

“AMATEURS IN BLACK”

Statement of

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Thank you for the opportunity to join respected colleagues and long-time friends to present views on this important issue. Since the matters we are discussing today have been thoroughly aired on many occasions over the past several decades, I will place maximum reliance on previous contributions and focus on fresh perspectives.

The antitrust and misuse rules applied to the practices we discuss today – tie-ins, bundling, grantbacks, beyond-term royalty provisions, and no-challenge clauses – have all evolved in roughly similar ways. From diverse but related origins, the rules evolved toward a point of maximum hostility – *per se* illegality, or something close to it – reached in the late 1960's and early 1970's. In 1984 the state of affairs was aptly summarized as follows:

A study of the legal principles by which antitrust concepts are applied to the licensing of intellectual property reveals a set of rules which are arbitrary, formalistic, riddled with inconsistencies and substantively useless technicalities, and greatly in need of fundamental reassessment. . . . [T]he difficulties result from the application to licensing situations of the rules of *per se* illegality used in antitrust cases, rules by which the commercial realities of certain transactions are rendered irrelevant in the interest of judicial convenience. . . .

From the standpoint of any company whose commercial posture requires reliance on patent or copyright licensing in order to recoup the cost of developing new technology, the rigidity and arbitrariness of the licensing cases is most unfortunate. Although not well documented, these factors may act as a substantial deterrent to such investment.¹

Bowman described the road to this predicament most effectively and it would be wasted effort to repeat his trail-blazing scholarship in any detail.² To take tie-in law as an example, Bowman locates the origin of the *per se* rule in cases involving the divisibility of patent rights, such as *Henry v. A. B. Dick Co.*, 224 U.S. 1 (1912). That case upheld a patent license of a mimeograph machine conditioned on the licensee's purchase of all unpatented supplies from the

¹ Robert P. Taylor, "Analyzing Licensee-Licensor Relationships: The Methodology Revisited", 53 *Antitrust L.J.* 577, 578-79 (1985)(footnotes omitted).

² Ward S. Bowman, Jr., *Patent and Antitrust Law: A Legal and Economic Appraisal* (1973); *see also*, W. S. Bowman, Jr., *Tying Arrangements and the Leverage Problem*, 67 *Yale L.J.* 19 (1957).

patentee. (The precise issue was whether a competing supplier of those unpatented staples to a licensee was guilty of contributory infringement.) The benign approach and the *A. B. Dick* case itself were overruled – over vigorous dissent by Justice Holmes – in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502 (1917). That case involved a license of a patented movie projector that limited the movies that the licensee could show on the projector.

Bowman identified a concept in Justice White’s dissenting opinion in *A. B. Dick*, later adopted as the majority view in *Motion Picture Patents*, that is recognizable as the predecessor to what we would now call leverage or patent-extension theories – the concept that the rights inherent in a patent can be used to project effects beyond their intended scope. White’s dissent, however, did not successfully articulate a coherent approach to assessing the competitive or other practical results of this type of conduct. Eventually, however, hostility toward patent linkages took root and spread from patent law to Clayton Act³ interpretation and then back to Sherman Act principles. *International Salt Co. v. United States*, 322 U.S. 392 (1947), announced a *per se* rule under Section 1 of the Sherman Act against the use of patents as a tying mechanism.

Eventually, the *per se* rule completely jumped the patent tracks and lumbered out across the broad fields of antitrust in *Northern Pacific Ry. Co. v. United States*, 356 U.S. 1 (1958). *Northern Pacific* involved extensive landholdings rather than patent rights as the springboard for the tying mechanism. Writing in 1973, Bowman characterized the situation as follows:

The development of the law with respect to tying practice has been a one-way street. Its signpost was misdirected by Justice White in *Motion Picture Patents* in 1917. His leveraging fallacy was received as gospel. Were it true, as succeeding justices assumed, much of the subsequent law would have been unobjectionable. But by parlaying a leverage fallacy with an unproved, incipient monopoly hypothesis (arising from an assumed identity between effect on *competitors* and effect on competition) the Court has since 1917 consistently applied faulty economics leading to the wrong answers to the questions it has asked.

³ *United Shoe Machinery Corp. v. United States*, 258 U.S. 451 (1922).

Bowman (*supra*) at 182. As we saw above, Taylor was not much kinder when he wrote his assessment eleven years later.

The intense focus on economic rationality characteristic of antitrust enforcement during the first Reagan Administration, however, encouraged the abandonment of the *per se* rules that had become common in this field.⁴ The reform of antitrust rules coincided with a wave of intellectual property changes that emerged from the same basic policy foundations. Intellectual property was recognized as fundamental to innovation, and the antagonistic relationship between knee-jerk legal rules and the incentives for innovation were clearly recognized. The Patent Term Restoration Act, the creation of the Federal Circuit and concentration there of all appellate jurisdiction regarding patents, the Chip Mask Work Protection Act, the National Cooperative Research Act, the National Cooperative Research and Production Act, the Stevenson-Wydler and Bayh-Dole Acts, strengthening of trademark and copyright protection and remedies, and a whole variety of like-minded reforms were all manifestations of a kind of Great Peace between the intellectual property and antitrust policy worlds that has prevailed since the 1980's.

Like any period of tranquility, this one has proven shakable with the inevitable passage of time, but the consensus regarding the need to maintain harmony between the intellectual property and antitrust worlds in pursuit of the shared objective of maximizing the wealth-creating potential of society remains largely intact. From the perspective of today's subject, the most important reality is that the forces chipping away at the *per se* rules are still very active. The *per*

⁴ The most obvious manifestation of this shift in policy – repudiation of the “Nine No-No’s” – was cited in Chairman Muris’ announcement of these hearings. Timothy J. Muris, Chairman, Federal Trade Commission, “Competition and Intellectual Property Policy: The Way Ahead” Remarks Before the American Bar Association Antitrust Section of Antitrust Law Fall Forum, Washington, DC, November 15, 2001, at n.3.

se approach to tying – described by no less an authority than Donald Turner as “ridiculous” almost twenty years ago⁵ – is slowly eroding. And, although the precise antitrust and misuse rules applicable to grant-backs, beyond-term royalty provisions and no-challenge clauses are often clouded, the auspices do not favor any continued use of *per se* rules.

Economic rationality is enjoying a zenith or at least an apparent local maximum on the Supreme Court. Almost all of the plaintiffs’ antitrust avatars are years off the Court. Although the Court’s Section 2 jurisprudence – often centrally relevant to intellectual property practices – lags other fields of antitrust doctrine in some important dimensions⁶, for the most part the Court is rightly suspicious of lower courts and agencies that overuse presumptions of anticompetitive effect. The Court seems interested in the reality of how markets actually function, and seems to place some importance on the recognition of this reality as the basis for antitrust decisions. The trend is amply demonstrated by the Court’s continuing rejection of decisions that rely on presumptions to prove anticompetitive impact in such cases as *California Dental Association v. Federal Trade Commission*, 526 U.S. 756 (1999), and *State Oil Co. v. Khan*, 522 U.S. 3 (1997). Indeed, one has to look all the way back to *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982), to find a Supreme Court case that puts any real steam behind the idea of using *per se* rules outside the arena of classic cartel conduct.

⁵ Panel Discussion, Remarks of Donald F. Turner 53 Antitrust L. J. 523, 529 (1985). The discussion cited here actually occurred at an ABA National Institute held on October 11-12, 1984.

⁶ Kenneth L. Glazer & Abbott B. Lipsky, Jr., *Unilateral Refusals to Deal Under Section 2 of the Sherman Act*, 63 Antitrust L.J. 749 (1995)(identifying need for more specific formulation than *United States v. Grinnell Corp.*, 384 U.S. 563 (1966), in defining monopolizing conduct). One could also identify the Court’s statements of the test for monopolization in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985), and in the monopolization part of *Image Technical Services, Inc. v. Eastman Kodak Co.*, 504 U.S. 451 (1992) – as distinct from the tie-in part – as demonstrating similar weaknesses.

But all of this is run-of-mill commentary. My main point simply picks up from the hope and perhaps the assumption that *per se* rules in the area of antitrust and misuse principles applied to intellectual property have limited shelf life. I think it is worth addressing how we can reduce reliance on *per se* rules, in accordance with the same principles adopted in the federal agencies' *Antitrust Guidelines for the Licensing of Intellectual Property* (1995), but I would like to base the discussion on an assumption that eventually the *per se* approach will be more-or-less officially abandoned judicially as well as at the agencies. I imagine that with the D.C. Circuit's decision in *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir.), *cert. denied*, 122 S. Ct. 350 (2001), some would say that day has already arrived, but one might cite with equal justification Judge Patel's decision in the *Napster*⁷ litigation as a counterexample.

So if we are to judge these intellectual property licensing restrictions according to a rule of reason – or at least a rule other than a *per se* rule – what should the analytical principles and the rules of decision be? This is an extremely challenging question, and it has been with us for a long time. It involves great speculation and difficult tradeoffs between the preservation of the benefits of rivalry and the preservation of the benefits of intellectual property and its use, dissemination and exploitation. There are no easy answers, and one of the most challenging parts of the issue is how to choose a decision-making structure that is most likely to produce objective, reasonable and correct answers.

The balance between rivalry and protection is fundamentally a question requiring economic expertise. There are disciplines within economics and econometrics that can be brought to bear on the empirical and theoretical issues. And eventually the process of decision-

⁷ *In re: Napster Inc. Copyright Litigation*, No. MDL 00-1369 MHP; C 99-5183 MHP Memorandum and Order (Feb. 21, 2002)(permitting discovery on copyright misuse claim).

making must rely on an assessment by the legal system of conflicting conclusions proposed to be drawn from the application of those disciplines. For example, in any future rule-of-reason tying case all kinds of legitimate purposes might be proposed, and all kinds of anticompetitive effects might be asserted. It is up to the expert economist, relying on a variety of quantitative tools and other arguments, to establish a vision of the practice, placed within its real-world context, that seems to accord with a particular view of the case. I think this is what enforcement agency officials mean when they say that the law is important, the facts are important, the economics are important, but overall the issue for decision is “who has the best story.” Increasing the sensitivity of our enforcement officials to sound economic arguments gives the expert a large role in the decision-making process, and in my opinion that is as it should be.

Recently the law has had some important things to say about the role of experts in legal decision-making. There is perhaps no area of law that has been revolutionized in recent years in quite the same way or to quite the same degree as the Supreme Court has revolutionized the consideration of expert testimony in federal trials. The instrument of this revolution is known collectively as the “*Daubert* Quartet”⁸, a remarkable set of decisions and for a number of reasons. First, although the *Daubert* rule appeared to many as a sharp departure from the previous law, all four of these decisions were unanimous. Apparently not a single Supreme Court Justice questions the proposition that it is the duty of the trial judge to act as gatekeeper for testifying experts, evaluating the relevance, reliability and “fit” of their testimony. Second, the *Daubert* Quartet has created a minor uprising in antitrust, leading in several cases to the

⁸ *Daubert v. Merrell Pharmaceutical, Inc.*, 509 U.S. 579 (1993)(Federal Rules of Evidence, not common-law “general acceptance” test, govern admissibility of expert scientific testimony in federal trials); *General Electric Co. v. Joiner*, 522 U.S. 136 (1997) (standard for review of admission scientific evidence is abuse of discretion); *Kumho Tire Co. v. Carmichael*, 119 S. Ct. 1167 (1999) (*Daubert* applies to all experts), and *Weisgram v. Marley Co.*, 120 S. Ct. 1011 (2000).

overturning of substantial verdicts and the rejection of economic testimony by experts with very uptown credentials – star-studded *curricula vitae* including full professorships at leading U.S. universities, and, in several cases, Nobel Memorial Prizes in Economics.

Now it might be objected that none of the *Daubert* Quartet involved antitrust claims, and that the Court might apply a different set of considerations to an antitrust case if the admissibility of expert testimony were presented to the Court in an appropriate case. In fact, I would argue that precisely the opposite is true. I believe that the *Daubert* principle first emerged in several Supreme Court antitrust cases and was merely articulated and announced more broadly in the Quartet. The first such case is *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The cutting issue in that case was the admissibility of expert testimony claiming that the evidence justified the inference that a conspiracy existed to charge low, predatory prices in order to drive out of business the U.S. manufacturers of consumer electronic products. The Court made an independent evaluation of that testimony and proclaimed it implausible and therefore not worthy of credit in the balance of Rule 56. Essentially the Court applied the reliability prong of the *Daubert* rule. And then, in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), the Court was confronted with a Robinson-Patman claim of “oligopolistic disciplinary pricing”, again supported by an inference based on the testimony of an expert economist. Although the decision is not based entirely on the rejection of this testimony, the doubtful reliability and fit of that testimony contributed substantially to the factual rejection of the claim. In a sense *Brooke Group* went farther than *Matsushita* because the legal viability of the claim was upheld, and the assertion that claims of oligopolistic disciplinary pricing are inherently implausible was rejected.

I believe the Court is telling us something very important in *Matsushita, Brooke Group* and the *Daubert* Quartet, namely that the institutions of litigation require some form of assistance when it comes to the determination of complex scientific questions. These clearly include the complex questions of economic analysis required to evaluate the competitive effects of intellectual property licensing practices. The application of *Daubert* principles by federal trial judges can be an important part of this effort to compensate for the institutional defects that the Supreme Court perceives within the litigation process. But there are other mechanisms available for the purpose, and we ought to undertake a conscious search for the best ones, especially in light of the supreme difficulty and complexity of the various questions relevant to the evaluation of licensing practices.

An obvious choice is the appointment of experts to assist the courts directly under Federal Rule of Evidence 706(a). Another similar choice would be to allow or encourage judges to retain law clerks with particular expertise to help with specific cases or groups of cases involving complex scientific issues. In the field of antitrust, however, I think the limited experience creates a record that must be declared mixed. The three main examples that I am aware of include Judge Wyzanski's reliance on his clerk Carl Kaysen in *United States v. United Shoe Machinery Corp.*, 110 F.Supp. 295 (D.Mass. 1953), *aff'd per curiam*, 325 U.S. 991 (1957) – a decades-long litigation regarded as a disappointment in terms of its results, if not in the merit of the analysis. The second example is Laurence Lessig's role in the District Court trial of *United States v. Microsoft Corp.*, which I understand was ultimately comparable to that of an *amicus curiae*. That example, too, has received mixed reviews as a model for the evaluation of scientific issues in antitrust litigation. On the other hand, it was an overflow crowd and the reviews won't be digested for a long time to come.

But it appears to me that the use of a 706(a) expert led to a very trenchant and successful analysis and a sensible result in *New York ex rel. Abrams v. Kraft General Foods, Inc.*, 862 F.Supp. 1030 (S.D.N.Y. 1993), the “Nabisco Brands” litigation involving ready-to-eat breakfast cereals, including Shredded Wheat. Our former antitrust colleague Judge Kimba Wood decided this case with the assistance of the venerable industrial organization economist and erstwhile policy czar, Dr. Alfred E. Kahn.⁹ The move appears to have been supported enthusiastically by both parties. The testimony that emerged from that exercise is fascinating and should be read by anyone who feels underexposed to balanced economic analysis in merger cases.

Could the quality of these expert interventions be improved by relying on an unimpeachable source? Justice Breyer has made some interesting observations on the institutional framework for the proper assessment of experts and expertise. Speaking before the American Academy for the Advancement of Science, he noted (quoting from Judge Acker):

Unless and until there is a national register of experts on various subjects and a method by which they can be fairly compensated, the federal amateurs wearing black robes will have to overlook their new gatekeeping function lest they assume the intolerable burden of becoming experts themselves in every discipline known to the physical and social sciences, and some as yet unknown but sure to blossom.¹⁰

There are no bodies that appear as obvious leaders in the field of certifying the objectivity and quality of economic analysis. The National Academy of Sciences appoints members in the field of Economic Sciences, and the list is as distinguished as they get. Members are selected “in

⁹ I should add as a matter of full disclosure that I was briefly and happily employed as Dr. Kahn’s Special Assistant for Antitrust and Regulatory Reform during his stint as anti-inflation czar in the Carter Administration (officially Chairman of the Council on Wage and Price Stability).

¹⁰ Associate Justice Stephen G. Breyer, “The Interdependence of Science and Law”, Address at the 1998 American Association for the Advancement of Science Annual Meeting and Science Innovation Exposition, Philadelphia, Pennsylvania (February 16, 1998).

recognition of their distinguished and continuing achievements in original research.”¹¹ I’m not certain, however, that this selection criterion is sufficiently specific to permit judicious selection of decision-makers or advisers in disputes regarding economic science occurring before courts or antitrust enforcement agencies.

I have also discreetly and very unofficially sounded out the American Economic Association on its willingness to provide lists of experts or qualifying criteria for experts to serve in the capacity of neutral advisers in complex antitrust matters. I’m sure it will warm the heart of every dues-paying AEA member – of which I am one – that the Association has a “certification” detector that immediately labels as a hostile intruder and immediately rejects any initiative suggesting that the Association might perform anything resembling a certification function. The AEA simply doesn’t want to be associated with anything that could be characterized as a professional barrier to entry, other than charge annual dues. Dues which, incidentally, are graduated according to the member’s stated annual personal income.

One can envision other means of focusing appropriate expertise on these extremely difficult problems. Perhaps there should be a multidisciplinary body consisting of intellectual property experts, technical experts and antitrust economists – all of who would, of course, be personally disinterested in the outcome of the specific dispute. Such a specialized body might be envisioned as a court of competent jurisdiction in the case of complex antitrust matters, including disputes involving intellectual property licensing practices, or it might simply play an advisory role to existing decision-makers, whether they are antitrust enforcement authorities or adjudicative bodies like the Antitrust Division and the FTC, or the federal district courts.

¹¹ See the “Overview” page accessible from <http://www4.nationalacademies.org/nas/nashome.nsf/>

To echo the opening theme – the same theme sounded by Professor Turner in 1984 – none of the practices we are considering here is appropriate for *per se* treatment. The auspices indicate that eventually, whatever the current state of the law, the *per se* rules applicable to intellectual property licensing practices will all fall. I read the *Antitrust Guidelines for the Licensing of Intellectual Property* as a strong and welcome endorsement of this trend. But we need now to focus on the practical challenges of making intelligent and efficacious decisions once we commit ourselves to the application of standard scientific method to disputes involving antitrust and intellectual property or misuse of intellectual property. I hope these hearings will produce some additional focus on this vital institutional question, which has long been sidetracked or ignored.