FEDERAL TRADE COMMISSION

I N D E X

FEDERAL TRADE COMMISSION

In the Public Hearing on:)
COMPETITION AND INTELLECTUAL)
PROPERTY LAW AND POLICY IN)
THE KNOWLEDGE-BASED ECONOMY.)
------------------------------)

MAY 2, 2002

Room 432
Federal Trade Commission
6th Street and Pennsylvania Ave., NW

The above-entitled matter came on for hearing, pursuant to notice, at 9:02 a.m.

WORKSHOP CHAIRPERSONS:

GAIL LEVINE, FTC
ROBIN MOORE, FTC
WILLIAM COHEN, FTC
WILLIAM STALLINGS, DOJ
MAGDALEN GREENLIEF, PTO

PANEL ON: A COMPETITION VIEW OF PATENT SETTLEMENTS

PANEL MEMBERS:

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

STEVEN A. STACKS, Dechert

THOMAS O. BARNETT, Covington & Burling

JOSEPH F. BRODLEY, Professor, Boston University School of Law

ROBERT N. COOK, Drinker, Biddle & Reath

JAMES J. EGAN, Novirio Pharmaceuticals

RICHARD A. FEINSTEIN, Boies, Schiller & Flexner

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

CARL SHAPIRO, Professor, Haas School of Business, University of California, Berkley

P R O C E E D I N G S

MS. LEVINE: Good morning.

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

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

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

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

We also have with us today James Egan, senior vice president of Novirio Pharmaceuticals; Robert Cook from Drinker, Biddle & Reath; Carl Shapiro of the Haas School of Business, University of California at Berkley; George Cary of Cleary Gottlieb, and Steve Stack from Dechert.

Just a couple housekeeping matters for the day. We're going to start the day with a couple presentations by Steve Stack and by George Cary. We've asked them to make some short presentations, just to kickoff the issues for us.

Steve is going to present on the cross currents of policy in the patent settlements area, and then George Cary is going to be making a presentation on some other key issues that have come up in the patent settlement area.

Then we're going to have a panel discussion. We're going to open it up to the entire panel for conversation, and basically we'll be covering three areas. The first area will be, why do firms settle patent litigation? What are the pro-competitive, efficiency-oriented reasons that firms settle patent litigation?

After that, I thought we would take a little break from about 10:00 to 10:15 and then we'll get into the real thorny questions of, When do patent settlements pose antitrust concerns, if they do, and finally, when does Noerr pose a defense to an antitrust challenge to a patent settlement?

With no further ado, let's turn to those PowerPoint presentations. Steve, would you kick us off, please?

MR. STACK: Picking up on Gail's suggestion, my experience with patent settlements basically comes from the perspective of the patent owner, so those of you who want to ready your ad hominem arguments, that's where I'm coming from. At least that's where my experience lies, and primarily in areas like pharmaceutical and chemicals.

I'm really going to talk about -- give a brief overview of some perspectives, which will just open up the discussion on why parties settle patent litigation, and then, as Gail said, I'm going to lay out some of the policies that are involved, and I was also asked to identify some of the unique antitrust issues, just lay them out to serve as a foundation for the further discussion.

So starting with why parties settle, a couple of reasons primarily. First and foremost, they want to eliminate risk and uncertainty. Most companies prefer not to entrust the fate of a key product into the unpredictable hands of a judge or a jury, if they can avoid it.

They would rather accept the compromise that gives them half a loaf rather than everything they want. It makes business planning a lot easier, in the long run reducing risk probably reduces your cost of capital, so in the end they settle cases for the same reason they buy insurance or they hedge currency risks. They want to eliminate uncertainty.

Also they want to obviously avoid litigation costs and the fall-out from litigation. We're talking about obviously the expenses of a trial, but there are other expenses as well or at least other costs as well.

We're talking about management distraction, adverse publicity. The analysts, if it's an important product, will follow the litigation. That tends to depress the shareholder value, and they want to avoid that adverse effect as well.

Also as they go through the course of a litigation, there's a dynamic factor at work. Litigation has its ups and downs, battles lost and won, and as the parties go through that process, they may begin to question whether they're likely to get what they hoped to get at the outset of the litigation.

As litigation expectations shift, other things are shifting as well. The market for the patented product may be changing. The parties' patent portfolios may be changing. A patent that's deemed to be very important at the outset of a litigation may, as further innovation is done by the patent owner, become less important. The strategic value of the patent in suit, therefore, may be changing as well.

As a result, business solutions that might have been unthinkable when the complaint was filed suddenly begin to look a lot more attractive, and as these factors begin to line up, the result is often a settlement agreement, and it's frequently brokerage by a judge or a magistrate or a courtappointed mediator.

Turning now to the policies that come into play. I don't intend to offer my own opinion on the relevance of the merits of each of these, but I'm just going to lay them out as policies that at least deserve some consideration.

I'll start with the obvious one since we're in an antitrust forum here, and that is preserving competition. It may not be quite as simple as it sounds. As we've seen from the outset of these hearings, maximizing consumer welfare requires some balance between short-term benefits from competition, uninhibited by patents or unimpeded by patents, and long-term benefits from innovation, which may be enhanced by patent protection.

That leads to the second related policy concern, the effect of patent settlement rules on innovation. The point here is that harsh or uncertain rules may deter settlements. That may lead to more uncertainty over the value of patent rights in general, which may in turn lead to less innovation, at least in those industries where patents form an important role in fostering innovation.

Another policy consideration, again central to antitrust, is efficiency. Two of the most obvious efficiencies I've mentioned before are eliminating risk and avoiding legal expenses. Here I want to suggest really a third one.

Litigation produces a lot of information about the patent and about the importance of the patent. The parties don't have that information in a normal licensing context. If you believe that better information leads to more efficient transactions, you might conclude that licenses negotiated in a settlement context are more efficient than licenses negotiated outside of litigation when you don't have that information that you get during litigation available to you.

So, to the extent that antitrust rules discourage settlements, they may drive the parties to do more licensing transactions outside of litigation before the suit is filed. They have less information there, and you might conclude that those transactions might be less efficient than the transactions you would get in a settlement context.

Another policy that comes into play obviously stems from the role of the courts in the patent system. To put it bluntly, they're the ultimate determiners of the patent validity, so it is their role, along with obviously the PTO and the processes of the PTO, to weed out invalid patents.

And it's for this reason that many of the antitrust and patent law doctrines that you see have been shaped by an explicit policy of encouraging challenges to patents.

Settlements obviously run counter to this policy since they take the issue of validity away from the court, so again you might say that strict antitrust rules that discourage settlements are a good thing, a good thing because force more cases to trial where invalid patents can be eliminated, but there's also a double edge to this sword as well.

If you force patent litigation into a dual to the death with no exit possible, you may deter patent challengers from entering risk in this the first place. The result would then be fewer patent challenges.

Last, but certainly not least, we have the judicial policy favoring settlement of litigation. There are really two dimensions to this policy. There's a general social policy that says compromise is better for the social fabric than a regime of what I'll call pistols for two, coffee for one, and far importantly, a strong need to clear the courts of disputes that do not need to be there.

I'll turn back to this policy later, but let me say that it's one that antitrust cannot afford to ignore because simply the plain reality is that judges are going to give it very great weight, and it's going to enter into their decisions whether antitrust purists would like that result or not.

Finally, let me just take a couple minutes to tee up some of the issues that are raised by settlements. I'll be focusing here on issues that are peculiar to the settlement context. There are obviously a lot of issues that come up with settlement agreements that are the same as issues that would come up in licensing agreements and would be treated in the same way that they would be treated in a licensing context, but what I'm going to focus on are agreements where the settlement context adds a dimension to the problem that isn't there in other contexts.

Without a doubt, the most difficult issue in the settlement context, at least in my view, is what credit you give to the patent itself and the power of the patent to exclude competition.

Settlement agreements very often contain licenses that limit the licensee's activity operating within the scope of the patent. They may restrict the licensee to a specific territory, to a specific field of use or to a particular time frame within the patent term. How you approach the exclusionary patent power of the patent will give you very different results when you consider those kinds of restrictions.

It seems to me there are basically three options. You can presume that the patent is valid. You can ignore the patent all together, or you can treat the patent's power to exclude as a fact issue, something that you litigate ab initio in each case.

If you assume that the patent is going to be valid, several things flow from that. The relationship is vertical, not horizontal. There's no anti-competitive effect that can be attributed to the settlement agreement because the restriction it's operating within the scope of the patent, and therefore there's no effect beyond the scope of the patent.

And thirdly, the 1995 IP guidelines and the case law analysis provides a rich source of authority for analyzing the licensing agreements because a great deal of it depends on the assumption that the patent is valid.

You can also ignore patent rights. In that situation the parties' relationship very often, if they're competitors or would be competitors otherwise, is horizontal, and many of the common licensing restrictions could be per se illegal. I mentioned before territorial restrictions, field-of-use restrictions and restrictions on time within the patent currently.

Finally, there's the possibility of treating the patent exclusionary power as a fact issue, something that the courts and the agencies really haven't tried to do so far, at least to any great degree. The key question under this approach is, What do you have to prove, and how do you go about proving it?

Must the antitrust plaintiff relitigate the patent case and prove that the patent is, in fact, valid, which would in a sense be a retroactive kind of determination? How would this square with the policy that I mentioned earlier favoring judicial economy, or can the plaintiff prove perhaps from the evidence of the parties' own assessments at the time they entered into the settlement, that below a certain probability of success, the exclusionary power can be discounted or even ignored all together?

If so, is this a workable standard? Why wouldn't you then apply the same analysis to ordinary licenses because when you think about it, a license really is a settlement agreement of a dispute that hasn't ripened into litigation yet.

Another issue: what is the relevance of intent? Can we use intent to separate good settlements from bad settlements? The first question there is, What kind of intent are we talking about, an intent to exclude competition? Isn't this why people get patents in the first place, to exclude competition? How reliable, therefore, is that as a criterion?

How about the intent to avoid a determination of patent invalidity, which is a factor in some of the older cases? Again isn't this always why people settle cases, to avoid an adverse decision? So how reliable is this as a criterion that would separate a good settlement from a bad settlement, or are there other forms of intent that might be relevant as well?

Next big issue, Is the per se rule appropriate in the settlement context? It seems to me this raises several subsidiary questions. What about the efficiencies we mentioned earlier? Don't these take you out of the per se category? Can we say that settlement agreements are anti-competitive in an overwhelming number of cases, which is another criterion for per se treatment?

If you think that the patent owner might win a significant number of cases that settled, then maybe settlements can't be illegal per se because they don't have that overwhelming statistical probability that they would be anti-competitive.

And finally, what about the judicial policy favoring settlements? Isn't this a redeeming virtue that in and of itself precludes per se treatment?

That leads right into the next significant issue. How in an antitrust analysis do you factor in the judicial policies favoring settlement? Is this a make weight? Is it a trump card? Is it something else?

One difficulty with this is it really operates outside the antitrust value scale. There's no competitive variable coming from this policy that you can balance with the other competitive variables that you usually turn to in a rule of reason analysis.

How then can you account for it since there's really no common unit of measurement that embraces all of these policies? How do reverse payments affect the analysis, obviously a big issue these days?

As you know, reverse payments are payments that run from a patent-holder to the alleged infringer. Normally you would expect the payments to run the other way. Given the suspicion that these payments may represent a sharing of monopoly rents, should they be presumed unlawful?

Is that presumption stronger when the amount of the payment exceeds any reasonable expectation that the alleged infringer would realize in terms of the amount of income if they successfully -- amount of profit if they successfully entered the market which they would enjoy?

And, finally, do settlements enjoy immunity under the Noerr-Pennington Doctrine? Do they come within the principle that immunizes activity that's incidental to litigation, or is there some other basis for immunity, and does it depend on the scope of the court's review or court approval?

These are some of the issues as I see them. I am sure that others will surface as the discussion proceeds, and I think George is going to flesh out some of the points that I treated rather cursorily.

MR. CARY: Thank you. Thanks, Steve.

My background is a little less focused than Steve's has been, for good or for ill. My background comes first from representing patent challengers in the high tech context. I also have background at the FTC working with patent issues and approaching it as an enforcement agency might.

I was involved initially on behalf of generics in challenging some of the agreements whereby generics and branded pharmaceutical companies settled patent disputes in a way that resulted in the generics not coming to market, but I've also advised branded pharmaceutical companies in terms of what kind of settlement agreements would pass antitrust muster, what kind of licensing agreements would pass antitrust muster, so I've been on both sides of that issue, counseled on both sides of that issue.

I've also been involved in the high tech area from the point of view of challengers who are asserting patent rights against monopolists. We represented Stack Computer, for example, when it was challenging Microsoft for a patent infringement, and I've been on the side of defendants who are also challengers to a monopoly position who have IP rights where the monopolist is in essence trying to put the competitor out of business by asserting IP rights against the smaller rival.

So my presentation is going to be a little less direct in focus than Steve's was, and I'm going to try to hit the issues from both sides, from all sides, just identifying what the issues are and talking a little bit about why firms settle and what the antitrust implications of that are.

Again, like Steve, I'm not necessarily going to take any firm and fast positions. Any position I take is going to offend somebody, so I'll lay them out there, and people can bat them down or applaud them as we go through.

So why do firms settle patent litigation? They settle because the gains from settlement in their judgment outweigh the costs of settling. That seems like a pretty bland and unobjectionable statement.

The question is, What are those gains, and how do those gains affect the antitrust analysis, and who's gains ought to be relevant in the antitrust analysis?

There are really several interested parties here, not only the plaintiff and the defendant, but there are also customers of each who have a vested interest in how the patent litigation is resolved, so I'm going to assess the question of what the gains from the settlement are from the perspective of all three of those interested parties.

First of all, both sides to a litigation benefit by reducing litigation risks and uncertainty, and as Steve pointed out, that can be, depending upon the value of the patent, a very, very important issue for the economics of the firm and for its position in the equity markets.

An important factor that contributes to that significance is the all or nothing nature of patent litigation. The patent holder wins and the competitor is out of business, or the defendant wins and the patent holder loses any return on whatever investment it made on the innovations that it's trying to vindicate. So the stakes are high, and without a compromise, there is very little room for anything but an up or down decision.

The settlement will avoid litigation expense, which can be considerable, especially for a challenger, a challenger to an incumbent with market power monopolists, and it also distracts senior management and senior technological officials within the company, and the value of this cannot be understated.

If you have a high tech company, you live and you breathe by virtue of the innovations you're able to develop in the laboratory, and having important officials in the company off worrying about litigation and taking depositions and helping the lawyers, that can be a very, very expensive proposition, again probably more so from the perspective of a challenger rather than an incumbent, but it's important to both.

What does the plaintiff get from settling the litigation? First and foremost, it gets compensation for the infringement of intellectual property from its point of view as it sees it. Some compensation is perhaps better than the risk of none, even though the gains of all would probably outweigh that, but from the point of view of a patent holder, they've invested in innovation. They've come up with a patent, and getting return on that patent is important.

Oftentimes patent settlements involve sort of clearing the debris. Two firms will have patent portfolios. Those patents portfolio pose a risk to each other. The patent portfolios, therefore, are hanging over each other, and a patent litigation on one or more of those patents may result in a complete cross license, which frees both firms from the risk of future patent litigation, frees both firms to innovate in the most efficient way without worrying about inventing around patents, and can therefore provide values to the plaintiff as well, in this context I suppose to the defendant of clearing the underbrush.

Those are sort of the standard business justifications for intellectual property settlements. I'm sure there are others, but there are also strategic implications that go directly to the role of antitrust in this context.

One of the benefits of patent settlements can be to raise the costs of the competitor firm. It can also be to limit competition between the plaintiff and the defendant. Raising the cost could result from the structure of a license that's issued, so instead of having, for example, a lump sum payment, you might have a royalty that's paid on sales over time. That affects competition in that it might affect the pricing incentives of the firm, the defendant firm.

It limits competition by virtue of restrictions in the licensing agreement, which explicitly state that the license is good for one field of use and not for another with a recognition that competition without the license would be risky and might invite future litigation.

It can also limit competition by virtue of a clause in the settlement agreement where the patent is acknowledged, and the scope of the patent is defined, thereby precluding the defendant from entering into another area having admitted that the patent covers that area.

Finally, the plaintiff could use the patent settlement to leverage its legitimate monopoly by virtue of the patent in a particular technology into market power that goes to a complete product area, whether or not the patent is relevant or even beyond that in some cases, and this can be accomplished through careful and skillful crafting of the settlement agreement itself, so obviously the last three of these bullet points raise antitrust questions.

Finally the combination of the patent positions of the two firms that might be exchanged in a cross license, potentially an exclusive cross license, could also raise barriers to entry to third-parties by creating a patent thicket that deters others from trying to enter.

What are the gains from settlement for the defendant? Well, first of all, obviously the defendant potentially gets to remain a competitor in the marketplace. That's typically the case in patent settlements, not always the case as we've seen in some of the pharmaceutical cases.

Defendants often have very, very powerful incentives to enter into settlement agreements, not only because it allows them to stay in the specific product market that's at issue by virtue of the patent itself, but also because companies oftentimes have very, very large sunk investments that are related to the patented technology.

This can be an important driver because even if the patent itself is not particularly valuable, the investment that the company has around a product that contains that patented technology can be quite substantial.

That being the case, the patent defendant would be quite willing to enter into quite onerous settlement agreements, even those that restrict its competitive freedom beyond what one would normally expect in a licensing situation if you're starting from the beginning in order to protect that investment.

One of those investments might be the good will of the firm with customers. One of the fallouts of losing patent litigation is a presumptive injunction against further infringement.

In that context, customers can be at risk. Customers who are using the patented product that is being infringed could themselves be liable for infringement and therefore face a considerable risk that the company that is the original defendant in the case has to protect if it's going to remain in business. It's got a goodwill investment with its customers, and it has to do what it can to protect those customers from a finding of infringement.

One of the cases that we have worked on recently involved semiconductor capital equipment, for example, where an entire fabrication facility might be shut down because of a small patent that covers one tiny piece of technology. That kind of a risk would put the company that supplied the equipment out of business because billions of dollars are at risk for the customers of that company.

Customers can benefit from settlements in a number of ways. A settlement that allows the firms to continue to compete increases competition and allows customers greater choice. It avoids disruption from the inability from using the infringing product which we've said can be quite significant.

Cross licenses between the patent plaintiff and the defendant can reduce both company's costs, spread technology and expand output to the benefit of the customers, and consumer welfare can be enhanced relative to litigation alternatives by reducing risk and basically benefitting not only the plaintiff and defendant but also customers in that context.

So the question is, are these on balance, these considerations indicate that patent settlements are pro-competitive or anti-competitive? Obviously the gains from patent settlements to litigants can be good or bad for customers as we've seen. Patent settlements can be either anti-competitive or pro-competitive, and the real question is how do you tell the difference?

Telling the difference is obviously what we're all about here, and it is an extremely challenging effort from the point of view of the antitrust agencies. The source of the problem is that patent litigation involves competitors. It implicates the ability of one of them to remain in the market.

Settlements often involve private agreements between competitors which directly implicate the extent of their competition going forward, so it raises all of the concerns that horizontal agreements would ordinarily raise, and antitrust has historically been quite suspicious of private arrangements governing competition.

But more than in other contexts, these kinds of horizontal agreements are very hard to sort out, and the pro and anti-competitive elements of it are very difficult to balance. It's extremely difficult for outsiders such as the antitrust agencies to determine what exactly is the field over which the patent precludes competition.

Uncertainty in these cases is generally high, as we've seen, even for the parties to be able to predict what the outcome of litigation will be, let alone for the antitrust agencies to second guess that, and to the extent that the uncertainty might have resulted in a competitor being out of the market all together, presumably any settlement relative to that outcome is going to be pro-competitive, unless it extends beyond the patent field, and even then weighing the benefits of keeping the firm in the patent field against the anti-competitive effect of precluding it from other fields is an extremely difficult calculus.

So the uncertainty of patent litigation, the uncertainty of the field over which the patent would effectively preclude competition and the draconian effect of injunctions means that the anti-competitive effects may outweigh by the pro-competitive effects, but coming to that conclusion is extremely difficult to sort out after the fact.

One of the big dilemmas here is that given the tremendous leverage that the plaintiff has, given the lack of relationship between the value of the patent itself, which maybe in the first instance could have been easily invented around or was not a necessary part of the product, but once it's incorporated in the product, there's a huge investment that is made and is riding on the continued necessity of using that patent.

There is a tremendous leverage for the plaintiffs, even with the low probability of success, and combined with a presumption in favor of an injunction, what this means is that it's very difficult for the courts to sort out exactly what the value of that patent is and attribute a value to it rather than simply saying, You're not going to go forward and compete with that patent any longer. So the defendant's willingness to settle given that asymmetry in cost is not a good proxy for consumer benefits.

Since the "but for" world is particularly difficult to divine, it is more difficult than usual for agencies to second guess the effects of the private arrangement. Nonetheless, some aspects of patent settlements can be identified as more likely to raise competitive concerns than others, and I'm going to throw these out as suggested topics of conversation rather than taking a position on any one of them.

Consider the following generalizations: Settlements that enable continued competition are more likely to be pro-competitive than settlements that preclude competition going forward, which raises the question about agreements that enable future competition in exchange for payments.

What happens if the settlement results in an agreement that the infringer can use the patent starting two or three years from now? How do you balance pro and anti-competitive effects in that scenario?

Settlements that license without restriction are more likely to be pro-competitive than settlements that confine competition through ancillary constraints. Payments from the infringer to the patent holder are more likely to be pro-competitive than payments from patent holders to the infringers, especially when this is coupled with delayed entry or other restrictions on competition going forward.

Cross licenses are more likely to be pro-competitive than patent pools, which combine in one hand the right to license the individual patents of the competitors. Nonexclusive licenses are more likely to be pro-competitive than exclusive licenses. Exclusive patent licenses can prevent third-parties from entering and eliminates competition in licensing.

Lump sum royalty is more likely to be pro-competitive than an ongoing royalty based on sales. Again, the assumption is that a variable payment will affect prices more directly than will a lump sum payment upfront. A lump sum payment upfront will more emulate the initial investment which is usually fixed for R&D.

The problem is that because these generalizations do not always apply, it is difficult to fashion per se rules. On the other hand, because of the great uncertainty and other limits on the agencies' ability to determine the likely outcome of patent litigation, with its "all or nothing" characteristics, it is difficult for the agencies to perform a rule of reason analysis, thereby creating the problem.

MS. LEVINE: Thank you very much. Thanks to both of you for teeing up the hard questions for us.

Again, let me sort of go over the ground rules. Please jump in at any time. We'll toss out questions -- Robin's going to throw out the opening pitch -- and please turn up your name tents like this if you want any one of us to recognize you so you have a chance to talk. And don't forget, as George and Steve did so well, please introduce yourself and give yourself some background so we know the context of your thoughts this morning.

Robin?

MS. MOORE: My first question was going to be: Why do firms settle? And focusing on the efficiencies, since both Steve and George gave us a number of reasons that firms might settle, maybe the best thing to do is open it up to the panel for comments and questions.

(Discussion off the record.)

MR. COOK: Hi. I'm Bob Cook, and I guess for the last three years I've provided counseling on some of these issues. Before that I was at the FTC and was involved in the investigations of the Digital Intel settlement and the Boston Scientific Ciba settlements so that's where I'm coming from.

And I think what came out is parties settle these for the same reasons they settle other lawsuits, and so it's efficient between the parties, and the question is whether -- and I think Carl pointed it out in his article, whether there are persons who might be harmed by the settlement that make it not efficient in an economic sense, and that's why antitrust comes up.

You might have consumers harmed, for example, in ways that are cognizable under antitrust, and that comes up. There might be other parties too. Settlements are not immune from other legal rules or regulation.

MS. LEVINE: Carl?

PROFESSOR SHAPIRO: Hi. I'm Carl Shapiro. I've actually been working on and writing papers on licensing going back about 15 years. More recently I've been involved in a number of these cases involving settlements, and I've written a paper, economic research paper which was made available I believe.

On this question about why firms settle, I guess I might suggest turning it around. Why don't firms only settle? The reason I put it that way is one of the principles from the law of economics, settlement generally, and not just in the patent area, is that since there are costs associated with litigation, that we would think typically there would be some mutual benefit of settling rather than incurring those costs.

So, in fact, the academic literature at least has asked, Why do we get disputes that continue, even though it's costly to fight it out?

Now, of course, you might just as well ask why don't we always have peace instead of war, but one of answers is the usual reason we don't get settlements is when both sides are relatively optimistic about their prospects, okay, so there's going to be disagreement about, I may think I have a 70 percent of chance of winning, and you may think you have a 50 percent chance of winning.

Well, those are kind of inconsistent, but we may hold those beliefs, and therefore we each want to pursue it. I would just throw that idea into the mix, that firms usually -- I mean, after all, we see tons of settlements. We see licenses. We see cross licenses.

We see enormous numbers of settlements usually before there is litigation, and then we see a relatively small number of litigations, and those are the cases where again by this basic principle, both parties are relatively optimistic, and so they want to go forward, and perhaps they learn more in the process that narrows those differences of opinion, and then they can settle at a later point, even if they couldn't settle it prior to entering into litigation.

PROFESSOR BRODLEY: I'm Joe Brodley. I'm a professor at Boston University Law School. Just in response to the last thing, Carl, you know, if they always settle, then we would have to subsidize litigation because without the flow of litigation, we wouldn't have any law.

So that parties when they litigate, thank God, really do have differing views or opinions about settlement.

MS. LEVINE: You don't want to go to a Code system?

PROFESSOR BRODLEY: I think that actually runs through some of the topics today, which is the positive value that litigation contributes both through clarifying the law and through the deterrent effect it has on improper patents.

So that's getting a little bit beyond the topic right now, but it just seems to connect with the fact that a world in which all cases settled would not be what we're aiming for and is not a legal world I suggest.

MS. MOORE: Jamie?

MR. EGAN: James Egan. I'm with Novirio Pharmaceuticals. And I would like to come at this from an industry perspective. I recognize the cost of litigation can be considerable in these matters, but in the bio-tech and pharmaceutical industry, at least in my limited experience, litigation costs often more or less is a rounding error.

When you're talking about patents that deal with billions a year and the lawyers are costing you ten million a year, for some of the CEOs in this industry, that's bigger than the greens fees, but it's not bigger than the cost of gassing up the G 5.

It's a situation where I think it many cases the consumer interest gets lost out in the shuffle. The activities of the legal profession, God love them, are important to us, although I don't know if we should subsidize them or get better laws, but the long and short of it is strong patents don't get litigated against. It's the marginal patents that do.

When you get into territories where you have two major players with the wherewithal and the interest to get into litigation, allowing them to come to a settlement and not have greater antitrust agency review on a regularized basis I think is a little bit like sending the goat out to guard the cabbage.

I think the consumer interest is best represented by the agencies who are the advocates. One of the background areas here for me is that the business community is an adversary system. That's what competition is really all about, and the legal system is certainly an adversary system, and I don't see strong advocate consumers in most of these settlement negotiations.

It's usually after the fact. I don't know for a fact whether people file Hart-Scott-Rodino disclosures when they reach these settlements or anything of that nature. I don't know how regular the communication is to the FTC or the Justice Department. I imagine litigants don't go in and ask the permission of the competition agencies on a regular basis.

But speaking more as a consumer, as someone who makes a living from a legal profession or someone that would like to protect patents, I was wondering whether there was any concern among all the citizens located here today, whether there's an interest in the consumer's interest in these settlements today.

MR. PROGER: Phil Proger, and let's see. I have represented patent holders in a number of industries, including today pharmaceutical patent holders who have been involved in some of these settlements, but in saying that, I want to round it out by saying I've been practicing antitrust laws for 29 years, and I'm a strong believer in our free market system, and antitrust is the referee of that system, so I think, I hope this can come out with some balance.

I think this is a difficult issue, and I think it is a very broad issue. You have a number of competing incentives. There's the incentives and goals for the society to have competition. There's the goal of society to have innovation through a patent and intellectual property protection system. After all that's in our Constitution to have it, and there's the goal of having settlements and judicial efficiency.

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

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

One point about consumers, certainly consumers benefit by good settlements and do not benefit by bad settlements, but let's remember, consumers also benefit by a system that rewards innovation and a system that promotes new drugs, new products, new inventions, new technology.

MS. MOORE: Bob?

MR. COOK: I was going to respond to something that Jamie said, that consumers aren't represented at the table, and in a sense this is kind of a classic law and economics problem because although you might believe that if transaction cost were zero, that the negotiation would produce the most efficient results economically, in some cases you have high transaction costs that bring certain parties in, for example consumers, that don't know about the settlement, who are sort of atomized people out there buying things, and they can't be represented.

And so it's possible that the result would be inefficient with regard to those consumers, and typically that's where the law steps in, to impose the results that would have come about if transactions -- excuse me, transaction costs had been zero, and I think that's what antitrust has a role in doing with regard to these settlements for that kind of harm that antitrust addresses.

MS. MOORE: George, did you want to say something?

MR. CARY: Yes, I wanted to pick up on something that Carl said and something Bob just said, and that is this question of why cases don't settle, and the assumption that it either has to do with transaction costs of arriving at that settlement or it has something to do with optimism about the patent.

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

He can extract all that sunk investment that the patent alleged infringer has incurred, and therefore he might demand that kind of a payment, and the infringer night cringe at having to pay that kind of a settlement fee in order to resolve a patent dispute where, in fact, that investment has very little to do with the specific patent at issue.

MS. LEVINE: Can you give me -- just to flesh that out a bit, can you give us an example of what you have in mind there?

MR. CARY: I'm going to tell you one that was in the news, and I'm not going to claim what the specific facts were, but it's a hypothetical. Somebody who holds a patent on windshield wipers for automobiles. The windshield wipers are tied into the way the car is manufactured for some reason, and to stop producing the cars in order to change the windshield wiper design might be disproportionately expensive relative to the value of a particular design of that windshield wiper.

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

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

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

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

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

MR. CARY: Conceivably, yes.

MS. MOORE: Rich?

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

I want to state for the record that although my firm is involved in privately litigating some of these issues, I have no role in any of that. I'm of course recused from participating in any private litigation that is related to matters I worked on at the FTC, but I have continued to think about these issues since I left the Commission last year.

And I'm sure I'll have other things to say later on, but what I wanted to just note sort of initially was something that popped in my head in response to Phil's comment about the benefits of the patent system as a reward, an incentive for innovation, all of which is absolutely true.

However, I think it's worth remembering that patents aren't forever, and exclusivity isn't forever, and the end of exclusivity is also an incentive for innovation, and to the extent that settlements may improperly prolong periods of exclusivity, they may be problematic for that reason.

MS. LEVINE: I have a follow-up question. I don't want to get into the nuts and bolts on the issues except how do you mean -- what kind of prolonging of the patent term do you imagine happening with patent settlement.

MR. FEINSTEIN: Well, it's probably most likely to occur in the setting that involves the Hatch Waxman settlements, which as I said, to the extent I have any expertise in this area, it would be there, and typically those settlements have not involved sort of the patent on the compound, which would in some sense be a blocking patent.

It tends to be a patent on the delivery mechanism or sort of the bells and whistles that accompany the basic patent, which typically has expired.

In that situation there could be -- you can imagine a settlement which could have the effect of prolonging -- in effect prolonging the period of exclusivity for the product as a whole.

MS. LEVINE: Thanks.

MR. BARNETT: I'm Tom Barnett. I'm with Covington, and I have advised a number of companies. I probably should confess I'm a bit like Steve. I tend to be on the patent holder side of the issue, so I will confess that up front, largely in the pharmaceutical area, and indeed I had some experience with Rich when he was at the FTC on some issues that at least touch on this.

I think there's been a very good summary of the reasons why you settle: the uncertainty, the cost. What I would like to underscore is a lot of the dynamics of what is involved and how difficult it is to take into account all of the factors that come into play, and just two sort of examples is, Why don't people settle?

On the one hand, if you are the patent holder, you're defending the patent and you have somebody challenging it, and you settle with this plaintiff or defendant, you may well have a stream of 5, 10, 15, 20 companies following on, and you've set a precedent now, and so the cost of your settlement is more than just the cost of this particular suit.

Also I guess on the other side of it is why you might settle, if you take the example of the pharmaceutical industry where you've got a major compound that's a billion, $2 billion a year drug, and a company is trying to decide whether or not to settle this challenge, it's not only the litigation cost, it's not only management distraction. To some extent it goes to the fundamental philosophy and business decisions of the company. Do I have one to two years of this revenue coming in to fund research and development? If there's uncertainty, I may be less hesitant to make that investment, so the settlement that prolongs the exclusivity period can in fact give me the assurance that I have the funds to undertake a high risk venture on a new compound that may cure cancer. Or do I have to retrench and look to be saving money, cutting back on R&D because I may lose this stream within the next year or two, whenever the litigation ends. And if it ends adversely, and as we've seen, for some of these major pharmaceutical compounds, when the company loses the patent, the very existence of the company is at issue, and that's certainly something that can be quite distracting.

So the main point is just taking into account those dynamics I think is a very difficult task.

MS. LEVINE: Does the length of the patent litigation -- is that a factor when firms are making these decisions?

MR. BARNETT: It can be a factor in a number of ways, but I think -- let me put it this way. I think the biggest challenge here is the uncertainty, and the longer the uncertainty goes on, the worse it is all around, and I mean it's sort of getting beyond the question, but I at least am interested in exploring ways in which we could reduce the uncertainty that these companies face on both sides of the equation.

MS. MOORE: Phil?

MR. PROGER: Let me just note that there's another reason why you may see a settlement that we haven't discussed, and that is there may be a disparity between the parties in terms of their capital and their longevity, and it works both ways.

If you are say a start-up company and you are the challenger, you may not have the wherewithal to go the full length of the litigation, but conversely if you're the patent holder and the challenger doesn't have adequate resources to give you a remedy should you prove to win, that's a pyrrhic victory for you, so those incentives often affect settlements.

I also wanted to note one other thing because I thought George introduced something that was very important. We're talking about settlements here, but really we should step back, and it's the litigation process because he was talking about how litigation in and of itself could be used as an effective tactical way to gain competitive advantage.

And I'll also note when we talk about settlements, that's sort of a nice rubric on what we're talking about, but we're really not talking about settlements because there's nothing inherently competitive or anti-competitive with settlement. It's the restrictions within agreements of settlements that we have to look at.

MS. LEVINE: Is that really a pyrrhic victory? You get something out of it, right? You get an injunction.

MR. PROGER: No. Let's say -- one of the things we haven't talked about here is the distinction between lawful competition and unlawful competition. What the patent laws give you is not a monopoly but rather the right to exclude. Whether it's a monopoly or not is an antitrust issue. But if you have a valid enforceable patent that somebody is infringing, and that someone therefore takes away legitimate returns that are owed to you for your innovation and ultimately you prevail, but if that entity is judgment-proof because they have no assets, where's your remedy? You've lost. Maybe your market has been destroyed and an innovator that faces that as all innovators broadly have to factor that into their R&D, to their other analysis to their decisions of whether they're going to proceed with the appropriate investors.

So from a societal standpoint, we need to be concerned about that.

PROFESSOR BRODLEY: My comment goes back to James Egan's remarks. I thought that you said something extremely striking. I wonder if other people agree. You said that strong patents don't get litigated and marginal patents do.

Now, I think that is -- I would like to know if the rest of you agree. What I'm thinking is that if that's the case, then the losses from litigation would be a lot less than one might think because it's -- the biggest problem in patents is the invalid patent because that causes a pure social loss. So if the class of more likely invalid patents are the ones being litigated, I didn't take that as an inference from what you're describing, but it seems to me this puts it all in great perspective.

Just as long as I'm talking about this, you said the consumer interest isn't represented directly. Yes, but of course that's where the government agencies come in. But the main thing I wanted to ask is whether the other people really agree with that statement.

MS. MOORE: I guess I'll take Tom and then Phil and then -- do you have a comment on that or do you have a different topic?

MR. COOK: I have a very brief comment, and I can hold off on that.

MS. MOORE: Okay. Great.

MR. BARNETT: I guess I certainly don't agree with the statement in that strong a form. I would say that the patents with the greatest degree of uncertainty are most likely to get litigated and you combine that where the most is at stake, and you can imagine, again to take just the pharmaceutical situation, if you have a generic company that's looking at getting into a $2 billion a year market, a relatively low probability of success may make it worthwhile to pursue that because the reward is so high.

Or you have a situation where the patent is very strong but the scope of the patent is unclear or uncertainty, and that may be what you mean by a weak patent in that context, but that to me doesn't say the patent is weak. There's just a great deal of uncertainty, and that leaves room for parties to disagree as to the probability of success as well as some of the other factors.

MS. MOORE: Phil?

MR. PROGER: I'll be real brief because I was going to say what Tom said in the Hatch Waxman context, I don't think that's necessarily a true statement.

MS. LEVINE: How is that?

MR. PROGER: Well, because under Hatch Waxman, the alleged infringer has very little risk because you file the ANDA pursuant to the statute, and that's your act of infringement, so as Tom pointed out you could have a very low probability of success against a very strong patent, but you don't have much at risk, and there might be an enormous reward if you could knock it out.

So you may very well want to challenge a strong patent that has a lot of returns.

MS. LEVINE: And in the non-Hatch Waxman context?

MR. PROGER: I think in the non-Hatch Waxman context, it's a little bit different because there you're allegedly infringing, and you may have a lot more at risk, and I think it also differs a little bit, and we failed to mention that a lot of times people get sued for infringing without realizing that they're infringing.

But when you said strong patents do not get challenged, particularly in the Hatch Waxman context, I don't think that's necessarily true.

MR. EGAN: I don't know anybody in my industry who's in the habit of challenging strong patents and doing well. Perhaps that's a new industry that will emerge. I don't know.

But my guess is that if people are talking about the scope of the patent, my recollection from years earlier when I was at the Department of Justice is that basically patents are an exception to the competition rule and that the public policy of the land is free competition.

If your patent isn't defensible and yet is established, that's in essence an injury to competition. If someone has an incentive to challenge your patent, and if the scope of your patent is narrowed from what otherwise might be perceived, that is a benefit for competition. Sure it's a loss to the patent holder, but it's a benefit to competition.

I think Hatch Waxman was brought on because there was certainly a perceived concern of the inadequacy of competition in that area.

I think it was the Roche Barr case that was one of the things that set the guideline and got an amendment so that the generic industry can do research work so that right after a patent is off, there might be somebody entering the market.

There is a difficult interplay between regulation and our pharmaceutical industry and patents and the long term it takes to come to market and the need for long-term investment. There's no question about that, but I would say that in terms of strong patents, if we could acknowledge that there are strong patents out there, many strong patents never get touched on major drugs.

If there is a drug -- a patent that has a vulnerability on a major drug, I agree with you, people would be more inclined to go after that, but I think that's more a measure of the patent than the size of the drug. Certainly it's an economic element to that as well.

But I don't think anybody, even on a major drug, will go in and fight the patent that is pretty much clear on its face. The generic industry is very cost-sensitive. If there would be anybody it would be more on the proprietary side would be inclined to think in those terms.

I think there have been studies done on the level of patent validity of cases that are litigated to a final conclusion, and I think as you go further into it, the validity of the patents tend to be less and less defensible, but I don't know.

I stand to contradiction, if that's not the case today perhaps the law has changed.

MS. MOORE: Bob, you've been waiting a long time.

MR. COOK: That's okay, I was just going to comment, and it's probably just as apropos now as it was when I was going to make it originally, that when parties are litigating these pleadings and arguing these cases and then settling these cases without thinking ahead of time they're going to have a settlement, that may raise antitrust issues, they often say things that come back to haunt them because you're making really statements applicable to product market issues because you're saying that they infringe, and you're saying you would have gotten all the sales that the other guy got.

And that's problematic then when you run into an antitrust review of the settlement because you may have foreclosed some of your issues. That was my comment.

MS. MOORE: I actually had a follow-up question to something you said earlier and something that George brought up in his presentation. When we kicked off, Bob, I think you said that you settle in the IP context for the same reason that you settle any sort of litigation, and when George was making his presentation, he brought up the point that in the patent litigation, you're pretty much talking about an all or nothing gain.

So I would like to get the panel's reaction. Is it different in the IP context? Are the efficiencies different because of that?

MR. COOK: Well, I guess my point was simply that the efficiencies are efficiencies between the parties.

MS. MOORE: Okay.

MR. COOK: That is, the parties have a view of what the outcome of the litigation is going to be, the cost of pursuing it and the cost of not pursuing it and strategies that may implicate other litigation and how much they're likely to attract or appeal other litigation that in the long run will lead them to make a decision when and how to settle, and that that is not as independent of antitrust considerations which go to consumer value and things like that.

That was my point.

MS. MOORE: Okay. Rich?

MR. FEINSTEIN: I wanted to throw one other thought into the mix on this little debate about strong patents and weak patents and which are more likely to generate litigation.

And I'm not a patent lawyer and would always defer to others on the distinction between a strong patent and a weak patent, but it does seem to me again built into the Hatch Waxman regulatory scheme, there's a little bit of a safeguard because that process begins with a certification by the ANDA filer that their product either does not infringe or that their patent in question is invalid.

Now, obviously those certifications can be made in bad faith, but that is a bit of a safeguard, and when you add to that the automatic, in effect, preliminary injunction for 30 months that follows with that if litigation is initiated, and the fact that that is usually the opening salvo on what can become a pretty expensive battle pretty quickly, it seems to me those are all factors that suggest that the least assailable patents are least likely to be challenged in that situation.

And again I say that more as a matter of logic than as a matter of patent expertise.

MS. LEVINE: Let me see if I can throw out to the panel a question Professor Brodley raised in the his written statements, and it was a question about the data. Have you all heard of any studies, any empirical evidence that shows what the competitive effects of patent settlements has been?

Maybe this is a question for our resident economists.

PROFESSOR BRODLEY: I'll defer to him.

PROFESSOR SHAPIRO: Well, I may be resident economist but I don't have a good answer. I know there's certainly a bunch of empirical work about sort of the win and loss rates of different cases that get litigated, but in terms of the actual effects of settlements, it's just always seemed to me the big problem for the empirical work is they say, We don't have a database of settlements, we just don't know what the universe is.

Again first off, and this is going to come up more this morning, how broad are we defining it in terms of settlement? If somebody has a licensing agreement is that a settlement, or is it only when they get into litigation and then they stop, that's a settlement? So what's the universe to begin with? You could define it quite broadly. A merger could be a settlement of IP litigation as well, so what's the universe you're talking about?

And is there a database? Most of these things are private anyhow. A lot of them are not HSR reportable certainly, so -- and I think Joel Klein a few years ago floated the idea of notification of settlement.

We don't have that so, I think there's just no good comprehensive databases on settlements or licensing arrangements for that matter, so to my knowledge at least it's more anecdotal and case-based that people talk about, Well, this settlement, the ones we've dealt with.

We look at the Intel Digital situation, and that was studied, and there was a consent order and so forth, so it's more case by case rather than any systematic empirical work, and I don't see must prospect moving beyond that given the data that's likely to be available.

PROFESSOR BRODLEY: I don't have the answer to the question you posed but let me suggest this. We do have data on the casualty rate of patents that are litigated in the courts, and it used to be overwhelmingly rejecting patentability.

Today I don't know the exact data but it's like a third or 30 or 40 percent. I don't know if anybody has that figure -- of the patents that go to the court, how many are ultimately invalidated. Maybe, you know, but anyhow it's really a substantial percentage.

Now, so we do have that data set. Is there any reason to think that the group of patents that are selected to go through litigation are not reflective of the totality? You said that, Well, they're optimistic, but both sides are optimistic.

Are there any reasons to think those patents are different? If not, then maybe that could be -- could supply some sort of a basis or an estimate for the ones we don't know anything about.

PROFESSOR SHAPIRO: I would add I know my colleague Mark Lemley at the Law School of Berkley has done some work on tracking these win and loss rates. That's one of the things we do have sort of systematic data on, and in particular how that changed after the creation of the Federal Circuit.

There was a shift, I can't remember the numbers, where I think patent holders were doing better, and then I think it settled out once people understood that so you went back sort of to an equilibrium that was arguably more favorable to the patent holders as a result of the CAFC.

But your other question I think is an interesting theoretical question, whether we should infer -- whether we can make an inference about the things that don't get litigated to conclusion, the patents that don't get litigated to the conclusion based on the probabilities associated with the ones that do, and I guess if I had to guess, I would say we probably we could use that number, but I may be missing something.

PROFESSOR BRODLEY: So anyway my best recollection is today it's about a third of the cases result in invalidation of the patents, so that's a working number I'll use, unless someone has a better one.

MS. LEVINE: I think this probably is as good a time as any to take a break. My apologies for promising a ten o'clock break and delivering at 10:20. It's a bad move on a moderator's part, but the conversation was so interesting and the panelists so engaged, I didn't want to cut it short. Why don't we meet back here about 15 minutes from now?

(Whereupon, a brief recess was taken.)

MS. LEVINE: Let's get started now with some of the hardest questions of the day involving patent settlements.

When do these patent settlements, if ever, pose antitrust concerns? What are the anti-competitive issues that lurk in certain kinds of patents settlements?

Professor Brodley, did you want to tee us off with a couple of thoughts on that?

PROFESSOR BRODLEY: Okay. I'll open it. Well, I think the first kind of area of concern is when the settlements involve collateral agreements that amount to horizontal restraints; that is to say, they involve competitors or potential competitors in the technology market, the goods market or the R&D market, and the collateral restraint affects competition between them in that market.

And it's particularly sensitive if the markets are concentrated. The issue then is whether these collateral restraints are unjustified in view of the efficiencies that they may create and always assuming, of course, that they're based on valid patents.

A second kind of restraint would be vertical restraints which ordinarily are not apt to raise grave issues at all, but vertical restraints where the patent owners, patent holders impose restrictions on competition among their licensees that can be injurious, that is to say, they might involve the fixing of output and market share, and that also -- those may be justifiable.

They're normal, in fact, in patent arrangements. But it is an area of concern when that kind of arrangement reflects in effect a cartelization or makes the market among licensees highly anti-competitive, and when the patent holder is actually sharing some of its rent in return for the agreements that create this. Then it begins to look like there's a concerted arrangement to gain from cartelizing a licensing market.

And a third area is the predatory extension of patent rights. This would be where a patent holder sacrifices present rent in order to extend its market power into another market or its present patent into other time periods, so this really is kind of form of predation which is similar to non-price predation outside the patent market, which is to say that it is a failure to maximize short run profits in return for anti-competitive gains later or in some other market.

I actually wasn't there yesterday, but I understand that Doug Melamed testified at the hearings on this issue, not the one we're discussing, but basically the idea of a similarity between what might happen in the patent field and what is the law in the unpatented area.

So those are just general comments. Obviously we're going to be going into lots of details about the particular kinds agreements. It seems to me that those three basic situations are of an antitrust concern.

MS. LEVINE: Thank you very much, and let me throw out a question to the panel, not only for your responses to Professor Brodley's thoughts because I think we can all benefit from those, but also whether you think whether the risk of anti-competitive agreements embedded within patent settlements is greater in an industry where R&D is a big factor.

It's a question that you raised in your questions to the FTC. The chemical industry, agricultural industry, pharmaceutical industry, where industries like these where R&D is a key factor, are we likely to see more anti-competitive risks in patent settlements?

PROFESSOR BRODLEY: Can I just ask?

MS. LEVINE: Sure.

PROFESSOR BRODLEY: The reason I asked that question was because if those are the areas -- pharmaceuticals, agriculture and chemicals -- where patents make the most difference in the company's profitability, then one might think that those are the areas where there would be the greatest concern about these antitrust topics.

MR. COOK: Just to jump in. I think that those are really the areas that are factually the most difficult, and this question brings us into really the facts of the individual cases. In a particular case with particular products, how does a particular settlement affect competition in light of what would have happened if these patents were litigated to a final resolution?

And the more complicated the product gets, the more difficult it I think gets to really answer that question, and these are really -- I think that question is why we're here and why this problem seems to be so intractable, and that unsatisfactory statement is my input on this subject.

MS. LEVINE: We're getting a lot of those, answering questions with questions today.

MR. CARY: I'm going to answer the question from a base of very little knowledge, but I'm going to throw a speculation out on the table and see what the response is.

I would guess that the risks of anti-competitive agreements and settlement of patent litigation would actually be higher in network industries, high technology electronics industries than it would be in chemicals, pharmaceuticals, agricultural I guess would be the other one, the reason being that it seems to me that's there a closer link to a patent in the chemical area where the result of that patent is that you have a monopoly over a particular product. The patent goes to the product. The product is out there, and there's a monopoly rent to be gained.

In the high tech area, one can speculate that you can leverage a patent on one aspect of a product in to market power with respect to a wider array of products that go beyond the product implicated by that single patent by virtue of the network effects or portfolio effects that might flow from being able to preclude competition in a broader field simply by precluding competition in a single product area.

So I would say that that's a more fruitful area to look than the areas that you've identified.

MR. EGAN: I would say that in the pharmaceutical and agriculture area, yes, you'll have composition of matter patents that tend to be relatively well designed and defined to a particular area.

If you look at Microsoft's behavior where basically they take a strength in one existing technology and they leverage that into emerging technologies and they play into an area of the law that's really not well addressed, I don't believe, by current case law, that's potential competition, and yet that's the area that everybody invested in on the margin.

Everybody was investing in Internet at a time when Microsoft was saying, I'll use my power on operating systems in order to develop a strong position in an emerging area.

I think patentability in that area may not have been one of the major drivers in that particular case, but if you look at a patent in one segment allowing you to leverage that power into another emerging section, that might be one of the areas you would look at.

In our industry, in pharmaceuticals, you might see the interplay between formulation technologies and composition of matter. You might see that same kind of thing in process chemistry and in chemicals and the like. It really does get down to interplays between patents. I'll leave it at that.

MR. BARNETT: I guess I had two comments. One, I think there was an earlier summary about the areas that are most likely to cause concern, and I think that it was a very good summary.

Whenever the settlement goes beyond the immediate scope of the patent dispute, I think you're most likely to have concerns. If there's a dispute over a pharmaceutical patent and the settlement is that you will not infringe that patent or make any other form of this drug, whether or not it violates the patent, I think that's going to raise suspicions.

The second comment though is in the industries that you identified, the chemical, the pharmaceutical and related industries where patents are important to that industry because innovation is so important to that industry, and so policy changes that undermine intellectual property protection can actually deter innovation, and I think you, in those industries, may have a greater risk of harming consumer welfare in the long run if you're not careful.

And so that it's not immediately clear to me that settlements are necessarily more suspect. They may be more beneficial from a dynamic point of view.

MS. MOORE: I have actually a two-part question that builds on a discussion we had earlier this morning, and that is consumers not being at the table or customers not being at the table when patent settlements are reached, and the question that I have is: Can we assume that the outcome that the parties are seeking in a settlement is necessarily the social desirable outcome, and how should that impact the antitrust analysis of settlements?

Carl? Sorry, Bob was actually first.

MR. COOK: I'm much more willing to listen to what Carl has to say than what I have to say.

PROFESSOR SHAPIRO: I think we absolutely cannot assume that the settlements reached that, while in the joint interest of the settling parties, are in the broader public interest and in particular in the interest of customers or other complimenters, for example, who would have -- who would have an interest.

To the extent there are benefits associated -- of a settlement associated with curtailing competition, customers can come up short. I mean, I'll give you an obvious example.

You may have a litigation, patent litigation between two competitors, very uncertain how it's going to come out. There's a good chance the patent will be invalid or non-infringed, in which case there will be a full-fledged competition. Customers will benefit. The companies agree to merge. They agree to merge, okay, obviously avoid litigation costs, eliminate the possibility of that competition either in the future or perhaps competition that's ongoing during the pendency of a litigation.

Let's just suppose there are no real efficiencies associated with the merger, to keep the hypothetical simple. Customers get the short end of the stick on that one, again assuming that these companies have let's say a large share of a relevant market.

So, in other words, if it was a merger that we would otherwise want to stop, the fact that it happens to be the settlement of the patent litigation is no trump card I would say for the merging parties and should give us no assurance that customers are not injured in fact.

So I just -- I would be surprised if anyone at the table thinks that there would be any general reason to believe that settlements, while in a private interest, are in the public interest.

MS. MOORE: Bob?

MR. COOK: Well, I think that's what I would have said if I were that smart, but I was also going to add --

PROFESSOR SHAPIRO: You could have said it more quickly though.

MR. COOK: I would have said it more quickly, but since the customers aren't there, there may well be customer or consumer concerns that simply aren't known to the parties settling or suppliers.

MS. LEVINE: What do you have in mind?

MR. COOK: Well, rather than what I have in mind, if you think about the dynamic process of competition and negotiation, you have two adversaries who are both suppliers of a product, say hypothetically, and they're going to try to work out an agreement that is value maximizing between the two of them.

They may well find certain areas of agreement that are agreeable to them but aren't agreeable to their mutual customers or their potentially mutual customers because, in effect, they take value from the customer and share it between the two. Hypothetically, I mean, I'm not thinking specifics, but that's why one couldn't rely on a negotiation between these two parties settling the litigation to protect the value that would be sought by the consumers who aren't part of it.

MS. MOORE: Steve?

MR. STACK: I think it's hard to disagree with what Carl said. I think the question is, therefore, what antitrust rules are you therefore going to impose on settlements? To the extent that you're talking about restrictions that fall outside the scope of the patents that are in litigation, we have a body of law that deals with that.

It's basically no different than the way you would analyze the license, and there are plenty of cases and guidelines in that this area. I think the hard question is, What about restrictions that operate within the scope of what is being challenged as a patent that may be invalid, and I think that's the hard question.

And there you have to really balance some other, it seems to me, policies that go to certainty of patents and the innovation benefits that flow from it.

MS. MOORE: Phil?

MR. PROGER: Maybe in the spirit of the conversation here and with the disclaimer that I have had the judgment to retain Carl on matters, I'm going to the point of saying, I don't find it hard to disagree with him at all, at least to this extent.

I think you have to ask yourself the question, What public policy, what public benefit are we talking about? There are other public policies other than competition. There are public policies of encouraging settlements, so I'm not sure that settlements in and of themselves are plus or minus from a public policy standpoint.

I think the issue is -- and this is where I was going to go, it's exactly what Steve just said, Tom earlier said, and I think we would all agree, that look, if your settlement goes beyond the scope of the relief you could have obtained in the litigation, I think that is a suspect area, and you have to look at that. It doesn't necessarily mean it's unlawful, but there's a restraint, and you have to apply antitrust analysis.

The real tough question, and the question that everyone has difficulty with is, How do you analyze settlements which are within the scope of the patent litigation, and one of the problems I have in doing that, and I confess, I don't have a ready answer for this, is to some extent you cannot make that determination without an ultimate determination of the validity and enforceably of the patent, because when we use the rubric or terms of art in antitrust like horizontal restraints, in fact you don't know that.

If, in fact, the patent is a valid and enforceable patent, and the defendant is actually infringing that patent, then they have no right to compete with infringing products. That's not lawful competition.

So I really think the difficulty for all of us to try to analyze this is to figure out a process of how you properly bring these factors in to play and to distinguish between what is lawful competition versus unlawful competition.

If I steal your goods and go out on the street and try to sell them, that's not lawful competition. If I get a license from D.C. government to be a street vendor, that doesn't give me the right to sell counterfeit infringing goods.

So I think the question of whether something is horizontal ultimately in this area becomes a question of whether or not the patent is valid and enforceable, and that ultimately is the rub here because that I think the end question, the determining question is the ultimate question.

MS. MOORE: How would you make that determination?

MR. PROGER: Well, that raises the question of whether if you were in subsequent antitrust analysis or litigation, ultimately the court has to determine the adjudicate the validity of the patent and its enforceability and whether there was infringement, and I understand that's a different issue.

Carl and others have written about ways to analyze this. My own view is I think ultimately you'll have to look at the nature of the restriction. You're going to have to look at whether it's within the scope of the patent, and you may have to try some of these issues and make a determination.

MS. LEVINE: Speaking of this going beyond the scope of the patent, I should mention that we're going beyond the scope of today's conversation in a sense already. Let me make a pitch for our next hearing. The Department of Justice is hosting a session on May 14 on just the question you've raised, on how to wrestle with the question of patent validity and invalidity, which in many senses today is the ultimate question when you're evaluating the patent settlement.

So we probably don't have time to get into the nuts and bolts of it all today, but please stay tuned, we will in another couple of weeks.

Professor Brodley?

PROFESSOR BRODLEY: Well, I just will add a brief comment to what all of you have explored on this, the other parties not represented. I would think another one is potential entrants who would enter if the patents were invalidated. I don't see that they're directly represented, and finally, government enforcers who don't know about the agreements and might want to be represented. They might want to take a position.

They're not present, and although I made the point before here, any general benefits that patent litigation confers on society such as precedents and the invalidation and deterrence of bad patents.

MS. LEVINE: I was just going to suggest that we take the three name tents that are raised here before getting to you, Tom, because I wanted at that point to turn to the question that you raised earlier, the question of whether going beyond the scope of the patent is an indicator of anti-competitive issues.

So, please, Carl? I'm sorry, Bob.

MR. COOK: Just bouncing off of what Professor Brodley said about other types of persons who might be affected by a patent settlement, there you have questions that may go, for example, to questions of antitrust standing, but you touched the issue of whether there may be other legal regimes besides the antitrust laws that are implicated by a patent settlement.

For example -- and then other persons who may be affected, holders of other potentially competing patents may be affected by it as well as potential entrants and so on and so forth, so it opened up really a broader issue that probably is well beyond this, but is the same ilk.

MS. MOORE: George?

MR. CARY: I wanted to just throw out contrary positions on both of the unobjectionable things that have been said.

First, with respect to the point that Steve made, yes, there is a body of law that deals with the circumstances outside the scope of the patent and the extent to which you can restrain your infringing competitor outside the scope of the patent grant.

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

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

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

So that's an area where I think it's worthy of discussion as to whether limiting the restraints to the scope of the license is, in fact, the best public policy -- I'm sorry, the scope of the patent is the best public policy.

Now, going to the other side, going to Phil's point about keeping it within the scope and then having the freedom to do what you want as long as it doesn't go beyond the patent grant, the problem with that is that what you're doing is you're converting the possibility or maybe in the way Phil said it the probability that you would have a monopoly by enforcing the patent to a certainty of a monopoly.

And the difference between a probability of a monopoly in an unlitigated patent and the certainty of a monopoly by private arrangement of the litigants can be quite a significant difference and can be quite detrimental to consumers.

So both of the kind of general rules that have been laid out I think have some infirmities from the point of view of pro-competitive or consumer welfare.

MS. MOORE: Steve?

MR. STACK: I just want to back Phil up on this one. I'll ask the question, Why shouldn't we have a rule that says if for those portions of your settlement that fall within the range of potential outcomes of the litigation itself, they ought to be presumed to be lawful, and I come at it for two basic reasons.

One reason is I think it's consistent with more of the policies that factor into this issue, and secondly, I think the alternatives to that seem a lot worse to me. I think a rule like that is certainly consistent with the presumption of patent validity that operates in patent law.

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

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

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

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

And I don't see that working. I don't think that when you -- given the range of error that you have in any probability analysis, I don't think that's a workable solution, and how do you prove it? Do you force the patent owner, for example, to waive its attorney/client privilege in order to be able to defend the assertion that this patent only had a 30 percent chance of success when the patent attorney says, No, it's 60 percent?

And at what point in time do you do that because the odds change as litigation proceeds, so that's where I come out, and that's why I come out that way.

MR. CARY: Can I respond briefly to that?

MS. MOORE: Sure.

MR. CARY: I think Steve makes an excellent point. It's a bright line rule that stays within the potential range of the possible outcomes. The problem is, as Steve points out, I think there's a real question as to whether the agencies can do anything other than what he just proposed.

You can't relitigate. There have been a number of instances where I think the FTC has looked at that option. There was one where they actually attempted that option, not to great success, and going behind the patent positions and trying to figure out who would have won or what the odds were, with all due respect to the FTC, which is an agency for which I have immense respect, I think it's just intractable.

I think it's beyond their -- the administrative competency of the agency to do that sort of thing, so what are you going to do? You've got to set up some kind of bright line, and the one that Steve sets up is not a bad one.

Maybe there's some procedural process like a Tunney Act process where the court that is deciding upon whether to accept the settlement has the opportunity to take input from other interested parties.

Maybe that helps, maybe it doesn't help, but it's a very tough problem if you're going to rule of reason to figure out what the odds were that the patent would have been upheld and then to figure out whether the settlement extends the monopoly beyond what it should have been extended to.

MS. MOORE: Jamie.

MR. EGAN: One of the concerns I have here is that the patenting system itself is not adversarial, although people applying for patents will disagree with that. Their examiners argue back and forth, and no third parties can get in there and really argue the points.

There is a duty of candor when you're filing a patent. You're supposed to tell all, show all. Oftentimes things come out when other people are looking at it that didn't amount to having told all and shown all.

If we're talking about patent settlements between two competitors reaching a conclusion put before a relatively overburdened judge on an issue that turns as to whether consumer interest is being helped or hindered, when our entire system is based upon adversarial process, simply saying that the advocates of the consumer whose job it is to permanently do this are overburdened or incapable, I wouldn't leap to the conclusion that two competitors who might not have the best interest of the consumer at heart are better capable in that setting.

And sure, it may be more difficult, but the thing at stake here is the consumer competitive interest, not the interest of the two competitors, and if anything, there are laws about maintaining the competition.

And I recognize that patents really support innovation and everything else like that, but at the end of the day, I think competition and free commerce is the preferred public policy goal.

Patents are temporary. They are seen as a necessary incentive, but they're not an absolute excuse, and once you have your patent, you're on notice that you must defend it, and I don't think it's too much of a burden for a patent holder to respond in an adversarial setting for the first time before he goes to a settlement with someone who represents a consumer interest.

MS. LEVINE: Tom, you were raising the issue before about restrictions that go beyond the scope of the patent. I don't know if you have your name tent turned up to talk about that or to talk about the current conversation.

MR. BARNETT: I can talk about that, although I will briefly endorse what Steve and Phil were saying. I certainly agree and part of -- I guess related to the question related to settlements going beyond the scope of dispute, because I think it's administratively very difficult and probably unwise to try to assess the validity of the patent or second guess that good faith dispute, if you're looking at a restriction that goes beyond the scope of the dispute, you can assume for the sake of the analysis that the patent was valid, and then you apply your normal antitrust analysis.

It's not that going beyond the dispute is necessarily a problem. If agree that I won't infringe anymore and I'll make the contribution to your favorite charity, it is unlikely to raise a concern.

But I guess my point is at that point I think you're subject to more normal antitrust analysis. That's what the agencies and courts are more used to doing, and it may or may not be a violation of the antitrust laws. That just depends on the facts of the given case.

MS. MOORE: Joe?

PROFESSOR BRODLEY: All right. Well, I would want to reply to many of the things you said, about how these cases are being handled.

First, I agree fully that the trying -- the retrying of a patent case in the antitrust arena is an undesirable and ultimately unwieldy undefeating means or instrument, so I agree with all of that.

But I don't think that -- I wouldn't agree that it then follows that as long as it's within the scope of the patent, that the parties should be allowed to do it. It seems to me that's contrary to the way that, for instance, the Guidelines consider these restraints generally, which is they do apply a rule of reason, but it's hard. I agree, it's extremely hard to apply the rule of reason.

What we should look for, and I don't have a formula to suggest all of them, but for indicators which will enable that solution and the courts can handle and which will promote the goals of both -- of the patent, innovation and antitrust.

And to say just a word more about that, so you start with the question, Does this arrangement involve collateral restraints which in the absence of patents would violate antitrust laws? If you don't have that, there's no case, so that's the first step, so you find that, but that, of course, is not exceptional itself.

Then you look for whether there are anti-competitive restraints. And then you ask in the first instance, Are there any kinds of presumptive criteria or indicators that might be used?

Well, one that is being used, and as I said we'll come to this later, but as an example of this approach is reverse payments, as an indicator which can be useful, and another one that I gather we may discuss, is the payment of a trivial royalty along with certain other factors.

And so then you look at the degree of the collateral anti-competitive restraints and their necessity. That would be part of the rule of reason analysis. You look and see if there are anti-competitive effects, and of course, it would have to be afterwards, but I suppose in assessing whether they're likely to be, and those are often hard to establish.

But in certain conditions, I think they would be indicative coupled with, for instance, the payment of a trivial royalty, but it's hard to figure the anti-competitive effects because obviously the restraint, which would be a per se violation in the absence of a patent, will have effects which you might find are anti-competitive, so that's not enough.

Well, then the cases in this area have also looked to intent, more so than in other areas of antitrust where that is dropping away a good bit as a factor, so while I think intent can be misused, as some of you have inferred already, but I think we know that we can use it when effects are not clear.

The Supreme Court has said so on more than one instance, but it has to be the proper kind of intent, and the kind of intent that one is talking about is not expressions of feelings or animosity or anything like that, but these are corporate documents which illustrate the likely effect of the transactions involved.

And finally, there's a business justification, so -- well, that's unwieldy. That's the modern rule of reason, and I don't see why we should give up on trying.

MS. LEVINE: I want to say thank you for that very thorough and very helpful exposition of a lot of the indicators of -- indicators of what may flag anti-competitive issues within patent settlements. I want to open that up to the panel now actually and get responses to your list.

I think a few of the indicators mentioned were restrictions that go outside the scope of the patents, reverse payments and of course a few others.

Can I get your thoughts on whether those things, those indicators, when you see them, do indicate any kind of anti-competitive concerns?

George?

MR. CARY: Yeah. I guess my reaction to that is that my sense of what Professor Brodley just described is not too different from what I heard Steve say in a sense. If you start with a presumption that one of the likely -- or I shouldn't say likely. One of the possible outcomes of the patent litigation is an injunction which precludes the competition that we're talking about here, then you either have to make an assessment in the antitrust context of what the likelihood of that outcome is and put a probability on to it and then compare that probability against the restraints that have been imposed by the settlement, which I think is impossible, or you have to assume that a full stop injunction would have issued, and therefore there would have been no competition within the scope of that patent altogether.

If you're going beyond the scope, outside the scope of the patent, reverse payments, those two examples that Gail just listed are examples that I would argue are outside the scope of the possible outcomes.

There's not going to be a restriction on competition outside the scope of the patent as a result of the litigation. There's not going to be a payment from the patent holder to the infringer as an outcome of the litigation, so I think Steve's rule captures those examples, leaving you with a question of, Are there antitrust agencies capable of making an assessment about the likelihood that the patent would have been held valid, thereby giving rise to the presumption that injunctive relief automatically flows.

MS. LEVINE: Phil?

MR. PROGER: I was -- well, one, let me just say that I think that we're in general agreement that it's the right analysis as Joe has set forth when you're outside the scope.

It's essentially a rule of reason analysis, and I don't think it is that alien to the antitrust process.

When you're within the scope, I think again that raises the difficult questions, and I don't have easy answers for it, and I wasn't suggesting in my earlier comment that it's easy to try the patent issues, but I still don't understand how you get around them.

And when you talk about reverse payments, one of the things that troubles me is what makes a payment reverse? I don't fully understand that. Maybe if someone could define that to me, that would be helpful.

Certainly --

MR. CARY: That's easy. It's a payment from the patent holder to the infringer.

MR. PROGER: Why is that reverse, though?

MR. CARY: Because typically it's the infringer that's liable for damages, not the patent holder.

MR. PROGER: Why do you say typically? Are there situations where it is not?

MR. FEINSTEIN: Let's talk outside the patent context for a second. Typically when you have a potential entrant and an incumbent, you would not expect the incumbent to be paying the potential entrant not to enter. To me that's sort of the essence of the reverse payment, stated most starkly.

MR. PROGER: What about when you have Hatch Waxman, Rich?

MR. FEINSTEIN: If anything, that may make the problem worse in my mind.

MR. PROGER: It means just the opposite to me. There you have the -- because of what Hatch Waxman does is essentially create a declaratory judgment process. There you have the alleged infringer as the nominal defendant, really the plaintiff under Hatch Waxman, and the alleged infringer has very little at risk, and the plaintiff, the patent holder, has enormous risks.

And I'm not surprised under those circumstances that the party with greater risk, more at stake, might end up paying the party with less in a declaratory judgment context.

MR. FEINSTEIN: But what is the source of that risk is I think the next question. Is it the risk of competition on the merits or is it some other risk?

MR. BARNETT: But it's more fundamental than that. The patent holder in that Hatch Waxman context has no claim for any damages against the generic company who typically files the paragraph 4 certification.

In that bargaining context, it's hard for me to imagine a situation where the generic company would be paying the patent holder anything. You start off where the default -- the best that the patent holder can get is zero, and given that they're the only ones who have something at risk here because a generic company can walk away at any time, you would expect any settlement to involve some flow of consideration from the patent holder to the generic challenger.

MR. PROGER: Exactly. I'm sorry. One thing I do not think is helpful -- George is right, it's intractable. I hear people say, Let's not try the patent issue.

On the other hand, I cannot believe that we want to set up a series of decision rules or operating rules here based on the percentages and likelihoods because I don't think how you really determine that, and I don't know how you make those standards, and what does that mean?

We have two alleged infringers. First one goes to the patent holder and says, I believe I have better than a 50 percent chance of winning, but I'm willing to settle if you pay me not to infringe, what do you think? Patent holder says, Sure, okay?

Under sort of the handicapping, that looks like a really suspect settlement, and I would agree with people who say that. The second infringer says, I'm not going to pay you, I'm going to trial. You go to trial. You go to the Federal Circuit, Supreme Court, patent is held as valid.

What was the right outcome? Was the first settlement anti-competitive? Turns out that they had no right to be in the market in the first place. I mean, we all want to find a rule that avoids the ultimate issue, and I would like to also. I just can't figure one out.

MR. FEINSTEIN: Can I -- I'm sorry?

MS. MOORE: I'll let you respond, Rich, and then I actually have a question.

MR. FEINSTEIN: I wanted to go back to what Tom said because maybe I'm just missing something, but it's not obvious to me why the potential entrant has no risk. I mean, they at some point -- if there's no injunction, they have the opportunity to enter, and that presumably brings with it substantial risk.

MR. BARNETT: If I could respond to that. The way Hatch Waxman is set up, it's so that you're entitled to bring the declaratory judgment action before the expiration of the patent that's at issue and during the pendency, at least the way it typically works out, the generic company does not enter, does not have the right to enter, and therefore until you get to the end of that process, there is no prospect of their entering, and the patent holder has no claim for damages.

MR. FEINSTEIN: Right, but during that part of the process, what's the incentive then for the incumbent to pay anything to the patent holder, to the generic?

MR. BARNETT: The incentive?

MR. FEINSTEIN: Yes, what's the pro-competitive incentive?

MR. BARNETT: Well, it's to avoid the uncertainty of the litigation. We talk about all the reasons, and just as one example, knowing that I have this stream of income coming in as a branded pharmaceutical company, a patent holder, I know that I can make investment in additional research and development, that sort of thing. I can continue to innovate within that product as well. I mean, there are a number of benefits associated with it.

MR. FEINSTEIN: Does it matter how much they're paid?

MR. BARNETT: As a practical matter, I understand the more they're paid, the more scrutiny it will get. It's not immediately clear to me that it should matter.

MS. LEVINE: That's actually a good entree to a question we wanted to address.

MR. COHEN: I see Carl's sign is up, and I know that you've written a bit on the situation where you have payments in two directions, a per unit payment coupled with a fixed payment. Maybe you could explain a little bit of your thinking on that.

PROFESSOR SHAPIRO: Okay. I guess it seems to me in the context of what several people have said, we're looking -- we can at least try to look for indicators of the terms of the agreement that are I'll say highly suspect so that we don't have to get this to the valuation of the patent strengths or weaknesses. At least that's one approach to try to take to see whether that's workable.

So I would start with the simplest case, patent license, that is, I sue you. I say you're infringing. We settle. You agree to pay me a certain amount per unit let's say. I would say I think there was in the scope of your question.

That obviously is a cost to you of doing business. You're going to compete against me now, let's suppose, but you're going to have this cost. Should we be at all suspicious of that agreement, just a classic licensing agreement? Whether entered into before or after litigation ensued, I don't care.

I would say, no. I would say no because there's -- you must have a view on sort of maybe you would win, maybe you would lose in terms of the patent litigation.

You wouldn't typically agree to pay more, to pay so much and burden yourself with cost unless you thought, Hey, there's a pretty good chance you would lose, and you would actually be out of the market.

So there's no inference based on that sort of simple classic licensing agreement that competition has been reduced by this agreement in comparison with what likely would have come about from litigation, which I think is ultimately the key question.

MR. COHEN: In a very simple form, does the form of the arrangement matter, whether it's per unit or lump sum? Does that suggest anything?

PROFESSOR SHAPIRO: Again if the payment is being made from the potential infringer to the patent holder, whether it's lump sum, per unit or some mixture I think does not matter.

Once we enter -- once we introduce though maybe two payments going in both directions, then the possibilities for mischief are very much present, and in particular, if I am the patent holder I -- if I pay you a lump sum and you pay me a royalty, well then that could definitely be anti-competitive.

I'm essentially paying you off in exchange for your agreement to burden yourself with costs or perhaps to leave the market for that matter, a variation on this. You might not come in until later or you might agree to leave, so once we have the payment flow going from the patent holder, that's the issue, not the structure of the payments coming the other way.

MS. LEVINE: We have a lot of tents up. Actually only one. Is this a response to --

MR. COOK: It was what I was going to say but cast in a response to what Carl said, but which is there's this discussion about the form of transaction really, what Professor Brodley and others have talked about going beyond the scope of the agreement or additional things, and in most cases, I think these are really just creative attempts to solve negotiating problems, and they're done without regard to antitrust issues.

And my suspicion is as this progresses over the years, people will be thinking more and more to antitrust implications as we go along, and so these forms of agreement will no longer emerge in patent settlements and, you'll have more things that are done to withstand antitrust scrutiny, taking into account the Competitor Collaboration Guidelines and merger laws and things like that.

So this may be more of a bump in the road in some cases than a permanent problem of patent settlements.

MS. MOORE: I wanted to go back to Phil's hypothetical for second and ask him to respond to something and open it up to the rest of the panel.

MR. PROGER: I knew I was going to get myself in trouble. Go ahead.

MS. MOORE: Well, in your hypothetical, and please correct me if I mischaracterize you, you have the first person settling with the innovator, right, patent holder, second person going to the market, and you have the patent being upheld as valid.

I guess my question would be: If you flip that, the second goes to trial and the patent is held invalid or not infringed or actually I guess it would just have to be invalid. What does that do to the first agreement as far as an antitrust perspective?

MR. PROGER: I actually think that that's a very good question, something that I have thought about, and you have to take a step back here. This is hard because we're marrying two different means to promote consumer welfare, and the concept that the means aren't necessarily compatible isn't self-evident to me and at least when we talk about something being anti-competitive, that's the wrong place to start.

I mean, I'm an antitrust lawyer. I believe in competition, but there is a system of intellectual property rights that grants you the right to exclude something that is infringing. That in its very basis is anti-competitive, and society has made a judgment we want that.

And just to an earlier comment, someone has said that competition is the preferred public policy over intellectual property rights, I would like to see where that is, and I don't know who made that judgment. Unfortunately, I think they're kind of equal, and you have to marry them.

So here the first thing I think you have to figure out is if the settlement is within the scope of what you can achieve in litigation, I think you have to figure out whether the patent was valid.

Then what happens is if subsequently you determine that the patent -- if a patent is valid, I would say it's per se lawful. Maybe that's going too far, but if the patent is valid and you settled within the scope of it and there's nothing else that is restricting, then you have the right to exclude, and the fact that you're going to share whatever returns you get I don't think is anti-competitive.

But the question you posed, Robin, is the most difficult, which is what happens if the parties -- let's set it up and eliminate the obvious.

If it is a bad faith settlement, they really didn't believe they had a valid patent and this is a sham, okay?

MS. MOORE: Okay.

MR. PROGER: And I'm not going to put Professional Real Estate Investors in this or that type of standard. I'm just going to say, if it's a sham it's anti-competitive, we shouldn't protect that.

What do you do in a situation where the parties honestly believe that they have a valid settlement, reverse it. I go to you and say, Look, I believe you have 90 percent sure that the patent is valid and enforceable, I'm infringing, we'll settle, and then subsequently it turns out that the 10 percent -- that for whatever reason it's not valid or not enforceable.

Then I think you have to apply the Noerr concepts and some of the standards we do under the rule of reason and look to, Was it a sham? Were the parties in effect trying to engage in what would otherwise be a naked restraint?

And I agree with Joe, that it is difficult to get intent here, and I don't think by intent we want to look at in terms of what was the intent of the parties in the sense of ultimately ignoring that to the exclusion of the effect.

But here when you're looking at this issue and looking at to determine whether it's a sham or not, I think you're going to have to look behind the curtain and see what the parties were trying to do here, and that gets very difficult.

MS. LEVINE: Let me see if I can return our conversation to a question that's come up a little bit, but let's get into the thick of it now, a question of whether patent settlements should be reviewed, when they are reviewed, under the standard review of per se or rule of reason.

Are there any types of settlements that should be viewed under the per se rule, and on the other hand, when should an agreement be analyzed under the rule of reason?

Rich, I know your views have evolved on this, so you've told me.

MR. FEINSTEIN: Yes, they have, and I've moved over the last several years I think more to the point of view that there are certain settlements, and they may be the easiest examples. They may be the ones where they have features that we all would agree are outside the scope of the patent, but where those features are present, I think a strong case can be made for a per se rule.

And I think it's important to remember just as -- and I completely agree that settlements are most of the time very desirable, and one of the reasons that they're very desirable is because they conserve judicial resources. They conserve the parties' resources. They conserve society's resources.

That's also why we have per se rules, for certain kinds of practices that are so unlikely to have any competitive benefits, we just agreed these should be prohibited, and we're going to move on, and it could be -- it's a follow-up on what Bob said. This could be a bump in the road.

I don't know. I don't know how widespread the agreements are that have the most problematic features -- and they're not always necessarily settlements, let's keep that in mind. Some of them are agreements that don't settle anything, but it may be that because of the scrutiny they've come under that they're not going to be -- they're not going to be a big problem in the future.

I think the study that the Commission is doing right now under [Section] 6b is going to be very informative on the scope of the problem and then perhaps also on the remedy, but I think a persuasive case can be made when you have features that are very difficult to justify as efficiency enhancing or pro-competitive to say they are per se unlawful.

MS. LEVINE: Any responses to that?

PROFESSOR BRODLEY: Well, yeah, I agree, but I would go a little farther. I mean, I don't know whether you would go this far or not, but I think the reverse payment should be either per se or presumptively unlawful.

And let me say just a word about that that replies to something -- some things that have been said earlier about the reverse payments. The vice in the reverse payments as I see it, the underlying vice, is it distorts the incentives of the parties.

That is to say, before the reverse payments, you had two parties who were disagreeing about the validity of the patents or the infringement, and one party is in effect trying to open this to competition.

I don't say that's good because maybe the patent should be open to competition, but I say that's a force that works in the competitive direction. The patent holder obviously wants to keep its patent and keep it closed to competition.

Now, they work that out in a settlement. Generally that may be okay, but with a reverse payment in this field is such that the patent holder can well afford to pay this challenger more than it could ever have earned by coming in competitively.

So that means that the dynamic by which we would get a normal, more or less market type solution is broken, and there's nobody left to represent the consumer interest. The two of them are actually sharing the monopoly risk, so -- and therefore you have to go to a regulatory solution if you're going to allow those things to go on and look into validity and all that sort of thing.

If you make it either presumptively or per se, what happens? You throw them into another kind of solution which would -- this has been suggested by Commissioner Leary in a paper recently -- by which they would have to trade in terms of the entry date that a generic would come in, and they could also negotiate the royalties.

Then the generic would still be in a competitive posture, and the generics would reflect the public interest in competition factored for the strength of the patents, so it seems to me that's the vice.

Now, beyond that, I haven't seen it. The only indicator that I'm playing with, and I wouldn't call it a per se or necessarily presumptive, but at least it might be a very useful indicator, is the trivial royalty, but I won't go into that until you want to.

MS. MOORE: I actually have a question for the whole panel. We've talked a lot about reverse payments today, and I wanted to find out if you guys are aware of these things existing outside of the Hatch Waxman or if the reverse payments -- if those comments are sort of directed at Hatch Waxman?

MS. LEVINE: Keep your signs up for the next question or for the previous conversation, but I guess our question is: Have you seen a reverse payment outside the Hatch Waxman context? Is that a no?

MR. FEINSTEIN: Well, I would just say that certainly outside of the time that I was at the FTC, I haven't seen that, and inside the time that I was at the FTC, that was something we were looking for and couldn't find any examples.

MS. LEVINE: None to be offered today, right? Hearing none, let's move back on to the discussion.

Carl, you had a comment?

PROFESSOR SHAPIRO: I wanted to respond to the question about when, if ever, per se treatment's appropriate, and I guess like most economists I tend to move right along to a rule of reason rather than per se, but I do think that with suitable care, certain reverse payments should be -- I'll say like either per se or sort of a presumption that they're anti-competitive.

What I mean by suitable care is I think first you want to look at the net payment that's involved, so there may be a more complex transaction going on so rather than just a naked cash payment in a reverse direction, if you have other consideration flowing, you would want to look at the net payment, and I would say you would also want to look at net payment in excess of what a litigation costs from the point of view of the patent holder, with the idea being that if the net payment is flowing from the patent holder and exceeds the amount of avoidance of litigation costs, then you ask yourself, What is the patent holder paying for, okay?

And I think a presumption -- maybe I would be comfortable with that, a presumption they're paying for some lessening of competition, and maybe that could be rebuttable, I guess, but that's a shortcut at least, some sort of shortcut rather than a full blown rule of reason which seems to be is probably a good idea with that fact pattern.

MS. LEVINE: Steve?

MR. STACK: Just again going back to the per se question, what are hallmarks of per se violations? One, no plausible efficiencies, and, two, a statistical probability, a very high statistical probability that this kind of practice -- and it's a typology really, you don't do it really on a specific instance by instance basis, and I don't think you have either of those in a settlement context.

You clearly have efficiencies, and you can't really say that settlements per se are going to be overwhelmingly anti-competitive. I think that most of the problems that Rich refers to and Professor Brodley refers to can probably be dealt with and maybe in a very truncated basis in a rule of reason analysis.

You've got the doctrine of ancillary restraints, and if you can't demonstrate that you fit within that doctrine, you may, even for an outlying restraint, end up with something very close to per se.

I would certainly not think that you could apply the per se rule to any restriction that operates within the patent's scope.

MS. LEVINE: Rich?

MR. FEINSTEIN: I think I just wanted to make it clear that I did, in fact, agree with Professor Brodley that I would include substantial reverse payments in the category that ought to be, and I'll adopt Carl's characterization, of presumptively unlawful. I mean, whether you go all the way to per se, I think there's a case to be made for that, and the paper that I guess will make it on to the web site explains why.

I don't think that any reverse payment necessarily puts you into a per se box or even a presumptively unlawful box. I think it's got to be a payment that's large enough to alter the incentives of the party that's on the receiving end.

And I guess in some sense that may take you one step beyond sort of classic per se analysis, but I think another thing that we have to keep in mind here, and again I'm focusing this on the Hatch Waxman context, it sort of ties in things people have said earlier, yes, there are efficiencies as between those two parties, but there are some third parties who are not necessarily benefitting from those efficiencies in the context of the reverse payment.

MS. LEVINE: Tom, let me call on you and ask you if you can take the conversation about rule of reason versus per se discussion -- you can certainly address reverse payments, but take it beyond that. How should other practices be reviewed?

MR. BARNETT: Well, I think -- in general I think the rule of reason makes the most sense, and certainly within the scope of the patent dispute, it's very hard for me to see, for the reason Steve articulated very well, why you would ever use the per se rule, assuming it's not a sham as Phil says.

I mean, if there's a objectively reasonable basis for a dispute between the parties, if they have resolved it within the scope of that dispute to say it is somehow -- any particular practice is an agreement that you're going -- the challenger is going to walk away, which is presumably the most threatening to competition, that is still within the scope. I just frankly have trouble seeing the argument for a per se rule within that context.

When you go to settlements that go beyond, I think Rich has a much stronger case. I mean, if the settlement involves an agreement that you're going to license your patent and they're going to purchase a separate unrelated product from you, you get into tying issues, as an example, and if the other elements of a tying claim are met, then the settlement may be subject to a challenge under a per se analysis in that context.

I do think it's worthy of mention that my understanding of the settlements that the Commission in particular has gone after without exception, and I'm open to being corrected -- but without exception involve something beyond really the scope of the actual patent dispute.

I alluded to one earlier, that you wouldn't make the patented product or any other substitute, as an example, and I think it is telling that the cases that the Commission has gone after involve this sort of reaching beyond the dispute, and that for a pure settlement, the hard case that Phil puts forward, I'll be surprised if you find anyone willing to put a per se rule to it, and even under the rule of reason I think it's a very tough case.

MS. LEVINE: Phil?

MR. PROGER: I think I agree with Tom. I think that in the area within the scope of the patent, I think we should follow rule of reason. Outside the scope of the patent, then while I'm generally not enamored with the per se rule to begin with, I think there are situations where it might apply.

Let's go back to what the rule is. If I recall correctly, in BMI and in CalDen, the Supreme Court has said we applied per se that always or amount always injure competition.

When you're within the scope of the patent, one of the set of conceivable outcomes could be, as I said, if the patent is valid, so I don't see how we can puts as a standard there that that would almost or always injure competition. That is why I would not favor per se within the scope.

Outside the scope I think is a different situation, but we're in an era where the Supreme Court has been narrowing the application of the per se rule, and now to apply it in an area fraught with uncertainties and difficulties I think would be problematic.

MS. LEVINE: Steve?

MR. STACK: Just one point, one caveat. When we talk about this distinction between using technology that's within or restraints that are within and without the scope of the patent, it's not as easy as you might think because obviously one of the issues is whether the infringing product is, in fact, within the scope of the patent or not.

And when parties settle, they want to get some closure on that issue, and they want to get some closure about whether, if the alleged infringer changes this little aspect of the molecule, they're going to be back in court again or not.

So I think the easy case is the one that says, You won't sell a competing product, but there's got to be some play it seems to me at the margin to be able to settle those questions which relate to whether -- what the scope of the patent is.

You may have the benefit of the Markman decision which will help you there, but you may not, and even that decision obviously is an interlocutory one which may or may not be correct.

MS. MOORE: Okay. I would like to shift gears now and focus our panelists on when Noerr applies to a patent settlement, and I'm going to throw out sort of a range of options just to move things along, those being to a stipulated dismissal, to something like a consent judgment, something like a Tunney Act proceeding, or something, a threat letter followed by an agreement not to offend again.

Anything between those that I've missed feel free to bring up to, so --

PROFESSOR BRODLEY: What's the question then?

MS. MOORE: The question broadly stated is: When does Noerr apply? How much judicial involvement do you need for Noerr to apply to settlement agreements?

MS. MOORE: Tom?

PROFESSOR BRODLEY: You start.

MR. BARNETT: Sure, I'll jump in on what I will presume will be one end of the spectrum, which is to say that -- let me put it this way. It's hard for me to understand why Noerr should not apply in virtually every instance, and to take as one of the examples you gave. The example you gave, a pre-litigation threat letter, it's my understanding of the case law is that there's a fair amount of support for the proposition that Noerr does cover that type of activity as a precursor to litigation. It involves no judicial supervision and presumably can lead to the recipient of the letter backing away and no longer seeking to compete in this area.

If that deserves Noerr protection, if you go ahead and file a suit and pursue it to some point and end up settling, with or without judicial supervision and approval, it's not clear to me why that is fundamentally different.

MS. MOORE: Rich?

MR. FEINSTEIN: Well, I certainly want to hear what

Professor Brodley has to say about this, but it seems to me that the logical extension of what Tom just said is that all settlements are immune from antitrust scrutiny, and I think we're past that point.

I don't know where you would draw the line, but what is particularly -- I'll start at the other end of the spectrum that you tossed out at me, where you have a private agreement followed by a stipulated dismissal of a lawsuit. The private agreement settled the lawsuit. All the judge sees under Rule 41 is that the lawsuit is dismissed.

I don't see an argument for that being immune from antitrust scrutiny. Obviously the battle is joined in my mind at least somewhere in between. I may have more to say about that, but I'll let some others chime in.

MS. MOORE: Joe?

PROFESSOR BRODLEY: Well, I agree with what Rich said. Imagine the sweep of the proposition that whatever imprimatur you put on the settlement, that the settlement then makes immune all of the agreement that you've reached.

I mean, who would follow any other course but get it into litigation, settle, and if you need a judicial signature, get the signature and now you've got immune transactions? So I think that that isn't enough to make the legal argument entirely, but I think it's something to keep in mind.

As far as the legal argument which is basically whether this involves petitioning, I think a clear distinction between the demand for payment and so forth, that's a part of the litigation -- clearly petitioning, that's a part of a litigation process.

It would be crazy to say that you can litigate but you can't ask for -- send a demand letter in advance, so the real question is really the bottom questions which is, What if a judge signs it or indeed the last question, What if the judge -- if there's approval, if the judge approves after what you call close scrutiny?

Well, getting back to the petition. Petitioning is designed to allow people to present views to the government and not be inhibited in any way. If all the judge does is to conduct what is really a formalistic -- ministerial is too strong -- but a formalistic procedure, the judge will almost inevitably sign a settlement if both parties will agree.

It seems to me that that does not involve the kind of petitioning which assumes some sort of a presentation in which a decision maker is giving views on which they can act, so let's get to the hardest one.

Imagine this there's some sort of close scrutiny, which doesn't occur now. That's ambiguous I think to begin with. What does it mean? The judge questions the two lawyers a bit, both of whom are eagerly asking him to approve? That doesn't seem to me to be petitioning in any meaningful sense.

It would only be meaningful if there's some sort of a hearing, some sort of a presentation. Plus it doesn't involve any presentation to the judge of the interests that he ought to consider if he's deciding in the public interest, and where is he going to get the information as to how to do this?

So I would say that petitioning, at the least, involves a process in which the government decision maker is at least open to the presentation of competing views. In a judicial situation this is usually a hearing.

And finally there's another doctrine that cuts on this, that there is precedent that says that where the decision maker is receiving information from consistently biased participants, that it's entitled to no immunity. Now, they're biased in the sense that they represent only a single interest, and it's consistent. That's the line of cases, Woods Expiration is one of them, so that also it seems to me supports the idea that this isn't petitioning.

Could it be petitioning? Yes. If some kind of a hearing is held that has some meaning, then sure, that could be a procedure, and the presentations and the judge's approval could be a -- could get you into petitioning. Somebody said the Tunney Act proceeding. That would be I suppose along those lines. Whether that's something we should do is another matter.

MS. MOORE: Okay. I think Rich was next.

MR. FEINSTEIN: I just wanted to echo in some sense what Joe just said. I mean, the point I didn't get to in my first comment, which I suspected someone would, is exactly that point, the petitioning point, and I think that the closer you get to something that looks like the Tunney Act proceeding, it seems to me the stronger the argument for immunity becomes, but we're on a continuum.

And I think you have to go quite aways from where Tom started to get there.

MS. LEVINE: Just in the interest of time, and I hate to do this, but I think we should probably take your comments, Jamie's comment and Phil's comments and then allow a little bit time for a very important question that our Department of Justice representative wants to throw out today.

MS. MOORE: Are you finished, Rich?

MR. FEINSTEIN: I am. I was already done.

MR. MOORE: Jamie?

MR. EGAN: I agree with Professor Brodley on this. It's a situation where a judge is basically put to giving an advisory opinion without somebody who is really the advocate for the position of the consumer present, and for that to be immunity in a setting when we always rely in other settings on an adversary process is pretty troubling.

Sure, everybody here says if you're acting in bad faith, nobody's ever going to agree to any of this. On the other hand, allowing Noerr to cloak something like that is going to put a chill on trying to even investigate into those kind of things if you have the presumption that there's a Noeer benefit on it, even if entered in bad faith, and I don't think the courts really want that result.

I think there is some immunity, a full hearing, where all the parties and interest including consumers would have to be adequately represented and by their appropriate advocates, and that setting I think would be the competition law advocates in the government.

MS. MOORE: Phil?

MR. PROGER: I certainly do not believe that every private agreement that settles litigation because it's settling litigation now is cloaked in Noerr, and as a matter of fact, I think I'm a little skeptical about that overall.

That being said, I'm a little bit confused about the comments with respect to your question on a consent judgment. If the question is, Does the consent judgment confer Noerr immunity over the private agreement, that's one question.

If the question is, Is the consent judgment immune, well, however that judge came to issue that order -- if the judge issues an order, whether the parties put it before the judge or that he or she just signed it, it's an order of the court, and I cannot conceive a basis that that is not protected if the parties obey the court's order.

And to say that you now have to have some sort of Tunney Act proceeding for the judge, maybe that's the way Congress may want to change the law, but that's not the law today. That Article III constitutional judge, he or she could use their own discretion.

One other point: we say the judge is not informed. In most of these cases, this judge, he or she has been presiding over this proceeding for a number of years, may have made a number of rulings in this case, and I'm not going to just automatically assume that he or she really doesn't know what's going on.

MS. LEVINE: Bill, do you want to ask our closing question of the day?

MR. STALLINGS: I think we've heard there are definitely some settlements that warrant antitrust scrutiny and that especially consumer interest is not necessarily at the table at the settlement process.

I'm wondering how basically the agencies should get involved in terms of how do we get notice? There was a mention earlier today about Joel Klein's proposal a few years ago to have some type of agency notification of settlements.

It seems to me we don't have the ability normally to hear about these things, and the parties don't have the incentives. Normally we get a competitor who complains about a practice, but in this case the competitor is silenced through the settlement.

So I would like to get the panel's viewpoints on whether there should be some type of notification system.

PROFESSOR BRODLEY: I don't want to keep anybody else from -- okay. Yeah, I think that there should be. First of all, the most limited thing which the Department of Justice was engaged in at one time as an attempt was they should have access to the interference settlement before the PTO, which they don't have now, and there's a decision standing in their way of getting it, but I think either that should be tested -- it was only in one circuit -- or should be tested again or that they should see if they can get a statutory amendment.

So that -- because the PTO according to Klein is unable really to obtain information -- the problem is that the settlement is supposed to include all the collateral agreements which, of course, is what the antitrust -- where the antitrust issues lie, and that the PTO has not been able to enforce that. And in any event, you would want an antitrust agency presence when you get to the collateral agreements that might be anti-competitive, so that's number 1.

Number 2, I think that the proposals in the currently pending Leahy, et al., bill, S. 754, which would require notification of settlements between generic and brand producers in the pharmaceutical industry, would be desirable.

That's passed the Senate Judiciary Committee, but that would be desirable legislation. It would give us a very limited inroad into settlements. And finally I think that I do agree with the proposal of Joel Klein, also of William Baxter, that there be a settlement notification procedure of some sort.

The scope would have to be narrowed. Perhaps it would be only a notification of settlements of infringement cases, and it would still probably have to be narrower in certain ways, but it seems to me that would be desirable.

In fact, I guess that's the single most fundamental need in this field, which is more information about settlements, and these are ways of getting it.

MS. LEVINE: Steve?

MR. STACK: I was just going to clarify one thing. I was not aware the Justice Department couldn't get access to that. I think the decision was -- and I was involved in the case actually. The decision was that the Justice Department does not have standing, but there is another sanction if the failure to file, if you fail to file, and that is that the patent is considered permanently unenforceable. It's not something you can cure.

But is the Department foreclosed from getting that information?

PROFESSOR BRODLEY: According to -- we'll ask the Department, but according to former Attorney General Klein, that provision has not been able to -- it's draconian but not enforced, and the Department doesn't have a way of enforcing it if they don't have standing.

MR. STACK: Well. They don't have standing to enforce a violation of failing to file, but my understanding was that they could get access to the information, and if they wanted to file an antitrust trust on the agreement itself, that they can.

MS. LEVINE: Since we're actually past the noon hour, let me take questions from Rich -- Rich and from Carl.

MR. FEINSTEIN: Just a real brief kind of off the top of my head reaction. I think I actually see both pros and cons to this kind of proposal. I think that the general notion of disclosure could be beneficial if for no other reason, if it had the effect of making it less likely that the most egregious kind of agreements would occur in the first place.

On the other hand, I think there's some really practical hurdles that would have to be overcome, such as when do you have to make the notification? Can you do your deal while the -- before the notification has been acted on? What happens -- and that in turn creates resource issues for the agency that's reviewing it, depending upon what the obligations are for a review, but I think the general concept is one that's worth taking a look at.

PROFESSOR SHAPIRO: I would pretty much second what Rich said. I don't know exactly what the costs that would be imposed by such a rule and one limited appropriately, but it seems to me if it's really notification and not pre-approval for starters, it should be hopefully fairly low cost, and it could make some companies think twice before they enter into what might be really an anti-competitive settlement.

Just knowing that it would be revealed to the agencies, that seems to me to really have some merit, if it's done carefully.

MS. LEVINE: All right. Let me thank our panelists. I must say this has been a truly impressive array of panelists today, and at least for me this has been one of the most vigorous and informative discussions of our whole hearings. It's just been wonderful.

Thank you very much. The agency appreciates it, and the Department of Justice and PTO as well, and I think the public record will reflect just a wonderful morning.

Thank you very much.

(Whereupon, at 12:03 p.m., the workshop was concluded.)

\- - - - -

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

CASE TITLE: COMPETITION AND INTELLECTUAL PROPERTY LAW AND POLICY IN THE KNOWLEDGE-BASED ECONOMY

HEARING DATE: MAY 2, 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: MAY 9, 2002

DEBRA L. MAHEUX

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 accuracy in spelling, hyphenation, punctuation and format.

DIANE QUADE