria for getting patents is to provide
4 design freedom. Because of the mutually assured
5 destruction problem, in other words, evaluating other
6 people's portfolios for the first time is an interesting
exercise when long-neglected Ma

1 And that's the business they're in.

2 So, I think it's imperative for the health of
3 the industry that certain broad cross-licensing continue.
4 Usually, there's not a problem. Like I say, as Carl
5 said, most of them are forward going. Many of them are
6 not. Some are, some aren't. Some industries participate
7 in what we call capture periods, capture patents that
8 will issue or capture patents that will be filed in the
9 next three to five years. It's rare that they go further
10 than that, mainly because economics change.

11 My experience, as far as carve-outs, is carve-
12 outs are very common amongst many companies because there
13 are a lot of them in multiple businesses. In general,
14 the way those carve-outs kind of go is it's carve-outs
15 for businesses that the other company is not in yet, but
16 that they might want to get into so that the carve-out is
17 designed so that it doesn't enable the other company to
18 use your patents against you in a business that you are
19 already in and they are not in. That's kind of how the
20 carve-outs typically are arranged.

21 So, usually the carve-outs don't attack the
22 core businesses where they're competitors. So, if H-P
23 and IBM, for example, were to be interested, they
24 certainly wouldn't carve out -- personal computers
25 wouldn't be a carve-out because that would be senseless.

1 Why would you do such a thing because ultimately both
2 companies are in the PC business? But usually the carve-
3 outs are fairly broad field of use carve-outs with the
4 idea that you still have some patent power that you can
5 exercise against the other party if they decide to go
6 into a business that you're in and they're not in.

7 Usually, it's pretty balanced. Sometimes
8 there's balancing payments. Usually the balancing
9 payments tend to be just cash, frequently one-time
10 payments of cash, sometimes significant amounts of cash.
11 Once again, ongoing royalties on broad cross-licenses, I
12 guess I've never seen one of those. I guess they
13 probably do have them, but it's usually someone will do
14 an analysis that my portfolio is bigger than your
15 portfolio today and you owe me X million dollars. And
16 time will pass, it will be four years from now and the
17 capture period will expire and then they get to
18 renegotiate.

19 But the objective during that four-year period
20 was to prevent any continuing litigation over the patent
21 portfolios during that period so people would be able to
22 design products and ship them without the threat of
23 injunctions primarily.

24 MR. SCHEFFMAN: Thanks, Jeffery. Joe, do you
25 have a comment?

1 MR. FARRELL: Yeah. Well, let me try to be a
2 little provocative here. I'd like to suggest that maybe
3 we can view a forward-going portfolio cross-license
4 partly in the light of a private intellectual property
5 policy, that is to say two firms or a bunch of firms get
6 together and decide that notwithstanding all the well-
7 acknowledged advantages of intellectual property, it's
8 actually more pain and inefficiency and trouble than it's
9 worth. They'd rather have the design freedom than have
10 the incremental incentive to innovate. They'd rather
11 have the freedom from submarines and nasty surprises and
12 marginal royalties than have the incremental incentive to
13 innovate.

14 First of all, I find this a helpful way of
15 looking at broad forward-looking licensing practices that
16 kind of developing a private intellectual property policy
17 has between the parties. I think one can look at it as
18 so often in either an optimistic or a pessimistic way.
19 The optimistic way says in circumstances and in
20 industries where those trade-offs suggest that maybe it's
21 better to have a weaker intellectual property regime, lo
22 and behold, the market works and people can negotiate
23 their way to exactly that. You don't have to change the
24 law, you don't have to have an industry-specific law or
25 enforcement policy in the courts or anything. That's the

1 optimistic view.

2 The pessimistic view is, look, our intellectual
3 property policy is so messed up, so dysfunctional that
4 people actually go to the trouble of negotiating around
5 it because you lose your design freedom, you have all
6 kinds of trouble if you allow the default court-enforced
7 intellectual property policy to govern what actually
8 happens in the industry. And I think there's a certain
9 amount of truth to both the optimistic view and the
10 pessimistic view. To me, that's a way to frame the
11 issues that helps provoke concern and maybe thought.

12 MS. MATHIAS: I have a question. We've talked
13 about how beneficial portfolio cross-licensing is,
14 typically in the semiconductor industry, but there are a
15 wide variety of industries where patents are employed
16 outside as semiconductors. What are some of the factors
17 that we might want to consider where the portfolio cross-
18 licensing and other industries, where there may not be
19 quite as much overlapping, that we should look to and
think about in our analysisFru6d in5sn3216

1 licensing is an obviously very effective way to minimize
2 some of the dangers for firms making sunk investments.
3 In many industries, those are significant, and certainly
4 for semiconductors, they're potentially huge.

5 I think that on the negative side there's the
6 question of disincentives for future R&D. To me, the
7 main question then really becomes as to the scope or the
8 number of firms amongst which these cross-licenses have
9 been exchanged. I mean, in Japan, which I studied long
10 ago, it seemed that these cross-licenses for broad
11 portfolio patents had a way of making it very hard for
12 new firms to come in and overcome the patent thicket, a
13 concept that Carl so beautifully described in his
14 writings, because they had very little to negotiate.

15 The idea in Japan, at least when it still was a
16 fearsome worldwide competitor as opposed to a pushover
17 nowadays, it seems that the way it all worked was for the
18 leading firms in the industry, whether they were
19 semiconductor firms or automotive firms or whatnot, was
20 to agglomerate huge portfolios which they were swapping
21 with each other, but which they were unwilling to trade
22 with the outside players.

23 So, from my perspective, the concern really
24 would have to be whether or not these portfolios fence
25 off would-be entrants while creating the design freedom

1 and innovative capabilities for the existing firms. That

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1 may not like the rate because they want something for
2 nothing, and that's always an interesting discussion.
3 But, very rarely would it be cases, such as the ones you
4 discussed in Japan, where a group of large corporations
5 would just refuse to license newcomers. That's been my
6 experience.

7 Now, as far as the disincentive, I think that
8 actually turns out to be -- patent broad cross-licensing
9 tends to be an incentive because what it does -- to
10 future R&D because it's the small companies that have to
11 be -- I think big companies, let's assume they're
12 spending 7 to 10 percent of their gross for R&D. What
13 they have to protect themselves against is somebody
14 coming along and not spending anything towards R&D. So,
15 they want to be sure that the small company that is just
16 starting in the industry is spending its 7 to 10 percent
17 and getting its few patents. So, although you're a
18 company like H-P, you may have 20,000 patents. A small
19 company with only one or two patents is just as dangerous
20 just because of the way the patent system functions.

21 So, I think the way this actually works is
22 because of the potential for the cashflows to work back
23 and forth that encourages small companies to get their
24 own patents and do their own R&D investment. That's been
25 my experience. Usually there's one hit on a small

1 company. They take one hit for \$10 million and then they
2 very quickly start finding their own patents on their own
3 R&D. So, they only have to pay it once.

4 MS. MATHIAS: I have a quick follow-up question
5 for Jeff and then we'll go to Joe. Do you ever see or
6 had you ever seen exclusive cross-portfolio licensing
7 going on? Was that --

8 MR. FROMM: I've never seen that. I've never

1 to myself. And so, why would we worry?

1 with some of these things.

2 MS. MATHIAS: Carl?

3 MR. SHAPIRO: I also wanted to pick up on the
4 issue of whether broad portfolio cross-licenses among
5 large incumbent firms would somehow keep out little firms
6 or entrants who are very small. It seems to me one way
7 they might, I suppose, is because the two companies or
8 multiple companies who are engaging in these cross-
9 licenses have the design freedom and the freedom from
10 paying royalties and therefore, can make better, cheaper
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1 every now and then, not so much in the patent business.
2 We're talking general -- not just patents, but IP rights
3 generally. I mean, the Microsoft license agreement
4 provides mechanisms to get back patent licenses that
5 probably they couldn't get but for the fact that they
6 have a strong copyright and trade secret position -

7 So, the problem does exist that people do
8 essentially say, well, I have my -- I haven't seen very
9 much in the way of the problem that you talked about,
10 which is about a 20-year-old problem. I don't know why
11 it seems to have disappeared, but it does.

12 MS. MATHIAS: Janusz?

13 MR. ORDOVER: First of all, I don't want to be
14 understood as saying that I think these issues are major
15 problems -- I am all in favor of substantial cross-
16 licensing activities. I think they are decidedly
17 beneficial. I think that the question really, in terms
18 of formulating public policy, is how these activities
19 affect or impinge upon, if at all, the next wave of R&D.
20 I mean, what has been done is done. It's good to be able
21 to share it. We know that it's good to share existing IP
22 in many ways.

23 The reason I brought up these "small firms,"
24 which do not have to be small necessarily in terms of
25 their market capitalization, but in terms of perhaps

1 their portfolio of knowledge within a particular area
2 where there are potential competitors, where the question
3 really arises of whether or not these cross-licensing
4 strategies have the effect of stimulating or retarding
5 the next waves of R&D competition.

6 And I think to the extent that they have a
7 stimulating effect, then they add more to the benefits
8 than just simply making it more competitive in the
9 current environment. Adapting a more static perspective
10 fails to capture these benefits. And one would want to
11 know a little bit more about how cross-licensing can
12 retard the next waves of R&D competition. Then, of
13 course, they raise these kinds of concerns of the folks
14 here, that DOJ and FTC are well-equipped to think about.

15 So, my point really was that we need to worry
16 mostly about the dynamic effects, as Joe pointed. How
17 strongly do we feel about these portfolios of patents?

1 not like they all are per se pro-competitive. One can
2 use that term.

3 MS. MATHIAS: Rick, we're going to go to you
4 next, but I had a quick question I wanted to throw out as
5 well as we haven't really focused on the consumers and
6 whether or not these portfolio cross-licensings pass on a
7 benefit to the consumers or not. So, I wanted to throw
8 that out and see what. . .

9 MR. RULE: Before I deal with that, I guess --

10 MS. MATHIAS: And you don't have to deal with
11 that if -- I know you had another comment.

12 MR. RULE: Sure. The one comment I wanted to
13 make is -- and I want to raise some old economy issues,
14 but I wanted to first address Dave's question about hold-
15 up.

16 It strikes me that one of the reasons not to be
17 terribly concerned is if the cross-license is simply a
18 substitute for other consideration. I mean, if you have
19 an asset that has a certain value and the counter-party
20 to the transaction can either pay you cash or they can
21 give you access to their technology, since our system
22 works on the proposition that if you have an asset, you
23 are entitled to basically reap its value in terms of the
24 price you'd set. I don't think you would be terribly
25 concerned -- at least this group -- should be terribly

1 effect on price. And I think there are unique problems
2 in the high tech industry because of the various points
3 that Carl and others have made. But I do think that, you
4 know, potentially the big issue is -- and this really
5 goes to consumers in many ways -- are the restrictions
6 that come along with the cross-licensing and the pooling
7 and I see Mike nodding his head. Maybe that's something
8 that appeals to us lawyers more than the economists.

9 But it is something that oftentimes, at least,
10 as lawyers, when they look at these problems, are
11 particularly concerned about as opposed to the question
12 of whether to enter into that agreement, per se.

13 MR. SCHEFFMAN: Okay, we have a lot of things
14 to cover, so I want to move to the next topic, which is
15 grantbacks and non-assertion clauses. Now, this is an
16 area -- as some of the others were -- I think it's
17 actually particularly important for us to be sure that we
18 understand what we mean by these, by grantbacks and non-
19 assertion clauses and how they differ or are similar.

20 I wonder, Mike, could you start us off with
21 that?

22 MR. McFALLS: Sure. I think the basic
23 definition of a grantback is it's a licensing provision
24 in which a licensee agrees to license back, in some form
25 or other, some IP which may or may not be related to the

1 initial IP licensed, for some period of time, in some or
2 all parts of the world. And I think that there's a lot
3 of variety here, and the variations that you see in the
4 provisions play a significant role from an economic
5 perspective and less so from a legal perspective in
6 evaluating what the likely effect of a grantback could be
7 or would be.

8 So, you could have royalty-free grantbacks or
9 you could have royalty-bearing ones. As I said, you
10 could have unlimited grantbacks with respect to
11 geographic scope or you could have territorial and
12 national restrictions. You could have unlimited fields
13 of use in which to apply, if you're the licensor,
14 whatever innovations come back to you, or you could be
15 restricted to the scope of the IP that you're licensing.

16 Also, grantbacks may grant the initial licensor
17 a right to actually sub-license the invention back and
18 you'll often see that perhaps in patent pools where the
19 initial licensor maybe has a dominant or pioneering set
20 of patents and wants to coordinate licensing among a
21 bunch of licensees for a variety of economic incentives
22 that may or may not be pro-competitive, but probably
23 often are pro-competitive.

24 And exclusive or non-exclusive, the grantback
25 can say, you, as licensor, have the exclusive right to

1 practice, make, use and sell the invention. Not even the
2 initial licensee will practice it or it can be completely
3 non-exclusive whereby the licensee can go out and license
4 this invention, subsequently developed, to somebody else.

5 And one thing I forgot to mention at the
6 outset, usually these apply to perspective inventions.
7 If all we're talking about are existing patents that a
8 licensee may have, then it's probably more accurate to
9 characterize, although certainly not necessary from an
10 analytical point of view, these as cross-licenses between
11 a dominant patent holder and somebody who has some
12 improvements on it that they've already patented.

13 So, I hope that's a useful landscape. The
14 variations don't afford us much of a common vocabulary.
15 But they are some of the distinctions worth talking
16 about.

17 MS. BURTIS: And, Mike, do you equate an
18 exclusive grantback with an assignable grantback? Are
19 those two things the same?

20 MR. McFALLS: They can be. I mean, it can be
21 exclusive between the licensor and the licensee if it's
22 assignable or assigned. It's akin to an acquisition.
23 So, you have one instead of two being able to practice
24 the invention.

25 MR. SCHEFFMAN: Jeff, could you tell us briefly

1 MR. McFALLS: My understanding of non-assertion
2 clauses, and I've seen them principally in the
3 biotechnology field, is it's a way -- a convenient way
4 for people to be able to effectively give comfort to
5 somebody they would otherwise license. But they can't do
6 so, otherwise they might come into conflict with other
7 licensing relationships they might have.

8 So, instead of licensing somebody, you'll give
9 them a non-assert if you, for instance, face exclusive
10 restrictions in another licensing agreement and somebody
11 has not drafted the exclusivity broadly enough to prevent
12 you from giving a non-assert. Also, you can avoid MFN
13 provisions this way that may appear in other licenses.
14 They're actually very pro-competitive from that point of
15 view, especially when, after negotiating your initial
16 licensing relationships, you soon discover that other
17 people have potentially catastrophic patent blocks on you
18 in very high cost industries to enter.

19 So, people, quite often, will enter these as a
20 way of giving comfort and consideration for getting
21 something in return. Essentially you're saying, instead
22 of giving somebody an affirmative grant, you give them
23 perhaps a broader grant and say, within this field, just
24 as within a license, I'm not going to see you on patents
25 that I have today. And unlike grantbacks, it can be

1 incomplete in that context because we subsequently
2 learned that there are also a variety of collective
3 rights organizations in those industries in which people
4 exchange consideration in the form of money payments and
5 actual cross-licensing agreements.

MR. FROMM: The distinction -- by the way, I've

1 because of the difference in the nature of patents and
2 copyrights or patents and trade secrets.

3 MS. LEVINE: That suggests for us -- and I want
4 to ask you in a moment what your experience is with non-
5 assertion clauses because I know you've had extensive
6 experience with them, but does that question suggest that
7 there really isn't an analytical difference between a
8 grantback and a non-assertion clause?

9 MR. FROMM: I've certainly felt that way, and
10 every time I've been -- certainly when you sit down and
11 actually analyze the words, there's a difference, but I
12 think the effects are the same. Outside of the context
13 of exclusive licensing, I mean, certainly in the non-
14 exclusive field, I can't see any difference in the
15 effect.

16 MS. LEVINE: So, that's to say a non-exclusive
17 grantback has the same economic effect as a non-exclusive
18 assertion clause? Is that what you're saying?

19 MR. FROMM: Yes, yes, as far as I can tell. I
20 mean, the economists can show us a difference, but I
21 can't see any difference when I negotiate the agreements.

22 MS. LEVINE: Carl, just for the record, I saw
23 your head shaking there. So, is that a head shake of
24 agreement with this statement or disagreement?

25 MR. SHAPIRO: I guess there may be legal

1 differences of note, but there don't seem to be
2 significant economic differences. Of course, I was
3 really shaking my head because Joe Farrell was shaking
4 his head. And Joe is always right.

5 **(Laughter.)**

6 MS. LEVINE: I missed that. Well, Joe, what
7 was your view?

8 MR. FARRELL: Well, this whole discussion is
9 striking me somewhat in the light of different verbiage
10 for two things that differ from each other but are the
11 same across these categories. One is we give each other,
12 let's say, particularly royalty-free permission to use
13 one another's IP, that already exists. And the other is
14 we do the same thing for IP that doesn't yet exist, and
15 those raise somewhat separate questions, I think.

16 The first kind is, hey, this is a cross-license
17 relative to the traditional intellectual property
18 benchmark if everybody keeps their inventions to
19 themselves, and anything less restrictive than that is
20 good. This is great, right?

21 It gets at what Sarah was saying about, we
22 haven't talked enough about consumers. Consumers are
23 implicit in that statement that this is great.

24 Then any questions along the lines that Janusz
25 raised about, well, what if it's only to some insiders,

1 well, the traditional analysis would say, hey, anything
2 is better than nothing and the benchmark is nothing, so
3 anything is better. And then I had my concern about,
4 well, perhaps you really need to evaluate this in the
5 context of, are you blocking a safety value that ideally
6 shouldn't have to be there at all, but, in fact, does
7 have to be there.

8 And then the forward-looking ones raise the
9 issues that, again, Janusz pinpointed which is, what does
10 this do to incentives for future innovation? Now, it
11 seems to me if you have firms who jointly lack
12 significant market power reaching agreements on a
13 forward-looking basis, then I would put that in the box
14 that I suggested, that I sketched out earlier, that
15 they've decided that the default IP policy is
16 dysfunctional and they're going to work around it, and
17 you can take either an optimistic or a pessimistic view
18 of that.

19 If, on the other hand, they do jointly have
20 market power, then potentially you need to worry that
21 they've decided that the incentives for innovation
22 created by the default system may be good for consumers,
23 but very bad for them, and so that's where you'd get into
24 some hard core antitrust concerns, difficult ones, but
25 hard core ones.

1 product, maybe a new product, and that company is going
2 to enter into those agreements with a number of different
3 companies, it may seek a non-assert with respect to the
4 company that is licensing the product.

5 With respect to that company's existing patents
6 and, perhaps, future patents that relate to the product,
7 that is, the initial product that's being licensed,
8 because the initial licensor is concerned that this new
9 product could go out there, a licensee could take it,
10 knowing at the time that it took it that maybe it had
11 patents that essentially could block that product, it
12 could be asserted against that product. But if there's
13 not something like a non-assert, there's a risk that the
14 licensee takes the product, the product develops
15 significantly, there are a lot of sales, there are a lot
16 of third parties who get involved, and then that licensee
17 asserts a claim against the licensed product.

18 So, in a way, there is -- a non-assert can be a
19 guarantee to the licensor of the first product that any
20 intellectual property issue that exists at that time will
21 be surfaced by the licensee, because presumably if the
22 licensee is going to give a non-assert, they have an
23 incentive -- they're giving up a right that they think is
24 valuable to identify that to the licensor and say, hey, I
25 need to be compensated in this agreement as a result of

1 that. So, it facilitates some bargaining. It also, I
2 think, lowers some of the transaction costs that
3 otherwise exist.

4 It also, if you have a non-assert, although
5 this, I think you can deal with in a grantback as well,
6 and is dealt with in a grantback, is it encourages the
7 licensor of the original product to essentially provide
8 information and details that otherwise might be used by
9 the licensee to develop a blocking patent position or
10 something in the future, again, like a grantback
11 situation. A non-assert protects the original licensor
12 against that happening by giving the information. That,
13 I would say, is pro-competitive because it, in fact,
14 encourages that exchange of information.

15 And then, finally, it seems to me that if
16 you're in the first licensor's position, you may be
17 concerned about the third parties to whom you sell your
18 product or license otherwise. And to some extent, if you
19 generally engage in an effort to get non-asserts, you are
20 protecting those other third parties because if you write
21 the non-assert correctly, the non-assert can run not just
22 to the licensor, but also those who license from the
23 licensor, and you protect them against the hold-up
24 problem of a patent issue that existed at the time of the
25 original licensing, but that is sort of held back to sort

1 of spring on an unsuspecting licensor, but also other
2 groups of licensees and hold them up.

3 MS. LEVINE: You're talking about a
4 contributory infringement problem?

5 MR. RULE: Right, or it could be direct
6 infringement because let's say that the other licensees
7 take my product and then use it in some way or resell it
8 in some way, and arguably, if my product incorporated
9 intellectual property that infringed the licensee's, then
10 he could assert it against those sellers. There's also
11 some more complex issues, as I understand it, but I don't
12 claim to fully understand them, that sometimes are not --
13 you know, if I license you, my technology may not
14 directly infringe yours. But when used together with
15 something else, like another device, may actually create
16 an infringement that then some third party may run afoul
17 of and, again, a non-assert can kind of protect in those
18 situations.

19 MS. MATHIAS: I'd like to throw a question out
20 Janusz I noticed you had your tent turned up, so don't
21 feel like you need to answer it, but I also wanted to
22 keep the ball moving. Joe mentioned, I believe, that
23 what we partly need to be looking at is the market power
24 of the people entering the grantbacks and non-asserts and
25 how they come into play. And my question is, at what

1 point are we looking at their market power? Are we
2 looking at it when they enter the agreement or are we
3 looking at it later in the future when the agreement goes
4 into effect and they start maybe getting market power
5 that they didn't have originally when they were beginning
6 the licensing?

7 Joe, your tent's up, so I'll actually --

8 MR. FARRELL: Good question. I think my first
9 answer would be at the time that they enter into the
10 agreement. I guess an exception would be if it's
11 foreseeable that they're going to have more market power.
12 But if it's just something that happens and it wasn't
13 particularly foreseen, or it was foreseen only as a
14 possibility but not as something predictable, then I'd
15 say you probably shouldn't look at that, you should look
16 at basically what they could see when they entered into
17 the agreement.

18 Let me focus on this question of market power
19 for a moment because it's -- I think it's quite a
20 powerful technique. We've been talking, I think,
21 about -- largely about horizontal competitors, cross-
22 licensing so that they can produce and compete. And
23 there, as I said, I think one screen would be, do the
24 firms entering into this agreement jointly have market
25 power?

1 As so often is the case, there's almost a
2 duality or a flipping when you move to vertically related
3 entities. I think this may have been part of what Rick

1 back to these grantbacks and non-assertion provisions.
2 Maybe it's all legal mumbo-jumbo for me, but I always
3 thought when I first learned about these grantbacks in
4 school, that their purpose of it was to address the
5 difficulties in writing complete contracts or the
6 reasonably effective contracts related to the transfer of
7 intellectual property.

8 So, I can give you a piece of IP and it could
9 be valuable, it could be less valuable, who the hell
10 knows what you're going to do it with it, you're gaining
11 certain things -- information which is hard to pin down
12 in terms of its complementarity with whatever assets you
13 may have now or in the future. And therefore, in order
14 to sort of facilitate licensing downstream, I think a

1 other a certain degree of assurance that what has been
2 rightfully transferred to you or what I have received
3 from you will not then trigger, further down the road,

1 I mean, the IP licensing guidelines and the
2 merger guidelines, all these talk about different
3 markets. It will be interesting to figure out where
4 exactly we should focus our attention when we talk about
5 the market power filter.

6 MR. FARRELL: Yeah, I agree. That's a good
7 question, and I haven't thought about it enough. But I
8 would say to the extent that we're worried about the
9 impact on future innovation, which I think is the core
10 worry, as you identified, presumably the market is the
11 innovation market, and I know some people don't like that
12 phrase, but you can translate that, of course, into
13 product market terms if you want.

14 MR. ORDOVER: I think future innovation market
15 is a very good concept. I don't understand why people
16 have taken such umbrage to it.

17 MS. LEVINE: Let me see if I can shift gears a
18 little bit to talk about non-assertion clauses by
19 themselves instead of contrasting them to other
20 creatures. Talk about whether they can enhance
21 competition or impede it and their effects on innovation
22 as well. Jeff, maybe I can start with you -- not just
23 because your tent is up already and you've been wanting
24 to speak for a while, but also because I know you've got
25 concerns about the scope of a non-assertion clause and

1 what it can mean for competition and innovation, for that
2 matter.

3 MR. FROMM: Right, and I totally agree with Joe
4 that it can play in the market power concept. The only
5 problem I have is market power is so very difficult to
6 measure until the Supreme Court has spoken.

7 But I think you're right that non-assertion
8 clauses or grantbacks, for that matter, can -- that are
9 broader in scope or broader in duration than the forward-
10 going license are a problem because it would tend,
11 especially if the -- let's take the extreme where there's
12 a non-assertion provision, which, in order to get a
13 forward-going license to one patent I have to forgive,
14 for all time, any -- you know, I have to give you back --
15 agree not to assert any of my patents against you or any
16 of your customers or any of my competitors for all time.

 I mean, we can write a non-assertion provision.

1 sort of heightened scrutiny toward such non-assertion
2 clauses which are more extensive in either scope or
3 duration than the forward-going license. That there
4 might be an indication -- the fact that such a non-assert
5 even exists, it's maybe an indication that there is
6 market power by the original grantor. It's not proof of
7 it, but people wouldn't generally agree to it unless
8 there were something going on. So, I think there ought
9 to be heightened scrutiny whenever there is a strong -- a
10 significant difference in the grantback or the non-
11 assertion provisions in the forward-going licenses.

12 MS. LEVINE: Okay. Rick?

13 MR. RULE: The point I would make is I think
14 any of these provisions, whether they're grantbacks or
15 non-assertions, really almost everything we're talking
16 about or will be talking about, can be abused and they
17 can be correctly used, and I would simply say that the
18 antitrust laws generally have appropriate tools for
19 analyzing those sorts of issues. I mean, I think it
20 would be problematic if you saw a company insisting on a
21 non-assert in exchange for a license that was a non-
22 assert that was not only unlimited temporally, but
23 unlimited in terms of geographic or product scope.

24 And I think it would -- that's not to say those
25 deals don't get cut, but I think if an antitrust lawyer

1 looked at it, an antitrust lawyer probably would be
2 somewhat troubled by a provision like that. And it does
3 seem to me that -- you know, to harken back to an old,
4 but important, antitrust doctrine of ancillary
5 restraints, I think if you apply the notion of reasonable
6 scope and duration and reasonable necessity or connection
7 to whatever is being licensed, that is a way, I think, to
8 constrain the scope of non-asserts to their appropriate
9 limits. But I agree, you can abuse anything and you can
10 certainly abuse a non-assert if it's way too broad and
11 it's unconnected to the underlying licensed technology.

12 MS. LEVINE: Michael?

13 MR. McFALLS: I was with the front end of what
14 Rick was saying, which is I think antitrust has plenty of
15 tools in the tool kit to deal with something like this.
16 But I don't think ancillary restraint is really the
17 answer because it's hard to see exactly what the
18 restriction on competition is if you simply have a mutual
19 non-assert or even a one-way non-assert. I mean, I would
20 think the ancillary restraints is more appropriate for a
21 restriction on price or territories that could arise
22 between people who might compete in the absence of a
23 cross-license or something like that.

24 But in terms of looking at, say, a completely
25 over-broad, non-assert in a commercial sense, I mean, the

1 way you'd analyze it is say, what are the effects likely
2 to be on perspective innovation from the person giving up
3 the non-assert, and why is it significant in a
4 competitive sense that somebody else will be able to
5 function without the fear of infringing in another
6 product market?

7 I mean, intuitively, at a very broad level, it
8 doesn't seem to have an exclusionary or collusive effect
9 on its face, and I think the focus, again, has to return
10 to what's the actual effect going to be on the grantor of
11 a non-assert's incentive to innovate, and are they an
12 important innovator in the product market in which that
13 entry could occur, and are you going to lose product
14 differentiation or value to consumers at the end of this
15 long road. As a practical matter, that's what an
16 antitrust case would look like in one of those
17 provisions, just as it might with a grantback clause.
18 Otherwise, we have the field of patent misuse to deal
19 with things like this and infringement suits.

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1 hypertext because there are lots of links going all over
2 the place here.

3 **(Laughter.)**

4 MR. FARRELL: So, Mike, as I understood his
5 comment, was suggesting you would look at the likely
6 effects in the product market, you would look at the
7 likely effects in the innovation market, and that might
8 be a fine thing to do, but it strikes me it's probably
9 going to be hard. And a complimentary technique which I
10 think hews more closely to the economics and also to this
11 private intellectual property policy box that I'm pushing
12 around would be to ask the question, not what are the
13 effects in the product market, what are the effects in
14 the innovation market, how do we weigh them, which is
15 going to be difficult, but to say, all these things are
16 trade-offs. The off-the-shelf, default IP policy is a
17 trade-off, and any private IP policy that you see people
18 implement amongst themselves is a trade-off.

19 And then you'd ask the question, how credible
20 is it -- and you might demand a fair degree of
21 credibility or -- I don't know -- how credible is it that
22 these parties have really seriously wrong incentives in
23 making that trade-off. And you can, perhaps, get
24 somewhere on that inquiry by thinking about the market
25 structure issues and questions of market power and

1 complementarities and so on without some of the detailed
2 information that you might need in order to do the
3 separate product market and innovation market inquiries.

4 I'm not suggesting you shouldn't do the latter,
5 I think you should use all the tools available and all
6 the information available, but I think it's useful to

1 analysis to analyze what the scope is, what the duration
2 is. All of those things really do, if you think about
3 it, play into it.

4 And one of the benefits of the way the doctrine
5 has developed over time is it incorporates those notions
6 and it provides a mechanism for folks at the time, in the
7 field, to basically make some of those decisions. I
8 don't disagree that ultimately looking at market
9 structure and trying to analyze effects is ultimately the
10 goal, but I do think that all antitrust rules and all
11 antitrust policies have to be measured against how
12 effective they are practically in accomplishing those
13 results because of information problems that we confront,
14 not only at the time we license things, but also,
15 frankly, when you get to court.

16 MR. FROMM: I just want to say one other thing.
17 I think there's a timing problem with antitrust rules,
18 which is by the time -- I agree with Rick that if you saw
19 a grantback of the type that I hypothesized in the
20 extreme that antitrust counsel would advise you against
21 putting that in there. But I would also point out that
22 the licensor's antitrust counsel -- he could find
23 antitrust counsel that would say, sure, that's fine. By
24 the time the case, in the unlikely event that it ever got
25 to court, by the time that happens, it's 10 years down

1 the stream or it's five years down the stream and a lot
2 of water's gone under the bridge.

3 So, I think as far as this session is
4 concerned, I think it's useful to contemplate what kind
5 of rules we might promulgate or the government might
6 promulgate or suggest as to how you would run your
7 activity, and that's the reason why I tend to not focus
8 so much on definitions of market power, because, as you
9 said, if you try to talk to your client about market
10 power, they just roll their eyes and what the heck does
11 that mean.

12 But I think if you focus on the -- and maybe
13 it's a patent misuse question of, is the grantback or is
14 the non-assert provision significantly more extensive
15 than the forward-going. That should be your threshold
16 question. That's my preference that the government would
17 say that anything that goes beyond that -- and I don't
18 mean trivially beyond that but significantly beyond that,
19 that ought to raise big red flags, because ultimately
20 it's saying that there really is market power.

21 Now, where that line is drawn, who knows? Like
22 I say, the Supreme Court will tell us some day on any
23 given set of facts, but I think from a competitive
24 perspective, which we're trying to encourage competition
25 in the innovation markets, and I like Joe's innovation

1 market concept. I think that that's the market we should
2 be focusing on and we want to provide guidelines for
3 people who are trying to do the right thing, and people
4 are trying to do the right thing all the time. It's
5 sometimes people get overzealous. Often you get
6 overzealous if you've got a monopoly position. Why not?

7 MR. ORDOVER: That's the only time it's fun.

8 MR. FROMM: Well, that's the only time you can
9 really make a lot of money. You know, you've got to have
10 an illegal drug or something that's a monopoly, you know.

11 MS. LEVINE: Any response to Jeff's plea for
12 workable rules?

13 MR. ORDOVER: No, I think I agree because I
14 would say that while these slogans, you know, ancillary
15 restraint doctrine and all that, they all are very
16 valuable, but I presume if two lawyers across this table
17 were to apply the same doctrine to a particular set of
18 facts, unless they colluded ex ante, would probably reach
19 or could reach different answers as to whether or not
20 this is really ancillary to a particular licensing
21 setting or an attempt to reach a contractually
22 satisfactorily resolution to whatever issue is present.

23 So, I think it would be very important if, at
24 some point, one can actually come to some agreement as to
25 what the shortcuts might be, not necessarily the sort --

1 those red flags?

2 MR. RULE: Yeah, a couple of points I would
3 say. First, there has yet to be a perfect legal rule
4 that is understood and beyond dispute when you get two
5 lawyers together.

6 MR. ORDOVER: Or two economists.

7 MR. RULE: Otherwise, you'd put us out of
8 business and we wouldn't want that. So, the fact that
9 there are disputes and two lawyers can basically take the
10 same rule and come to different conclusions and argue
11 those conclusions, I don't think is necessarily a
12 condemnation of a particular rule. I mean, you know, the
13 merger guidelines are a perfect example of that, and I
14 think any sort of expectation or hope on the part of the
15 FTC or the Department of Justice that you're going to
16 develop those rules this time around, I think you
17 probably ought to set your objectives a little lower.

18 The second point I would make is that -- I
19 mean, personally, I find approaches like -- and I use
20 ancillary restraints because of reasonable necessity, but
21 there are other ways that one can explicate that. I
22 think at least the attempt that we made back in the '80s
23 was in the now defunct International Guidelines of '89.
24 But if you look at that you'll see a general sort of
25 approach to evaluating restrictions in intellectual

1 property licenses. But it's more, in the antitrust
2 vernacular, a rule of reason as opposed to per se.

3 And the concern I would have about what my good
4 friend Janusz just said is that it reminds me of the Nine
5 No-Nos from the early '70s. I think those of us old
6 enough to remember those Nine No-Nos in those days
7 recognize that they were far more problematic, generated
8 far more uncertainty, generated far most cost, I think,
9 to the system than did a kind of a rule of reason
10 approach that we've evolved to in the interim.

11 I would also argue that -- and I'll just make
12 this point quickly -- I think it's probably wrong to say,
13 well, that's not an antitrust problem, let's just look at
14 it under the misuse doctrine. I would refer anyone
15 interested in the topic to a speech that I still think is
16 probably the best ever given by the late Roger Andewelt
17 when he was a deputy in the Antitrust Division, who
18 basically pointed out that the misuse doctrine is
19 essentially an antitrust doctrine, and it kind of got
20 perverted along the way into a very bizarre doctrine.
21 And Roger really was sort of one of the first to advocate
22 bringing misuse back to its antitrust roots, and he
23 actually was pretty successful in that because the
24 Federal Circuit, in many ways, kind of followed him along
25 and I think had a lot of respect for him when he was a

1 judge on the lower court there.

1 answer. You may have an answer now, but we have to go on
2 to a different topic. But in the final wrap-up, I
3 certainly intend to ask it again.

4 But our next topic in moving along, because
5 we're running behind schedule, is reach-through licensing

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1 an option to an exclusive license, and then they see
2 their tool all over the country in labs, and when there's
3 innovation, that's how they get their value.

4 So, to us, in our world, we would consider that
5 a reach-through. So, to then start the new session, we
6 would consider a reach-through to be any provision that
7 really requires a continuing relationship with the
8 provider of a material or the licensor. And I should
9 say, we don't always see it in a licensing context. We
10 deal with material transfer agreements and sometimes very
11 informal letter agreements. It's not always a license
12 situation. But very often the tool is patented.

13 So, we would consider a reach-through to be
14 either a request for a portion of royalties if, in fact,
15 we make an innovation with a tool and license it and get
16 future royalties, even restrictions on what we can do
17 with new intellectual property that may arise out of use
18 of the tool. So, for example, unreasonable requests to
19 review what we might publish or what results we might
20 publish, requests to restrain perhaps negative results.
21 We view all of those as reach-throughs. I can tell from
22 the discussion this morning that's a different
23 definition, perhaps, than in the antitrust world.

24 But our concern with these types of requests is
25 in the biomedical research enterprise, when a provider of

1 a tool who may have that tool patented requests a
2 continuing relationship, it really serves to restrain
3 future innovation. It can result in a pile-up of

4 royalties so that it could actually prevent a product

5 from being marketed, because of the relationship between the biomedical's medical

6 prevent a isomed

1 scientific innovation. So, for us, it really acts as a
2 restraint on innovation.

3 So, let's see, did I define what we think of as
4 a reach-through?

5 MS. SCHEFFMAN: Thank you. Michelle, what do
6 you see the economics here?

7 MS. BURTIS: Well, I was wondering actually
8 first, does NIH have a problem with paying? I mean, the
9 restrictions, I can understand why you would have a
10 problem with that and how it might dampen further
11 innovation. But do you, as an alternative, just pay some
12 lump sum for the research tool?

13 MS. MCGAREY: Well, we'd rather -- yes. I
14 mean, I think that -- and I realize I'm probably not
15 speaking for universities because I think in some context
16 universities would rather agree to a grantback or a
17 reach-through of some type, depending on what the tool
18 is, rather than pay out of their research budget.

19 But from our point of view, a broad enabling
20 tool should be available on the market as something you
21 can buy versus something that requires you to get a
22 research partner.

23 MS. BURTIS: Well, typically, people have liked
24 reach-through agreements because then it's a way to
25 efficiently price because -

1 MS. MCGAREY: Right.

2 MS. BURTIS: -- if, you know, whatever is
3 commercialized never has a market, then the person who
4 has bought the tool ends up paying a very little amount
5 for the tool. On the other hand, it's just sort of a way
6 for everybody to share the risks. I think that's
7 probably why they've become much more popular.

8 MS. MCGAREY: Um-hum.

1 MR. FROMM: Now, the problem that you have is
2 they're not novel.

3 MS. MCGAREY: Right.

4 MR. FROMM: And that's the reason why he didn't
5 do it.

6 MS. MCGAREY: Right.

7 MR. FROMM: So, now, is he getting royalties on
8 things that he didn't get a patent to, that patent claims
9 don't read on or define a problem, but he couldn't have
10 gotten those patent claims and I think there's something
11 sort of weird to saying that by contract, not only -- as
12 you point out, not only are we getting something that he
13 couldn't have got, but the patent office has probably
14 already ruled he's not entitled to.

15 MS. BURTIS: But would you agree he's entitled
16 to a fee?

17 MR. FROMM: Of course. But it's the same
18 problem --

19 MS. BURTIS: I mean, it's just a way to
20 structure the fee.

21 MR. FROMM: Hey, I want a fee, too. But if I
22 have a patent on a voltameter, should I be able to get a
23 fee for every car that's tested with that voltameter?
24 That's an absurd thing.

25 MS. BURTIS: Well, if your voltameter is a

1 great product, then yes, you should get a big fee. But
2 if it turns out your voltameter doesn't work very well,
3 then that fee will end up -- if it's a reach-through
4 royalty, will be very low.

5 MR. FROMM: So, you're just arguing that I can
6 structure any royalty agreement, for any tool, any way I
7 want and it should be legal?

8 MS. BURTIS: Yeah. I mean, it doesn't
9 necessarily have to be intellectual property, I guess.

10 MR. FROMM: I just think that --

11 MS. BURTIS: It's just a way to pay.

12 MR. FROMM: I'm not saying that there should be
13 a per se illegality to it --

14 MS. BURTIS: That's good.

15 MR. FROMM: -- any more than there should be a
16 per se illegality to getting royalties past the
17 expiration of a patent or a per se rule against
18 grantbacks that are more extensive. I'm not arguing for
19 Nine No-Nos or any per se rules here. I'm just saying
20 that we ought to look at those kinds of things very
21 carefully because once again, it's a heightened scrutiny
22 kind of a question, that if I'm going to get royalties on
23 unpatented items, there is -- what I'm getting, I'm using
24 the leverage of my patented tool to change the economics
25 of the downstream markets, the things that I didn't

1 invent.

2 MS. BURTIS: There are agreements where people
3 get royalties in terms of some payment on things that are
4 not intellectual property, though.

5 MS. LEVINE: Barbara?

6 MS. MCGAREY: Well, from our point of view,
7 whether it's legal or not, it comes down to something
8 that we're not willing to let our scientists agree to
9 that and what happens in a practical sense is that tools
10 are not available and science -- I mean, if you had a
11 scientist here they would say, oh, it's completely stop-
12 science. But by that they mean it's delayed a year or
13 two in terms of getting the tools they need. They have
14 to either make them themselves in their labs, you know,
15 enter into a collaborative relationship to get one which
16 they didn't necessarily want.

17 So, it fosters a big delay, and in biomedicine,
18 that's just a huge deal because biomedicine is traveling
19 very quickly. And so, it means that certain tools are,
20 perhaps, completely unavailable or just worked around and
21 the cost is time.

22 MR. SCHEFFMAN: Is NIH a little bit different?
23 I'm, as many others here, a faculty member on a
24 university with a very big medical center, Vanderbilt,
25 and I think their position is changing because they see

1 this as a profit center of intellectual property they
2 will create and they like to get reach-through royalties
3 because that's the way of maximizing the value of
4 intellectual property.

5 MS. MCGAREY: Well, in terms of them importing
6 research tools into their science, they don't like them
7 necessarily, although sometimes it's a way to get free
8 tools, and if they don't see anything new coming out of
9 the research, then they're willing to go ahead and give
10 the option rights. In other words, you say, well, you
11 know, probably nothing commercial is going to come of
12 this research, which is famous last words for scientists,
13 but then they're willing to give the reach-through.

14 In your situation, you're probably talking
15 about technology that they're trying to license out.

16 MR. SCHEFFMAN: Things they create for the
17 purpose of not just research, but trying to make money
18 for the medical center.

19 MS. MCGAREY: Well, yeah. I should have said
20 in the beginning, I think in the context of reach-
21 through, I think we're talking about broad enabling tools
22 that are not destined to be products themselves one day
23 because when you're licensing out a product, there's a
24 whole different scheme, or licensing out even a tool that
25 you're licensing to a company that's going to produce it

1 as a product and sell it, then, again, you know, you have
2 sort of a more standard licensing arrangement versus
3 reach-through.

4 I don't think too many universities use reach-
5 through for their tools. Well, for one thing, hopefully
6 they don't if they're NIH-funded because our policies are
7 against that. Maybe they do. But it's mostly something
8 that companies do, small companies in particular,
9 because, again, it's an issue of value or companies that
10 are sort of in the middle in terms of they want the
11 grantback rights so that they can license those out.

12 I mean, a good example is if a scientist is
13 using a computer array technology to try to find disease
14 genes and you find a disease gene. If that array
15 technology has a reach-through or a grantback, the
16 company may be a technology company. They're not going
17 to commercially develop a disease gene, but they're going
18 to turn around and sub-license it to a pharmaceutical
19 company for lots of money. So, it's a way of getting
value for your tool.

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1 to get a return on the patents they've got and I would
2 not particularly expect reach-through royalty licensing
3 arrangements to slow things down unless you have a rule
4 that prevents them. Then, if you won't let your
5 scientists pay me for my IP, well, why should I give it
6 to them for free? I'll exploit it myself.

7 So, the rules may be slowing things down, but
8 not the reach-through licenses. Actually, they're
9 prohibition.

10 More generally, I guess I'd like to get into
11 the next -- and this is partly in response to some of the
12 things you said, Jeff. What I think is correct and maybe
13 an important economic point, there's concern, I've heard,
14 maybe outrage, even, that somebody might seek royalties
15 for products beyond the scope of the patent, just like
16 they might seek royalties beyond the lifetime of the
17 patent, which seems to me the law sort of takes a dim
18 view of these sort of things. With economics, it's not
19 nearly so unfavorable. In fact, there's basically some
20 theorems that spreading out royalties over a larger brace
21 and a lower rate could be better.

22 So, I have a question when I hear those sort of
23 stories. Why did anybody agree to pay royalties on
24 something that wasn't infringing? And I would think
25 normally the answer is, well, they got a lower rate on

1 the stuff that was infringing. Maybe you have another
2 answer, okay?

3 MR. FROMM: That's not the normal case.

4 MR. SHAPIRO: But I don't claim to understand
5 it. So, I just want to know why.

6 MR. FROMM: Sometimes licensors and licensees
7 do agree to royalties that run past the lifetime of a
8 patent for exactly economic reasons, that they need to
9 reduce the royalty rate to compete with some other
10 product to keep the cost of the end user product down and
11 those kinds of things. That does happen. But just as
12 often it happens because the licensor has market power,
13 has real market power and they've got the ultimate tool
14 that allows you to produce a product that -- in other
15 words, it's not that the royalty rate is lower, it's the
16 royalty rate is the same. It's just they get to extend
17 it for 50 years instead of 20.

18 MR. SHAPIRO: Well --

19 MR. FROMM: I know from an economic perspective
20 the question is what is the right royalty rate. But I'm
21 saying that happens as well.

22 MS. BURTIS: It would probably be higher for
23 the regular term, though, than it is for over the 50-year
24 period.

25 MR. FROMM: No -- well, like I say, both of

1 those events happen. Both of those events happen.

2 MR. SHAPIRO: I guess I would be skeptical of
3 the notion that I could charge you a royalty rate, the
4 same royalty rate, and then just get a broader scope with
5 the same intellectual property. I mean, that doesn't
6 sound like I would normally think of bargaining working
7 out, whatever the degree of market power is.

8 And finally, since you raised this last
9 question, it seems to me if you're vertically integrated
10 and you're letting your own researchers or downstream
11 folks use a tool with no charge, let's say, but you still
12 want to charge other people, I mean, and that is a
13 classic sort of vertical situation where you might be
14 less inclined to license it outside to the extent you've
15 got downstream interest, I'm not sure what we can do
16 about that short of imposing some sort of duty to deal,
17 which I would not get to very easily. I don't think
18 you'd want to have a non-discrimination rule necessarily
19 and if you give it free internally, you have to give it
20 for free externally. But that might be worth looking at.

21 A starting way to view it is, that's nice.
22 Efficiency is associated with vertical integration, but
23 it might annoy the third parties who are feeling they're
24 at a disadvantage.

25 MR. FARRELL: Well, I was going to say sort of

1 what Carl said, but let me say it more pugnaciously.
2 Coming back to the interchange a few minutes ago between
3 Michelle and Jeff, so the question is why this horror at
4 royalties being charged on things that are not in the
5 patent, either because they are not products that
6 infringe the patent or because they're something too far
7 down the road.

8 Carl and Rich Gilbert published a paper about a
9 decade ago where they show that the least distorting way
10 to raise a certain amount of reward for innovation is to
11 have an infinitely long-lived but relatively weak patent.

12 One can go beyond that and say that the least
13 distorting way to raise a certain amount of money for an
14 innovator is to have Ramsey taxes on all goods, whether
15 or not related in the least to the innovation and whether
16 produced using the innovation or not. Those Ramsey taxes
17 will presumably be perpetual and very, very low.

18 So, what's wrong with this picture? Well, one
19 thing that's wrong with this picture is, who sets these
20 royalty rates? If you're allowed to set it on everything
21 and you're allowed to include non-users of the
22 technology, then you have an awful lot of power, so we
23 have this ad hoc structure or maybe a natural structure
24 where people can just say no and go away and not pay you
25 anything.

1 So, then the question is, the bargaining is,
 2 the default outcome is, you don't get to use the
 3 intellectual property and then you're trying to negotiate
 4 something that's bilaterally efficient, in other words,
 5 least distorting from the point of view of the two
 6 parties jointly with that default outcome to govern
 7 basically the bargaining positions.

8 Now, I think it's pretty clear in these
 9 bilateral problems, as opposed to the full Ramsey, that
 10 there are externalities from these agreements. And
 11 therefore, it's not the case, as it would be with a fully
 12 Ramsey set-up that efficiency is served by allowing full
 13 flexibility. But I also don't think it's at all clear,
 14 from an economic point of view, that you'd want to limit
 15 them the way that Jeff's intuition or that the law on
 16 patent extension limits them.

17 So, it seems to me a sensible starting point
 for policy is 25 points

1 MS. LEVINE: Frances?

2 MS. MARSHALL: My question really goes to this
3 issue of what's the anticompetitive element here that
4 antitrust authorities should be concerned about. We have
5 heard a lot in these hearings about the effects on
6 innovation of these sort of reach-through royalty
7 agreements, particularly when they are stacked, when
8 there's more than one research tool that's being used.
9 But if we assume that the research tool is validly
10 patented and that the owner of that patent has the
11 accompanying right to exclude, and can choose whom to
12 license and to whom not to license, is there anything
13 here that we should be concerned about from an antitrust
14 perspective with respect to reach-through royalty
15 arrangements?

16 MR. ORDOVER: It's hard to say what it would
17 be. I know of a case in which there is actually a
18 research tool -- I don't want to disclose what it is, but
19 there is a way of involving some genetic testing in which
20 -- it turns out it is very difficult to collect a royalty
21 on the use because it's very widespread, it's hard to
22 monitor who is doing how much of it. It's in the labs,
23 it's in the universities, some people can do it in their
24 home, actually on the stove, all kinds of stuff. I mean,
25 it's true. They call it home brew.

1 So, you know, you have a problem for an
2 intellectual property which is actually essential to a
3 lot of stuff, and yet, monitoring its usage and
4 therefore, collecting the value is almost impossible.

5 So, what do you do? Well, one thing you can do
6 is perhaps try to collect the royalty on equipment that
7 can perform the test. So, maybe measuring voltage is a
8 brilliant idea, but how can you figure out who is
9 measuring how much voltage and how often. But maybe you
10 can try to say, hey, every time you buy a voltmeter,
11 you're going to pay me 10 bucks. That seems like a
12 fairly reasonable thing.

13 So, from my perspective, I would say that the
14 issue is really, you know, how important is it for us to
15 believe that the people who do contribute very important
16 intellectual property to society should be entitled to
17 some return, even though the only way to collect that
18 return seems to be by putting a levy on the product that
19 doesn't seem to fall within the scope of the particular
20 patent, and these kinds of doctrines which say, well, you
know, if the product can be used only for that purpose,

1 of an efficient tax.

2 So, really, again, we're going back to the
3 question of whether or not these kinds of taxes that go
4 beyond the actual license collection mechanisms, that go
5 beyond the patent at issue, are really distortionary, and
6 to my view, they are not distortionary if they don't, in
7 any form or fashion, for example, prohibit entry into the
8 exploitation of the underlying intellectual property with
9 the tools or with the products on which the levy is being
10 imposed. So, if anybody can get into the voltmeter
11 business and just has to pay some kind of a royalty,
12 what's the big deal?

13 If you say, okay, you pay me the royalty and I
14 will not -- but I'm only going to allow you to be the
15 licensed -- the one that's going to be in compliance with
16 my intellectual property, I think that begins to create a
17 problem. Whether you are using that intellectual
18 property actually diminishes competition downstream as
19 opposed to somewhere else.

20 MR. SCHEFFMAN: Thanks, Janusz. I want to give
21 Barbara and Rick a chance to comment. We are really
22 late, so we have to move to the next topic, but we want
23 to hear your comments on this.

24 MS. MCGAREY: I'll talk fast. Well, NIH is as
25 outspoken as we can be. We certainly don't like reach-

1 through, we don't agree to it, we don't like our grantees
2 to agree to it, but I don't think I can say that it's
3 anticompetitive or it's something that the Federal Trade
4 Commission or the Department of Justice needs to look at
5 because in my experience with this, I mean, this sort of
6 concern started in the early '90s and I think it's
7 something that the marketplace takes care of, perhaps,
8 very painfully. I mean, we don't like it. Sure, we'd
9 love somebody to solve this problem for us, but the
10 market really does solve it, because what happens is if a
11 recipient does not like the terms, they don't engage in
12 the terms.

13 And, you know, from the standpoint of
14 biomedical research, maybe it's a problem, but in terms
15 of anticompetitiveness, I can't really say that it is
16 because we've had many examples where we've simply said
17 no or we continued to negotiate and we've negotiated the
18 reach-through out or not, or our scientists have simply
19 designed a better mouse and that -- I think really the
20 market takes care of it because there are not too many --
21 I don't know, I can't think of an example where this
22 problem, as painful as it was, that ultimately what I
23 would call market forces didn't work this out.

24 MR. RULE: It strikes me that this is
25 essentially a throwback issue. I mean, *Brulotte v. Thys*,

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1 Since it's an idea, it's information, it's zero
2 marginal cost and it's got a positive marginal cost and
3 therefore, a positive marginal value, you would expect
4 somebody to be able to reap a reward and, again, I've
5 never heard any argument as to how somebody can obtain a
6 royalty that exceeds the value to the licensee of
7 whatever it gets. I mean, that's the absolute constraint
8 on what they're going to pay. And the antitrust issue, I
9 think today, is one of excluding people from the market.
10 I think for the reasons the economists have said,
11 generally, these kind of devices typically, it seems to
12 me, actually expand the scope and the dissemination of
13 the technology rather than restrict it, and so, if
14 anything, these are really largely a non-event from an
15 antitrust standpoint. There may be other reasons for
16 them, but I don't think antitrust really has a valid
17 basis for attacking.

18 MR. SCHEFFMAN: Short comment, Joe?

19 MR. FARRELL: Yeah. I mean, I'm not sure that
20 I would agree with the focus on: is the IP holder getting
21 too much money? It seems to me a more important issue
22 is, does the structure of these continuing payment
23 streams, for example, discourage appropriate challenge
24 and litigation of the patents by specifying that payments
25 continue even if the patent were to be found invalid or

1 the product non-infringing?

2 Incentives to challenge, we know, are
3 problematic in any case because of the pass-through
4 problem that I was talking about earlier. Similarly,
5 with incentives to settle, we know how problematic that
6 is. And it seems to me many more problems lurk in that
7 sort of area than in the possibility that some IP holder
8 is getting too much money.

9 MR. SCHEFFMAN: Thanks, Joe. Okay, the final
10 topic is kind of an interesting topic because things have
11 changed so much with respect to this, which has certainly
12 parties that engage just in research and not in the
13 sordid activity of producing goods used to be considered
14 very good, as opposed to suspicious folks who produce
15 goods in technology and then license it to other folks.
16 But now they're increasingly concerned about the
17 licensing practices of entities that only do research and
18 create intellectual property and license that.

19 What are the issues there? Are there bona fide
20 issues here? Joe?

21 MR. FARRELL: Yes. I like the way you set it
22 up and I think maybe it's no coincidence that the view
23 has changed, and what else has been changing at the same
24 time is the extent to which intellectual property
25 protection is readily given on innovations that, at least

1 according to some smart and informed observers, maybe
2 should never be given so much protection.

3 So, I propose that we should think about the
4 non-vertically integrated IP holders issue in the
5 following way. If the IP were fully legitimate in all
6 possible senses, then the fact that you're not vertically
7 integrated doesn't let you extract more than the value of
8 your technology, so there's really no problem.

9 However, coming back to something that I think
10 I was saying earlier in a slightly different context. If
11 what's going on is you have a system where there's too
12 many IP rights being granted and the market has developed
13 a safety valve in the form of cross-licensing and similar
14 things that rely on vertical integration and production,
15 then having a non-vertically integrated IP holder
16 represents a blockage at the safety valve. And if your
17 world view is one in which the safety valve is not
18 needed, in other words, you intellectually truly presume
19 that the intellectual property is valid and infringed,
20 then I don't think you can do a good job of understanding
21 the concerns about non-vertically integrated IP holders.

It seems to me the right wayms trdon't think which 68.

21

1 deal with patents that should never have been issued, and
2 then having non-vertically integrated IP holders blocks
3 or gums up that safety valve.

4 MR. ORDOVER: I just want to ask a question of
5 Joe. How does one know whether the IP should or should
6 not have been issued? I mean, what's the standard -- I
7 can understand a certain unease with extremely broad
8 patents to things that we believe should be somewhat in
9 the public domain, but --

10 MR. FARRELL: I don't propose to evaluate any
11 particular piece of IP, if that's what you're asking.
12 I'm saying, if we believe, as I think there's every
13 reason to believe, that a lot of pieces of paper with the
14 word "patent" on them come out that shouldn't come out.
15 I don't have to identify which they are in order to say
16 we probably need a safety valve to prevent that doing a
17 lot of competitive harm.

18 MR. SHAPIRO: I guess I want to mostly second
19 what Joe said. I mean, just from my experience with a
20 number of industries and companies, there's real fear by
21 particularly some of the large companies of the patent
22 holder who kind of appears after significant sunk
23 investments have been made, is totally an IP shop or
24 somebody who purchased the patent from somebody else not
25 in the industry, and there's virtually no way -- you

1 can't fight back very easily, okay?

2 Now, again, as Joe said, if the patent is
3 totally legitimate, you know, tough luck, you know, pay
4 up, I guess. But if you think, maybe there's problems
5 because it was submarine or it was delayed or there's
6 hold-up or it was too broad, then you say this is kind of
7 the horror story where somebody who can seek injunctive
8 relief against a large revenue stream that may give
9 returns way out of proportion to any real innovation.

10 You know, I've even seen a situation where a
11 portfolio was split up and some patents split off to a
12 third party who had no other commercial interests, so
13 they could assert it most aggressively against other
14 industry players. So, I think it's a real, real issue.
15 Unless you are totally calm about what the PTO is doing,
16 this is something to worry about.

17 MR. FROMM: I just wanted to say one thing.
18 There's a -- Joe and Carl apparently believe that it's a
19 PTO problem. That's not been my experience. I mean,
20 there are patents that we all know that get issued and
21 that's what the process is all about, but I think there's
22 another aspect to it, which is when you're evaluating a
23 patent that's been granted, there's this presumption of
24 validity and I can read words and you can read words in
25 the claims and we can then decide that we don't believe

1 that we're talking about the same thing.

2 It's not the PTO that caused that, it's just
3 the way the system functions. In other words, the patent
4 claims, which are archaic at best, aren't as precise
5 about what they cover as anybody would wish. That's just
6 the way the system is, it's always been that way and it
7 probably will be that way even if the PTO were to crank
8 down the rules on what it allowed.

9 So, what that ends up meaning, as a potential
10 licensee facing one of these problems, is that you can't
11 agree what the words mean. So, you might very well agree
12 that the patent is valid if it was granted, if it only
13 covered what it was that it was examined on. But often,
14 that's not what the patentee is arguing. He's arguing
15 it's covering something that it was never examined on.
16 Is that the Patent Office's problem? Well --

17 MR. ORDOVER: I think that there's been a big
18 change in the ratio of these patent claims that are being
19 upheld in the courts. It's not only a PTO problem, but I
20 think that 30 years or 40 years ago, if you were to go to
21 court and try to challenge somebody's infringement of
22 your legitimate patent --

23 MR. FROMM: Prior to 1981.

24 MR. ORDOVER: '81, yes. Let's say the
25 likelihood of winning would have been 25, 30, 35 percent,

1 now it's close to 85 to 90 percent. I think that's a big
2 deal. The PTO does presumably what they do, although not
3 necessarily always that well. But it's the pendulum that
4 I talked about a little earlier on which we are now in a
5 regime in which intellectual property is sacrosanct to a
6 large extent and that, of course, gives these kinds of
7 strategic powers to firms whose IP may be very, very weak
8 or not substantially valuable. But then it goes back to
9 something that someone else said.

10 If this IP is so valueless, how come it can
11 create all that mischief? So, you've got to have the
12 reconcile on these things but maybe that's for another
13 day.

14 MR. SHAPIRO: Just to clarify. I think -- by
15 the way, my colleague, Mark Lemley, looked at some of the
16 data on this and I believe what he found was that after
17 the CAFC was set up, then the patent holders were doing
18 better in terms of these statistics for a while. But
19 then, of course, people adjusted in terms of which cases
20 got brought and returned to -- I don't know if it was
21 50/50 or whatever it was, but sort of with a different
22 recognition of what the underlying property rights were.
23 So, that's a little different than what you said.

24 MS. BURTIS: I guess that was my question, too,
25 is I don't -- as much as you may not like it, why isn't

1 this just a situation where the perspective licensee
2 evaluates the strength of the patent and attacks it if
3 they don't want what the licensor -- you know, the patent
4 holder is asking for. I don't see why this is bad from a
5 societal standpoint.

6 MR. FROMM: Well, it's because of the sunk
7 investment problem that Carl mentioned.

8 MS. BURTIS: Well, that's due diligence.

9 MR. FARRELL: Only partly because of that.

10 MS. BURTIS: That gives that patent holder more
11 power and everyone might not like it, but why is -- I
12 still don't understand, why is that not a legitimate
13 patent that can't be asserted?

14 MR. FROMM: Well, maybe the question is, why is
15 that a problem? I think the simple answer is when you
16 have -- we had a conference call earlier that talked
17 about two different kinds of non-vertically integrated
18 organizations, research corporations that actually do --
19 what I call Fab-less (phonetic) companies, Fab-less
20 organizations, NIH, UC-Berkeley, Stanford. I mean,
21 they're not vertically integrated but they really do
22 research. And so, any dollars that they get on licensing
23 presumably flow back into research.

24 So, in that sense, if they can extract high
25 royalties from some third party that flows to researchers

1 at NIH or wherever, that benefits society in about the
2 same way as if it were kept by the ultimate licensee.

3 But the situation is different when you're
4 talking about the non-vertically integrated organization
5 which is not a research company, which is purely a
6 licensing entity. What does it do with the cash? So,
7 every dollar you take away from a research entity is --
8 well, we can quantify it. For every \$250,000 you take
9 away from a company like H-P, that's one engineer you
10 fire. It's that simple. That's the economic reality
11 today. Now, at NIH the numbers may be different, but the
12 ultimate result is the same. So, the question is, is
13 there a difference economically? Is there something
14 wrong with extracting money from a research-doing
15 organization and giving it to the guy so he can buy
16 another BMW? Somehow that bothers me.

17 MS. LEVINE: Joe, do you have a response to the
18 BMW point?

19 MR. FARRELL: Yeah. I don't favor kind of
20 trying to track the money and assuming that
21 mechanistically money flowing into certain hands gets
22 spent on research at the margin, money flowing into other
23 hands doesn't lead to research. I'm sure there's some
24 truth to that, but there's also a lot of truth to the
25 idea that people evaluate the profitability of research

1 plans and will do them if they're profitable or if
2 they're not profitable, so flow of funds may make less
3 difference at the margin.

4 But I wanted to come back to what Barbara was
5 asking which is, so if a patent holder of possibly a
6 slightly weak patent gets more money, is that a big
7 problem? And that's kind of what Jeff was responding to.

8 I have a different response, which is, yes, it
9 is, and the system that we have is one where, as I
10 understand it, you apply for a patent, you get a piece of
11 paper that tells you -- patent -- out of the patent
12 office, if you're at all lucky, and then that's not the
13 end of the process. The process continues with your

1 patents, which was too weak originally, is even weaker,
2 and so you get more of these what I will tendentiously
3 call monopoly mark-ups, and that's bad.

1 Just as we assume that people don't like
2 creating competition against themselves, and therefore,
3 generally don't require unilateral licensing to occur --
4 compulsory licensing -- we also tend to think that people
5 who are vertically integrated will have less of an
6 incentive to license, unless, of course, they're faced
7 with mutual assured destruction.

8 So, when we speak very broadly about non-
9 vertically integrated patent holders, I think outside of
10 some industries the record is more positive, even if
11 there are Lemelsons out there.

12 MS. MATHIAS: Just as a follow-on question to
13 the non-vertically integrated companies, under what
14 circumstances -- I mean, we've talked about the pros and
15 the cons of these, but under what circumstances would the
16 agencies need to investigate or have any concern about
17 this or is it just something that is beyond what we can
18 do?

19 MR. McFALLS: If I could hop in right away on
20 that. The second part of the questions that you included
21 sort of had an underlying premise that there are firms
22 out there that buy up a series of patents which may be
23 complements in a broad sense, but which may confer some
24 greater element of market power than any patent
25 individually would or the patents disbursed among several

1 different firms. I think there you have literally a
2 statutory hook for looking at that practice beyond just
3 what would otherwise be a Noerr-protected right to
4 enforce your patents, which is what precedes patent
5 enforcement, which is Section 7, Acquisition of Patents
6 and Exclusive Licenses.

7 And if it is the case that in the absence of
8 the acquisition, the previous owners of the patents would
9 have licensed them more broadly or at lower rates, which
10 may be very difficult to investigate or prove, but may be
11 worth looking at, and then what you have after the
12 acquisition is higher licensing fees, for instance. That
13 like say the Ciba-Sandoz consent may be worth your time
14 and consideration.

15 MR. SCHEFFMAN: Well, I'll go back to what I
16 said to begin with. It is funny that -- a lot of what I
17 heard about the concern about the IP houses used to be
18 exactly the concern about big companies with big
19 portfolios getting spurious patents and exerting them
20 against their competitors or excluding. There was a
21 whole Congressional hearing about that, about alleging
22 that that's what Japanese companies do. But it's
23 interesting that the focus has changed. Maybe there's
24 not a problem on the former sort anymore.

25 Anyway, we're at the wrap-up. I'll ask the

1 cosmic question -- let me say, again, where I think we
2 are. We have had enforcement in the areas over the last
3 10 years in the areas involving standards and
4 intellectual property and Hatch-Waxman. Those are sort
5 of garden variety antitrust, don't raise overly complex
6 IP issues.

7 At the same time, the Nine No-Nos have gone
8 away in that enforcement program and the law has been
9 much more relaxed with respect to what it allows in
10 licensing practices. Have we got the balance right? If
11 you were an enforcer, should we be devoting a lot more
12 attention to looking at licensing practices beyond those
13 involving standards and sorts of things, these general
14 issues, cross-licensing, grantbacks, those sort of
15 things, or will private enforcement take care of it or is
16 the market working it out?

17 MR. SHAPIRO: Maybe I'll start since I'm going
18 to have to rush out, actually. I think your cosmic
19 question, it's really too much to ask. I think we can
20 really see where we are on the overall balancing of too
21 lax versus too tight.

22 I think it's also a false goal to try to have a
23 precise list of Nine No-Nos -- or how many yes-yeses did
24 you want, Janusz? Twenty-three?

25 MR. ORDOVER: An unbounded number.

1 MR. SHAPIRO: Look, obviously, when the IP
2 guidelines sought to address these things in a guideline
3 fashion rather than an enumeration of this is okay or
4 that's not okay. I would hope the hearings overall would
5 give an opportunity to at least say something about
6 issues that weren't fully addressed in the guidelines. I
7 don't think that they need to be wholesale rewritten but,
8 you know, there's more issues, things that have come up.

9 I mean, I guess I feel the balance is
10 reasonable. It's hard to tell from the DOJ and FTC cases
11 because there's not that many cases, you know, that are
12 publicly sort of we know exactly what's going on. I
13 mean, I could go back and criticize the FTC Intel case
14 again, but I've already had a sub-career doing that.

15 One thing you might do, for example, is to
16 weigh in more on private cases. In a way, sort of
17 competition advocacy to say, you know, maybe not

1 MR. RULE: I guess I would say that the balance
2 seems -- I think it's impossible to say that there's a
3 perfect balance and that we've got it right now as
4 opposed to five years or ten years ago. I'd like to
5 think that maybe, you know, about 14 years ago we had it
6 right.

7 **(Laughter.)**

8 MR. RULE: And it's changed a little since
9 then. But I think it's hard to say. I think we are
10 probably closer to the right place than we were at the
11 time of the Nine No-Nos. I think the approach is a
12 little more sensible and sensitive and economically-
13 based.

14 I think, also, if you look at what has happened
15 over the last 10 years, I think the courts have done an

1 it's a problem and you think it's a travesty of justice
2 if anybody actually does challenge it. So, you know, the
3 fact that my clients aren't being challenged right and
4 left, I think, means that you're getting it right.

5 So, I think that it has moved back. I think,
6 as much as I hate to admit it, part of it has to do with
7 the fact that people like Janusz and Carl and Joe and
8 you, Dave, are more involved in the process than
9 economists were 30 years ago, and I think that's made a
10 difference. And generally, I think it's made a
11 difference because folks have moved to a rule of reason.
12 So, there are always opportunities to fine tune at the
13 margin, but I think they are marginal issues as opposed
14 to really significant ones as have existed at various
15 times in the life of the antitrust laws.

16 MR. SCHEFFMAN: Janusz?

17 MR. ORDOVER: A quick comment. Of course, I
18 agree that it's impossible to find the right balance of
19 those. Obviously, Rick was close. But I think that

really the issue goes to 33.5 dmm/tlportunitkd,Ed TDfm5 Bie-68.o

1 groups of firms, whether it's a standard setting
2 circumstance or infringement or whatnot, if there is this
3 huge problem of under-enforcement, which there may or may
4 not be, I just don't know. Then, obviously there ought
5 to be more involvement from the FTC and the DOJ because,
6 after all, they are the ones who try to internalize that
7 externality and deal with it both from the standpoint of
8 forcing an individual case, but also signaling to the
9 outside world, which I think is extremely valuable, where
10 it is that the regulators believe the balance ought to be

1 Dell consent decree, that is a tremendously positive
2 thing in the industry. It short circuits a lot of
3 discussion. It assists in speeding innovation because it
4 gives you a guideline about where the limits are.

5 Attorneys are good at trying to push the limits
6 for their clients, that's what we do for a living, and

41

1 stepped over the line. Maybe it's hard to find the right
2 case, but I think it's valuable for you to keep looking.

3 MR. McFALLS: Just if I could add one thing. I
4 think the guidelines are fine as is. The cases have been
5 appropriate, and from what I've seen, the investigations
6 have been of significant issues that are raised by
7 ambiguities in the guidelines that redrafting will not
8 fix. What will fix the ambiguities that exist in the
9 guidelines, especially in cross-licensing restrictions
10 and settlements, are having adjudications in front of the
11 Commission and also in the appellate courts, and I think
12 that's the way that this field was reconceptualized in
13 the late '70s and early '80s, and that's what's going to
14 happen now.

15 MS. LEVINE: Well, thank you for all your
16 comments today, from all of you panelists. You know that
17 you have been our grand finale. This is the final day of
18 public hearings in the nine-month process of our
19 intellectual property interest hearings and I'm pleased
20 that we ended with a bang. Thank you very much for your
21 comments, not just today, but for our returning
22 panelists, for your comments on previous days. We've
23 collected a wealth of information through these
24 intellectual property interest hearings and now it's time
25 for us to do our job in synthesizing the information.

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C E R T I F I C A T I O N O F R E P O R T E R

MATTER NUMBER: P022101
CASE TITLE: INTELLECTUAL PROPERTY WORKSHOP
DATE: NOVEMBER 6, 2002

I HEREBY CERTIFY that the transcript contained herein is a full and accurate transcript of the notes taken by me at the hearing on the above cause before the FEDERAL TRADE COMMISSION to the best of my knowledge and belief.

DATED: NOVEMBER 14, 2002

SONIA GONZALEZ

C E R T I F I C A T I O N O F P R O O F R E A D E R

I HEREBY CERTIFY that I proofread the transcript for