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DEPARTMENT OF JUSTICE ANTITRUST DIVISION  
and FEDERAL TRADE COMMISSION

Hearing on:

COMPETITION AND INTELLECTUAL PROPERTY LAW  
AND POLICY IN THE KNOWLEDGE BASED ECONOMY

Strategic Use of Licensing: Is There Cause  
For Concern about Unilateral Refusals to Deal?

Wednesday, May 1, 2002

Great Hall of the U.S. Department of Justice

333 Pennsylvania Avenue, N.W.

Washington, D.C.

## 1 PARTICIPATING PANELISTS:

2

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4 Carnegie Mellon University

5 Jonathan Gleklen, Arnold &amp; Porter

6 Paul Kirsch, Townsend and Townsend and Crew

7 Benjamin Klein, Professor of Economics,

8 University of California, Los Angeles

9 Jeff MacKie-Mason, Arthur W. Burks Professor of

10 Information and Computer Science and

11 Professor Economics and Public Policy,

12 University of Michigan

13 A. Douglas Melamed, Wilmer, Cutler &amp; Pickering

14 Carl Shapiro, Transamerica Professor of Business

15 Strategy and Professor of Economics,

16 Haas School of Business, and Director,

17 Institute of Business and Economic

18 Research, University of California,

19 Berkeley

20 Chris Sprigman, King &amp; Spaulding

21 Mark Whitener, Antitrust and General Counsel,

22 General Electric

1 PARTICIPATING PANELISTS (Continued):

2

3 John Shepard Wiley, Jr., Professor of Law,

4 University of California, Los Angeles

5

6

7 HEARING MODERATORS:

8 Pam Cole, Department of Justice

9 Gail Levine, Federal Trade Commission

10 Sue Majewski, Department of Justice

11 R. Hewitt Pate, Department of Justice

12 C. Edward Polk, Jr., U.S. Patent and Trademark

13 Office

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1 MORNING SESSION

2 (9:30 a.m.)

3 HEWITT PATE: Good morning. I'm  
4 Hewitt Pate, one of the deputies at the Antitrust  
5 Division. I'd like to welcome everyone today to  
6 our hearing. Thank you all for coming.

7 It looks like we've got a good group  
8 here to hear what I think is going to be a  
9 terrific panel on refusals to license. The title  
10 of the program is Strategic Uses of Licensing:  
11 Is There Cause for Concern About Refusals to  
12 License?

13 Before I introduce the program  
14 somewhat, I want to especially thank Frances  
15 Marshall and Susan DeSanti from the FTC for all  
16 their work in putting these hearings together,  
17 and personally thank Pam Cole, Sue Majewski,  
18 and Howard Blumenthal for helping with the  
19 preparations today.

20 We're here to talk about as it's  
21 most usually described whether there is a tension  
22 between antitrust and intellectual property, a

1 tension that seems mostly to be discussed in the  
2 context of the Ninth Circuit's Kodak case and the  
3 CSU case from the Federal Circuit.

4 Those followed the Supreme Court's  
5 1991 decision in Kodak establishing contrary  
6 to the amicus submission of the Antitrust  
7 Division that there could be market power in  
8 an after-market for service of equipment as to  
9 which the upstream sales market was competitive.

10 That has led to what might be  
11 described as a cottage industry of ISO  
12 litigation. And that's produced a number of  
13 opinions.

14 The Kodak case from the Ninth Circuit,  
15 about which you'll hear a lot today, stands  
16 generally for the proposition that a refusal to  
17 license IP is presumptively okay, but that if a  
18 plaintiff is able to show that the business  
19 justification offered in support of the refusal  
20 to license was a pretext, then antitrust  
21 liability may attach.

22 The Federal Circuit took a very

1 different view of whether antitrust liability  
2 might lie for a refusal to license, at least an  
3 unconditional refusal to license in the CSU case,  
4 and went on to say in some dictum that has been  
5 the subject of much discussion that antitrust  
6 liability for a refusal to license could not  
7 exist except in the context of tying, fraud on  
8 the Patent Office, or sham litigation.

9           We're going to talk today primarily  
10 about unconditional refusals to deal. Other  
11 sessions have dealt with licensing terms and  
12 conditioning that are of interest in these  
13 hearings.

14           I think as one of the papers for this  
15 panel said, my own concern in listening to this  
16 is not whether there is some abstract concern  
17 about licensing practices, but whether there are  
18 really situations in which it would be  
19 appropriate for Courts to impose antitrust  
20 liability.

21           I have some views on that. But from  
22 the Division and the FTC's perspective, we're

1 here today to listen to a terrific panel.  
2 Among the questions I think that will be very  
3 interesting to have discussed is this underlying  
4 question of whether there is a difference between  
5 IP and other forms of property for purposes of  
6 applying the antitrust laws.

7           Certainly as it's described in  
8 litigation you often see arguments made that of  
9 course IP is different because it's mentioned in  
10 the Constitution, whatever that would mean, or  
11 because it is a right to exclude as though that  
12 necessarily implies that IP is different from  
13 other forms of property.

14           There are other ways in which it  
15 might be though. Certainly the statutory scope  
16 of a patent right deserves examination. And if  
17 Congress defines the scope of a patent right in  
18 a way that differentiates it from other property,  
19 that's something that obviously deserves  
20 consideration.

21           Secondly, I think we have some well  
22 qualified panelists who will discuss whether



1     there is an economic difference between the  
2     two forms of property, whether the ease of  
3     reproduction of intellectual property, at  
4     least intellectual property of some forms,  
5     is a differentiating factor.

6                     Another question is whether there  
7     are situations or what situations there are where  
8     the owner of any type of property whether IP or  
9     otherwise really does have a duty to refrain  
10    from unconditional refusals to deal.

11                    Aspen Skiing is a case that's much  
12    discussed. But of course there was a prior  
13    course of conduct. And I think it will be  
14    interesting to hear from the panel as to what  
15    situations there are where a blanket and  
16    unconditional refusal to deal should raise  
17    antitrust concerns.

18                    What about other forms of intellectual  
19    property, trade secrets and copyrights, for  
20    example? I'll put aside trademark which I think  
21    of as a type of IP that's really for a different  
22    purpose than the ones we're concerned with.

1           The two main cases deal with patents,  
2           and those seem to be the predominant form of IP  
3           that's discussed. But is there a reason that  
4           trade secrets or copyrights should be subject to  
5           a different form of analysis?

6           I think it would seem odd to  
7           most people to imagine a Court requiring the  
8           disclosure of trade secrets. Is that because  
9           there really is a difference between trade  
10          secrets and patents as it relates to antitrust  
11          law?

12          Or if it is odd to think of a Court  
13          compelling that, does that call into question the  
14          extent to which a required license is needed in  
15          the patent context?

16          And how are Courts to administer  
17          disclosure of trade secrets, for example, if  
18          that -- if the principles of a required duty to  
19          deal obtain there? Even in the patent context  
20          sometimes the use of a patent requires underlying  
21          know-how and trade secrets, trade secret  
22          disclosure perhaps.

1                   Would under the Kodak analysis, for  
2                   example, there ever be a claim that the service  
3                   personnel of an ISO have an antitrust entitlement  
4                   to training from the equipment manufacturer?

5                   And finally I'll end with this. I  
6                   wonder how big a problem or how fundamental a  
7                   problem is this? The question gets posed as one  
8                   of a fundamental tension between antitrust and  
9                   IP.

10                   Is it that, or are these cases really  
11                   just an outgrowth of the Supreme Court's Kodak  
12                   decision and the Supreme Court giving a green  
13                   light potentially to the establishment of  
14                   antitrust liability in a situation where that  
15                   hadn't been thought very likely before?

16                   Maybe another way to ask that is  
17                   whether the Division was right in 1991. So with  
18                   that let me turn the program over to Pam Cole who  
19                   will handle some housekeeping issues and then  
20                   introduce our panelists.

21                   PAM COLE: Good morning. Yes. I get  
22                   to handle some housekeeping issues. I hire

1 somebody at home to do that, but I'm going to do  
2 it here. Let me just talk a little bit about  
3 just some basic nuts and bolts issues.

4 We're in the Great Hall of the Justice  
5 Department, as I'm sure you are all aware, which  
6 means that in order to leave this room you need  
7 to be escorted. We do have paralegals in the  
8 back of the room wearing green name tags, and  
9 they will escort you wherever you need to go.

10 If you need to make a phone call, you  
11 should go up to the seventh floor. I guess cell  
12 phones don't work here. And they will escort you  
13 up to the seventh floor.

14 The timing of this is such that we  
15 are going to end the morning session at noon,  
16 have about an hour and a half break for lunch,  
17 reconvene at 1:30, and then end the session at  
18 4:00.

19 For the sake of the panelists in terms  
20 of the microphone, if you can talk right into the  
21 microphone -- and it may not come on until a few  
22 seconds after you pull it close to you. So it

1 will be working. You just need to wait a little  
2 bit of time.

3 Let me just make some introductions  
4 of the panelists. My name is Pam Cole. I'm an  
5 attorney with our San Francisco office of the  
6 Justice Department, and it's great to be here in  
7 Washington, D.C. I've been here since last week  
8 at the spring meeting, so I'm eager to get home.

9 To my right is Ed Polk. He's with the  
10 U.S. Patent and Trademark Office. And to Hugh's  
11 left is Sue Majewski. She is an economist with  
12 our economics group here at the Antitrust  
13 Division.

14 And to her left is Gail Levine with  
15 the Federal Trade Commission. These are the  
16 representatives from the government. I'm now  
17 going to go through and make introductions of our  
18 panelists. I'm going to make introductions in  
19 the order of their presentations. We drew straws  
20 and Jonathan Gleklen gets to go first.

21 Jonathan is -- first of all let me say  
22 that when I introduce the panelists, I certainly

1 cannot do their biographies justice in terms of  
2 the extensiveness of their qualifications. But  
3 for the sake of time I'm just going to make some  
4 short introductions.

5 I also want to say personally that  
6 after are viewing all of the panelists'  
7 presentations I really appreciate the amount of  
8 work and thought that all of you have put into  
9 these presentations. And I sincerely mean that.

10 I never thought that refusals to  
11 license could be as interesting as all of you  
12 have made it in your presentations. And I think  
13 this is really going to be a fun panel.

14 So Jonathan Gleklen is a  
15 partner at Arnold & Porter in Washington, D.C.  
16 Jonathan served as counsel to Xerox in the In  
17 Re: Independent Service Organizations antitrust  
18 litigation case. That's more commonly known as  
19 the CSU case. And obviously that case is going  
20 to be subject to extensive discussion in today's  
21 session.

22 Next up will be Chris Sprigman. Chris

1 served as -- Chris is currently counsel at King &  
2 Spaulding in Washington, D.C. Prior to joining  
3 the firm Chris served as appellate counsel to the  
4 Antitrust Division of the Department of Justice.  
5 In both capacities Chris has focused on the  
6 intersection of antitrust law, intellectual  
7 property, and competition policy.

8           Following Chris will be Ben Klein.  
9 Ben is a professor of economics at UCLA. He is  
10 an internationally recognized expert in antitrust  
11 economics, intellectual property, contractual  
12 arrangements, and industrial organization.

13           Presenting with Ben will be John  
14 Wiley. John is a professor of law at UCLA where  
15 among other things he teaches antitrust law and  
16 intellectual property. He is published widely in  
17 both of these areas.

18           Next up will be Ashish Arora. He is  
19 an associate professor of economics and public  
20 policy at Carnegie-Mellon University. His  
21 research centers around the areas of economics of  
22 technological change, management of technology,

1 intellectual property rights, and technology  
2 licensing.

3           Following Ashish will be Paul Kirsch.  
4 Paul Kirsch is a neighbor of mine and also a  
5 partner at Townsend and Townsend and Crew in  
6 San Francisco. Paul's practice includes both  
7 intellectual property and antitrust. And he  
8 extensively represents the antitrust plaintiffs.  
9 Paul is one of the attorneys who represented  
10 Intergraph in the Intergraph versus Intel  
11 antitrust and intellectual property litigation.

12           Carl Shapiro will be next. Carl, for  
13 those of you who don't know him, which I'm sure  
14 many of you do, is the Transamerica Professor of  
15 Business Strategy at the Haas School of Business  
16 at the University of California at Berkeley.

17           He is also is director of the  
18 Institute of Business and Economic Research  
19 and professor of economics in the economics  
20 department at UC-Berkeley. Professor Shapiro  
21 also served as deputy assistant attorney general  
22 for economics in the Antitrust Division of the



1 U.S. Department of Justice during 1995 to 1996.

2           Following Carl will be Jeffrey  
3 MacKie-Mason. Jeffrey is the Arthur W. Burks  
4 Professor of Information and Computer Science and  
5 professor of economics and public policy at the  
6 University of Michigan.

7           He has testified as an expert  
8 economist in numerous antitrust cases and was the  
9 expert for the plaintiffs in both the Kodak and  
10 Intergraph refusal to deal cases.

11           Following is Mark Whitener. Most  
12 importantly it is Mark's birthday today. Mark is  
13 antitrust counsel for General Electric. Before  
14 joining GE Mark served as deputy director of  
15 FTC's Bureau of Competition where he supervised  
16 the FTC's non-merger enforcement in matters  
17 involving intellectual property and other issues.

18           Mark also supervised me when I was at  
19 the FTC, so I get to ask him some hard questions  
20 today. Mark also worked on the intellectual  
21 property guidelines while he was at the FTC.

22           Finally Doug Melamed who is not here

1 yet -- hopefully he will be arriving later. But  
2 I want to talk a little bit about Doug. Doug is  
3 a partner in the Washington, D.C. office of  
4 Wilmer, Cutler & Pickering and co-chair of the  
5 firm's antitrust and competition policies group.

6 Prior to joining the firm he worked  
7 for the Antitrust Division of the U.S. Department  
8 of Justice for four-and-a-half years including  
9 his most recent position as acting assistant  
10 attorney general.

11 And another important housekeeping  
12 matter. Please make sure to save me one  
13 chocolate croissant back there. Otherwise you  
14 can help yourselves to any food and drink that  
15 you would like.

16 The way that this is going to go  
17 today is that we're going to have PowerPoint  
18 presentations, various types of presentations.  
19 We're going to have discussion about the  
20 presentations, questions and answers.

21 We're hoping that the panelists  
22 because they are really so impressive will

1 mostly guide the discussion.

2           And what I'd like the panelists to do  
3 is after a particular presentation if you have  
4 a comment or question about the presentation, if  
5 you could just turn your name tags on their side  
6 like this. And we will call on you for your  
7 questions or comments which will hopefully  
8 facilitate discussion.

9           And I think that is about it. So why  
10 don't we start with Jonathan. And, panelists,  
11 you're free to go up to the -- if you're doing  
12 a PowerPoint especially, you should go up to the  
13 podium or whatever you want to do.

14           JONATHAN GLEKLEN: I'd like to thank  
15 the Department of Justice and the FTC for having  
16 these hearings. It's an important topic, and  
17 it's one that I've basically built my entire  
18 career on. I'm Jon Gleklen. I'm a partner  
19 at Arnold & Porter.

20           And I've been working on the Xerox ISO  
21 litigation since the summer of 1992 when I was a  
22 summer associate. So the first disclaimer is

1 I don't stand here representing anybody's views  
2 other than my own, not Arnold & Porter's, not its  
3 clients, not even Xerox's.

4 Pam asked me to start out by talking  
5 a little bit about the Xerox case and the facts  
6 and the decision and what to make of it, just  
7 to clarify what the case is and isn't about,  
8 something that I admit is hard to do by reading  
9 the Federal Circuit's decision.

10 I've done this in more detail in an  
11 article that's available in the back, and it will  
12 be up on the website. But the short facts are  
13 Xerox makes, sells, services copiers and  
14 printers.

15 And CSU, Copier Services Unlimited,  
16 was an ISO, an independent service organization  
17 that serviced those copiers and printers.  
18 Starting in 1984 Xerox unilaterally decided that  
19 it was no longer going to sell parts to ISOs.

20 It later decided not to sell software  
21 as software became more a component of the  
22 copiers and printers it was selling. Xerox

1 didn't agree with anybody. It was a completely  
2 unilateral decision. Xerox unlike Kodak didn't  
3 agree with its customers that the customers would  
4 not supply parts or software to ISOs.

5 Customers were free to and in fact  
6 did buy parts from Xerox and sell them to ISOs.  
7 Xerox simply unilaterally decided we're not going  
8 to sell parts to ISOs except to the extent that  
9 they are also end users. There was a class  
10 action litigation. Xerox settled it in 1994 by  
11 agreeing to sell parts to ISOs, directly to ISOs.

12 And everybody ended up getting the  
13 same prices and the same quantity discounts, with  
14 a single exception which was the U.S. Navy which  
15 had a cooperative service agreement with Xerox  
16 where Xerox serviced the copiers while they were  
17 in port and the Navy serviced them when they were  
18 out at sea.

19 CSU opted out of the settlement of the  
20 class action and filed their own lawsuit. CSU  
21 challenged a couple of things. They challenged  
22 Xerox's past, pre-'94 refusal to sell parts and

1 license software and Xerox's current '94 and  
2 thereafter pricing, saying that those were also  
3 exclusionary.

4           And CSU's theory was basically the  
5 Kodak theory. Xerox has a parts and software  
6 monopoly, and it is leveraging that monopoly to  
7 obtain or maintain a monopoly in a market for  
8 the service of Xerox's copiers and printers.

9           Like I said, their only conduct at  
10 issue was unilateral. The only claims were  
11 section II claims, no section 1 claims, no  
12 tying, no concerted refusal to deal. Xerox  
13 counterclaimed patent/copyright infringement plus  
14 some trademark and state law claims.

15           And Xerox's argument was that CSU  
16 had used infringing parts, these third-party  
17 parts vendors had sprung up, they made parts that  
18 infringed Xerox's patents, CSU bought and used  
19 those;

20           And that CSU had essentially stolen  
21 disks containing diagnostic software and upgraded  
22 diagnostic software, had reproduced that software

1 by installing it on copiers and printers, and  
2 then infringed the copyrights again by using the  
3 software which was unlicensed.

4 The nice thing about the Xerox case  
5 is that it's a pure law school case. There are  
6 essentially no disputed issues of fact at the  
7 end of the day. CSU conceded that all of their  
8 injury was attributable to Xerox's refusal to  
9 sell or license patented and copyrighted  
10 materials.

11 Basically they said there's no  
12 but-for causation; if we can't get the patented  
13 photoreceptors and the patented and copyrighted  
14 diagnostic software, we're out of business; so  
15 the only thing that matters is the patented  
16 stuff. CSU conceded the infringement of the  
17 patents and copyrights.

18 And their only defense was a misuse  
19 defense. So the remaining issues, as I said,  
20 were pure questions of law. And there are  
21 basically three of them:

22 Can a pure unilateral refusal to sell

1 and license software or parts covered by patents  
2 and copyrights violate section II?

3 Can, quote, unquote, high prices,  
4 whatever that means, violate section II because  
5 it's anticompetitive conduct? And can this past  
6 refusal to sell or the ongoing high prices be  
7 misuse?

8 The District Court -- if you go on  
9 Westlaw, you'll see that there are literally a  
10 half dozen District Court decisions on summary  
11 judgment and various motions for reconsideration.  
12 But after you parse the various District Court  
13 decisions, you basically get to four key  
14 holdings.

15 One is that unilateral refusals to  
16 deal are neither anticompetitive under section II  
17 nor inequitable conduct or whatever the  
18 standard would be for misuse. High prices for  
19 intellectual property are neither anticompetitive  
20 nor misuse.

21 The number of markets, antitrust  
22 relevant markets affected by a refusal to license



1 is irrelevant. And the IP holder's intent  
2 underlying its refusal to license is irrelevant.  
3 Nice, clearcut.

4 The Federal Circuit, well, they  
5 affirmed, and that we can understand. And the  
6 rest of their decision is -- you know, it's a  
7 mess. It's confusing. Nobody can really  
8 understand what it means.

9 I'd like to say that the right way to  
10 read the Federal Circuit's decision is that they  
11 affirmed the District Court and to ignore their  
12 language which just doesn't make any sense. I'll  
13 concede that.

14 The decision -- you know, they don't  
15 cite the helpful precedent. Believe me, we cited  
16 more cases on point than the Federal Circuit  
17 managed to find.

18 The Federal Circuit's decision focuses  
19 on whether IP was used to obtain monopoly power  
20 outside the statutory grant without actually  
21 saying, well, what is the statutory grant.

22 And then it comes up with some

1 exceptions to the right to unilaterally refuse  
2 to license which don't make any sense so -- as  
3 Hugh Pate said, tying, fraud on the PTO, and sham  
4 litigation. Well, tying is not a unilateral  
5 refusal to deal. So tying is not an exception  
6 to your right unilaterally to refuse to deal.

7           Fraud on the PTO, well, that doesn't  
8 make any sense because if you committed fraud on  
9 the PTO you don't have valid IP. So there is no  
10 valid IP that you have refused to license. And  
11 then the last exception is also wrong I think,  
12 sham litigation. This just doesn't make any  
13 sense to me.

14           You could engage in sham litigation,  
15 and the sham litigation itself might be unlawful,  
16 but that doesn't -- it's not clear to my why the  
17 underlying refusal to deal should be unlawful.  
18 Think of the hypo of a plaintiff -- I'm sorry.

19           An IP owner wants to make sure  
20 they get Federal Circuit jurisdiction because,  
21 God knows, they don't want to be in the Ninth  
22 Circuit. So they say we're going to file

1 a patent infringement claim that we know  
2 is meritless because we know they are not  
3 infringing. And you get antitrust counterclaims  
4 based on your past refusal to deal.

5           If you satisfy all of the elements,  
6 that sham litigation might in fact be an  
7 antitrust violation. But I don't see why that  
8 should make the underlying unilateral refusal to  
9 deal unlawful. And that's important because the  
10 measure of damages may be very different.

11           Your antitrust injury from the sham  
12 litigation, your damages are basically your cost  
13 of defending the suit. Your injury from the past  
14 refusal to deal could be millions or, according  
15 to CSU's economists, hundreds of millions of  
16 dollars.

17           So I think it is an important  
18 distinction, and the Federal Circuit's decision  
19 just doesn't make any sense. So, as I've said, I  
20 think the right way to read the Federal Circuit's  
21 decision is that it's limited.

22           I've written this article basically

1 addressing Chairman Pitofsky's or former Chairman  
2 Pitofsky's concerns that he expressed in I guess  
3 two speeches and in an article. One concern is,  
4 you know, the Xerox decision could -- or people  
5 call it the CSU decision. I call it the Xerox  
6 decision.

7           It could be read to say that selective  
8 licensing is always lawful, and that depends on  
9 what you mean by selective licensing. If it's  
10 tying, that's not a unilateral refusal to deal.  
11 But if you pick your licensee, that I think is  
12 a unilateral refusal to deal.

13           And the Federal Circuit is not the  
14 first Court to decide that in the Xerox case.  
15 Other people have challenged selective licensing.  
16 You gave my competitor a license. You didn't  
17 give me one. And Courts have said that that's  
18 lawful.

19           Conditioned licenses, again tying  
20 or exclusive dealing, that's not a unilateral  
21 refusal to deal. I don't think the Xerox case  
22 touches it. Price fixing, the example Chairman

1 Pitofsky gave is, you know, there's essentially  
2 a price fixing or a vertical price fixing  
3 conspiracy with a licensor and its licensees.

4           And you terminate somebody who breaks  
5 with the price fixing conspiracy. The underlying  
6 price fixing conspiracy is unlawful.

7           The termination may -- it seems to me  
8 irrelevant whether the termination of the guy  
9 because he breached -- he didn't go along with  
10 the price fixing conspiracy, whether that's  
11 lawful or not doesn't make a difference.

12           And fraud on a standard setting  
13 organization just seems to me like the sham  
14 litigation. It's the underlying fraud that's  
15 the anticompetitive conduct. The subsequent  
16 unilateral refusal to deal, whether or not that's  
17 unlawful really doesn't make a difference.

18           Let me talk briefly about why I think  
19 the Federal Circuit got it right in Xerox though,  
20 as I say, you wouldn't know why from reading the  
21 opinion. I think it is compelled by Supreme  
22 Court precedent. And it is in fact consistent

1 with every lower Court's decision except for the  
2 Ninth Circuit's.

3 I think the result is compelled by the  
4 language in the legislative history of the patent  
5 act. And finally I don't think there are any  
6 good alternatives to the rule that the Federal  
7 Circuit came up with.

8 The Supreme Court has been consistent  
9 that a patent or copyright conveys a right to  
10 refuse to deal. Leave aside the issue of whether  
11 that can be antitrust -- cause antitrust  
12 liability.

13 I've put the cases up on the  
14 PowerPoint from cases from Continental Paper Bag  
15 that exclusion of competitors is the very essence  
16 of the right conferred by the patent, to Dawson,  
17 to Stewart which is a copyright case.

18 You know, the copyright owner has the  
19 capacity arbitrarily to refuse to license one who  
20 seeks to exploit the work. So I think we have  
21 common agreement that the IP laws themselves  
22 convey this right. So the question is: What

1 do the antitrust laws say about that?

2                   And I think the Supreme Court  
3 precedent though not specifically addressing  
4 the unilateral refusal to deal point is pretty  
5 consistent that if conduct is authorized by the  
6 IP laws it doesn't violate the antitrust laws.

7                   So there's the famous Simpson dicta,  
8 the patent laws in pari materia with the  
9 antitrust laws and modify them pro tanto.

10                   To translate that into English, the  
11 patent laws and the IP law -- and the antitrust  
12 laws address the same subject. And the patent  
13 laws modify the antitrust laws as far as they,  
14 that is the patent laws, go. And I think the  
15 Supreme Court was clearly saying patents are  
16 different.

17                   In Simpson they were distinguishing  
18 U.S. versus General Electric. They said there  
19 we said -- you know, everybody may agree the  
20 decision is wrong now. But they say in U.S.  
21 versus General Electric we said resale price  
22 maintenance is lawful. But that was a patent

1 case. And patents are different.

2           So I think Simpson clearly stands for  
3 the proposition that the Supreme Court recognizes  
4 that there are differences where the IP laws give  
5 you rights.

6           Precision Instrument Manufacturing,  
7 United Shoe, you know, a patentee's exercise  
8 of its right to exclude others from use of the  
9 invention is not an offense against the antitrust  
10 act. Admittedly none of these cases were  
11 directly addressing a unilateral refusal to  
12 deal.

13           But there are lower court cases that  
14 do. And those are with the exception of the  
15 Ninth Circuit pretty consistent. SCM versus  
16 Xerox, this is really the same thing as an ISO  
17 case now.

18           Xerox had patents on parts that it was  
19 refusing to license to an equipment competitor,  
20 not a service competitor. SCM was an equipment  
21 competitor, exactly the same issue.

22           The Court says Xerox's refusal to



1 license the xerography patents was permissible  
2 under the patent laws and therefore does not  
3 give rise to antitrust liability. You've got the  
4 Miller case. If you lawfully acquire your IP you  
5 don't violate section II by maintaining that  
6 monopoly by refusing to license.

7           And there are other ISO cases: Data  
8 General in the First Circuit, Service & Training  
9 in the Fourth Circuit. Like I said, I think it's  
10 not just the case law. It really is the patent  
11 act. 217(d)(4) in the 1988 amendments to the  
12 patent act I think is the most directly on point:

13           No patent owner otherwise entitled  
14 to relief for infringement or contributory  
15 infringement shall be denied relief or deemed  
16 guilty of misuse or illegal extension of the  
17 patent by reason of having done one or more of  
18 the following, and then listing refuse to license  
19 or use any rights to the patent.

20           Now, all of that language other than  
21 refuse to license or use any rights to the patent  
22 was there in 1951. So the relevant legislative

1 history is the 1951 legislative history. And the  
2 Antitrust Division opposed that original 1951 law  
3 saying it would carve out an area in which the  
4 antitrust law does not operate.

5           And then it's not on the PowerPoint,  
6 but if you look at the legislative history Wilbur  
7 Fugate who testified for the Antitrust Division  
8 said, quote: The proponents of the bill indicate  
9 that such a result is contemplated in the  
10 language of 217(d). So that's the legislative  
11 history of the original act.

12           You've got the 1980 amendment which is  
13 just add one more type of conduct onto the long  
14 list that already existed of things that were not  
15 misuse. The sponsor, Representative Kastenmeyer,  
16 says what we're doing is we've got SCM; that's  
17 good law; basically we want to codify that law.  
18 Look at the language.

19           The language is repetitive if  
20 antitrust claims are covered. Misuse or illegal  
21 extension, unless that means misuse or -- misuse  
22 which is not usually the way we interpret

1 statutes, the legal extension has to mean  
2 something else.

3 And finally, you know, barring misuse  
4 is pointless if the same conduct violates the  
5 antitrust laws.

6 If Congress intended to say you can  
7 do this and still have your patent enforceable,  
8 if the same conduct violates the antitrust laws,  
9 plaintiff is entitled to an injunction saying you  
10 can't do this anymore. So it would be pointless.

11 Let me then turn to basically what's  
12 the alternative. Well, you have the leveraging  
13 theory which comes out of footnote 29 in Kodak.  
14 What are the problems with this? First of all,  
15 it is not clear to me that anybody who espouses  
16 this has really been serious about this one  
17 market, two market thing.

18 Even CSU basically said, you know,  
19 you can refuse to license Kodak in the equipment  
20 market, but you can't refuse to license us. And  
21 I don't think there's any principle there other  
22 than there is a special rule for ISOs, and the

1 antitrust laws don't create special rules for  
2 ISOs.

3           The other problem is it reads the  
4 right to use out of the patent act. IP is always  
5 used in a market other than the market for the  
6 IP. We may sell software in the -- sell  
7 diagnostic software, license diagnostic software  
8 in the software market.

9           But the diagnostic software is used  
10 in the market to service the copier. Other  
11 problems, every refusal to deal case becomes a  
12 market definition exercise. How do you properly  
13 define the markets, which means outside the  
14 Second Circuit you can never win on a motion  
15 to dismiss?

16           And it's real hard to win a market  
17 definition point on summary judgment which means  
18 that all of these cases go to trial. And finally  
19 I don't think there is any case law support for  
20 it. Footnote 29 which is -- in Kodak which is  
21 the precedent that everybody cites for this, it  
22 is a footnote about tying.

1           The Court says we are addressing  
2     tying. And it was in a case that doesn't involve  
3     intellectual property although IP was later an  
4     issue in the Kodak case. The record before the  
5     Supreme Court is crystal clear. It's in the  
6     brief that Kodak did not raise its IP rights.

7           And the plaintiffs actually said, you  
8     know, we asked Kodak do you have any IP rights,  
9     and they said no. Another alternative: Well,  
10    let's just treat patents like any other kind of  
11    property, no special rule for IP. So we can  
12    apply the same rules that we use for regular  
13    property.

14           So there's the intent test from  
15    Colgate and Lorain Journal. And pretext is like  
16    the intent test, and that's the Ninth Circuit's  
17    test. The intent test comes from the famous line  
18    from Colgate which starts out: In the absence of  
19    any purpose or effect to create a monopoly, you  
20    have a right to refuse to deal.

21           The problem here is that intent is  
22    meaningless. The purpose of IP is to exclude.

1 It kind of doesn't make any sense to say you  
2 refuse to license your IP with the intent to  
3 exclude people because that's the right that  
4 Congress gave you. Look at professional real  
5 estate investors.

6 This is what the precedent says. To  
7 condition a copyright upon a demonstrated lack  
8 of anticompetitive intent would upset the notion  
9 of copyright as a limited grant of monopoly  
10 privileges. Continental Paper Bag, you may  
11 refuse license without question of motive. Again  
12 we have the high cost of enforcing IP rights.

13 Remember that every infringement case  
14 is implicitly a refusal to license case. If you  
15 had licensed in the first place, you know, you  
16 wouldn't have an infringement case. You can't  
17 win a motion to dismiss. You have some bad  
18 documents; it shows bad intent.

19 You lose summary judgment or you don't  
20 get past summary judgment. Essential facilities,  
21 you know, to quote Francis Ford Coppola or Joseph  
22 Conrad, you can take your pick: The horror, the

1 horror.

2           Why anybody would want to extend the  
3 essential facilities doctrine beyond the very  
4 narrow range of cases hopefully in the distant  
5 past to which it's going to apply is beyond me.  
6 I recognize that the precedent is ambiguous,  
7 reject it as a matter of law in SCM where the  
8 plaintiff cited Otter Tail.

9           Some District Courts have rejected  
10 it. Other Courts seem to have assumed that the  
11 essential facilities doctrine could apply but  
12 just chose not to apply it. It's got the same  
13 practical problems as the intent test.

14           You have the Federal Circuit's rare  
15 cases, quote, unquote, where you won't frustrate  
16 the objectives of the copyright act. They give  
17 the example of unlawfully acquired IP. I don't  
18 know why you should have antitrust liability for  
19 refusal to deal there as opposed to antitrust  
20 liability for the unlawful acquisition.

21           And it's hard to think of any  
22 other examples other than unlawful acquisition.

1 Remember, if unlawful refusals -- if refusals to  
2 deal are unlawful, so are high prices. I put up  
3 this nice quote from CSU's chairman because it is  
4 so entertaining:

5 We're prepared to give Xerox 200 to  
6 300 percent mark-up. We would ask the Court to  
7 say that a 200 percent to 300 percent mark-up  
8 over an objective standard with respect to cost  
9 is a sufficient margin for anybody, including  
10 ladies' dresses.

11 I don't think we want the Courts  
12 treating IP the same as ladies' dresses. How do  
13 you figure out what's an unlawfully high price?  
14 It's perfectly rational for the IP owner to  
15 charge his indifferent price; I would have made  
16 this much profit if I had refused to license.

17 It's theoretically rational for the  
18 licensee or the putative licensee to pay  
19 anything -- any fee up to 100 percent of its  
20 economic profits. How do you show that that's  
21 exclusionary or bad intent? I don't think  
22 there's a workable way of doing it.



1                   And again if high prices are lawful,  
2                   what benefit do we really get from barring  
3                   refusals to license? If you can choose any price  
4                   and we're not going to have the Courts inquire  
5                   into the price, how is the world a better place,  
6                   bottom line?

7                   The decision theoretic approach,  
8                   it's in a recent Antitrust Law Journal article  
9                   that analyzed tying. Basically how many false  
10                  positives, how many false negatives? This  
11                  to me suggests a rule of per se legality.

12                  If we agree that there are at most  
13                  very limited and at the at least no circumstances  
14                  under which a unilateral refusal to license  
15                  should violate the antitrust laws -- and there  
16                  are real costs to false positives in terms of  
17                  lost incentive to license.

18                  And there are even costs for true  
19                  negatives of defending the case. There are real  
20                  costs here. And I don't see any significant  
21                  benefits, modest benefits at best unless we're  
22                  going to have the Courts governing what you

1 can charge for IP.

2 I close by saying, look, the antitrust  
3 laws are a blunt instrument; you have treble  
4 damages; you've got the cost of litigation. I  
5 recognize that there are areas where we may all  
6 agree that refusals to license are a real  
7 problem.

8 What I'd suggest is the remedy is  
9 not treble damages and attorneys' fees and  
10 turning the plaintiffs' bar loose. But if it's a  
11 problem, have Congress enact statutory compulsory  
12 licensing as they have done in certain  
13 circumstances under the copyright act.

14 Then you don't face treble damages.  
15 Everybody knows what the rules are. Everybody  
16 can follow the rules. Thanks.

17 (Applause.)

18 CHRIS SPRIGMAN: Hi. Jon Gleklen and  
19 I begin in agreement which is that the only clear  
20 part of the Fed. Circuit's decision in Xerox was  
21 that the Fed. Circuit affirmed a District Court  
22 holding that allowed a unilateral refusal to deal

1 and basically declared it immune from antitrust  
2 liability.

3           What interests a lot of antitrust  
4 lawyers and what alarms some of them is not that  
5 bit of clarity. It's the relative sea of murk.  
6 And I wanted to spend a little bit of time  
7 exploring some of the murk.

8           First of all, the question arises  
9 whether the Xerox holding is limited to  
10 unilateral refusals to deal or whether it applies  
11 more broadly to other kinds of refusals to deal,  
12 refusals that are the result of agreement.

13           And the reason this concern arises in  
14 large part is because one of the exceptions to  
15 the holding that the Federal Circuit noted was  
16 tying. Tying agreements come outside of the  
17 Xerox rule of per se legality. Well, tying isn't  
18 usually unilateral or usually thought of as  
19 unilateral.

20           And so that raises the question, well,  
21 if they noted one condition that comes outside of  
22 the rule, what about all the other kinds of

1 conditions that appear in licenses, the kinds of  
2 conditions that we see analyzed in the agency's  
3 IP guidelines, for example, exclusive dealing  
4 provisions that tie out competing products from  
5 distribution;

6 Or non-compensatory discount  
7 structures of the type that Professor Ordober  
8 analyzed in an article that have no compensatory  
9 points along their curve and therefore are seen  
10 as non-profit maximizing at any point and a  
11 simple foreclosure device;

12 Or grantbacks, especially broad and  
13 exclusive grantbacks that have potential effects  
14 on innovation incentives and create antitrust  
15 concern for that reason.

16 Now, these are provisions in licenses  
17 that you see from time to time. They are  
18 generally subject to rule of reason analysis.  
19 Are these provisions left out of the exceptions  
20 to the Xerox rule? Probably not. I don't think  
21 that's the right reading of Xerox.

22 The Solicitor General filed a brief

1 when the Supreme Court asked for his views saying  
2 that they don't think that's the right reading of  
3 the case. But it's not so clear that it isn't.

4           And there's a District Court of  
5 Northern California in March of 2000, an  
6 opinion in the case Townsend versus Rockwell  
7 International that basically used a lesser  
8 included rights rationale to say in effect that  
9 if in fact you as a patent holder have the right  
10 to refuse to license, you have the right to  
11 pretty much do anything else short of that.

12           You have the right to put conditions  
13 into licenses without fear of liability. The  
14 District Court didn't mention the right to fix  
15 prices, but one would question whether in fact  
16 that is a lesser included right within the right  
17 to refuse to license. I don't know if the  
18 District Court would go even that far.

19           The case essentially involved patents  
20 relating to 56K modem technology, and there was  
21 an infringement suit and a counterclaim in that  
22 infringement suit that alleged that there in fact

1 had been an agreement to license only on the  
2 basis of licenses that included conditions of  
3 cross-licensing and other forms of reciprocal  
4 dealing.

5           The Court essentially ignored the fact  
6 that there was the allegation of an agreement and  
7 said, well, the licensor can do what it wants as  
8 a lesser included right. I'm not so sure that  
9 Townsend can be blamed on Xerox. But there it  
10 is nonetheless. It shows that a reading of Xerox  
11 that is quite broad is out there in the world.

12           It's available to other Courts.  
13 Interestingly enough the Solicitor General's  
14 brief which came after the Townsend opinion  
15 didn't mention the Townsend opinion. I don't  
16 know what that suggests. But it's something  
17 that's worth noting.

18           This raises the question I think of if  
19 we assume for a moment that unilateral refusals  
20 to deal are really the territory of the Xerox  
21 case -- if the territory is broader than that we  
22 have real problems. But assume for the moment

1 that unilateral refusals to deal is the territory  
2 of the Xerox case.

3           Is that narrower rule of more or less  
4 per se legality for a refusal to license right?  
5 Well, Jon Gleklen said and others have said that  
6 it kind of has to be definitionally because the  
7 patent is a right to exclude, and a refusal to  
8 license is merely an exercise of the right to  
9 exclude.

10           That makes sense in a kind of  
11 tautological way. But think for a moment about  
12 what the right to exclude actually is. If you  
13 look at other forms of property, the right to  
14 exclude is an essential part of what we think of  
15 as property generally, your house, your store,  
16 your factory.

17           Much of your ability to enjoy and to  
18 make money from that asset stems from your right  
19 to exclude.

20           And generally although refusal to deal  
21 laws are in the area of some doctrinal confusion  
22 and concern, especially with respect to the

1 essential facilities leg of it, we generally  
2 think that your right to refuse to deal in  
3 tangible forms of property runs out where your  
4 refusal to deal liability begins.

5           The Xerox rule essentially says that  
6 IP is special in some sense. Now, this is a view  
7 that I think contains some assumptions that are  
8 interesting and I want to talk about just for a  
9 moment. The agency's IP guidelines don't say  
10 anything definitively, but they do have some  
11 portents.

12           It's been noted many times that the  
13 IP guidelines essentially say that intellectual  
14 property is property. Well, property, the right  
15 to exclude incident to other forms of property  
16 doesn't give you per se immunity from a refusal  
17 to deal liability. Well, why might the right to  
18 exclude for IP be different?

19           Well, there's a couple of arguments.  
20 First of all, it's the only right. Your right  
21 granted in the patent act is the right to  
22 exclude. There are other rights incident I



1     suppose, the right to transfer that patent to  
2     your heir or to an assign. But the right to  
3     exclude is really the key right.

4             As well the right to exclude is said  
5     to be the basis for the incentive to innovation.  
6     That is what Congress was really getting at in  
7     the patent act. I'll talk a little bit more  
8     about that in a minute.

9             It's worth noting though that in  
10    terms of the idea that the right to exclude is  
11    the only right incident to IP, well, the question  
12    I suppose is even if it is the only right how far  
13    does that right go? Does it include the right  
14    essentially to exclude up to and past a point  
15    that antitrust liability would normally begin?

16            Jon Gleklen mentioned the Supreme  
17    Court opinion in Simpson versus Union Oil. This  
18    is interesting. I did an English translation too  
19    of what they said.

20            And I think when I did the English  
21    translation I concluded that the best thing that  
22    one could learn from this opinion is that a rule

1     should be imposed on judges that if you are going  
2     to say something in Latin, don't say it, because  
3     what's been said here doesn't say anything about  
4     the extent to which the patent laws modify the  
5     antitrust laws in this particular area.

6                    To the extent that the patent laws  
7     and the antitrust laws relate to the same subject  
8     matter, the Supreme Court says the patent laws  
9     modify the antitrust laws to that extent or as  
10    far as they go. Well, how far do they go? How  
11    far does the right to exclude go?

12                   The Supreme Court has merely raised  
13    the question and hasn't given any kind of an  
14    answer. One way of looking at this is laws  
15    in *pari materia*, as the Supreme Court said  
16    generally, should be harmonized.

17                   There's a canon of construction that  
18    says they should be harmonized. And that would  
19    suggest -- although mildly because canons of  
20    construction point both ways. They point all  
21    ways.

22                   But it would suggest mildly that to

1 the extent we're worried about the scope of the  
2 right to exclude it should basically extend only  
3 so far as the right to exclude extends for other  
4 forms of property. And that antitrust liability  
5 for refusals to deal is quite narrow and, as  
6 we'll discuss later, should be retained.

7 Jon also talked a bit about the 1988  
8 patent act amendments, the Patent Misuse Reform  
9 Act. And this piece of legislation basically  
10 removes from misuse liability refusals to deal.

11 The question is whether the additional  
12 language misuse or "illegal extension of the  
13 patent right" also means that antitrust liability  
14 for refusal to deal is removed. Well, a few  
15 things can be said about that. One, the  
16 Solicitor General's brief pointed out that  
17 it's the Patent Misuse Reform Act.

18 It doesn't apply on its face to  
19 antitrust. The Solicitor General's brief also  
20 pointed out that antitrust exemptions are  
21 disfavored. And if this is an exemption or an  
22 attempted exemption, it wouldn't be an explicit

1 one. It would be an implicit one.

2 I think more pertinently and focused  
3 on the language, illegal extension of the patent  
4 right sounds like misuse. There are a number of  
5 cases in the Federal Circuit and elsewhere where  
6 misuse is defined as broadening the physical or  
7 temporal scope of the patent grant with  
8 anticompetitive effect.

9 The focus is on the use of market  
10 power that stems from a patent to gain leverage,  
11 a monopoly or something less than that, in some  
12 other market or in some other product that's  
13 outside the scope of the grant, whatever that  
14 might be in an individual case.

15 So the language basically to me sounds  
16 like Congress is saying something once and then  
17 saying it again which is not all that unusual.  
18 Now, if the right to exclude in the patent act  
19 doesn't extend, isn't complete, and doesn't rule  
20 out liability for refusal to deal, what is the  
21 test?

22 The essential facilities doctrine, not

1 too promising as Jon pointed out. There are not  
2 too many recent cases. It's been -- the doctrine  
3 itself has been picked apart pretty thoroughly.

4           But there is refusal to deal liability  
5 unrelated to essential facilities that focuses on  
6 the conduct at issue and asks whether, first of  
7 all, a licensor or a property owner generally has  
8 monopoly power and whether the conduct that's  
9 being examined involves some sacrifice of profit  
10 that would otherwise be available to a lawful  
11 monopolist or to a monopolist, period, through  
12 exercise of ordinary monopoly pricing.

13           The idea essentially is that a  
14 monopolist is free to charge monopoly rents,  
15 that a monopolist is free to do the thing that  
16 monopolists usually do which is to constrain  
17 output and raise prices, but that a monopolist is  
18 not free to sacrifice profit in order to further  
19 constrain output and raise price potentially for  
20 the purpose of foreclosing competition down the  
21 line.

22           And the Ordovery/Willig articulation of

1 this test focuses on as one prong the promise of  
2 recoupment later. But that element of recoupment  
3 is not always articulated in the test. The test  
4 is profit sacrifice explainable only really  
5 through its effect on competition.

6 A couple of things to say about this  
7 test. First of all, it's narrow. The plaintiff  
8 has to show that the defendant has monopoly power  
9 in some relevant market. And the plaintiff has  
10 to prove profit sacrifice in the particular way  
11 that the test articulates which is a fairly  
12 difficult thing to do.

13 It was done in the Microsoft case, but  
14 it won't be done I don't think that often. This  
15 raises the issue now of remedies. If you're  
16 going to have refusal to deal liability based on  
17 this narrow test if you find a refusal to deal  
18 violates the test, what do you do about it?

19 That's a difficult question because  
20 there is no prescription in the antitrust law  
21 against charging a monopoly rent. But a remedy  
22 would ordinarily involve a compulsory license of

1 some kind in order to license. And that gets a  
2 District Court or some other Court into the  
3 business of regulating the price of a license.

4 Well, one possibility is that if there  
5 is a course of licensing with other licensees who  
6 seem fairly similar to the would be licensee, you  
7 could essentially impose a license on similar  
8 terms and a similar price.

9 But I think as we are going to hear a  
10 bit later, that creates a problem by preventing  
11 some efficient price discrimination. This is a  
12 tough issue. I think we'll talk a bit more about  
13 this.

14 But there's one possible approach  
15 which is to allow -- to delay remedies and to try  
16 to get parties to bargain, as has been put in the  
17 shadow of the liability finding. That may be one  
18 way to try to set a price, not a perfect way, but  
19 perhaps worth discussion.

20 I want to come back to innovation for  
21 a moment. One of the reasons that the right to  
22 exclude is often said to be complete, to rule out

1 antitrust liability, is that if it weren't we'd  
2 have helpful effects on innovation and the  
3 incentive to innovate which is the thing that  
4 the patent laws are trying to provoke.

5           The simple rule that more exclusion  
6 equals more innovation I think is probably  
7 something we can get rid of pretty quickly. And  
8 there's been a lot written on this, and there are  
9 several reasons to think that there is no simple  
10 equivalence between exclusion and innovation.

11           A more exclusionary patent regime of  
12 course does potentially raise the incentive for a  
13 pioneer. But follow-on technologies which may be  
14 very important for the commercial usefulness of a  
15 product may be disincentivized if the power of  
16 the pioneer to exclude is set too high.

17           That's a relatively narrow concern. A  
18 broader concern is whether innovation incentives  
19 are sufficiently sensitive at the kinds of  
20 margins we're talking about of narrow refusal to  
21 deal liability that we can reliably say across  
22 industries that there is going to be any



1 significant incentive diminution at all.

2           There's an interesting article that I  
3 recommend to you by Ian Ayres and Klemperer in  
4 the Michigan Law Review in '99 that helps to make  
5 the point about why we might want to consider  
6 refusal to deal liability as being potentially  
7 helpful and good policy.

8           Ayres and Klemperer coin a term the  
9 stationarity intuition which they apply to an  
10 idea that small restrictions on the scope of the  
11 right to exclude may in fact be good policy  
12 because they reduce somewhat the patent holder's  
13 profit but reduce deadweight loss by a lot more.

14           And although they don't mention  
15 refusal to deal liability as a candidate for  
16 carrying their model into effect, I wonder  
17 whether it might be.

18           Just a bit to close on what the  
19 stationarity intuition is. Under Ayres and  
20 Klemperer's model they imagine a small narrowing  
21 of the scope of the right to exclude such that  
22 the price goes from  $P-M$  to  $P$ -prime.

1                   The right to exclude is somewhat  
2 narrowed. And the quantity goes up from Q-M to  
3 Q-prime as a result because the monopolist has  
4 less power over the price. The profit loss from  
5 this small narrowing of the right to exclude is  
6 the area B minus the area A. The monopolist  
7 loses revenues by a lower price on current sales.

8                   The monopolist then gains revenues  
9 on additional output. And compare that to the  
10 relief from deadweight loss from the same move  
11 which is the area described in B plus C which  
12 is larger under a lot of different assumptions  
13 than -- by a lot than the profit loss.

14                   The point that Ayres and Klemperer  
15 make is that, over relatively small adjustments  
16 to the scope of the right to exclude, social  
17 welfare may often go up. The incentive to  
18 innovate may be unaffected or it may change a  
19 little bit. It's hard to say. But this is a  
20 trade-off that we should desire.

21                   So to sum up, the argument -- the IP  
22 argument that the right to exclude is complete is

1 an interesting argument, but it's based on some  
2 assumptions that may not be correct.

3           And refusal to deal liability in a  
4 regime where the right to exclude is not complete  
5 but is in fact limited by a narrow antitrust  
6 refusal to deal test may in fact increase social  
7 welfare markedly. Remedies is a continuing  
8 concern. I think we'll talk more about that.  
9 Thanks.

10           HEWITT PATE: If there are panelists  
11 who have questions, as Pam mentioned, go ahead  
12 and put up your name tag, and I'll look forward  
13 to getting to those. Let me start with one which  
14 I indicated in my opening remarks. I have a  
15 sense that a lot of this litigation takes place  
16 in the ISO context.

17           And that's not surprising since in the  
18 Supreme Court Kodak case there seems to be an  
19 approval of the notion of liability for extending  
20 a patented parts monopoly into the service  
21 market. And not surprisingly where there's  
22 Supreme Court precedent like that litigation is

1 likely to follow.

2                   For Jonathan or for others, do you see  
3 in your practices or in litigation a move toward  
4 a more general assertion of the notion that there  
5 is a unilateral obligation to deal on certain  
6 terms? The Townsend case has a little bit  
7 different fact pattern. But what experiences  
8 have people had with this?

9                   JONATHAN GLEKLEN: The reality is I  
10 have built an entire career on defending either  
11 the Xerox case or cases that I think are -- you  
12 know, you can draw analogies to the Xerox case.

13                   I mean I've done what I think is  
14 really the same issue for Intel and for General  
15 Electric, literally the same issue in an ISO  
16 case for General Electric.

17                   And I think Intergraph as Paul will  
18 talk about is at some level a question about your  
19 right to refuse to deal. So I think it's out  
20 there. And it's -- you know, it's a big target.

21                   As I tell people when I'm  
22 counseling clients, even if you think you have

1 a 90 percent chance of winning, if you're facing  
2 a 10 percent chance of \$200 million in liability  
3 and you can settle the case for \$10 million, you  
4 should settle the case for \$10 million. I think  
5 the plaintiffs' bar recognizes that as well. So  
6 it's out there.

7 HEWITT PATE: Other comments? If not,  
8 Professor Klein?

9 BENJAMIN KLEIN: I think you're right  
10 that these cases have to do with ISOs. But the  
11 question I would like to ask -- and I'm obviously  
12 making a comment by asking this question -- is  
13 let's assume that we have the same fact pattern  
14 except there were no ISOs.

15 Let's assume that a manufacturer of  
16 equipment had a warranty which included all  
17 service when they started. So as an economic  
18 matter, we really have the same situation, that  
19 consumers cannot buy service from anybody other  
20 than the equipment manufacturer.

21 I'd like to ask the panel or anybody  
22 in the audience whether they would think -- my

1 reading of the law is that there basically would  
2 be no antitrust problem with that.

3 GREG WERDEN: That's probably a  
4 minority view. Most antitrust lawyers say  
5 it's a tie. I've asked them the question.

6 BENJAMIN KLEIN: Okay. Let me hear  
7 a case that has to do with that where a firm  
8 clearly doesn't have market power in the  
9 precontract market like Kodak or Xerox or anybody  
10 else. To show an illegal tie obviously you need  
11 market power in the tying good market.

12 I maintain that you would never go  
13 down the road that we've gone down in this case,  
14 not just because we don't have people to bring  
15 the case that have been alleged to be hurt, the  
16 ISOs, but because it would not fit into the  
17 category -- in the usual category of an illegal  
18 tie.

19 And it certainly -- I think what is  
20 basically involved in these cases is -- at least  
21 initially in terms of the Supreme Court case is  
22 a holdup, that you need a change in the policy

1 where ISOs are put out of business.

2 HEWITT PATE: Carl?

3 CARL SHAPIRO: I've been involved  
4 myself in a number of these ISO cases: Kodak,  
5 Siemens, Verian Equipment. And I think there is  
6 a common fact pattern that is very attractive to  
7 private plaintiffs. The ISOs are smaller. They  
8 tend to be appealing to the Jury as opposed to a  
9 large corporate defendant.

10 There is this notion of these separate  
11 markets, which they probably are separate  
12 markets, a various parts market versus a service  
13 market. The patent -- the IP is all in the parts  
14 area.

15 And a number of these companies  
16 have for whatever reason adopted policies or  
17 strategies where they are taking a number of  
18 their profits through the labor mark-up rather  
19 than just the parts. So it makes it attractive  
20 for service people to leave, to try to set up  
21 their own business, and then they need the parts.

22 So there's kind of a complex of

1 situations here, and of course all following  
2 the Supreme Court's '91 decision which opens up,  
3 look, this is an area that looks like tying is  
4 a real possibility here.

5           It looks like after-market power could  
6 be real. And of course the Jury can understand.  
7 Hey, I want to get my car serviced and I don't  
8 want to pay the dealers the high prices for the  
9 parts. So there are a lot of components here.

10           But I think, you know, a lot of that  
11 has been driven by notions of tying and leverage  
12 which is somewhat distinct from the core issue  
13 before us today which is simply unilateral  
14 refusal to deal.

15           And one of the interesting things  
16 about the Kodak case is after it was remanded  
17 as a tying case it transformed into a total  
18 unilateral refusal to deal case once the tying  
19 claims were dropped. But still of course the  
20 plaintiffs prevailed there.

21           HEWITT PATE: Well, in CSU itself  
22 the reservation is made of the question of a



1 unilateral refusal to deal that goes beyond  
2 the statutory grant.

3 I wonder if in the unilateral  
4 blanket refusal context any of the panelists  
5 have comments on what it means to go beyond the  
6 statutory grant. That seems to be a key question  
7 here.

8 CHRIS SPRIGMAN: Well, there are  
9 a couple of possibilities. The beyond the  
10 statutory grant language suggests I think what  
11 the Xerox opinion later makes clear, that the  
12 Xerox Court feels that the right to exclude is  
13 complete.

14 And so it only makes sense to have  
15 antitrust liability for refusals to deal that  
16 have some effect outside the statutory grant.

17 Now, I think for antitrust purposes  
18 that would mean in some other relevant market or  
19 a refusal to deal that has innovation effects  
20 that would prevent competition at some time when  
21 the relevant IP has expired.

22 I think that's another possibility.

1 And that sounds a lot like, for example, what  
2 you see in some of the misuse cases that concern  
3 grantbacks. But very little was articulated to  
4 specify what the Court meant. So that's by way  
5 of a guess.

6 JONATHAN GLEKLEN: I actually -- I  
7 have a different view. I think what the Federal  
8 Circuit means by the statutory grant is the right  
9 to make, use, or sell an item that is within the  
10 claims of the patent.

11 So if you've done nothing more  
12 than refuse to allow others to make, use, sell,  
13 import, offer for sale something that is within  
14 the claims of the patent, you are not beyond the  
15 statutory grant.

16 There is actually a case. It's an old  
17 Tenth Circuit case which says you have the right  
18 to prevent others from making, using, selling.  
19 But what you can't do is make a contract that  
20 goes beyond that or that conditions that.

21 So really tying is outside the  
22 statutory grant because you are doing something

1 more than exercising the rights granted by the  
2 patent. Price fixing is beyond the statutory  
3 grant.

4 But if you just say you can't make,  
5 use, or sell something that infringes the claims,  
6 I think you're within the statutory grant though  
7 I will concede that the Federal Circuit doesn't  
8 say that. I just think that's what they must  
9 have meant.

10 DOUGLAS MELAMED: This is anticipating  
11 what I'll be saying later. A lot of the  
12 discussion we have heard and will hear has to  
13 do with the likelihood that a unilateral refusal  
14 to deal might be anticompetitive.

15 That in large part raises the issue  
16 of the so-called one monopoly profit problem  
17 and a variety of other problems.

18 I'm in the camp of those who think  
19 that a unilateral refusal to deal is rarely  
20 anticompetitive in an antitrust sense, although  
21 I think it's clear from the literature and I  
22 think it's clear from cases that there are

1 situations in which a unilateral refusal to  
2 deal can indeed be anticompetitive.

3           The question is not whether  
4 unilateral refusals to deal are likely or  
5 unlikely to be anticompetitive; it seems to me  
6 whether intellectual property should be treated  
7 differently from other things that one might  
8 refuse to deal.

9           I think this issue of within the  
10 statutory grant demonstrates the difficulty of  
11 going down the formalistic path of trying to draw  
12 these kinds of lines. I don't know what that  
13 means.

14           Surely it wouldn't strike me as  
15 sensible to say that if you are in a leveraging  
16 situation you can state a claim that is not  
17 immune from the antitrust laws.

18           But if, for example, you are in a  
19 Microsoft situation and Microsoft had chosen to  
20 do in Netscape simply by not disclosing its APIs  
21 to them claiming they were copyrighted, that  
22 that would somehow be immune from antitrust

1 assault because after all that was within the  
2 intellectual property, namely protecting their  
3 monopoly in operating systems.

4 I think what that language means  
5 however is an intuition that I believe to be very  
6 central to intellectual property law and I know  
7 with a greater confidence to be central to  
8 antitrust law.

9 And it is an intuition that says  
10 you can exploit whatever power you have if  
11 it's lawfully obtained whether it's through  
12 intellectual property or simply skilled foresight  
13 in industry.

14 You can charge monopoly profits. You  
15 can probably, as Ben Klein will say later today,  
16 price discriminate to maximize your profits.

17 But what you might -- must -- what you  
18 may not do through a tie-in, for example, which  
19 is not permitted under the IP laws or some  
20 circumstances under the antitrust laws, what you  
21 may not do is sacrifice profits for the strategic  
22 objective of gaining power beyond that which you

1 lawfully obtained by skilled foresight in  
2 industry, in antitrust parlance, or by the  
3 intellectual property that you owned in  
4 intellectual property parlance.

5           And I think that must be the intuition  
6 behind that kind of language which doesn't  
7 otherwise make much sense if you try to translate  
8 it into the formalistic question of what is the  
9 scope of the patent and what market does the  
10 patent give you rights in and those kinds of  
11 questions.

12           HEWITT PATE: If that's the test, is  
13 there implicit a requirement of recoupment, do  
14 you think, a requirement that the plaintiff show  
15 recoupment as likely?

16           DOUGLAS MELAMED: Yes, in theory.  
17 Now, whether there is an appropriate area in the  
18 law to presume recoupment without having to prove  
19 it is a second order question. But in theory,  
20 absolutely.

21           HEWITT PATE: Jeff, do you have a  
22 comment?

1                   JEFF MACKIE-MASON: Yeah. This is  
2 probably mostly a question to Jonathan. It's  
3 really a puzzle I've had that comes from the  
4 issue about things being within the statutory  
5 grant. As an economist I've been trying for some  
6 years to figure out what that means, and I know  
7 I'm not there yet.

8                   I wanted to raise a couple of  
9 hypotheticals, one of which -- well, both of  
10 which probably sound a bit farfetched but as far  
11 as I can tell are not ruled out by at least  
12 Jonathan's and many people's interpretation of  
13 the Fed. Circuit in Xerox.

14                   And that is it sort of -- it starts  
15 with Kodak because one of the things the Ninth  
16 Circuit had to deal with in Kodak, which was a  
17 puzzling situation for it I think and it's one of  
18 the reasons that Kodak is different in some ways  
19 from the other cases, is that very few of the  
20 parts that were involved in Kodak actually had  
21 patents.

22                   There are arguments about that. But

1 something like 65 to 100 out of 10,000 parts had  
2 patents. And there was never any allegation that  
3 those -- well, I shouldn't say that, and Carl  
4 will argue with me.

5 But the case did not revolve around  
6 the criticality of those parts the way it did in  
7 Xerox where the parties basically admitted that  
8 those parts were the crucial parts. So, you  
9 know, a question arises: Is it really the  
10 intellectual property that's being used or  
11 protected?

12 I mean after all the ISOs weren't  
13 making parts in competition. They were really  
14 just acting as agents for the customers and  
15 installing parts on behalf of customers.

16 So the hypothetical I want to raise  
17 and just hear reaction from Jonathan or anybody  
18 else is what if Xerox patented the design on  
19 a washer, Xerox or anybody, and attached that  
20 washer to all of its other parts, just glued it  
21 on, had no functional use, but they attached it?

22 Does that now mean that all of their



1 parts are protected by patent and they don't have  
2 to sell any of them because of that? Or, and  
3 even perhaps more extreme -- I'm not sure  
4 actually if it is close to the Fed. Circuit  
5 decision. But a more extreme example:

6           Suppose they had some copyrighted  
7 text on the packaging in which the parts were  
8 distributed? Does that copyrighted text and the  
9 right to protect their copyrighted text mean that  
10 they don't have to sell the parts because there  
11 is copyrighted text on the packaging?

12           I mean these are a little extreme,  
13 but there is really a question: What is being  
14 protected in these cases?

15           JONATHAN GLEKLEN: It's a clever  
16 hypothetical, and I think it raises an important  
17 issue. I think the law has given us a way to  
18 deal with that though which is the law of tying  
19 and the related law of predatory innovation.

20           I want to buy the part without the  
21 patented washer. You refuse to sell it to me.  
22 You have no good reason to refuse to sell it

1 to me. Or somebody did the hypo, you know,  
2 I inscribe a short, original poem on each of  
3 my parts.

4                   Your refusal to sell -- you have  
5 no good reason for linking the stupid patented  
6 washer to the valuable yet unpatented part,  
7 though I'd also wonder whether you could  
8 really have market power in that part that's  
9 of significance to the antitrust law because  
10 somebody else could design the part without  
11 the stupid patented washer.

12                   HEWITT PATE: I suppose by using the  
13 washer you meant to make it a stupid washer. I'm  
14 not sure if that's true.

15                   But if it is true, I guess the Baird  
16 case I believe it is from the Federal Circuit  
17 suggests that, you know, a change in design that  
18 really doesn't have any function may not be quite  
19 the same thing as a really valuable washer that  
20 got added to a lot of other parts that were, you  
21 know, not patented.

22                   JEFF MACKIE-MASON: Yeah. I did mean

1 it to be a stupid washer. And obviously there's  
2 possibly some answer although I shudder at the  
3 thought of trying to litigate and determine  
4 whether particular design decisions -- I mean it  
5 actually isn't that stupid a hypothetical in the  
6 sense that in many of these cases it wasn't the  
7 whole device or unit that was patented.

8           It was some piece of design or process  
9 within the device. And whether or not that was  
10 essential is unclear. And I think actually,  
11 Jonathan, to have the market power despite the  
12 stupid washer probably is there. Kodak did in  
13 its parts, and most of those had no patents  
14 involved.

15           And for that matter most of Xerox's  
16 parts didn't either, and they probably had market  
17 power in those parts even though those weren't  
18 the ones that were critical to the technicians.

19           HEWITT PATE: Other comments on the  
20 hypothetical?

21           BENJAMIN KLEIN: The part, the stupid  
22 washer may serve no technological function. But

1 it may serve a legitimate economic function that  
2 it permits the IP holder to efficiently collect  
3 for the value of the IP which is something that  
4 could explain what happened in Baird.

5 I mean it might be very difficult for  
6 an IP holder, for example, somebody that has --  
7 I forgot what that case was, some kind of biopsy  
8 gun or something.

9 And they were clearly using the  
10 needles as a way of metering the demand for the  
11 gun. And people were coming in and arbitraging  
12 the situation and putting their own needles on  
13 there.

14 And it's not clear to me that it's not  
15 procompetitive and efficient to allow the firm  
16 to prevent somebody from doing this because it's  
17 not permitting the IP holder to actually collect  
18 for the use of the IP and -- although this is  
19 obviously not what the Court said.

20 And there's obviously a whole  
21 continuum of cases here. But I would maintain if  
22 the firm doesn't have market power in the biopsy

1 gun that they should be allowed to try to collect  
2 for the IP in any way that they find economically  
3 efficient.

4 And if you prevent it, they're just  
5 going to have to move to a less efficient way of  
6 doing it including raising the price of the  
7 biopsy gun, and then doctors that use very little  
8 of this are not going to be able to buy it,  
9 et cetera, et cetera.

10 So I think we have to look at it when  
11 we say that the innovation doesn't serve any  
12 function. We should not just be looking at it in  
13 the technological way that it's not serving any  
14 function. It might be permitting the IP holder  
15 to collect efficiently for their property.

16 HEWITT PATE: Okay. Well, that may be  
17 a good place to stop. I know metering is going  
18 to be an issue we're going to discuss later  
19 today. We're scheduled for a fifteen-minute  
20 break. So let's go ahead and take that and  
21 reconvene right around 11:00 hopefully.

22 (Recess.)

1                   HEWITT PATE: We're going to resume  
2 the morning session now with a presentation by  
3 Professors Klein and Wiley.

4                   JOHN WILEY: Good morning. I'm John  
5 Wiley. With me is Ben Klein. We're from UCLA,  
6 and we're very pleased to be here. We're here  
7 to talk about this conflict that Hugh Pate  
8 introduced and that the speakers and discussants  
9 have covered in quite a bit of detail so far.

10                   This pair of cases is conventionally  
11 thought of as an antitrust/intellectual property  
12 conflict, the conflict between the Kodak case  
13 which was obviously a plaintiffs' judgment for  
14 some number of dozens of millions of dollars.

15                   It wasn't a colossal case, but a few  
16 dozen million here, a few dozen million there,  
17 pretty soon we're talking about real money.  
18 There was an intellectual property defense  
19 attempted by Kodak, the defendant, and it  
20 flopped. The Ninth Circuit said it was pretext.

21                   So in contrast to that case is the  
22 Xerox decision. And of course that was a

1 striking defense judgment. There the defendant  
2 tried to deploy an intellectual property defense  
3 and did so to great success. It worked like a  
4 charm. So it seems like we have a conflict here.

5 And indeed we do for intellectual  
6 property and antitrust lawyers. The cases are a  
7 puzzle for antitrust cops like the Federal Trade  
8 Commission and the Department of Justice. The  
9 cases present a puzzle: what to do about this  
10 pair of cases.

11 They are particularly embarrassing  
12 I think not only because of the rather direct  
13 conflict. The facts aren't identical, but they  
14 are pretty darn close. So there's a striking  
15 conflict, we submit. And, moreover, the losing  
16 party in this pair of cases was that well known  
17 photocopier monopolist Kodak.

18 Excuse me. I've got to go Kodak this  
19 document. Would you please Kodak that for me?  
20 Well, so the one who ended up losing is not the  
21 firm that's traditionally thought of as the  
22 market leader in photocopiers. So the conflict

1 is all the more intense.

2 Now, our position is that to consider  
3 these cases as an intellectual property antitrust  
4 conflict is to misperceive the key issue. It  
5 is indeed true that most people talk about the  
6 antitrust intellectual property conflict in these  
7 cases. But we think these two cases are actually  
8 about something else entirely.

9 To emphasize the intellectual property  
10 angle we say is the wrong perspective. Rather  
11 we say that in fact the two cases are in a  
12 profound way about antitrust treatment of price  
13 discrimination. Now, you can't learn that from  
14 looking at the cases. The cases never talk about  
15 price discrimination.

16 And there's a reason for that. The  
17 lawyers in the case never talked about price  
18 discrimination, and there's a reason for that.  
19 The reason for that is mistaken antitrust  
20 hostility to price discrimination.

21 Antitrust cases in the past have  
22 damned price discrimination as a legitimate



1 business justification in dicta, and it is those  
2 cases we say that are to blame for the confusion  
3 in this area.

4 So our basic position is that the real  
5 problem in this area is not one of intellectual  
6 property policy. It is this old antitrust dicta  
7 about price discrimination. And that's what  
8 really needs to be fixed.

9 Price discrimination or metering,  
10 as it's been called this morning, is often a  
11 reasonable and entirely procompetitive way to  
12 collect for the use of valuable property, any  
13 kind of property, not just intellectual property.

14 So really these cases we think are  
15 about something other than what the doctrine says  
16 they are about. So we would like to turn to the  
17 basic economics of what's going on in these cases  
18 to understand the real conflict.

19 And for this I'm going to ask Ben  
20 Klein to talk about the economics of price  
21 discrimination and the practices in these cases.

22 BENJAMIN KLEIN: I guess you've heard

1 my story already about how refusals to deal  
2 enable a firm to price discriminate. And price  
3 discrimination is used here as an economist uses  
4 price discrimination.

5           This is not in the Robinson Patman  
6 sense, but in the economic sense just that there  
7 are different customers or customer groups.  
8 And you can earn different economic margins by  
9 charging differential prices relative to the  
10 costs of servicing those two groups.

11           And the usual economic analysis  
12 is that the people that use a product more  
13 intensively, the higher service users, probably  
14 have a greater willingness to pay. They have  
15 a greater all or nothing value that they are  
16 willing to place on the package. So you want to  
17 charge the more intensive users a higher price.

18           And one way to separate out the users  
19 and charge the more intensive users a higher  
20 price is to collect it on an after-market product  
21 like the service.

22           So this is just, you know, the razor

1 blade strategy. And the interesting economic  
2 question is if you want to meter after-market  
3 demand why don't you just put it on the parts.

4 Put an up-charge on the parts and  
5 therefore, the people that use the equipment more  
6 intensively and need more replacement parts are  
7 the ones that will end up paying a higher price.  
8 And I guess there's nothing more on that slide.

9 But the reason that it may not be  
10 profitable to put it on the parts, put the  
11 up-charge on the parts as an efficient metering  
12 device, is that the firm may want to price  
13 discriminate across consumers in a number of  
14 other ways, like by the type of service they  
15 purchase, whether they want, you know, repair  
16 service within 3 hours or whether they are  
17 willing to wait 24 or 48 hours.

18 You also may not to charge large  
19 users that service their machines themselves very  
20 low prices because those are probably the most  
21 knowledgeable customers and probably have the  
22 most elastic demands. And it seems like there's

1 evidence in these cases that in fact the  
2 self-service prices were relatively low.

3           And therefore you don't want  
4 to collect it as an up-charge on the parts  
5 price because then you would be charging the  
6 self-service customers too high a package  
7 price. And in addition there's some variable  
8 proportions. I hope I don't use too much jargon  
9 here.

10           But there is a trade-off between parts  
11 and service that if you jack up the price of the  
12 parts people may just service the machine more  
13 intensively and not need to repair it and replace  
14 the parts as frequently.

15           So for all these reasons it may be  
16 economically efficient to collect it in the  
17 after-market for the service. Now, the problem,  
18 John and I say, is that this is okay except in  
19 the case law -- and it's not really that  
20 important in the case law. There are a few  
21 dicta.

22           But it's more a major part of

1 antitrust scholarship that price discrimination  
2 has a bad rap. And in particular there are two  
3 characteristics of price discrimination that are  
4 considered bad: One -- and this is by far the  
5 most important that messes things up -- that  
6 price discrimination is evidence of market power.

7           And the best quote we can find for  
8 that was in Fortner II where the statement is  
9 something like price discrimination implies the  
10 existence of power that would not exist in a free  
11 market. And the second bad rap is that price  
12 discrimination has bad economic effects.

13           And this one, it's more difficult to  
14 find in the case record, but we found something  
15 in Jefferson Parish that's in our paper that  
16 talks about the social costs of permitting a  
17 monopolist.

18           It assumes the first thing, and  
19 then it says if you let a monopolist price  
20 discriminate you increase the social cost  
21 associated with that. So let's go through  
22 these things one at a time.

1                   The first bad rap, that price  
2   discrimination is evidence of market power,  
3   it's pretty obvious to an economist that price  
4   discrimination is not evidence of market power.  
5   It's only if you think of competition as the  
6   perfectly competitive benchmark.

7                   But once you have differentiated  
8   products, just about every firm can price  
9   discriminate. And every firm has a negatively  
10  sloped demand curve, and they can therefore  
11  possibly increase their profits by price  
12  discriminating. And I always -- I never  
13  know what example to give my classes.

14                  I mean this -- price discrimination is  
15  all pervasive, and really just about every firm  
16  does it. I usually talk about manufacturers of  
17  products in a grocery store where they have very  
18  small market share. Some of these people are  
19  giving out coupons and giving discounts to some  
20  people and not discounts to others.

21                  But clearly people are not price  
22  takers like in the textbook economic model of,

1 you know, the wheat farmer. But probably the  
2 best example is -- I decided is -- John and I,  
3 that we have negatively sloped demand curves, and  
4 we can price discriminate. In fact some people  
5 might say we're doing that today.

6           But I don't have to worry about if  
7 I increase my price a dollar for my consulting  
8 services that my demand goes to zero. And if  
9 I want to, I do have the ability to price  
10 discriminate.

11           And the key thing here, the key  
12 analytical point is that the ability to affect  
13 your own price, that is the ability to have  
14 individual firm pricing discretion over what  
15 you're going to charge, does not imply the  
16 ability to affect the market price.

17           Even though I could figure out  
18 what consulting rate I'm going to charge for  
19 my services and if I want to I can price  
20 discriminate, I obviously have no ability to  
21 impact the market for consulting services. I  
22 have a trivial market share. And anything I do

1 will have absolutely no effect in that market.

2           So maybe I should -- I thought there  
3 was something else on that slide. Let me just  
4 say before I go on to bad rap two that this is  
5 the problem that causes most of the difficulty,  
6 just being able to assume that if you see price  
7 discrimination it's evidence of market power.

8           And it's not only why firms can't use  
9 a metering defense as an efficiency rationale for  
10 how to collect for their intellectual property  
11 and other property, but it actually is perverse.  
12 It goes the other way.

13           And when the Kodak case went back on  
14 remand to trial, actually there was no longer  
15 this assumption that the Supreme Court had that  
16 there was no precontract market power. And there  
17 was a whole -- Jeff can talk about it because he  
18 was there if he remembers the facts.

19           But there was a whole debate about  
20 when Kodak had market power. And the plaintiff  
21 ISOs actually used the fact that Kodak was price  
22 discriminating as evidence that they had market



1 power, not this holdup condition that the Supreme  
2 Court was concerned about, but actual precontract  
3 market power because they were charging customers  
4 different prices.

5           And the defense had a very difficult  
6 time. The example that they finally used to show  
7 that market -- that price discrimination is not  
8 evidence of market power is they used movie  
9 ticket pricing. I'm not sure that was the best  
10 example. But that was the example they used.

11           They said, look, there's senior  
12 discounts. There's children's prices. There's  
13 all this other stuff. But it's -- you're going  
14 up -- you're clearly going uphill if you want to  
15 say that price discrimination is part of a normal  
16 competitive process even though we think it is.

17           The second problem about price  
18 discrimination is that price discrimination  
19 implies economic cost. And price discrimination  
20 clearly does not necessarily have social costs.  
21 Price discrimination in fact can often be good  
22 for consumers. There's this casual notion that

1 price discrimination is good for the firm.

2           It increases its profitability.

3 But it's not good for the public. And that is  
4 generally not true as a general proposition. And  
5 there are plenty of circumstances where the total  
6 quantity goes up or doesn't change. And in  
7 particular in many circumstances there can  
8 be an increase in the user base.

9           This is a way -- without price  
10 discrimination some markets and some consumers  
11 may not be served at all. By lowering the  
12 equipment price low intensity users who would not  
13 purchase the package if the equipment were priced  
14 higher get the opportunity to use it.

15           So it increases the user base. And  
16 the usual effect because it increases the firm's  
17 profitability is it increases the incentive for  
18 the firm to innovate.

19           So the general proposition that  
20 there's this trade-off between the short  
21 run or static inefficiencies when you have  
22 price discrimination against these long run

1 efficiencies increasing the incentives to  
2 invest are not necessarily there. And I guess  
3 I should -- how many more slides do we have?

4           Let me just say one more thing.  
5 There are some examples where a refusal to deal  
6 is not just an efficient way to collect for  
7 your intellectual property, and it may have  
8 anticompetitive effects.

9           I personally believe that those  
10 cases are extremely rare, the cases where the  
11 firm is using it to create a barrier to entry, to  
12 maintain the monopoly, or to leverage it into a  
13 market where there are very large economies of  
14 scale like in the Winston model.

15           But they certainly -- those models  
16 certainly don't apply to these ISO cases. And I  
17 think it's easy to screen out those cases by just  
18 having some kind of market share screen for the  
19 firms.

20           Then it becomes a question about how  
21 do you define a relevant market and do you want  
22 to say that Kodak has a monopoly on the sale

1 of Kodak copiers, or do you want to define a  
2 reasonable market. John, do you want to finish?

3 JOHN WILEY: So the key question here  
4 today is really: What should the government do?  
5 What should the FTC, what should the Antitrust  
6 Division do about this conflict in the case law?

7 And we say the following: First of  
8 all, let's be clear about what's going on in  
9 these two important cases.

10 They are cases that are really about  
11 price discrimination where Kodak, where Xerox are  
12 selling machines at a relatively low price and  
13 then collecting additional fees based on service  
14 and parts so that high intensity users pay more,  
15 low intensity users pay less. The cases are  
16 about price discrimination.

17 And the antitrust policy that is  
18 hostile to price discrimination forced Kodak to  
19 submerge the true explanation for its conduct  
20 and never to be candid about what it was really  
21 doing. To be candid that, oh, yes, we're just  
22 price discriminating would be to invite virtually

1 a stipulation of liability.

2           So we proceed immediately to the  
3 question of, okay, now that you have told us what  
4 you are doing, the only issue is how many dozens  
5 of millions of dollars will you have to pay for  
6 it. That's mistaken antitrust policy.

7           So the correct antitrust policy would  
8 recognize that price discrimination is okay, that  
9 it's a valid business justification for a refusal  
10 to deal. Now, if we acknowledge that's part of  
11 the normal competitive process that you as  
12 lawyers are price discriminating, you don't  
13 have a single rack rate necessarily.

14           Well, maybe you do in your firm. But  
15 you know of other firms where the same lawyer may  
16 be billing one client at \$400 an hour and another  
17 client at \$200 an hour. That doesn't mean that  
18 that lawyer is a monopolist.

19           That's a common business practice.  
20 And it's not a bad business practice. That  
21 justification should be valid whether or not the  
22 case involves intellectual property. So Courts

1 need help in this area.

2                   And it would be appropriate for the  
3 high prestige federal antitrust cops to intervene  
4 appropriately, to look for cases that come up  
5 like this in the future, and to intervene as  
6 the Federal Government often does to try to  
7 eventually get the Supreme Court to change these  
8 Fortner and Jefferson Parish dicta that drive the  
9 true explanation for these cases into hiding. We  
10 would all be the better. Thank you very much.

11                   (Applause.)

12                   HEWITT PATE: We're going to continue  
13 with Professor Arora's presentation. I'll throw  
14 something out not for discussion but maybe to  
15 think about after he concludes, which is whether  
16 the problem John and Benjamin have discussed  
17 doesn't go beyond antitrust.

18                   It seems to me that as a matter of  
19 patent law -- I think of the Salt case -- there  
20 may be problems with using metering from a misuse  
21 perspective.

22                   Or even over time one form of price

1 discrimination might be to allow those who don't  
2 have enough money to pay the royalty sought by  
3 the patent holder up front, but they could do so  
4 over a long period of time that extended beyond  
5 the patent term.

6 The Supreme Court makes clear that as  
7 a matter of patent policy you can't do that. So  
8 I don't know if that elicits any comment later  
9 on. Maybe that's something we can address. But  
10 Professor Arora's ready to go. Let's move to  
11 him.

12 ASHISH ARORA: Thank you very much.  
13 I'm very pleased and honored to be here. I've  
14 listened with great interest to the presentations  
15 and read many of the submissions with a lot of  
16 interest in large measure because I'm mostly  
17 ignorant about many of the detailed matters that  
18 the folks who have presented before me have  
19 talked about.

20 My interests are primarily in  
21 voluntary licensing. That's what most of my  
22 research is in in economics, in technology as

1 an economic commodity, and specifically as an  
2 economically tradeable commodity.

3 So I'm interested in when  
4 technologies get traded, when they get bought  
5 and sold, when and under what conditions and with  
6 what consequences. And so I'll tell you a little  
7 bit about just a very brief comment on that.

8 That leads to sort of the second part  
9 which is from my perspective it's natural to  
10 think of intellectual property as any other type  
11 of property. And I couldn't agree with Chris  
12 more when he says, look, the right to exclude  
13 is implicit in all property.

14 There's nothing particularly different  
15 about intellectual property. However, from a  
16 transaction perspective, so if you think about  
17 doing something about a refusal to license, there  
18 are some interesting differences. And Hewitt  
19 Pate mentioned some of those. And I'll talk a  
20 little bit about that.

21 So there's some good news, bad news  
22 from the second bullet. The third bullet I guess



1 you should put down to my naivete which is sort  
2 of fools rushing in where angels fear to tread  
3 which is I'm actually going to propose something  
4 that works or might work and see whether -- how  
5 many of you think this is a sensible proposal.

6           As I said, I guess I've got nothing to  
7 lose because I have no particular stake here. So  
8 I believe it was Jonathan who said that IP is not  
9 used in that market. And that's sort of partly  
10 true. And many people sort of make claims of  
11 this kind, that there's no market for technology  
12 or no market for innovation.

13           That's sort of true. But it's not  
14 really in the following sense. Based on whatever  
15 data we could find, Mark Whitener and I have been  
16 trying to estimate, get some sense of how big is  
17 in fact the market for technology.

18           So if you put together all the  
19 different deals where technology is changing  
20 hands for money and you try to put dollar values  
21 on that, it turns out it's not an insubstantial  
22 number. Our best guess is it's somewhere between

1 30 and 50 billion dollars per year.

2           And our data, I should point out, are  
3 roughly 1990 to 1996 or '97. And obviously you  
4 can quibble about how one does it. But as order  
5 of magnitude these numbers I think are pretty  
6 sensible. And so from my perspective, I think of  
7 these trades as socially beneficial. They avoid  
8 duplicate R & D.

9           They promote diffusion of technology.  
10 They promote specialization and enhance the rate  
11 of innovation. And so in that sense I have a  
12 pro-IP bias, I think, of crisp IP. I've written  
13 a strong -- and I don't want to be held to that.

14           But certainly crisp, well defined  
15 intellectual property is good. I'm a firm  
16 believer in that. And a flip side, a sort of  
17 benefit of market for technology is that some of  
18 the practical problems of pricing get easier when  
19 there is a market for this stuff.

20           So as I said, I think of IP as any  
21 other type of property right. And in passing  
22 I should mention that if you have markets for

1 technology, then you can have market power in  
2 those markets. And sometimes it's taken as  
3 axiomatic that because you have a patent you're  
4 going to have a monopoly.

5 I think that's highly overstated.  
6 The typical case is you have substitutes. So  
7 Professor Klein talked about differentiated  
8 products, and I think that's a good way to think  
9 about the market for technology.

10 And I think the federal agencies have  
11 been properly watchful about accumulation of  
12 market power. And I think they are to be  
13 commended for that.

14 So this perspective then says I'm  
15 mischaracterizing the IP against antitrust  
16 challenge or sort of carving out separate things,  
17 separate ways of looking at IP I find actually  
18 disturbing.

19 And I find it particularly disturbing  
20 because we're going to soon live in a world where  
21 there's going to be IP sitting in lots of places.  
22 There's going to be embedded software in all

1 kinds of things that you probably don't think of.

2 And to carve out separately that goods

3 are going to be treated one way and IP is going

4 to be treated a different way is just going to

5 make I think a mess.

6 Now, that said, I think IP is

7 different partly because it's not clear what the

8 scope of the property is and because it often has

9 to be bundled with other stuff. And this is -- I  
10 guess my take -- well, let me back up.

11 There are two outstanding examples of

12 compulsory licensing in U.S. history. They both

13 happened after wars, and they both dealt with

14 German patents and a variety of German industrial

15 property.

16 And essentially German patents were

17 taken over and made available to U.S. firms.

18 There is a lot to be learned from that, and

19 that's not been sufficiently studied.

20 But one interesting thing was U.S.

21 firms found it extraordinarily hard to make use

22 of the patents. It was very, very difficult.

1 Partly this had to do with German patenting  
2 practices. But part of it was you need a lot of  
3 know-how and this know-how had to be gotten in  
4 various ways.

5           And there are lots of examples of how  
6 U.S. firms went about trying to get know-how.  
7 And maybe at a different time I can tell you some  
8 interesting stories about the use of something  
9 that looked like Super 301 except in reverse, the  
10 U.S. trying to get intellectual property by  
11 threatening trade sanctions.

12           Anyway, so what does this mean? Well,  
13 what this means is compulsory licensing is going  
14 to be tough. How do you ensure that the know-how  
15 is being transferred? That's going to be a hard  
16 problem.

17           Second, I think policy has to be --  
18 has to allow flexibility in contracts. If we  
19 want efficient transfer of technology, the  
20 know-how has to come along with the intellectual  
21 property. And I've done some research on this  
22 and others have too.

1                   But basically bundling is one way, not  
2                   the only way, but it's one way in which you can  
3                   accomplish the successful transfer of know-how  
4                   which is not patented and subject to sort of --  
5                   there's a greater danger of opportunistic  
6                   behavior or of the buyer sort of not behaving  
7                   properly and so on.

8                   So I guess in that sense this would  
9                   say, well, we should use compulsory licensing or  
10                  something that looks like that, you know, with a  
11                  great deal of caution because it's going to be  
12                  hard.

13                  There are possibly related issues  
14                  where if you compel people to license and this is  
15                  anticipated they may hold more of the property  
16                  which is not patented in the form of know-how on  
17                  the chance that you have a greater likelihood of  
18                  protecting that.

19                  So let me move to the last part which  
20                  is I suppose both -- well, this is a part that I  
21                  have most fun doing because it's completely new.  
22                  And this is a part that may I suspect prove to

1 be -- well, I'll leave you to decide whether it's  
2 useful or not.

3           So I'm going to just make some  
4 premises. There are cases in which refusal to  
5 deal may reduce social welfare. There is not  
6 going to be any special immunity just because a  
7 thing is patented.

8           Incidentally, as I read the evidence  
9 there seem to be sort of separate treatments of  
10 copyrights and patents which on one ground can be  
11 defended that a patent is sort of a hard right.  
12 You have a greater threshold to cross.

13           But since Mr. Polk is here from  
14 the PTO, it's worth pointing out that at least  
15 according to some estimates the probability  
16 that a patent will be granted is in excess of  
17 90 percent. And if those statements are correct,  
18 we're approaching something that looks like a  
19 registration system for a patent.

20           And I confess the Patent Office's  
21 greater drive to be more customer friendly  
22 worries me even more because I'm not sure they

1 have correctly identified their customer. It is  
2 not the guys applying for the patent alone.

3           Anyway, that's a -- I couldn't resist  
4 since Mr. Polk is here. So I'm not even going to  
5 try to give this -- ground this in any kind of  
6 legal doctrine or principle, and less forgivably  
7 not even in a well worked out theory of  
8 economics.

9           Basically I guess the idea is if --  
10 what we are worried about with this refusal to  
11 license is, look, if we impose this there is  
12 going to be reduced incentive to innovate versus  
13 some sort of benefit.

14           One way of thinking about this is we  
15 should try to have some sort of commensurability  
16 or proportionality between -- we should have some  
17 sort of proportionality. And I guess one way to  
18 begin is by saying, so why is the license needed.

19           My perspective suggests that there  
20 are always substitutes. Maybe not the best ones;  
21 maybe they are not perfect substitutes. But they  
22 are usually pretty good substitutes.



1                   Unless we have something that's --  
2           well, even take the strongest patents you can  
3           think of, which is a composition of matter patent  
4           in chemicals. So DuPont had nylon. Well,  
5           IG Farben figured out a slightly different  
6           version which is perlon, perfectly valid patent.

7                   So that then leads to the question, so  
8           why is the guy asking for a license in the first  
9           place; why doesn't he just try to invent around?  
10          There could be two reasons for this, or at least  
11          two reasons.

12                   One says, look, the technology is  
13          really superior. The alternatives are really  
14          inferior. And so in that sense I think there's  
15          no question. If a technology is really superior,  
16          you probably don't want to compel a license. The  
17          patent holder has truly sort of discovered  
18          something useful.

19                   And I'll try to explain that a little  
20          bit more. The second reason could be that what  
21          the patent holder is trying to do is leverage or  
22          gain market power in a related market by

1 exploiting some sort of standard.

2           And here I'm sort of building on a  
3 very interesting article by Robert Merges. It's  
4 called Who Owns the Charles River Bridge, and you  
5 can get it off his website at the UC-Berkeley law  
6 school.

7           So this part, at least the idea  
8 of leveraging I've learned from reading that  
9 article. And the principle I want to try to  
10 implement is that the social benefit of the  
11 innovation should be commensurate with the  
12 private benefit.

13           So we want to let the patent holder  
14 get rents from this market. But you should not  
15 be allowed to leverage, quote, a very small  
16 property right into a very large market.

17           And let me quickly tell you how to do  
18 it and I can tell you the problems with it as  
19 well. So the basic idea is what you think about  
20 doing is you take the IP and you spin it off.

21           So you take the IP that's been refused  
22 license, take it out as a separate firm and ask

1     yourself what would be the value of the spinoff.  
2     And I'm going to propose that that's at least a  
3     first reasonable order approximation of what the  
4     social value of this innovation is.

5                     And if there is a big difference  
6     between the estimated value of the spin-off and  
7     the market that's being sought to be leveraged or  
8     where this license is being refused, then you  
9     say, well, why is this? Is there a general  
10    complementarity, or is there something else  
11    going on?

12                    And if you can not find -- so this is  
13    sort of like the stupid washer example. If there  
14    is no sort of real reason for the washer to be  
15    there, you might sort of look deeper. I'm not  
16    claiming that this is the complete test. This is  
17    one possible way of implementing this.

18                    I'm running out of time. So let me  
19    quickly just tell you what are the objections to  
20    this because I believe the best defense is to  
21    admit up front what the problems are. Yes, it  
22    does -- it will impair incentives to innovate.

1           Yes, it is in conflict with the  
2 doctrine that patents contemplate the right to  
3 exclude. And, yes, it does run into the valid  
4 objection that this method ignores legitimate  
5 complementarities.

6           And, yes, there is the problem of  
7 the difference between the patent scope and the  
8 market scope. And, yes, it's not going to be  
9 easy to do.

10           But this brings me back to my starting  
11 point. When markets for technology -- if they  
12 continue to grow, it won't be as difficult as it  
13 might otherwise be. Thank you very much.

14           (Applause.)

15           HEWITT PATE: Comments or questions on  
16 these presentations? I guess personal privilege  
17 for Mr. Polk here.

18           EDWARD POLK: I thought I may go  
19 unscathed here since we were talking about  
20 licensing. But just to make sure we are clear,  
21 the approval rate for the Patent Office is about  
22 60 percent which is pretty much in line with

1 other countries.

2 I know an earlier speaker had  
3 suggested 90 percent, but if I could draw  
4 from Mr. Bush there with his fuzzy math, the  
5 90 percent there.

6 Another point that Mr. Arora raised  
7 which I think is a good point there is it seems  
8 as far as the patent, the difference between the  
9 patented property and the other property, it  
10 seems that it may be better antitrust policy or  
11 even the whole competition that we're looking at.

12 It seems that a lot of folks are  
13 saying that there should be somehow an allowing  
14 of others to piggyback off of the patented  
15 property. And if we're interested in  
16 competition, shouldn't we be more interested in  
17 allowing companies to design around, or if they  
18 think the patent is invalid -- I don't know.

19 Maybe you can answer this. In the  
20 Xerox case I didn't see any challenges to the  
21 validity of the patent which, you know, that's  
22 a way of getting around someone refusing to

1 license; invalidate their patent or go out and  
2 make your own product.

3           And if there are any comments you  
4 would maybe know the facts of Xerox that would  
5 answer it.

6           ASHISH ARORA: Could I just get the --  
7 on the numbers, this is an article by Quillan and  
8 Webster. And the difference is in how you treat  
9 continuations. Anyway, I have no particular  
10 expertise. If this is true, the 90 percent is  
11 disturbing.

12           JONATHAN GLEKLEN: Just so people  
13 know, on the facts of Xerox there is no challenge  
14 to the validity of the patents. CSU conceded  
15 invalidity and infringement.

16           CHRIS SPRIGMAN: On the issue of  
17 piggybacking on others' patents, I take that to  
18 be -- to relate to comments I made about the  
19 scope of the right to collude and comments that  
20 Professor Arora also made.

21           I think it's important to state again  
22 what's at stake here between a complete right to

1       exclude and a right to exclude that extends only  
2       so far as antitrust liability for refusal to deal  
3       begins. This is not a huge difference. I think  
4       though it's an important difference.

5                 The question is what right to exclude  
6       does the statute grant. Well, it's clearly  
7       not -- it's not clearly one or the other. And  
8       there are good I think reasons to think for  
9       efficiency that the right to exclude should be  
10      limited at the margin by refusal to deal  
11      liability.

12                I think there's also something else  
13      that's worth saying. I've heard at a lot of IP  
14      conferences among the IP community the right to  
15      exclude is talked about in this kind of totemic  
16      fashion. What else could it be but the right to  
17      exclude? Exclusion is the right.

18                Well, the Founders didn't see it that  
19      way. I'm pitching my own articles. But I wrote  
20      an article about the Copyright Term Extension Act  
21      that you can find on [find law.com](http://findlaw.com) some weeks ago.

22                And there is a hyperlink to some

1 letters, some correspondence between Jefferson  
2 and Madison when Madison was trying to convince  
3 Jefferson to temper his hostilities to monopolies  
4 a little bit and allow the Congress -- allow some  
5 authority for the Congress to grant limited  
6 periods of exclusive rights for the purpose of  
7 incenting innovation.

8           The Founders viewed IP with a  
9 jaundiced eye. And what's interesting about the  
10 effort or the kind of assumption that the right  
11 to exclude in IP is somehow different from  
12 property is it turns the founding conception  
13 about the purpose and scope of the IP clause  
14 in the Constitution really on its head.

15           HEWITT PATE: Doug?

16           DOUGLAS MELAMED: I just wanted  
17 to pick up a little bit on the notion of  
18 disproportionate leveraging from I guess  
19 Professor Merges, as translated by  
20 Professor Arora.

21           On the face of it I must say I'm very  
22 skeptical both of the notion that there is some



1 normative significance to the idea of leveraging  
2 something small into something big. I'm not sure  
3 what that means.

4           It might be a very tiny thing that  
5 actually has enormous value in enormous markets.  
6 And the empirical exercise of trying to spin off  
7 the IP and then value it, I don't know how one  
8 does that.

9           I don't know how one does it without  
10 losing the potential for synergies if you  
11 abstract it from the vertical integration and  
12 so forth. But it seems to me that with a very  
13 slight tweak there is a potential in that idea.

14           And that is this: If you imagine as a  
15 mind experiment that the intellectual property  
16 has been abstracted from some institutional  
17 setting and is now held by IP Co. for a licensing  
18 or exploitation, its highest and best use, you  
19 can then ask the question: What would IP Co. do  
20 with that?

21           And you can compare it to what  
22 defendant has done with it. And that may

1 illuminate the question, is defendant using it  
2 strategically, not to maximize its value but  
3 rather to achieve some anticompetitive or what  
4 you would call some recoupment payoff.

5 And that might help identify those  
6 instances in which the IP is being exploited in  
7 an anticompetitive way.

8 ASHISH ARORA: I agree. That's sort  
9 of what I had hoped to do in my slide ten, but  
10 never got to it.

11 HEWITT PATE: One of the questions  
12 that's been raised is whether the right to  
13 exclude ends where the duty to deal under  
14 antitrust law begins. Is there anybody who is  
15 interested in taking a stab at the general  
16 question of when the duty to deal ought to begin?

17 It was suggested to me yesterday in  
18 another context that if you look at the cases,  
19 essential facility and otherwise, you don't  
20 really find liability except where a firm was  
21 dealing with others or was allowing others to use  
22 the facility and then discriminatorily declined

1 to allow the plaintiff to do so.

2           And perhaps in those situations it was  
3 clear that a profit maximizing opportunity was  
4 being let go in order to recoup profits after  
5 eliminating a competitor later. Under what  
6 circumstances would a blanket refusal to deal  
7 from the outset give rise to a duty to deal?  
8 Doug?

9           DOUGLAS MELAMED: I think as a matter  
10 of theory or principle whether there was -- had  
11 been a prior practice of dealing that was  
12 terminated or whether that was dealing and then  
13 some discriminatory or differentiated non-dealing  
14 shouldn't be necessary.

15           I mean I think in the AT&T case I  
16 don't know what the history there was. But it  
17 wouldn't seem to me that liability would have  
18 depended on prior dealing by AT&T and MCI.

19           On the other hand -- and therefore,  
20 by the way, I think I disagree with Chairman  
21 Pitofsky who seems to believe that as a matter of  
22 principle if you never deal you are in a safe

1 harbor territory.

2           On the other hand, you clearly have to  
3 have a benchmark. You have to have some way of  
4 saying what are the terms on which one might have  
5 expected this party to deal; what basis do we  
6 have for thinking that dealing might have been  
7 profitable and might have been practical and  
8 might have been efficient?

9           And so in the absence of some  
10 benchmark in the experience of this defendant  
11 dealing with somebody, if not the plaintiff,  
12 somebody, it probably would be a very unusual  
13 case, maybe one like Otter Tail were AT&T  
14 required regulatory oversight for the Courts to  
15 feel that they had a sufficient benchmark. But  
16 that to me is a matter of prudence and  
17 expediency, not one of principle.

18           MARK WHITENER: Can I reply to that?  
19 That's an interesting point because one of the  
20 things that happens I think when you acknowledge  
21 that to have a meaningful remedy you need some  
22 sort of benchmark is you start affecting behavior

1 simply by stating that rule.

2           So, for example, if an IP owner  
3 is making the decision initially whether to  
4 integrate vertically or to exploit their IP in a  
5 particular area, they are now going to have to  
6 take into account the fact that once they are  
7 occupying that space under some statements of the  
8 legal rule they have taken on greater exposure  
9 because now by occupying that space, by making  
10 what let's just assume for the moment is an  
11 efficient decision to exploit their IP in a  
12 particular sphere, or let's say to license some  
13 one, pure, non-competing customer, now they have  
14 created a benchmark.

15           And so now you have gone from a  
16 situation where you might not have had a  
17 meaningful remedy to one in which, well, you  
18 have created now a standard against which you are  
19 going to be held and you are going to be required  
20 to license.

21           I just add that my general observation  
22 about probably this whole day and picking up on

1 the last two presentations is I think that it's  
2 going to be very interesting to hear as the day  
3 unfolds who can articulate, you know, a  
4 meaningful standard for liability if in some  
5 cases there is liability for a unilateral refusal  
6 to deal.

7                   And a standard that doesn't simply  
8 restate the boilerplate of exclusionary conduct  
9 but that sets out at least some realistic  
10 description of necessary or sufficient  
11 conditions, to apply that standard to a refusal,  
12 I think it's a very difficult thing to do.

13                   I think various people have taken a  
14 stab at it. I'm not sure anybody has succeeded.  
15 And especially I'm not sure anybody has succeeded  
16 without essentially requiring an after the fact  
17 assessment of, well, what might have been the  
18 profit maximizing behavior for this IP owner  
19 when they made the initial decision whether to  
20 license, whether to exploit, and how to exploit.

21                   JONATHAN GLEKLEN: Two points, both of  
22 which are following up on Mark. And I think what

1 he said is exactly right. The first is -- and  
2 this came up -- I think it was an FTC  
3 investigation of a transaction that Monsanto  
4 was doing, basically reacquiring IP that it had  
5 formerly licensed.

6 And Dennis Yao concurred and then  
7 wrote an article about it. And what he said  
8 is you have to be very careful that we don't  
9 penalize people for making bad licensing choices  
10 and then trying to change their mind, because if  
11 you do that it creates huge incentives never to  
12 license.

13 If I know that once I license I either  
14 can't terminate the license or can't reacquire  
15 the licensed IP or that that is going to be a  
16 benchmark for what a reasonable person would have  
17 done under an Aspen type test, a lot of people  
18 are going to just say forget it; I'm not going  
19 to do it.

20 Related to the second point that Mark  
21 said, I'm willing to agree in the abstract that  
22 we can construct a model either, you know,

1 spinoff to IP Co. or are we trading off  
2 short-term profits for long-term monopoly profits  
3 with a recoupment test.

4 But I just don't know how that works  
5 in practice without turning every refusal to  
6 license case into a case that goes to the Jury  
7 because you don't win those cases on a motion to  
8 dismiss.

9 And I don't even think you win them on  
10 the motion for summary judgment because you can  
11 always find an economist, with all due respect  
12 to the folks on this panel, who is willing to  
13 testify that, you know, you don't pass the test.

14 Except in extreme cases like Microsoft  
15 where you are giving the stuff away for free, I  
16 just don't know how you prove on a summary  
17 judgment record that I was going to recoup or not  
18 recoup, which means every case goes to the Jury.

19 And if we read that very, very few  
20 cases should result in liability for a refusal to  
21 license, it just seems to impose huge costs for  
22 very marginal benefits.



1                   HEWITT PATE: Let me go to Chris and  
2 then back to Mark.

3                   CHRIS SPRIGMAN: Take a quick stab  
4 at Mr. Whitener's challenge and also at some  
5 comments that John just had. First of all, every  
6 case does not go to a Jury. The DOJ just lost a  
7 case on market definition on a PI.

8                   And it's market definition and market  
9 power, in fact monopoly power here is something  
10 that is a substantial screen as that experience  
11 shows. Plaintiffs are going to have to walk in,  
12 and they are going to have to prove up why this  
13 IP holder has sufficient power that they should  
14 get to a Jury.

15                   We're reminded again and again and  
16 again that the former assumption that a piece of  
17 IP gives you market power in some relevant market  
18 is a ridiculous assumption.

19                   And because it is, it is the fact that  
20 the market power, monopoly power screen has some  
21 effect. Once you get past that screen, the  
22 question is whether the defendant has forgone

1 monopoly profits which it's entitled to reap in  
2 return for exclusion which it hopes to exploit in  
3 the future and recoup and put itself in a better  
4 position.

5                   That's a difficult set of issues. But  
6 it's worth remembering that that difficult set of  
7 issues is not relevant only in the IP context.  
8 It's relevant to any refusal to deal case in  
9 any context.

10                   And it may be the fact that our  
11 squeamishness with refusal to deal law in the  
12 IP context is reflective of our general  
13 squeamishness with respect to refusal to deal  
14 law. But, you know, again it's worth  
15 considering.

16                   If refusal to deal liability is  
17 sufficiently narrow, and if a sufficiently narrow  
18 constraint on a monopolist's right to exclude is  
19 imposed, we may benefit from uncertainty. An  
20 imperfect machine may be in our interest.

21                   And so the entire conversation may  
22 have somewhat of an Alice in Wonderland quality

1 about it in that in the end if we think the test  
2 is hard and we think it's going to lead to  
3 uncertainty and caution, that may be good.

4 HEWITT PATE: Mark?

5 MARK WHITENER: Well, we can agree on  
6 one thing, which is that it's probably hard to  
7 really resolve the issues we're talking about  
8 today without at some point taking on  
9 non-intellectual property.

10 I think it's enough for the agencies  
11 in this exercise to address the disputes and the  
12 uncertainty in the IP area. And as I'll say this  
13 afternoon, I urge the agencies to do that.

14 But there is some electric tension  
15 once you start talking about non-IP. And I think  
16 the basic principles that I will talk about this  
17 afternoon would apply in large part to non-IP  
18 as well.

19 But I think it's not enough for those  
20 proponents of a duty to deal in some cases to say  
21 that it's rare. It's not enough to say that  
22 plaintiffs lose cases. And it's not enough to

1 say that there is some theory of exclusion that  
2 we apply every day.

3           You know, we've got to get to the  
4 hard questions. What is the conduct that's  
5 exclusionary? Is it the non-sharing of the  
6 property right? Yes or no? What are the  
7 justifications in a rule of reason analysis which  
8 surely it must be that are taken into account?

9           Is it the desire to achieve a full  
10 return on the initial investment in the IP? And  
11 then you get to remedy. And I think that issue  
12 alone probably is enough to really bog us down  
13 for a whole other day.

14           HEWITT PATE: Let me throw out a  
15 couple of questions. It seems obvious to look  
16 at refusal to deal law where the question was  
17 whether the refusal to sell a part was -- where  
18 the question is whether that was legitimate.

19           Would it have made a difference do  
20 people think if the context had arisen in a more  
21 pure patent context, say, that the ISO wished to  
22 manufacture a patented part in its own plant and

1 maybe could have done so more cheaply and a  
2 refusal to license prevented them from doing that  
3 even if there were no question of a refusal to  
4 sell a product?

5           Likewise, does it make a difference,  
6 as has been suggested, whether know-how or trade  
7 secrets would be required to be conveyed in order  
8 to make use of the property? Does that make any  
9 difference in how the antitrust law ought to view  
10 these situations? Well, I got Mark to turn his  
11 sign down with that question. All right. Carl?

12           CARL SHAPIRO: I'll just briefly say  
13 it seems to me the know-how point is a very good  
14 one. In some contexts, as Professor Arora  
15 pointed out, the patent may not -- a license to  
16 the patent may not be worth much without some  
17 hand-holding and other expertise.

18           That just I think reminds me at least  
19 how IP is not that much different than other  
20 areas where there may be some costs associated  
21 with the holder of the rights if there's going to  
22 be mandatory -- if these duties exist.

1           As I will say after lunch, I think it  
2           is a reason to treat IP like other types and not  
3           have these duties in either area.

4           But it's good that -- it's not sort of  
5           the pure case of, you know, you just send over a  
6           piece of paper that says, fine, you can use this  
7           patent; go to the Patent Office and look up the  
8           patent and you'll be fine; goodbye. There's more  
9           involved, which is what would be true for other  
10          types of property often.

11           HEWITT PATE: Other comments? Gail?  
12          Other questions that people want to throw out?  
13          If not, I'll try to avoid violating the cardinal  
14          rule of moderating, which is never make people  
15          late for lunch and if possible let them have  
16          lunch a little bit early.

17           That means that we'll pick up with  
18          Mr. Kirsch's presentation as the first thing  
19          after lunch. I'll unfortunately be absent for a  
20          while and turn the panel over to Gail and Sue and  
21          Pam and hope to rejoin you later. So we will  
22          reconvene at 1:30. Thanks.

1                   PAM COLE: And I just want to say we  
2    have a lot of interesting speakers after lunch.  
3    So please come back and we'll take some breaks so  
4    you can take a walk and wake up after lunch.

5                   (Lunch recess.)

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1 plaintiff and what some of their options are  
2 today.

3           They are somewhat limited as you might  
4 guess based on what you heard this morning. So  
5 just to start off, I can tell you that in the  
6 last few months we have in my firm and I  
7 personally have come in contact with several  
8 victims of unilateral refusals to deal  
9 intellectual property rights.

10           I'll just give you a few examples.  
11 There's a biotech client of ours who is a small  
12 player in the market for producing chemical  
13 compounds which are used in researching  
14 pharmaceuticals.

15           And they were told by the market  
16 player who has 85 percent of the market that they  
17 would not even consider negotiating licenses on  
18 the patents which are arguably blocking patents  
19 in the market.

20           In the electronics industry, the  
21 telecommunications electronics industry, we had  
22 another client who was told that -- by a patent

1 holder that they could receive a license if they  
2 paid 150 percent of their profits to them.

3 Our client not surprisingly refused  
4 that offer. And now they are a defendant in a  
5 patent infringement lawsuit.

6 In the Napster case, the digital music  
7 industry case pending in San Francisco before  
8 Judge Patel, one of the arguments that prevailed  
9 in opening up the antitrust counterclaims to  
10 discovery a few months ago was that the recording  
11 companies were refusing to deal their copyrighted  
12 materials to not just Napster but many other  
13 digital companies in Napster's position.

14 And then another case that just came  
15 up yesterday in the agricultural machinery  
16 market, there is a claim that I just learned is  
17 pending where a competitor has alleged that a  
18 patent holder has refused to license its patent  
19 to anybody in the industry and then has gone out  
20 into the market and told all the customers that  
21 they are infringing.

22 And one of the competitors of the

1 patent holders has sued under the Lanham Act  
2 basically saying that those allegations were made  
3 in bad faith -- there were allegations of fraud  
4 on the Patent Office -- and that it was  
5 inappropriate for them to refuse to deal this  
6 license.

7           And it's inappropriate for them of  
8 course to go into the marketplace and make these  
9 statements. And then the recent cases that we  
10 talked about this morning, Intel, Intergraph,  
11 Kodak, Xerox, and the Microsoft case, all  
12 concerned variations of refusals to deal.

13           And I'll grant -- I think Carl Shapiro  
14 was speaking about this earlier -- that most of  
15 these cases, especially the ISO cases were more  
16 involving leveraging and tying and after-markets.  
17 And so whether or not there is a pure unilateral  
18 refusal to deal that could be anticompetitive I  
19 think is a good question.

20           In some sense if a patent holder  
21 simply acquires patents and refuses to license  
22 them to anybody, it doesn't create a problem

1 unless there's marketplace conduct. You know,  
2 somebody has decided to get into the hobby of  
3 collecting patents. Nobody would care.

4 So that type of pure refusal to  
5 license doesn't create antitrust concerns. But  
6 it's when people start going into the market and  
7 saying we're going to start to enforce our patent  
8 rights that issues start to come up.

9 And so fortunately for plaintiff  
10 lawyers, unfortunately for the plaintiffs,  
11 there's often a lot of predatory conduct  
12 associated with refusals to license IP including  
13 fraud on the Patent Office and tying and tie-out,  
14 coercive reciprocity where patent holders are  
15 requiring all IP rights in return from a  
16 potential infringer.

17 There's marketplace accusations of  
18 patent infringement, as I said before, and  
19 interference with customers, and the array of  
20 conduct is unlimited. So when I am presented  
21 with a telephone call by a frantic potential  
22 plaintiff in a case like this, they ask me what's

1 the law.

2           And I try to give them legal advice  
3 and I tell them, well, in the Federal Circuit if  
4 your case gets to the Federal Circuit, the law is  
5 clear. The intellectual property holder can do  
6 whatever it wants to do. And look at the CSU  
7 case and Intergraph.

8           I think it's plain the distinctions  
9 about what the fine language means about whether  
10 the statutory grants language in that -- in the  
11 CSU decision I think is for -- is potentially  
12 down the road might be an issue. But it is very  
13 expensive to litigate.

14           And if the claims are going to go  
15 to the Federal Circuit, I tell the potential  
16 plaintiffs that they are probably going to lose.  
17 So I also tell them of course about Kodak in the  
18 Ninth Circuit, that there is a different rule,  
19 that you look at antitrust intent.

20           And there is a rebuttable presumption  
21 that refusing to license the patent was valid, a  
22 valid business justification. But that

1 presumption can be rebutted if there's evidence  
2 of anticompetitive intent.

3           And then that's also supported of  
4 course by the U.S. v. Microsoft case and the  
5 contents of copyright law where the D.C. Circuit  
6 said the use of lawfully acquired property can  
7 give rise to tort liability. And that was the  
8 famous example of the baseball bat.

9           They described Microsoft's copyright  
10 defenses as frivolous and basically said that if  
11 a plaintiff acquires property like a baseball bat  
12 and uses it improperly, it can lead to tort  
13 liability. Why shouldn't the same be true about  
14 intellectual property? I also tell them that I  
15 think personally Kodak is the better rule.

16           It's the better rule I think for a  
17 number of reasons because it tries to balance two  
18 important schemes and policies. We've heard some  
19 discussion today about it.

20           There's the intellectual property  
21 holder's interest in innovating and in obtaining  
22 a return on that innovation plus there are the

1 policies of competition and creating competition  
2 for consumers. I also think that the Kodak  
3 comports with the DOJ/FTC guidelines in that it  
4 does not immunize IP from antitrust liability.

5           It focuses on the commercial realities  
6 that I think in all antitrust cases Courts have  
7 been instructed by the Supreme Court in the Kodak  
8 one case to talk about. And then I don't see  
9 that Kodak is going to wreak havoc. I think  
10 section II claims are very difficult to prove.

11           As Chris was discussing earlier today,  
12 it's very difficult to prove monopoly power and  
13 very difficult to prove antitrust intent. In  
14 fact after Matsushita and Celotex and those  
15 lines of cases you almost have to prove that the  
16 anticompetitive intent of the defendant was the  
17 only intent they had.

18           It's not that you can just find one  
19 document in their file. Federal Judges are very,  
20 very inclined to consider granting summary  
21 judgment in monopolization cases. And then  
22 another point that I don't think anyone has

1 mentioned here today, intellectual property  
2 rights are not absolute.

3           In the context of patent infringement  
4 cases, somebody's intellectual property rights  
5 can be lost if they are accused and it's proven  
6 that they committed equitable estoppel or laches  
7 or unclean hands.

8           And I'm of the opinion that if the  
9 patent holder is severely harming consumers,  
10 engaged in anticompetitive conduct which severely  
11 harms consumers and that can be proven, that that  
12 should also defeat an intellectual property  
13 holder's right to use its patent as it could  
14 otherwise.

15           A refusal to license I think  
16 especially concerning cases involving industry  
17 standards and network access, and those are the  
18 essential facility cases, and then something I  
19 think Professor MacKie-Mason will discuss later,  
20 I don't think there is any evidence that the  
21 Kodak rule actually inhibits innovation.

22           If Kodak created some uncertainty in



1 the law that you could look to the party's intent  
2 and potentially down the road subject a patent  
3 holder to antitrust liability and because that  
4 rule was there you -- people stopped trying to  
5 get patents and trying to put R & D into patents,  
6 I don't think they can prove that.

7 I don't think that's true. In fact  
8 there's no empirical evidence that I know of  
9 that after Kodak came down innovation patent  
10 applications slowed down at all. So do I think  
11 Kodak is perfect, by the way?

12 I don't; in fact I would argue that  
13 not only should a Court have to look into the  
14 antitrust intents of the defendant, they should  
15 also take a look at -- rule of reason look at  
16 what actually is happened in the industry, which  
17 Kodak arguably did not do.

18 My conclusion though again to the  
19 potential plaintiff is that Xerox is the rule and  
20 that because if you are -- if you follow an  
21 antitrust case and somebody cross complains or  
22 counterclaims right now for a patent infringement

1 counterclaim, you're going to go to the Federal  
2 Circuit.

3           And if you have been sued like that  
4 one circumstance I mentioned earlier, somebody  
5 asked for 150 percent of profits, then the  
6 potential plaintiff says I don't want to pay  
7 that; I want to continue to stay alive. They are  
8 sued. You're in Federal Court. There is a  
9 patent infringement lawsuit.

10           You counterclaim with antitrust  
11 violation. You're also going to the Federal  
12 Circuit. So it's very difficult to get around  
13 the Xerox rule. There is a case pending in the  
14 U.S. Supreme Court that might change that for  
15 antitrust counterclaims.

16           And the issue is whether or not the  
17 Federal Circuit still has jurisdiction when  
18 antitrust claims only arise in the context of  
19 counterclaims. But right now the debate about  
20 which is correct, Xerox or Kodak, is largely  
21 academic in Federal Court.

22           So often we talk to plaintiffs about

1     what their other options are.  And their most  
2     important other option I didn't put up on the  
3     board here.  That's do nothing.  And often that's  
4     what they choose.

5             Most often plaintiffs say I'll risk  
6     the possibility that someone will sue me for  
7     patent infringement and that I can litigate the  
8     case, find some prior art, and try to settle on  
9     favorable terms because it's difficult.  It's  
10    expensive to litigate these claims.

11            So as I said before, there is a Lanham  
12    Act claim pending.  What I tell them is they  
13    can't pursue other unfair competition claims like  
14    Lanham Act claims if they have the marketplace  
15    misconduct, the bad faith accusations of  
16    infringement.

17            There are also possibilities of state  
18    law causes of action in states like Minnesota and  
19    Texas that have Sherman II equivalents, they can  
20    pursue an antitrust monopolization claim and  
21    argue that Kodak is the better rule.

22            And then there are cases, the IMS

1 health case and Magill out of the EC in which the  
2 EC seems much more inclined to consider  
3 compulsory licensing and inclined to review  
4 unilateral refusals to deal IP as causes  
5 antitrust concerns.

6           And then the other thing of course  
7 they can do is convince the DOJ and the FTC to  
8 prosecute claims and try to change the rule  
9 because the government of course cannot be -- can  
10 sue any way they want. They can prosecute in the  
11 Ninth Circuit if they chose, and they can try to  
12 change the law if they believe it is appropriate.

13           Quickly, the Zenith versus Exzec case  
14 is an interesting case because it -- the Federal  
15 Circuit did leave the door open a crack in saying  
16 that we will look at intent, similar in some ways  
17 to the intent that the Kodak decision looked  
18 about -- looked at when we are looking at  
19 marketplace misstatements of infringement.

20           So parties do state a valid Lanham Act  
21 claim, a valid federal unfair competition claim,  
22 not a section II claim, but a Lanham Act claim,

1 if you can allege that you -- that the patent  
2 holder went out into the market and said in bad  
3 faith that you were -- that the patent infringer  
4 was violating the patent. And that's one option  
5 to try to get around Xerox.

6 The Exxon case also says that tortious  
7 interference claims are not pre-empted. And the  
8 Lingo versus Microsoft case in California  
9 Superior Court in which we're involved in also  
10 says that the copyright pre-emption claims of  
11 Microsoft did not pre-empt the Cartwright Act and  
12 Unfair Practices Act claims, the California State  
13 claims of the class action plaintiffs.

14 So the bottom line here is the outlook  
15 for plaintiffs in private courts is very bleak.  
16 And we're counseling plaintiffs. We're preparing  
17 two complaints right now in State Court to try to  
18 get around the Xerox rule. And I think that  
19 other firms, other plaintiffs' firms are doing  
20 the same thing.

21 Until the law changes I think the DOJ  
22 and the FTC will have to pursue anticompetitive

1 refusals to deal to try to limit the Xerox rule.

2           Otherwise as in the U.S. v. Microsoft  
3 case the national and international competition  
4 law and policy may continue to be developed by  
5 State Court judges and State attorneys general  
6 which I don't necessarily think is a good idea.  
7 Thank you.

8           PAM COLE: We're going to have Carl  
9 Shapiro and Jeff MacKie-Mason make their  
10 presentations. And then we're going to have some  
11 discussion. So panelists, hold your thoughts  
12 about Paul's statements.

13           CARL SHAPIRO: Good afternoon. I'm  
14 Carl Shapiro, University of California Berkeley.  
15 Well, today's topic is one that's close to my  
16 heart since I feel like it's about ten years ago  
17 that some of the real discussions in the Kodak  
18 case were triggered by the Supreme Court  
19 decision.

20           And I've had the occasion as I  
21 mentioned earlier to work on a number of these  
22 ISO cases over the years including Kodak, and in

1 fact some of the other cases that have been  
2 mentioned prominently today I've been involved in  
3 including Xerox, Intel, and Microsoft.

4           And it's a good -- I think it's a  
5 good -- these issues have been around for if not  
6 50 years, 100 years. So it's good every ten  
7 years or so to just remind ourselves of the  
8 issues and put them in current parlance, see if  
9 we have anything new to add. Maybe a little bit.  
10 We'll see.

11           I'm lacking a PowerPoint presentation.  
12 I will make several points. I have five points  
13 to make. You can pseudo-PowerPoint. Just write  
14 down the five points and then we'll go from  
15 there.

16           First point, treating IP the same as  
17 other forms of property, I would say certainly on  
18 the economics side there's no reason to treat IP  
19 differently just because it is -- has a different  
20 maybe legal basis. That's not too compelling to  
21 me as an economist.

22           I guess what I mean by that is all

1 forms of property, probably are forms, all forms  
2 I can think of right now involve some investment  
3 to create or protect the property -- at least I'm  
4 talking about commercial property here -- with  
5 the hope of some financial return that has to be  
6 based in some significant part on ability to  
7 exclude others from simply making use of it even  
8 though they did not invest in it.

9           So in that sense patents or copyrights  
10 seem no different than real estate or plant and  
11 equipment investments. So it's interesting to me  
12 a number of people seem to be saying, well, it's  
13 established perhaps that there is a duty to deal  
14 for other forms of property. So we should have  
15 it for IP as well.

16           I would actually flip that on its head  
17 a little bit and say it's not clear there should  
18 be such duties -- I'll give more nuances on that  
19 as I go -- generally and either for IP or for  
20 other forms of property. But generally we should  
21 think about treating them the same.

22           Now, of course people have gone on



1 about how they are not quite the same. The main  
2 thing of course that's noted by everybody about  
3 intellectual property that's different is that  
4 it can be shared without taking away from the  
5 original owner.

6 Or put differently, there are no  
7 capacity constraints associated with its use as a  
8 general principle. Actually if you take that  
9 seriously that might give you more reason to want  
10 to share intellectual property than other  
11 property.

12 I mean if I have a production line and  
13 I have to let you use ten percent of it, maybe I  
14 can't produce as much of my own stuff because of  
15 the capacity constraints. That is typically not  
16 an issue for intellectual property.

17 So to the extent there are these  
18 fundamental differences it might lead you to  
19 think you should be more aggressive or more  
20 inclined to impose duties on intellectual  
21 property. But I think that would in fact be the  
22 wrong way to go for reasons I'll describe more in

1 a moment.

2           The only thing that muddies that up a  
3 bit I think is we had a discussion earlier about  
4 how simply giving a patent license may not be  
5 sufficient for somebody to use the property fully  
6 if they need trade secrets or know-how or other  
7 inputs such as engineering help or that which  
8 would involve physical capacity constraints or at  
9 least marginal costs associated with the transfer  
10 of the information.

11           So that's my first point. The notion  
12 that IP deserves some special treatment seems  
13 doubtful on economic grounds.

14           Now, you may tell me that because of  
15 the way the patent statutes work to lawyers, you  
16 know, it clearly should be treated differently.  
17 But I think the economics is similar, and  
18 recognizing the fact that IP can be replicated or  
19 shared pretty easily, that's my first point.

20           Second point, mandatory licensing  
21 requires price regulation. When you really get  
22 into this, I think the practitioners all point

1 out -- well, particularly those who are more  
2 hostile to duty to deal. It's, well, if you are  
3 going to force somebody to deal what are going to  
4 be the terms and conditions of the dealing?

5           And I think -- that I think is quite a  
6 powerful argument because I think pretty much  
7 everybody says, well, we don't want to turn the  
8 Courts into a bunch of regulatory bodies saying a  
9 200 percent mark-up is okay here or a 500 percent  
10 there or we calculated somebody's rate of return  
11 and it was adequate or excessive.

12           So I think to the economist the  
13 refusal to deal is setting an incident price.  
14 So another way to think about it is what are the  
15 terms on which the person is willing to deal.  
16 There's probably some terms if pushed and they  
17 are not acceptable to the other party.

18           So of course one way to view this  
19 whole area is that, you know, plaintiffs here  
20 don't like the terms that were offered and they  
21 want to get better terms, negotiate better terms,  
22 and use antitrust lawsuits or at least the

1 prospect of them as part of those negotiations.

2 Well, you are into terms and  
3 conditions and that has I think inevitably a  
4 regulatory flavor and it's just I think you have  
5 to be realistic about that if you're going to go  
6 in this direction. It's one reason I think to be  
7 extremely wary.

8 Now, we've heard and I think you'll  
9 hear from Professor MacKie-Mason, well, the IP  
10 laws are kind of crude and there is a balancing  
11 that needs to be done and so forth; why tilt so  
12 far on one side and just give these patent  
13 holders such discretion. I agree that the IP  
14 laws are sort of a crude instrument.

15 The fact is we're not I think ever  
16 going to be able to say, you know, the patent  
17 length or breadth is optimal or should be a  
18 little bigger or less. And I'm a big believer in  
19 the need for some reform of the patent system.

20 The hearings, the portion of these  
21 hearings that were held in Berkeley, you know, we  
22 spent a lot of times actually on problems with

1 the patent system.

2           But I want to come out quite strongly  
3 in the view that if we think that patents are too  
4 broad or being -- or that bad patents are being  
5 issued or anything along those lines, I think  
6 that we should reform the patent system rather  
7 than gear up a whole regulatory apparatus through  
8 antitrust law imposing duties.

9           And again in part that's because of  
10 the lack of attractiveness of having the Courts  
11 determine what terms and conditions are  
12 acceptable or which are not.

13           A little story from the Kodak case on  
14 that: Kodak had set these prices for its parts  
15 that largely were used as an internal transfer  
16 price to sell from the parts division to the  
17 service division. And those were the prices that  
18 the plaintiffs wanted to buy the parts at.

19           Of course Kodak said, well, those  
20 weren't prices that were ever set to sell in  
21 large quantities to third parties, and we would  
22 want to set higher prices.

1                   And the plaintiffs of course -- and  
2                   they will always say this, say we of course  
3                   understand you get to have a reasonable price and  
4                   a reasonable return; all we want is a reasonable  
5                   price. And then you get into, well, what does  
6                   that mean.

7                   Of course when it came to calculating  
8                   damages the plaintiffs in the Kodak case said,  
9                   well, we should have been able to buy the parts  
10                  at exactly the prices Kodak was selling them  
11                  internally. And that was what was put forward  
12                  for the Jury.

13                  So there's always going to be what's  
14                  reasonable, what's not reasonable in terms of  
15                  these prices. The best you could hope to do I  
16                  think is to look for circumstances where there is  
17                  a dealing that's going on and there's some  
18                  discrimination. So one group is being sold parts  
19                  or refused a license.

20                  A plaintiff comes forward, I want a  
21                  license on the same terms as the other guy, which  
22                  is the advantage of at least the Court does not

1 have to completely construct the terms and  
2 conditions.

3           They can say, well, we see some terms  
4 and conditions; maybe we would require those to  
5 be offered to the plaintiff or some other class  
6 of licensees that are not -- that the company has  
7 not voluntarily offered them to. But then you  
8 start to think about that and you realize wait a  
9 moment.

10           The whole economic conditions may be  
11 different. Maybe I offered a license to you to  
12 use my patent in a field that I'm not  
13 particularly interested in pursuing.

14           But there is an area where I am  
15 interested in and I am trying to reserve for  
16 myself, and I think we understand field of use  
17 restrictions, typically legitimate. And I don't  
18 want to offer a license on the same terms to a  
19 direct competitor in a geographic area or a field  
20 of use where I have chosen I want to pursue it.

21           So nondiscrimination there may be an  
22 easy out for a Court or a Jury, but it doesn't

1 really have a very good economic basis in terms  
2 of kind of getting legitimate returns I would say  
3 to the patent and the investment.

4 Third point, this whole question of  
5 looking at intent as a way to decide these cases  
6 seems to me, you know, fundamentally flawed. The  
7 Kodak rule has been I think widely and I think  
8 rightly criticized, saying, well, it's okay. If  
9 you refuse to license because you are protecting  
10 your patent rights, that's okay.

11 If you refuse to license because  
12 you want to protect a return on your R & D  
13 investments, not sure that that's considered  
14 okay. If you refuse to license because you want  
15 to exclude the other guy so you can make more  
16 money with your own product, then that's not  
17 okay, or something along these lines.

18 This just doesn't make economic sense.  
19 So the whole notion that we need this inquiry to  
20 determine the intent and the purpose of the  
21 refusal I think is wrong. I think it's not a  
22 useful direction of inquiry.



1           I mean I'm prepared to assume that  
2 typically when there is a refusal it is because  
3 there it is in the commercial interests of the  
4 patent holder not to license, at least on the  
5 terms that the other party would find acceptable.

6           That will typically be part of the  
7 earning a return on the R & D and the investments  
8 that are reflected in the patent. And it may  
9 very well lead to exclusion or lead to higher  
10 prices in the short run. We can sort of presume  
11 all those things in comparison with a more  
12 attractive license that's being sought.

13           So I don't know that we need an  
14 inquiry into all that. That's going to be the  
15 typical fact pattern. And I don't see why that  
16 would justify imposing this duty. And it's not  
17 clear what the limiting principle really should  
18 be.

19           I mean one of the arguments Kodak made  
20 actually was, well, if we have to sell these  
21 patented parts against our will to ISOs, do we  
22 have to license the patents that go into the

1 photoreceptor belt, one of the key parts in the  
2 machine, to Canon. They are a competitor.

3           They may think, hey, this is a cool  
4 way of making copiers that they hadn't quite  
5 thought of. They want a license too. And I  
6 think most people even though sympathetic to the  
7 ISOs would say that's not right. It's all these  
8 ISOs somehow deserve or need the parts or  
9 something.

10           But Canon, they should look out for  
11 themselves. They should make their own damn  
12 copier. But what's the limiting principle once  
13 you start in this direction? And intent can't be  
14 it.

15           Fourth point, more methodological.  
16 I'm just concerned about the use of some of the  
17 terms here. Unilateral refusals, I'm big on  
18 using the term conditional or unconditional  
19 refusals.

20           The lawyers have been struggling for a  
21 long time with what does unilateral mean versus  
22 agreements, particularly in vertical contexts

1 where it doesn't really hold up as well as it  
2 does in a horizontal setting. I guess I take --  
3 I understood the topic today to be unconditional  
4 refusals to deal.

5 I'm just not going to license to you.  
6 And I'm coming out pretty strongly that that's  
7 generally within the rights of the property  
8 holder, intellectual property or otherwise.

9 Once you get into conditional refusals  
10 to deal, well, I won't sell to you unless you  
11 take my other product; I won't sell to you if you  
12 buy from my competitor; I won't sell to you if  
13 you do this or unless you do that, well, now  
14 we're into a whole set of basically restrictions  
15 associated with licenses.

16 And those seem to me very much  
17 suitable for the subject of possible antitrust  
18 scrutiny and limits. Otherwise all of a sudden  
19 tying and exclusive dealing and all manner of  
20 things can get -- sort of tucks in under  
21 intellectual property. And that can't be right.

22 That does seem to me the danger in the

1 Xerox decision, that it sort of hints at this  
2 sort of -- this broader permissions for  
3 conditional refusals to deal.

4           Now, some people argue, oh, well, if  
5 you can unconditionally refuse to deal then you  
6 should certainly be able to conditionally refuse  
7 to deal because it's more accommodating. That's  
8 just not right. You can create incentives  
9 through conditional refusals that you can't  
10 create through unconditional refusals.

11           An exclusive dealing arrangement would  
12 be sort of an obvious example. So that's where I  
13 think we want to kind of rightly focus our  
14 attention on these restrictions and conditional  
15 refusals although I understand that's not the  
16 core topic today.

17           Selective licensing is exactly the  
18 same analysis. I'm only going to choose to  
19 license to people who don't deal with my  
20 competitors. Well, that's very much akin to  
21 exclusive dealing.

22           It's just who am I willing to offer my

1 license to even if it is not an expressed  
2 provision that you deal exclusively with me. So  
3 selective licensing and conditional refusals seem  
4 to me fair game.

5 And I wish that the Supreme Court had  
6 granted cert. in Xerox so they could have cleared  
7 that up and taken a good whack at the Kodak  
8 decision in the Ninth Circuit at the same time.

9 Last point, and I'm running out of  
10 time, what to do about historical course of  
11 dealing. And I don't have a particularly good  
12 answer here. This is of course is part of Kodak  
13 in terms of if you've been dealing with people  
14 for a while can you stop. All of us think of  
15 Aspen Skiing obviously as well.

16 I think -- let me just list the  
17 arguments as I see them without really putting  
18 forward a strong view one way or another, much  
19 less an answer. It seems to me there are three  
20 reasons you might think why you would want to  
21 impose a duty on let's say a patent holder who's  
22 been dealing to keep dealing.

1                   And then I'm going to put the counters  
2           to each of these. So the first reason would be  
3           dealing has proven to be feasible, okay, and it  
4           appears to be perfectly consistent with the  
5           investment and creation of the property in the  
6           first place. They've been dealing with people,  
7           so why not -- we can see that this works in  
8           practice. That's one.

9                   Second one, you can use the  
10          pre-existing terms and conditions as a template.  
11          So at least if you're going to have to engage in  
12          regulating the terms and conditions, it's a  
13          little easier. You say, well, do what you did  
14          last year.

15                   And then the third thing would be  
16          maybe people have relied on an expectation that  
17          there would be such dealing. And so the ending  
18          of the dealing could be seen as a form of  
19          opportunism. So I think those are legitimate  
20          arguments. Each one has a counter.

21                   The first one the counter would be,  
22          look, conditions change. I was dealing with

1 people for a while, but now I want to create the  
2 new generation of my product and I want to do it  
3 differently and maybe I have more quality control  
4 or some other set of commercial interests.

5           So I don't want to be stuck forever  
6 just because I chose to do something ten years  
7 ago. We need flexibility. Really the second  
8 point has the same counter.

9           Well, I've been charging certain  
10 prices. I want to change the prices. I want to  
11 change the terms. What, I can't change them?  
12 It's still a form of regulation even if you are  
13 tying me to yesterday's prices.

14           And the third, the reliance issue,  
15 I think it is a serious question. Shouldn't  
16 private parties if they are going to make  
17 reliance investments seek their own assurances  
18 that a standard will be open or something will be  
19 licensed on an ongoing basis, rather than some  
20 sort of broad antitrust regime that would require  
21 ongoing dealing?

22           So you could at least ask is it really

1 a market failure that needs to be fixed which is  
2 one of the issues that has come up with Kodak and  
3 opportunism generally. So with that I'll turn it  
4 over to Professor MacKie-Mason. Thank you.

5 JEFF MACKIE-MASON: Thank you all for  
6 being here and having me. It's a pleasure to be  
7 here.

8 Like Carl I have been involved in most  
9 of the cases we have talked about today, in  
10 Kodak, Intergraph, Xerox, a slightly different  
11 one, CCS v. Xerox which was the same case as CSU  
12 essentially but got the rug pulled out from under  
13 it by the Fed. Circuit when it made the CSU  
14 decision. And Microsoft.

15 I've been however on the opposite side  
16 from Carl in all of those except Microsoft. But  
17 despite that I may disappoint you and perhaps our  
18 organizers today by not disagreeing with Carl  
19 very much. I'm not sure if we were hired as the  
20 entertainment for the day.

21 But I'm not actually going to argue  
22 with him very much about anything. In particular



1     like Carl to a large extent I'm not really  
2     interested today -- my understanding about the  
3     purpose today was not really to argue the facts  
4     of specific cases, but to think about the  
5     principles that are raised by the issues in these  
6     cases.

7                     And I'm going to try to stick almost  
8     entirely to an economic perspective about those.  
9     Many of the issues I think are clearly legal, but  
10    I want to talk about some of the economic  
11    principles involved.

12                    The summary of the points I want to  
13    make, first, I think the IP/antitrust conflict  
14    properly defined is inevitable, and I'll explain  
15    what I mean by that.

16                    I'm going to claim that both economic  
17    theory and empirical evidence really offer  
18    disappointingly little to guide us on where to  
19    draw the lines and how to devise an optimal  
20    IP policy or an optimal antitrust policy  
21    particularly where they conflict. There are some  
22    clear situations where I think there is guidance.

1                   And that's useful. Whatever the legal  
2 rules are, even if we don't have the policy  
3 right, there are things that economists can  
4 certainly analyze. There are things that we can  
5 do to help implement or apply the rules. It  
6 would certainly help if the rules were clear  
7 which they aren't at the moment in this area.

8                   And it would help even more for the  
9 economists at least if they were grounded on  
10 economic principles. And that's something I do  
11 want to argue. I think there is a reason why  
12 they should be. And again I think some of the  
13 key rules today really aren't economically  
14 coherent. They are not necessarily incoherent.

15                   Since we don't know exactly what they  
16 are it's a little hard to say what they are. But  
17 they certainly aren't economically coherent.  
18 First I really think there is not much argument  
19 that refusals to license can harm competition.

20                   In fact at some level it's within the  
21 notion of not selling something so somebody else  
22 can resell it or compete with you. Of course

1 that's the case.

2           But there are some specific cases that  
3 most of the speakers today have noted where  
4 there's reason to be concerned potentially about  
5 how refusals can harm competition. You can use a  
6 refusal so implement tying. You can use a  
7 refusal to foreclose or leverage into a second  
8 market.

9           You can use it potentially to protect  
10 a monopoly in a current market. That was one of  
11 the arguments in the Intel cases, that its  
12 refusal to -- its withdrawal of its previous use  
13 of -- allowing people to use its intellectual  
14 property was a way of trying to protect its  
15 current monopoly.

16           It may or may not have gone beyond its  
17 rights. So at least among economists I don't  
18 really think there's much dispute that there is  
19 potential harm to competition. And what that  
20 leads to is a reduction in aggregate consumer  
21 surplus, what we call static welfare harm.  
22 Prices may be higher.

1                   Quality may be lower or suboptimal.  
2     The variety of products available may be less. I  
3     really don't think there is much dispute about  
4     those possibilities, and there are plenty of  
5     cases where it is clear that that's happening.  
6     On the other hand refusals can benefit  
7     innovation. The option to refuse is a strategy.

8                   It's a potential competitive strategy,  
9     not letting somebody use your property electric  
10    or otherwise. I agree with Carl that the  
11    distinction I don't think makes much sense at  
12    least from an economic point of view.

13                  And in particular the option to refuse  
14    at least potentially increases the expected  
15    return that somebody could get from their  
16    property. It's essentially another arrow in the  
17    quiver. It's one more thing, one more strategy  
18    you can implement.

19                  And there are certain circumstances in  
20    which being able to refuse to deal with your  
21    property will allow you to increase your profits.  
22    And of course with a reduction in the

1 incentives -- sorry.

2           With a reduction in profits you don't  
3 have as much -- or expected profits, you don't  
4 have as much incentive to invest in innovation in  
5 the first place.

6           I do want to note that something that  
7 isn't actually talked much about in this  
8 literature in the recent years but it's also true  
9 and has been around for a long time in the  
10 economics literature is the fact that it isn't  
11 the case that an increased monopoly return always  
12 leads to more overall invention in society.

13           Static monopoly distortion sometimes  
14 reduces aggregate innovative effort. Greater  
15 expected returns to the firm we generally expect  
16 to increase the innovative effort by that firm.  
17 But it may discourage innovative effort by other  
18 firms. And there are examples of that.

19           And in fact I think the Microsoft case  
20 is rife with examples of that at least allegedly.  
21 The proof of the harm to innovation was perhaps a  
22 little scanty. But Microsoft arguably leveraged

1 its desktop operating system monopoly into a lot  
2 of other products.

3           And it's clear I think to certainly  
4 any casual observer and to most of the people who  
5 invest in this industry that it's discouraged  
6 other firms from investing in innovation in these  
7 other products because they don't want to go up  
8 against Microsoft. They know they'll lose.

9           Whether on net that's led to more or  
10 less innovation we don't know. It may be that by  
11 restricting Microsoft's monopoly returns  
12 Microsoft will invest less. But by allowing  
13 Microsoft less trammeled rights or less  
14 restricted rights to exercise its market power,  
15 that will discourage innovation by others.

16           So in thinking about how to balance  
17 the returns to innovation and allowing options to  
18 do things like refusing to deal as we are  
19 focusing on today to innovators which increases  
20 their expected returns potentially with the  
21 benefit of increased innovation, how do we  
22 balance that against the other harms from market

1 power that can be obtained -- sorry -- caused by  
2 conduct that the innovator undertakes with its  
3 property.

4           Even if we know that the option to  
5 refuse on net is a benefit to innovation -- and  
6 we don't actually know that as a general  
7 principle about all innovation. As I said,  
8 there's been a longstanding theoretical empirical  
9 debate.

10           And it's ambiguous whether or not the  
11 protection of intellectual property on net  
12 increases innovation, certainly not all the time.  
13 Even if we assume that there is a net benefit, we  
14 still have the trade-off of the static harm.

15           And there are going to be times when  
16 the static harms will exceed the dynamic benefits  
17 or the monopoly distortion will exceed the  
18 innovation benefits. So where should policy draw  
19 the line? I'm not talking now about how should  
20 we interpret the given law. But what should the  
21 law be? This conflict is there.

22           Should we permit all refusals to deal?

1     Should we permit none of them?  Should we permit  
2     some of them and define rules under which we say  
3     which ones are permitted and which ones aren't?  
4     We, economists, don't have an answer for you on  
5     that.  We don't have a theoretical answer I claim  
6     and we don't have an empirical answer.

7                 We don't know-how to really measure  
8     and we haven't really successfully measured the  
9     net benefits from intellectual property  
10    protection.  And we don't know-how to measure the  
11    expected harm to consumers overall from allowing  
12    refusals to deal.  We can look at it case by  
13    case.

14                Even there we can't really get a  
15    calculation because slightly restrict -- or  
16    somewhat restricting the returns to a particular  
17    firm ex post, after they have already innovated.  
18    They have some property.  If we say they can't  
19    refuse to license in some case, we lower their  
20    returns.

21                But the social policy issue is how  
22    much effect does that have on future innovative



1 investment by other firms. We really can't tell  
2 you that. So I say the conflict is inevitable.  
3 But if we step back for a moment, we should be  
4 careful about what we mean by conflict here.

5 Both monopolization law and  
6 intellectual property protection law are actually  
7 trying to advance the same objective I would  
8 argue, consumer welfare. Now, that's standard  
9 among economists to say that that's really the  
10 purpose of these laws. Others will argue there  
11 are other purposes.

12 But for our discussion today I don't  
13 think we need to argue about other purposes  
14 because certainly nobody has raised any of the  
15 other issues that there might be. They are both  
16 concerned with consumer welfare. But there are  
17 two different instruments.

18 One is concerned with more or less  
19 static or fixed market conditions, and the other  
20 is more concerned with dynamic issues and  
21 innovation. At times they are going to run into  
22 conflict. They are two different instruments

1     trying to achieve the same goal but in different  
2     ways.

3                     And that's not always going to lead to  
4     a clear answer about which one should trump the  
5     other or how we should decide. Fortunately the  
6     Courts don't ask us on a case-by-case basis to do  
7     that.

8                     Even under rule of reason analysis,  
9     we're not asked to do a global calculation of the  
10    total social benefits net of the benefits of  
11    innovation from a particular restriction versus  
12    the harm to consumer welfare. But they are going  
13    to come into conflict. There is no way to get  
14    around that. Should IP trump antitrust?

15                    Is that the right resolution of this  
16    conflict? I say surely not, at least not in  
17    general. I'm speaking a little bit more  
18    generally than just refusals to deal here. I  
19    actually am pretty sympathetic to those who think  
20    that any restrictions on refusals to deal should  
21    be very limited.

22                    I do not think that refusals to deal

1 generally are a problem. But let me talk more  
2 generally for a moment. The IP wins view seems  
3 to be the motto du jour. It seems to be a  
4 generous interpretation, but nonetheless a common  
5 interpretation of the Fed. Circuit's Xerox  
6 opinion.

7           But does that make sense as a matter  
8 of policy? Does it make sense to have unlimited  
9 incentives for innovation, that there should be  
10 no restriction on the returns that a person can  
11 get from their intellectual property?

12           Generally there's no reason to think  
13 that because there are offsetting harms caused by  
14 the exercise of monopoly power. And this isn't  
15 really a deep point. The Constitution grants  
16 Congress the right to give for a limited time  
17 these monopolyrights. And indeed patent rights  
18 are limited in time.

19           If we thought that there should be  
20 unlimited benefits -- I thought I had another  
21 line here. If we thought there should be  
22 unlimited benefits, then we might as well just

1 say the patents should run forever. There should  
2 be no time limit on them.

3           Clearly we intend for their to be some  
4 limits on the returns to intellectual property.  
5 And the question is where should they be in this  
6 intersection with antitrust. Well, what can we  
7 offer if we can't tell you where that boundary  
8 should be exactly? There's some clear case where  
9 is advice is reasonably unambiguous I think.

10           And I also think that we have  
11 reasonably robust tools for analyzing situations  
12 if the rule is clear. But unfortunately I think  
13 the rules right now aren't very clear. Some  
14 clear cases: Most economists now I think  
15 probably agree that it doesn't make sense to  
16 intervene if a firm doesn't have market power in  
17 the first place.

18           The mere refusal to license something  
19 when the firm doesn't have market power in the  
20 ancillary market or wherever it is that the  
21 complaint is arising doesn't make much sense. I  
22 say this is a more robust version of the Chicago

1 school dictum.

2           The Chicago school theory some years  
3 ago was that you couldn't get two monopoly rents.  
4 There was no gain from tying or leveraging  
5 because you could extract all the monopoly rent  
6 in the first market.

7           In fact that's not true. There have  
8 been a number of demonstrations both theoretical  
9 and empirical situations in which there are gains  
10 from tying or leveraging. But a variant on the  
11 Chicago theorem is that generally you can't  
12 leverage market power out of nothing.

13           If you don't have market power, then  
14 refusing to deal isn't going to give it to you.  
15 And I'm absolutely fine with that. There are  
16 some other clear cases.

17           I don't want to go into them now in  
18 part because I think they are very limited in  
19 applicability where we can unambiguously say  
20 antitrust should trump or IP should trump in this  
21 particular instance.

22           I do want to warn that I think simple

1 theories sometimes can be too simple and are  
2 taken too quickly as an opportunity to try to  
3 resolve things in the law.

4 For example, before Kodak some  
5 economists and then Justice Scalia in his dissent  
6 seemed to believe that as a matter of theory, as  
7 a matter of natural law if you will it would be  
8 impossible to exert anticompetitive power in an  
9 after market if you had a competitive foremarket.

10 That turns out not to be true, that  
11 you can cause monopoly distortion. You can have  
12 monopoly harm. There are debates about how  
13 significant it is. Carl and I have debated this.  
14 It may not be very important empirically.

15 But the fact is that the theory was  
16 just wrong, that you can cause distortion in  
17 an after-market even if the foremarket is  
18 competitive. It was too simple. It ignored  
19 some things that go on in reality.

20 In post Kodak -- there are so many  
21 different Kodak cases or opinions you have to be  
22 clear which we mean. Post Kodak '92 theory, as

1 some have noted originally Kodak was not an  
2 intellectual property case either in the law or  
3 in the facts.

4           The intellectual property issues  
5 weren't raised really until trial and then in the  
6 appeal to the Ninth Circuit. One of the  
7 arguments made by the defense experts and in a  
8 recent paper by Carlton and Waldman is that the  
9 manufacturers could have implemented exactly the  
10 same economic results by charging very high  
11 prices for parts.

12           And that would be legal, that it's  
13 perfectly legal for a monopolist to charge high  
14 prices for their patented goods. And if they  
15 raised the prices sufficiently, ISOs wouldn't  
16 have been able to compete and they would have  
17 gotten the same effect or they would have been  
18 able to compete only a little bit around the  
19 fringes.

20           But that's also I think too simple.  
21 In fact Klein and Wiley in their paper today note  
22 and others have noted as well that because parts

1 and service labor are substitutable that that  
2 itself would cause a distortion. The effects  
3 wouldn't be equivalent.

4           It may be that they could keep out  
5 competition, but they would have other effects on  
6 the market. So to say they could do the policy  
7 equivalently by raising parts prices was just too  
8 simple. It doesn't solve the problem there.

9           Today Ben Klein and John Wiley suggest  
10 that -- and I may be mischaracterizing because  
11 I'm not really clear that they were really  
12 suggesting this. But they seemed to be  
13 suggesting that refusals to license are simply  
14 price discrimination.

15           Now, I'm not sure if they meant just  
16 in these cases in Kodak and Xerox. But they  
17 seemed to be saying that what was really going on  
18 was price discrimination, and we should evaluate  
19 the case as a price discrimination case and not  
20 think of it as a refusal to license. But we know  
21 that's not always true.

22           There are several other non-price



1 discrimination motivations for refusals to  
2 license. So a theory that is based on price  
3 discrimination isn't sufficient to answer the  
4 problem either. So what can we do?

5           The second point about what economists  
6 can do, given that we have some rules, given that  
7 we do have some case law, we have some statutes,  
8 what can we add in trying to implement those or  
9 interpret those?

10           Well, to my reading as a non-lawyer it  
11 seems clear that antitrust does impose some  
12 limits on the use of intellectual property. The  
13 Supreme Court in Kodak -- its Kodak decision and  
14 the D.C. Circuit in its Microsoft decision cited  
15 it and went on to say some things of their own.

16           We have held many times that power  
17 gained through some natural advantage such as a  
18 patent can give rise to liability if the seller  
19 exploits his dominant position in one market to  
20 expand his empire into the next. Now, is that  
21 just tying as some people have suggested because  
22 the context of that quote was about tying?

1 Maybe, maybe not.

2           But in many cases there are clearly  
3 some limits. Much of the case law seems to focus  
4 on those limits being defined by power extended  
5 beyond the statutory scope of the patent. We  
6 talked about that some this morning, or the  
7 copyright grant.

8           Well, the problem for an economist is  
9 that we don't know, as I said earlier, really  
10 what patent scope means. Suppose it means, as  
11 something suggested this morning, the relevant  
12 antitrust market defined as we normally define  
13 antitrust markets for that patented good or  
14 process.

15           Well, if that were the case then we  
16 could apply standard market definition analysis  
17 which we're reasonably good at to determine  
18 whether some exclusionary act is immune from  
19 antitrust prosecution. If it's not an act that's  
20 affecting competition outside the relevant market  
21 for the patent, then it's immune.

22           That might be the rule and we could

1 help answer that question. Unfortunately as far  
2 as I can tell there is no really good reason to  
3 believe the patent scope is the same as the  
4 relevant antitrust market. And I don't actually  
5 think it probably should be.

6           There are a number of reasons to think  
7 that the market for a particular innovation has  
8 little to do defined in the usual antitrust sense  
9 with the scope of that innovation, what that  
10 innovation was designed for or what it could be  
11 used for.

12           And it would probably be way too much  
13 of a restriction on the returns to inventors to  
14 say that it can't do anything outside of the  
15 narrowly defined market for its innovation. So  
16 we have little guidance on what scope means  
17 except that we know that it's important.

18           It shows up in many of the major  
19 cases including the Supreme Court decisions.  
20 Unfortunately to figure out what scope should  
21 mean in some optimal policy sense we have to  
22 solve the original problem that I posed which is

1 that we'd have to figure out where we want to  
2 draw the boundaries.

3           How much return should firms be able  
4 to get on their intellectual property and where  
5 should we draw the restriction? And we  
6 economists again claim we can't give much  
7 guidance on what scope should be. But I know  
8 that as long as scope isn't defined clearly we  
9 also can't do much to help you implement it.

10           So absent the right answer we need a  
11 clear answer. Without that we waste resources in  
12 litigation and we probably discourage firms from  
13 investing and innovating. As Paul Kirsch said,  
14 right now the rule of the land seems to be Fed.  
15 Circuit Xerox and perhaps even a broader version  
16 of Xerox.

17           Some people seem to think Xerox is  
18 broader than maybe the Fed. Circuit intended  
19 because of some of the dicta in the case. If we  
20 have confusion, that's going to affect people's  
21 innovation and investment decisions. I think we  
22 need these rules to be economically sound.

1                   If we accept the purpose of IP law and  
2 antitrust law is economic, it is to maximize  
3 consumer welfare, then there is a justification  
4 for writing the rules to implement them in terms  
5 that make economic sense. I'm just going to  
6 really repeat something here that Carl said so  
7 I'll do it very briefly.

8                   Kodak, the Ninth Circuit in its  
9 decision on the trial appeal ruled that looking  
10 at intent was relevant for deciding whether or  
11 not this was a reasonable business justification.  
12 I'm actually with Carl on that. I don't agree.  
13 I don't think that makes sense for exactly the  
14 same reasons he said.

15                   All IP law is designed to allow firms  
16 some right, some limited right, but some right to  
17 exclude. Another way of thinking about it is  
18 from a policy point of view it's designed to give  
19 firms profits, returns to their investments to  
20 encourage innovation.

21                   So anything a profit maximizing firm  
22 does with its intellectual property in some sense

1 if they are intelligently profit maximizing is  
2 motivated by exactly the thing that the law  
3 stands for, which is to get returns to the  
4 profit.

5           So any intent that you have to use  
6 your property to make profits falls within the  
7 notion of what the intent is of the intellectual  
8 property law. So I don't think asking that  
9 intent solves anything. I do think in the facts  
10 of this case that Kodak was not about  
11 intellectual property.

12           It was about other things. But that's  
13 a debate about that case and I'm not interested  
14 in that right now.

15           So my conclusion is if the primary  
16 purpose of these laws is economic and if it's  
17 really the same purpose, to promote consumer  
18 welfare, then we need to work towards rules that  
19 are sensible in economic terms for deciding which  
20 law takes place when and which holds.

21           When we have second best rules,  
22 we can do something about implementing them,

1 interpreting them. But it would sure help if the  
2 Courts could be convinced to try to lay down case  
3 law that makes sense in economic terms. And  
4 that's a plea to those who write amicus briefs  
5 and such to the Courts or maybe to Congress.

6           This is something that has been  
7 largely worked out in market definition. Thirty  
8 years ago market definition was pretty much  
9 economically incoherent. Now days I think  
10 everybody is pretty comfortable with the basis  
11 for market definition and how we do it.

12           Factually it still can be a morass.  
13 But we all understand and we basically all agree  
14 on how to do it. I think the same possibility is  
15 there for this boundary between IP and antitrust  
16 law.

17           We may not get it exactly right, but  
18 we can at least hopefully develop it in a way  
19 that's economically coherent so that we then give  
20 certainties to the companies that are investing.  
21 They know what they are up against, and they can  
22 make rational decisions. Thank you.

1 (Applause.)

2 PAM COLE: Before the government  
3 people or the feds or the cops, as John Wiley  
4 calls us, jump in with questions, do any of the  
5 other panelists have questions about -- or  
6 comments about some of the presentations that  
7 were made? Chris?

8 CHRIS SPRIGMAN: Professor Shapiro  
9 talked about mandatory licensing essentially  
10 being an activity that requires price regulation  
11 which I think is right. But I'd be interested to  
12 hear your view on the following observation.

13 Infringement liability requires  
14 mandatory licensing because an award of damages  
15 for infringement is essentially equal to -- it's  
16 a proxy for a license that isn't there. And that  
17 requires priceregulation because we don't allow  
18 the infringer to say, you know, I want X and the  
19 Court just awards X.

20 We have Courts making damages awards.  
21 Now, the incentive to innovate for that  
22 prevailing plaintiff is going to be affected



1 going forward by what the prevailing plaintiff  
2 got. It doesn't seem to trouble us that we have  
3 Courts setting those awards.

4 So why is it any more troubling than  
5 mandatory licensing in the refusal to deal  
6 context? In fact maybe it's much more troubling  
7 because it's much more common.

8 CARL SHAPIRO: Well, I think  
9 there's -- obviously it's quite a big project  
10 every time one needs to calculate reasonable  
11 royalties or damages in an infringement case, and  
12 it tends to be fairly idiosyncratic to the case.

13 I guess I would say that's an  
14 inevitable by-product of an intellectual property  
15 rights regime where infringement is sometimes  
16 found therefore to be suitable awards to the  
17 patent holder.

18 I'm not keen on expanding the universe  
19 of situations in which we have to do those  
20 calculations to involve all manner of situations  
21 where parties could not voluntarily come to  
22 terms.

1                   And so now an antitrust plaintiff says  
2     you have to deal and we'll have to go through  
3     presumably experts and other calculations to  
4     determine the terms. It won't be any easier.  
5     But there will be more of that necessary.

6                   And that's what I'm concerned about as  
7     being inefficient and without a good basis, a  
8     broader policy basis for wanting to go in that  
9     direction.

10                  PAM COLE: Doug?

11                  DOUGLAS MELAMED: I have a slightly  
12     different take on this. Clearly there are the  
13     kinds of transaction costs that Carl was  
14     referring to.

15                  One of the ways to put those in  
16     context though is to understand that the reward  
17     for those costs is not only the obtaining of  
18     a remedy in that particular case but the  
19     reinforcement, the deterrent value of the  
20     antitrust law and the prevention of what may be  
21     a much wider spread pattern of anticompetitive  
22     conduct, and if you are not willing to incur them

1 in those instances when the matter comes to  
2 litigation.

3 Specifically on the question of how  
4 do you set the terms, I mean remember if you're  
5 looking at it from the standpoint of remedy we're  
6 not talking about taking away anybody's property.  
7 We're talking about what in some parlance would  
8 be called converting a property right into a --  
9 a property rule into a liability rule.

10 And then at the remedy stage frankly  
11 it doesn't strike me as terribly important  
12 whether -- how precise you are. If you charge  
13 a royalty of two percent and it ought to be  
14 1.8 percent, I mean or 2.2 percent, I mean big  
15 deal. It isn't that huge a matter.

16 To me the greater difficulty though,  
17 or great difficulties are twofold. One, to the  
18 extent that the remedy entails not price terms  
19 like the know-how issues Professor Arora referred  
20 to earlier or some of the issues that, for  
21 example, we get into in Microsoft, then you are  
22 really into an intractable problem where you

1 can't simply move along a continuum of price and  
2 say, oh, we're a few cents off; who cares.

3           And secondly and most importantly, to  
4 me the hard question is determining when did the  
5 defendant cross a line when he said I'll license  
6 to you for X percent and no less.

7           At what point is that a pretext, is  
8 that anticompetitive because he was not behaving  
9 in some anticompetitive way, versus when is it  
10 refusal to deal not anticompetitive. I guess  
11 what I'm trying to say is the price issue it  
12 seems to me is a much tougher one at the  
13 liability stage than at the remedy stage.

14           PAM COLE: Jonathan?

15           JONATHAN GLEKLEN: Yeah. I guess I'd  
16 also just disagree with the relevance of Chris'  
17 inquiry. In a patent infringement case you get  
18 two things. You get an injunction. You almost  
19 always get an injunction against the infringer.  
20 And then we just need a system to compensate you  
21 for your past harm.

22           And whether reasonable royalty is

1 the right thing as opposed to an unreasonable  
2 royalty, that's a decision that Congress made,  
3 and it may or may not be the right one to create  
4 the right incentives. But I think the key  
5 issue -- the key point for our discussion here  
6 is what they get as the injunction.

7 PAM COLE: Mark?

8 MARK WHITENER: Just to kind of chime  
9 in on this, the question -- and I'm agreeing with  
10 John essentially. You're trying to figure out  
11 what the plaintiff lost because the defendant  
12 used their property in the past.

13 In a refusal case we're really  
14 struggling with what would be the standard  
15 against which you're trying to calculate the  
16 royalty. And what that goes to is the -- you  
17 know, is the benchmark a market price? Is it the  
18 price that fully compensates the innovator for  
19 their investment?

20 And that could be a lot bigger swing  
21 than one or two or five percent. It could be  
22 50 percent. It could be a lot higher. And add

1 to that the fact that for a case to lie in this  
2 area you assume among other things by most  
3 standards market power.

4 And so you have the consequence that  
5 the more valuable the intellectual property is  
6 the more likely there is a violation. Well, that  
7 would suggest that the higher the reasonable  
8 royalty would likely be.

9 DOUGLAS MELAMED: Yes. This is  
10 just a suggestion. It's easier to answer. But  
11 conceptually I think the question, the benchmark,  
12 is what is the profit maximizing price. He's  
13 entitled that one. But he's not entitled to give  
14 up profits for strategic reasons.

15 MARK WHITENER: And if we properly  
16 define what profit maximizing is, we might get  
17 to agreement. But I'm not sure you are going  
18 to come to the same figure that I am when I'm  
19 looking at the entire flow of profits that stem  
20 from my innovation and my ability to exclude  
21 others from having access to it.

22 CARL SHAPIRO: And I'm looking

1 forward to your next paper, Doug, describing --  
2 enumerating these strategic reasons that are not  
3 considered legitimate versus the other profit  
4 maximizing reasons that are okay.

5 DOUGLAS MELAMED: Half an hour. I'll  
6 try it.

7 PAM COLE: John, did you have a  
8 comment?

9 JOHN WILEY: Yes. I wanted to speak  
10 to Jeffrey MacKie-Mason's question to us. Were  
11 we talking about all refusals to deal when we  
12 said price discrimination was an explanation for  
13 some of them. And the answer is no. We are not  
14 talking about all refusals to deal.

15 Some refusals to deal are simply --  
16 there are a million different reasons why people  
17 refuse to do business. One of them though is to  
18 effectuate in essence price discrimination.

19 And we think when we are talking about  
20 refusals to deal in the antitrust/IP context  
21 that's a significant explanation because we think  
22 it's the explanation for both cases that have

1 created the conflict.

2           Now, I'd be interested in getting  
3 Professor MacKie-Mason's view on whether he  
4 thinks that it's a legitimate explanation for  
5 business to say we refuse to deal because we're  
6 trying to price discriminate.

7           Would he be sympathetic to that  
8 explanation? Or would he regard that more as an  
9 explanation that would condemn the refusal to  
10 deal as a matter of antitrust law?

11           JEFF MACKIE-MASON: Thanks for asking.  
12 I thought of commenting on that this morning when  
13 you spoke. But the discussion moved elsewhere,  
14 so I held back. I certainly agree with you that  
15 price discrimination is not always a bad thing  
16 for welfare.

17           In fact one of my earliest papers was  
18 an example of when price discrimination could be  
19 improving. So I'm on record on that. And I  
20 was a bit confused about another thing you were  
21 arguing when you said that price discrimination  
22 doesn't indicate market power, that it's a common



1 practice.

2 I guess I would say that differently.

3 I think it is an indicator of market power. It's  
4 not sufficient by itself. But the fact that  
5 firms can charge different prices to different  
6 consumers is I believe a reasonable indicator  
7 that they have some ability to potentially charge  
8 prices different from the competitive level.

9 And if there are barriers to entry,  
10 for instance, then they may be able to exercise.  
11 So I say that because I was a little confused by  
12 whether you were saying it shouldn't be used as  
13 an indicator of market power or whether it  
14 shouldn't be viewed as anticompetitive conduct.

15 And your question now by business  
16 justification seems to be that. I definitely  
17 don't think that price discrimination should be  
18 certainly per se illegal as anticompetitive  
19 conduct. I actually didn't think anybody really  
20 did anymore.

21 I thought the -- I thought you had to  
22 reach a little bit far to find case law that made

1 price discrimination seem like such a bad thing.  
2 I didn't think the Courts were as critical of  
3 price discrimination as you were. What I think  
4 about it, is it a valid business justification?

5 To my mind the notion of valid  
6 business justification has always been -- the  
7 language is a little strange. Does valid  
8 business justification mean that the firm has a  
9 profit maximizing reason to do it? Well, then  
10 that's not saying anything at all because  
11 monopolists are trying to maximize profits.

12 I always take valid business  
13 justification to be a question about whether  
14 there is a procompetitive justification,  
15 whether the firm is doing that and it will have  
16 procompetitive effects. And the answer for price  
17 discrimination is sometimes yes, sometimes no.

18 So I wouldn't give it a blanket pass  
19 the way I think you're suggesting, that we should  
20 give it a presumptive procompetitive business  
21 justification standing. But I also wouldn't give  
22 it a blanket negative. I would say that

1 unfortunately with price discrimination it's  
2 ambiguous.

3           And if you really think that's what's  
4 going on in a case, you may have to look into it  
5 on a rule of reason basis. But I wouldn't say  
6 that that's a presumptive procompetitive business  
7 justification.

8           JOHN WILEY: I understand what you are  
9 saying about the ambiguity in welfare terms of  
10 price discrimination. But I'm worried that first  
11 of all it's beyond any practical judicial ability  
12 to untangle, you know, to do a reliable welfare  
13 analysis of price discrimination in any given  
14 case.

15           I guess I'm more convinced that price  
16 discrimination is commonly accomplished by people  
17 with absolutely no market power than you are. I  
18 suppose it's unfair to put you on the spot and  
19 ask you if you price discriminate. But would you  
20 be willing to allow that, you know, of economic  
21 consultants who do?

22           And to return to my example of the

1 morning, law firms that price discriminate. If  
2 we think of everyday businesses that are charging  
3 different customers different prices, I think it  
4 snaps into focus immediately that this is a  
5 practice that's extremely widespread throughout  
6 the economy and is absolutely no sign at all of  
7 appreciable market power.

8           So if that's the case -- maybe I  
9 should just stop there. I've gone on long enough  
10 with my question.

11           My concern is for any case-by-case  
12 adjudication as to whether price discrimination  
13 in this particular situation is welfare enhancing  
14 or welfare diminishing, to ask a Federal District  
15 Judge to do that is really to consign ourselves  
16 to decades of litigation.

17           JEFF MACKIE-MASON: I agree with that.  
18 I guess I haven't actually seen that many cases  
19 where price discrimination was really alleged as  
20 being anticompetitive conduct except, you know,  
21 in Robinson Patman type cases. And all I was  
22 saying is I don't think that it should be a

1 presumptive business justification.

2           We shouldn't presume that it's  
3 procompetitive and say that if they are doing it  
4 for price discrimination reasons then that's a  
5 valid business justification. I think if that  
6 is going to be raised -- which as you said it  
7 wasn't -- in either Kodak or Xerox -- and I  
8 was -- as an aside, I'm sort of interested in it.

9           It's certainly not that Kodak  
10 was embarrassed to talk about its price  
11 discrimination. I discovered they were doing  
12 it because of Carl's excellent testimony in the  
13 class action case where he praised them and  
14 bragged about how much price discrimination they  
15 had and that's why they shouldn't certify a  
16 class.

17           I said, wow, they're doing a lot of  
18 price discrimination. That's an aside. I  
19 just don't think it should be a presumptive  
20 procompetitive business justification. As far as  
21 market power, I think if you see substantial  
22 price discrimination, more than sort of

1 frictional price discrimination.

2           Then it's a sign of at least some  
3 local market power. I think that was part of the  
4 problem with the movie theater example. There  
5 you had intellectual property, movies, and you  
6 had also geographic markets. So there was some  
7 local price discrimination. Is it enough to  
8 raise it to the level of antitrust concern?

9           Of course it often isn't. That's why  
10 I say you have to meet other conditions there as  
11 well. There have to be barriers to entry. It  
12 has to effect a significant amount of commerce.

13           So I think that it's potentially an  
14 indicator, especially if there is a large amount  
15 of price discrimination and they are able to  
16 prevent arbitrage. But by itself it's not enough  
17 to judge that they have market power.

18           PAM COLE: I wanted to turn the  
19 discussion a little bit to this subjective intent  
20 versus some type of objective analysis debate.  
21 I've been trying to keep a Gallup poll here in  
22 terms of where people stand on certain issues.

1                   And if my poll is correct, Paul Kirsch  
2                   is really the only one who has stated that he  
3                   thinks the subjective intent test is at times an  
4                   appropriate test. And maybe this is a question  
5                   for Paul and then comments.

6                   But, Paul, I think you also said that  
7                   you did not think the Kodak case was perfect  
8                   because it didn't take a rule of reason analysis.  
9                   It didn't do any type of rule of reason analysis,  
10                  which, you know, seems to be somewhat in conflict  
11                  with the subjective intent test.

12                  So are you proposing some type of  
13                  middle ground here in terms of performing -- the  
14                  Courts performing some type of rule of reason  
15                  analysis coupled with the subjective intent?

16                  PAUL KIRSCH: I think that's exactly  
17                  right, Pam. Excuse me. I wouldn't want to be  
18                  the only one on this panel that was -- an eminent  
19                  economist who was supporting antitrust intent as  
20                  the only way to suggest there could be section II  
21                  liability in a refusal to deal case involving  
22                  intellectual property.

1           I think Kodak isn't perfect, as I  
2       said. And I think there should be a rule of  
3       reason analysis together with an analysis -- a  
4       detailed analysis of what the market is, what's  
5       going on in the market. And how you define the  
6       market again is critical.

7           It's not just the technology market or  
8       the market that's covered by the patent at issue.  
9       It might be in related markets, submarkets, or  
10      adjacent markets. And it's not just the conduct  
11      of the patent holder with regard to the patent,  
12      refusing to deal on the patent. It's how they  
13      deal with other competitors.

14          It's the effect of their other conduct  
15      on consumers. And in some ways I think we might  
16      return to an essential facilities doctrine  
17      analysis if necessary if it's, for instance, an  
18      important patent affecting public health.

19          Then maybe patent holders do have a  
20      duty to deal if somebody has an anthrax patent  
21      that will -- could create an anthrax vaccine.  
22      I don't think that the antitrust laws should be



1 just wiped aside and say that you can't get into  
2 somebody's intent plus a detailed market  
3 analysis. And I hope I wasn't the only one.

4 I think Chris earlier may have  
5 suggested that he agreed in some limited  
6 circumstances you can look at the patent holder's  
7 intent in refusing to deal. So, Chris, I hope  
8 you back me up here.

9 CHRIS SPRIGMAN: I'm not sure I said  
10 that.

11 PAM COLE: Nice try, Paul.

12 CHRIS SPRIGMAN: I think this Kodak  
13 opinion has become radioactive and it's a little  
14 unfair. When the Court was talking about intent,  
15 it was talking about an instruction to the Jury  
16 and whether an instruction to the Jury that was  
17 insufficient was nonetheless harmless because  
18 Kodak's late in the game trundling forward in one  
19 paragraph of the closing argument of an IP --  
20 protecting investment in IP justification was  
21 not basically credible.

22 It was a pretext. I'd like to be

1 charitable to this opinion and say it can be  
2 reconciled with a better approach which is  
3 not subjective intent so much as intent as  
4 objectively probative of a strategy that had no  
5 justification but for its exclusionary effect,  
6 no profit maximizing justification but for  
7 exclusion, by which again I mean to say that  
8 although the intellectual property holder is  
9 entitled to exclude and thereby collect a  
10 monopoly rent -- and I think the Kodak Court did  
11 say that -- that this reliance on its investment  
12 in intellectual property as a justification was  
13 in fact too feeble to rebut the possibility or  
14 the likelihood that this strategy was in fact  
15 something more than profit maximizing for a  
16 monopolist.

17           It was in fact exclusionary past the  
18 point where that was. So this reading of Xerox  
19 requires a lot of interpretation and charity.  
20 But I think it's available and it's somewhat  
21 unfortunate language in the same way that the  
22 Kodak language about the three exceptions to its

1 rule of per se immunity is unfortunate.

2 PAM COLE: Another Gallup poll  
3 that I've been trying to take during the  
4 presentations -- and I realize that Mark and Doug  
5 still have some presentations to make -- is the  
6 sentiment of the panel in terms of whether or not  
7 there should be restrictions on refusals to deal,  
8 antitrust restrictions.

9 And it seems to me that the sentiment  
10 of the panelists is either that there should be  
11 no restrictions whatsoever or if there should be  
12 restrictions those restrictions should be very  
13 limited. I think that's pretty much what  
14 Professor MacKie-Mason stated when he presented.

15 And for those panelists who believe  
16 that there should be some restrictions on a  
17 unilateral refusal to deal albeit limited  
18 restrictions, could you comment or discuss what  
19 are some necessary predicate conditions, if you  
20 will, in terms of when those limited restrictions  
21 should apply.

22 I mean obviously a finding of market

1 power seems to be one that we would all agree on.  
2 Are there any others that come into mind in terms  
3 of when those limited restrictions on a refusal  
4 to deal should apply? I don't know.

5 Professor MacKie-Mason, have you had  
6 any ideas in terms of what you were thinking when  
7 you said there should be limits? I assume from  
8 that there should be instances in which you think  
9 there should be restrictions.

10 JEFF MACKIE-MASON: I do although it  
11 starts to ask me to be a lawyer to try to draw  
12 these distinctions because I'm not sure we could  
13 really make the argument clearly on economic  
14 grounds. But I think it's more just a gut  
15 instinct. Carl made the distinction between  
16 conditional and unconditional refusals to deal.

17 That's a distinction I think is  
18 important. But it also worries me a bit because  
19 it's not -- even that there is still semantic  
20 debate about what is conditional and what is  
21 unconditional. You know, the refusal to deal  
22 parts to ISOs is conditional on them being ISOs,

1 not owners of equipment.

2           There is a question of as long as they  
3 don't use those parts to sell to another consumer  
4 who could buy them as a several servicer, then is  
5 that what we mean by conditional, unconditional?  
6 I think some obvious things that are conditional  
7 should be restricted. Tying is an example.  
8 Ability to implement price fixing is an example.

9           I'm not convinced, but I think it is  
10 a debate that would be good to have and wasn't  
11 reached really in the Intel cases.

12           Whether or not course of reciprocity  
13 should be restricted, you know, in that case  
14 Intel withdrew its intellectual property arguably  
15 allegedly to coerce firms to give away their  
16 intellectual property for free, to grant Intel  
17 zero price royalties.

18           So there we had a case of one firm  
19 using the fact that it had market power plus some  
20 intellectual property to coerce firms dependent  
21 on intellectual property to give us essentially  
22 their property rights, or at least that's what

1 the argument was.

2           It didn't really get a decision  
3 because the Federal Circuit ruled the Intergraph  
4 case on other grounds and the FTC case settled.  
5 But I think course of reciprocity is another  
6 case.

7           So these mostly are things that appear  
8 to be conditional, but it's not entirely clear to  
9 me what's conditional and what is unconditional.  
10 I think that's a semantic issue. And from an  
11 economic point of view I'm not sure the  
12 distinction is that clear.

13           PAM COLE: Chris?

14           CHRIS SPRIGMAN: I think one other  
15 limiting factor is that I would want to -- and  
16 Professor Ordoover talks about this as the third  
17 prong of his but-for test. I would want to  
18 understand early what the mechanism is for  
19 recoupment.

20           If there's no obvious mechanism for  
21 recoupment, then query whether you should even  
22 look further into the question of profit

1 sacrifice because the question of what is the  
2 monopoly maximizing price is more I think  
3 empirical, tough, intractable.

4           The other thing is imagine an instance  
5 where a patented component for a machine is  
6 being sold to licensees, being licensed to  
7 licensees. And you had a situation where the use  
8 of that component involved a lot of transfer of  
9 know-how over time.

10           And the patent owner decides, well,  
11 I'm going to identify the five or six companies  
12 who are most likely to be able to take that  
13 know-how and design around and limit the length  
14 of my patent monopoly.

15           Now, that's probably unilateral  
16 although I know there are a lot of theoretical  
17 issues about what is unilateral and what isn't,  
18 and I think we have to draw some lines. I think  
19 I'd call that unilateral. But the effect of that  
20 might be to suppress innovation that would  
21 otherwise come along.

22           And the recoupment mechanism there

1 is quite clear. And maybe there is a profit  
2 sacrifice in the process. So there is the kind  
3 of case where, you know, if you could imagine the  
4 facts you might get a relatively clear answer.

5 PAM COLE: Yes. Go ahead, Mark.

6 MARK WHITENER: But I guess then that  
7 raises a couple of questions. Is it recoupment  
8 if I make more money in servicing equipment  
9 because I didn't sell my patented parts to ISOs?

10 Maybe a little bit harder question but  
11 one that I think actually comes out the same way,  
12 is it recoupment if by not selling those parts  
13 the ISOs don't get educated on how to be better  
14 servicers of my equipment because they gain  
15 experience by using the parts?

16 And even though that experience is  
17 sort of you could say something they've gained on  
18 their own, they wouldn't have been able to do it  
19 if they didn't have access to my parts in the  
20 first place.

21 So we talk about recoupment, but we  
22 still have to come back to what we really mean



1 by that in the context of where the conduct is  
2 essentially I'm not going to give up the patented  
3 property.

4 PAM COLE: We're going to take a  
5 ten-minute break in just a few minutes. I did  
6 have one other question. But for the sake of  
7 time I want to make sure that my fellow  
8 government people did not have questions that  
9 they wanted to ask. Gail or Sue?

10 GAIL LEVINE: I had a question for  
11 Professor Wiley and Professor Klein about their  
12 thesis. I understand that your basic point was  
13 that many of these unilateral cases, unilateral  
14 refusal to deal cases, in fact even the leading  
15 ones can be described as metering cases.

16 But I gather from your recent  
17 interchange with Professor MacKie-Mason that  
18 doesn't go for all of them.

19 Can we use the insights of your thesis  
20 about price discrimination in some way to help us  
21 decide how to resolve the cases that aren't --  
22 that don't boil down to metering cases?

1                   JOHN WILEY: We didn't speak to that.  
2           Let me give my co-author a crack at it. Our  
3           thesis this morning dealt very specifically with  
4           one particular justification for refusals to  
5           deal.

6                   And it really has a recommendation  
7           explicitly for the FTC and the DOJ and for  
8           private counsel representing people who may have  
9           an antitrust problem that could be explained by  
10          a price discrimination rationale.

11                   I'm less confident than Professor  
12          MacKie-Mason that the case law is so distant.  
13          I think it's rather threatening in this area.

14                   And I urge the government decision  
15          makers here self-consciously to do what  
16          government decision makers have done historically  
17          in antitrust law, which is actively try to  
18          influence the content of antitrust policy that's  
19          generated by our Appellate Courts, particularly  
20          the Solicitor General's office and the Supreme  
21          Court, that are tremendously significant policy  
22          decision makers here.

1                   Now, how are these government decision  
2 makers going to find the right case involving  
3 price discrimination? Counsel can bring them to  
4 them and say, you know, remember that guy Klein  
5 and that guy Wiley; we've got that case.

6                   We could really use some authoritative  
7 help coming in and saying price discrimination is  
8 an explanation that ought not to condemn this  
9 refusal to deal.

10                  Now, about other refusals to deal that  
11 aren't explicable on those grounds, let me turn  
12 it over to Ben Klein. But this is action items  
13 both for the government and for private counsel  
14 with cases that fit this description.

15                  HEWITT PATE: May I ask just a  
16 follow-up then?

17                  JOHN WILEY: Sure.

18                  HEWITT PATE: Do you think we should  
19 be looking for opportunities to ask the Supreme  
20 Court to overrule Brulotte and the Morton Salt  
21 case which seem to me to be very readily  
22 describable as metering cases? This is what I

1 was talking about when Ashish was going to the  
2 podium earlier.

3 JOHN WILEY: I think that's an  
4 extremely logical question. It shows that you  
5 totally get our presentation that you're thinking  
6 about those other cases. I'm going to give you  
7 the classic appellate lawyer's response which is  
8 that case isn't before us right now.

9 All I'm asking for is on the refusal  
10 to deal point accept price discrimination as a  
11 legitimate justification. It may well be that  
12 there's implications that extend further.

13 But you could deal only with the case  
14 on the issue presented today and still do some  
15 real good. I'd be sympathetic to further  
16 extensions. But that's not necessary for right  
17 now.

18 GAIL LEVINE: Why is that a good place  
19 to start as a -- as a sort of matter of advocacy?  
20 Why is this particular area of price  
21 discrimination case law the place to press first?

22 JOHN WILEY: Because we have a very

1 sharp conflict that somebody's got to fix sooner  
2 or later. The Supreme Court and the Solicitor  
3 General may have been convinced in the last go  
4 around that the conflict wasn't sharp enough.

5 I think you've heard today  
6 overwhelming response that, golly, there's a lot  
7 of the private sector out there looking for  
8 guidance on this point. The way to cure these --  
9 this conflict we say is to understand the  
10 underlying economics and to allow people to talk  
11 about it without fear of automatic liability.

12 BENJAMIN KLEIN: To answer your  
13 question, I mean we -- I don't want to overturn  
14 all tying law and all of that on this basis. So  
15 I guess this is where we disagree. We're talking  
16 about unilateral or unconditional refusals to  
17 deal.

18 I think the important point in trying  
19 to distinguish the metering cases from the  
20 non-metering cases, you have to do a fact based  
21 analysis. And there's other reasons, as Jeff  
22 said, for refusals to deal other than price

1 discrimination.

2           But they are -- in the cases that  
3 we've looked at, they are generally very, very  
4 limited, these alternative models that have  
5 very limited applicability and where you're  
6 foreclosing a crucial input to protect your  
7 monopoly or to create a monopoly, in the Winston  
8 case about leveraging into another market.

9           You need these conditions about large  
10 economies of scale in the tied goods market where  
11 somehow using this refusal to deal is going to  
12 make it difficult for a new copier manufacturer  
13 to come in and get personnel that could service  
14 their machines.

15           And so -- and I think Jeff agreed  
16 that these models have very, very limited  
17 applicability.

18           What I think happens is it comes down  
19 to the question of the relevant product market,  
20 which is -- although Jeff says that's something  
21 we all agree on, I think that really becomes the  
22 empirical question on all these cases.

1                   The question is: Is it useful to  
2     define a market for the service of an individual  
3     firm's products even if they have a very small  
4     market share and abstracting from any kind of  
5     opportunism or holdup problem, which is what is  
6     done in all these cases?

7                   And I guess what I would say first of  
8     all in terms of these section 2 claims is price  
9     discrimination, if you think that it is a  
10    metering explanation, price discrimination should  
11    be sufficient because it doesn't -- you don't  
12    have the Ordovery/Willig standard anymore. No  
13    profit is being forgone.

14                  In fact they are getting extra short  
15    run profit. So there's not this problem of  
16    recouping it in the future. And this question of  
17    recoupment I agree is an important question.

18                  To an economist it's always recoupment  
19    because you're not doing anything as a business  
20    firm if you're not maximizing, you know, the  
21    discounted value of your profit stream and  
22    therefore you're getting some future wealth.

1 That standard only works if you're talking about  
2 recouping it in future monopoly profit.

3 And that only works if you define an  
4 arbitrary monopoly service market. So that's  
5 what really this whole thing comes down to. Can  
6 you define such a market? It's an empirical  
7 question.

8 But I would say that in most of these  
9 cases if you find out that it's metering you  
10 should be home free in terms of talking about the  
11 competitive process and predatory behavior. And  
12 we shouldn't be out there -- and that's what I  
13 didn't like about the debate that was going on  
14 between you two.

15 Whether quantity goes up or goes down  
16 from the discrimination of the metering I don't  
17 think is important because the antitrust  
18 authorities should be regulating the competitive  
19 process.

20 We shouldn't be going into a  
21 restaurant and saying, look, they are over  
22 charging for the desserts and under charging for



1 the entrees and there's distortions and maybe the  
2 quantity goes up and maybe the quantity goes  
3 down, just as long as it's not predatory behavior  
4 and the conduct is just part of a normal  
5 competitive process, that should be the end of  
6 the game.

7 JOHN WILEY: And, Ben, you and I  
8 completely agree with that. We have some  
9 continuing disagreement on the snappiest response  
10 to the MacKie-Mason point. But we're reading off  
11 the same sheet of paper.

12 PAM COLE: Okay. Let's take a quick  
13 ten-minute break which means we should be back at  
14 3:15. And then we're going to have Mark Whitener  
15 and Doug Melamed.

16 (Recess.)

17 PAM COLE: Paul Kirsch has to leave  
18 in about 15 minutes because he's flying out of  
19 Baltimore. I don't understand why, but that's  
20 what he's doing.

21 So Jonathan wanted to follow up on  
22 something that Paul said. And then, Mark, if you

1 can -- I see you are well positioned to -- okay.

2 All right. So go ahead, Jonathan.

3 JONATHAN GLEKLEN: I thought to be  
4 honest the most stunning thing that Paul said  
5 is that if you have the patent on the cure for  
6 anthrax and you refuse to license it and you do  
7 it out of bad intent and you have a monopoly in  
8 some relevant market for anthrax cures, that  
9 that's an antitrust violation.

10 I can't tell you that innovation would  
11 be reduced if we told -- you know. Pick a  
12 valuable drug patent and said you know you have  
13 to create generic competition, one time deal,  
14 special circumstances. So to do the rule of  
15 reason analysis I can't prove to you that the  
16 result is procompetitive.

17 But I guess I would inquire whether  
18 there is anyone else on the panel who thinks that  
19 that's the right result. And I'd also say I  
20 think there's case law out there that would  
21 support that.

22 I mean if you are going to treat

1 patents like other IP, I think broad reading, you  
2 know, of Colgate, you had an intent to maintain  
3 your monopoly. You refused to license.

4 But I guess I would be surprised if  
5 other people think that's the right result under  
6 the antitrust laws, as opposed to some public  
7 health regulation that Congress may pass if there  
8 is a national emergency.

9 PAM COLE: Well, Paul is in the back  
10 of the room. Does anybody else want to comment  
11 on Jonathan's questions or comments? Go ahead,  
12 Doug.

13 DOUGLAS MELAMED: I can't resist.  
14 Clearly it's not an antitrust violation. But it  
15 does seem to me there are tort principles that  
16 would say that you cannot suddenly raise your  
17 price to hold up the victims of the disaster,  
18 that you have to sell it at what otherwise would  
19 have been the market price. But I agree it's not  
20 an antitrust principle.

21 ASHISH ARORA: Just a little  
22 historical anecdote. At the end of World War II

1 chemical companies -- one prominent example  
2 is ICI -- were compelled to license their  
3 polyethylene compositional matter patent. It's  
4 hard to figure out what would have happened if  
5 they had not.

6 But it is true that innovation  
7 proceeded very vigorously despite that. Now,  
8 special circumstances and all that kind of stuff.  
9 I find it troubling that people state as a matter  
10 of principle that compulsory licensing will  
11 result in bad things.

12 HEWITT PATE: May I ask a quick  
13 question? If it's true that Colgate stands  
14 for the general purpose proposition that the  
15 refusal -- that the right to refuse to deal is  
16 conditioned on the absence of bad intent, does  
17 that mean either that the Ninth Circuit must be  
18 right in Kodak or that the only way to say that  
19 it's wrong is to say that intellectual property  
20 is treated differently?

21 JEFF MACKIE-MASON: You're referring  
22 to the language in Kodak that said absent a

1     purpose to monopolize a trader is free to choose  
2     with whom he must do business?

3                   HEWITT PATE:  Right.  I started by  
4     saying if it stands for that.

5                   JEFF MACKIE-MASON:  I'm not sure that  
6     purpose meant subjective motive.

7                   JONATHAN GLEKLEN:  I don't know that  
8     the only inquiry there is intent, but I think it  
9     affects the relevance.  I think Colgate says if  
10    you're not -- if you don't have a monopoly and  
11    you're not keeping a monopoly you can refuse to  
12    deal.

13                   But if you do have a monopoly and  
14    you're keeping the monopoly as a result, you  
15    don't have a right to refuse to deal.  Maybe  
16    Colgate is just wrong.  Maybe Colgate is bad law.

17                   PAM COLE:  Okay, Mark.  You've been  
18    very patient.

19                   MARK WHITENER:  I always thought  
20    Colgate was most often cited for the proposition  
21    that you can decide unilaterally what to do with  
22    what you own.  And I read that language as sort

1 of a Court saying we never say never.

2 I mean there is a temptation in this  
3 area of antitrust to sort of carve out exceptions  
4 or to give yourself a little wiggle room which is  
5 in my mind part of the problem.

6 Okay. I'm Mark Whitener. I'm  
7 antitrust counsel at GE. And my perspective is  
8 as one who has been in antitrust enforcement. I  
9 actually supported some cases that some of the  
10 dais opposed. And some of them involved  
11 intellectual property.

12 So I think there is an important role,  
13 a very critical role that antitrust plays in the  
14 economy generally and in intellectual property in  
15 particular.

16 But I do have some thoughts on this  
17 unilateral or I think it's fair to assume for  
18 purposes of my remarks unconditional refusals  
19 to deal or refusals to license. And I should  
20 probably make it clear that these views are mine  
21 and not necessarily those of GE. I don't have a  
22 PowerPoint presentation either. But.

1           I have two very simple bullets if you  
2           want to visualize them on the screen. What's  
3           wrong with the state of the law today, and what I  
4           think the agencies can do about it partly as a  
5           process of having these hearings and giving some  
6           greater policy guidance going forward. Now, let  
7           me address the state of the law briefly.

8           And it's been discussed at length  
9           today so I won't go into a lot of detail. But  
10          there are really two issues I think, two aspects  
11          of the Kodak decision that cause great confusion.

12          And in particular my perspective is  
13          that of a counselor to one company in particular  
14          that has long been an innovator and an owner of  
15          intellectual property.

16          And those two aspects of the decisions  
17          or fundamental flaws you might say are first this  
18          artificial subdivision of IP rights into multiple  
19          markets for purposes of applying the law of  
20          unlawful extension of IP rights from one market  
21          to another.

22          And the other is this analysis,

1 emphasis on subjective intent and actual versus  
2 pretextual motivations for refusal to license.

3           Now, on the first point, the Ninth  
4 Circuit basically said that a unilateral refusal  
5 to deal can be unlawful simply because the patent  
6 rights at issue can be subdivided into multiple  
7 antitrust markets, which is often going to be  
8 nothing more than saying as I think someone  
9 pointed out this morning, there is a market for  
10 the intellectual property itself.

11           And there is -- there are one or more  
12 end uses for that intellectual property. There  
13 may be many.

14           And as I'll come back to in a moment,  
15 how many markets a particular innovation can  
16 affect or in how many end uses it can be  
17 exploited is something that's probably going to  
18 be unknown and unknowable to the innovator at the  
19 time they are making the initial investment.

20           So under this approach virtually any  
21 time that the subject matter of the patent, the  
22 claims, the technology, the innovation that's



1 claimed by the patent has more than one end use  
2 or can be categorized as falling into more than  
3 one antitrust market, then you have at least much  
4 of the predicate for an unlawful extension of a  
5 monopoly from one market to another.

6           And obviously to find that there is  
7 market power, monopoly power in at least one  
8 market -- and even if we sweep aside the old  
9 erroneous equation of intellectual property  
10 rights with market power, it quite often will be  
11 the case that particular set of IP rights will  
12 create market power, or at least that's a fact  
13 issue that gets to a Jury.

14           Now, you know, this is a very  
15 difficult question for counselors and for IP  
16 owners because, as I said, it seems to me pretty  
17 clear that the question of how many notes there  
18 are Mozart wrote in the symphony or how many  
19 markets you can divide the IP into ought to be  
20 irrelevant to determining whether there is an  
21 antitrust violation.

22           But the other critical point is you

1 are not going to be able to know often when  
2 you're innovating, when you are making the  
3 investment or trying to decide how much to  
4 invest, how you will ultimately exploit, what  
5 business plan you will use to go to market with  
6 the technology, whether you're going to be  
7 dealing with one, two, three, or more antitrust  
8 markets.

9           And the other thing I want to say  
10 about this and the other Ninth Circuit Kodak  
11 issue that I'm going to talk about is what we're  
12 dealing with here fundamentally is uncertainty.  
13 It's of course a problem if liability is imposed  
14 based on these theories.

15           As Doug and others have pointed out,  
16 not a lot of cases actually end up with damage  
17 awards. Some do. But more importantly the  
18 specter of liability and the fact that liability  
19 turns on these very difficult if not unknowable  
20 questions creates a chilling effect.

21           It creates uncertainty which in turn  
22 undermines the rationale for and the degree of

1 investment in innovation. Now, you know, how  
2 much does it do that?

3           And Pam gave me permission sort of to  
4 breach the lunchtime privilege by describing a  
5 conversation we had at lunch today in which she  
6 talked about a very interesting case she handled  
7 when she was a young lawyer and was working in  
8 Colorado and went out and successfully prohibited  
9 springtime hunting of female bears who had cubs.  
10 Is that basically right? Close enough.

11           PAM COLE: That's right.

12           MARK WHITENER: And one of the  
13 arguments she faced from the Court was, well,  
14 do you have any empirical evidence of how many  
15 bears, you know, how many fewer bears if any we  
16 have because of this -- because of this policy or  
17 how many bear cubs are being killed because their  
18 mothers are hunted?

19           And she basically said, well, you  
20 know, we may not have a whole lot of evidence,  
21 but if you are saying that there is no loss,  
22 tell that to the dead bear, the point being we

1 shouldn't place the burden on the IP owners or  
2 on the innovators to prove the degree to which  
3 innovation is chilled when there is essentially a  
4 forced diffusion of the technology by virtue of  
5 the antitrust laws.

6           So I think that directionally it seems  
7 to me clear that innovation is reduced when the  
8 ability to reap a return on the investment is  
9 diminished and when uncertainty is introduced  
10 into the process as to whether you're going to be  
11 able to reap that return.

12           Now, the second problem with the Ninth  
13 Circuit Kodak decision just from the standpoint  
14 of practical sort of counseling and decision  
15 making for IP owners and their lawyers is this  
16 idea that the patent holder has to demonstrate a  
17 legitimate business justification for exercising  
18 its patent rights to exclude others.

19           And then the Court compounded this  
20 problem by not only putting that sort of intent  
21 into play but saying that you can have a  
22 purported justification, but it can be

1 pretextual.

2                   Now, I suppose that that's in a way a  
3 logical thing to say. Once you have concluded  
4 that intent is relevant, I guess you want to  
5 figure out what the intent really was.

6                   But problem was that the distinction  
7 the Court drew was essentially meaningless, that,  
8 for example, the evidence -- main piece of  
9 evidence I believe the Court pointed to for  
10 finding pretext was the fact that the Kodak parts  
11 manager had said that patents did not cross his  
12 mind when Kodak began its policy of selling parts  
13 only to end users and not to ISOs.

14                   This is obviously a distinction  
15 without a difference. On the one hand between  
16 the desire to protect intellectual property  
17 rights which was the defense that had been  
18 asserted and the Court found would have been  
19 legitimate, versus a desire to eliminate  
20 competition, or as the Court said a hostility  
21 to competition.

22                   Those both describe the same business

1 objective. And legally and analytically the  
2 distinction is meaningless. From a counseling  
3 standpoint, try to explain to a business person  
4 the difference between those two things.

5           What you explain is of course that  
6 it's always a good idea to create documents that  
7 emphasize the positive and that don't talk about  
8 harming competition and cutting off air supply  
9 and destroying the bad guys. That's just common  
10 sense.

11           But it shouldn't be the ultimate or  
12 a critical issue in determining whether there's  
13 antitrust liability. And then once that fact --  
14 and clearly that is a fact, what was the intent,  
15 what was the real intent, what was -- or was it a  
16 pretext.

17           Once that becomes an issue, an element  
18 of the offense, then it is a question for the  
19 Jury. And as John said, you know, if you are  
20 before a Jury you face the prospect, some  
21 probability, even if it's low, of liability,  
22 potentially quite large damages if you look at

1 the array of arguments that might be made.

2           It creates a settlement value and it  
3 creates very real effects even if very few cases  
4 actually get to the point of substantial damage  
5 awards. The other thing I'd point out is that  
6 the magnitude of the risk increases as the value  
7 of the intellectual property itself increases.

8           That is to say all else being equal a  
9 more valuable, a more important innovation is  
10 more likely I think to be susceptible to the  
11 kinds of arguments that at least under Kodak can  
12 create liability, all else being equal. More  
13 likely I would say to be found to create or  
14 confer market power.

15           More likely to be something that a  
16 competitor will say that they need in order to  
17 compete with you. So this is precisely the  
18 situation where the innovation is the most  
19 valuable to society, where liability is -- where  
20 the risk of liability is the highest.

21           Now, Xerox, the Xerox Court, Federal  
22 Circuit, addressed Kodak. That analysis has not

1     been met with universal approval.  It's fair to  
2     say I suppose even by the successful litigants.  
3     So I'm not going to defend Xerox's analysis.

4                   I do want to though respond briefly to  
5     what I see as a couple of the camps into which  
6     criticism of Xerox falls.  One is that it got it  
7     wrong, that Kodak is either right in the result  
8     or in the analysis.  I don't agree with that.

9                   Another is that the Xerox Court  
10    in this dictum inaccurately or incompletely  
11    described the so-called exceptions to the general  
12    right to refuse to deal.  That dictum can be  
13    criticized as confusing, inaccurate, or  
14    incomplete.  I agree with that.

15                  But the criticism I want to respond to  
16    and I want to spend the most time on now for a  
17    couple minutes is the idea that -- and this was  
18    expressed in the SG's brief in the case opposing  
19    cert. -- is that, look, as a general matter we  
20    should refrain from creating categorical sort of  
21    exceptions to the antitrust laws or categorical  
22    rules of legality or immunity.



1           Those are disfavored. We should look  
2           at cases on a case-by-case basis. We should look  
3           to see whether particular conduct runs afoul of  
4           some theory of competitive harm. Now, this  
5           sounds like a very flexible approach, and so  
6           therefore it might be seen to be a reasonable  
7           approach at first blush.

8           But I think when applied to unilateral  
9           or unconditional refusals to deal that it's wrong  
10          for several reasons. First of all, just the fact  
11          that section 217(d) of the patent act does appear  
12          to give -- to be a Congressional expression of  
13          treating at least patents differently than other  
14          forms of property.

15          But, second, you know, I think  
16          you have to look at the fact when critics of  
17          categorical legality point to situations where  
18          they think liability should be imposed, often  
19          I think you can if you look carefully at those  
20          arguments you conclude that they involve some  
21          form of conduct other than a pure or  
22          unconditional or unilateral refusal to deal.

1 That might well be analyzed under existing and  
2 much more widely accepted antitrust theories.

3           The other problem with this criticism  
4 of Xerox, that it improperly creates sort of  
5 immunity for a certain category of conduct, is  
6 that the critics don't -- I think still have not  
7 successfully articulated a theory of violation  
8 that fits within the bounds of antitrust analysis  
9 as we sort of commonly look at it today at least  
10 in this country.

11           And as I said earlier, I don't think  
12 it is enough to say, well, apply the general  
13 section 2 framework.

14           Look for exclusionary conduct which,  
15 you know, harms competition without sufficient  
16 efficiency justifications or under the sort  
17 of expanded idea of predatory conduct that  
18 sacrifices, you know, short run profit for some  
19 long run anticompetitive gain.

20           Each -- in the interest of time I  
21 won't sort of take each of those elements  
22 specifically.

1                   But each one it seems to me at least  
2                   so far as what I've heard from proponents of some  
3                   duty to deal in IP rights really fails in going  
4                   element by element and saying, okay, what is it  
5                   about the pure, unconditional refusal that is the  
6                   exclusionary conduct.

7                   How do we measure this predatory or  
8                   anticompetitive effect, and what do we take into  
9                   account on the procompetitive side? Is the  
10                  desire to extract every last dime of return from  
11                  the intellectual property right a legitimate  
12                  justification?

13                  Or is that itself if characterized the  
14                  wrong way somehow viewed as exclusionary? And  
15                  that's all before you get to the question of  
16                  remedy. And when you get to the question of  
17                  remedy I think as Carl and others have said, I'm  
18                  not sure we really want to ask the agencies and  
19                  the Courts to be regulators of price.

20                  And even if we're talking about a  
21                  simple nondiscrimination order it's really not  
22                  so simple.

1                   So what I think we really need to do  
2    is focus on antitrust as an enforcement, a law  
3    enforcement regime in which we only prohibit  
4    conduct or require a remedy when we have a  
5    clear theory of harm that has -- you know, it's  
6    economically sound, that can be expressed and  
7    understood by businesses up front.

8                   I don't think the question ought to  
9    be posed as to whether there is some generalized  
10   concern by those who are denied the rights to  
11   intellectual property that others have developed.  
12   And I think the way for the agencies to deal with  
13   this is in essence through the IP guidelines.

14                   My sense is the IP guidelines have  
15   been enormously successful. They make it fairly  
16   clear it seems to me that the guidelines do not  
17   view unilateral refusal to deal in IP as a  
18   violation. If that's not sufficiently clear  
19   I think it should be made clear.

20                   I would have thought that that's the  
21   policy that was expressed in '95. The Solicitor  
22   General filed a brief in the intervening years

1 that took a somewhat different view.

2           So it may be appropriate for the  
3 agencies as an outgrowth of these hearings to go  
4 back and resolve this question in a way that  
5 everybody can agree is clear and that everybody  
6 can understand. Thanks.

7           (Applause.)

8           PAM COLE: Okay, Doug. And, Mark,  
9 happy 35th birthday.

10           DOUGLAS MELAMED: I'm going to focus  
11 on one question, but there will be implications  
12 for others.

13           The question I'm going to focus on is:  
14 Is there something about intellectual property  
15 that should cause it to be treated differently  
16 for purposes of refusal to deal violations under  
17 the antitrust laws from other kinds of property?

18           Now, the first thing that I did when I  
19 began to think about this question was to look at  
20 it as a legal question. What's the law? The law  
21 is quite clear. Immunities from the antitrust  
22 laws are disfavored.

1           One should look either for clear,  
2           express Congressional intent to immunize conduct  
3           or for repugnancy between some other body of law  
4           and antitrust. And without that the antitrust  
5           laws ought to prevail because of their enormous  
6           importance to our economy.

7           And if you go through that legal  
8           exercise which I think few of the cases for  
9           understandable reasons have not gone through, you  
10          find that there is no legal basis for an immunity  
11          for intellectual property law. The IP statutes  
12          do not provide for antitrust immunities.

13          While it is true that they gave what  
14          appear to be unqualified grants of authority to  
15          license and exploit and use the property and so  
16          forth, the language and the legislative history  
17          I think makes clear that that is intended to  
18          do more than to ensure that the owner of  
19          intellectual property rights will have rights  
20          that are not inferior to those that we normally  
21          associate with the owner of tangible property.

22          The legislative history of the 1998

1 amendments which refer to the use of refusal to  
2 deal as a defense I think demonstrates the same  
3 thing.

4           Similarly I think if one looks at the  
5 Supreme Court cases, some of the old cases that  
6 used broad language about the rights of  
7 intellectual property holders, one finds that  
8 they were using either the language that was  
9 contemporaneously used to describe the rights  
10 of the holders of tangible property or that  
11 in context they quite clearly meant that  
12 intellectual property rights should not be  
13 inferior to those of the rights of other --  
14 rights of owners of other kinds of property.

15           So I think using traditional legal  
16 tools while arguments can be made on both sides  
17 I'm persuaded that by far the stronger argument  
18 is that there really is not a good legal basis  
19 consistent with the general proposition that  
20 immunities are disfavored for finding an  
21 immunity.

22           But I'm willing to grant that because

1 no one seems to care about that -- and by no one  
2 I mean the cases, Supreme Court and lower Court  
3 cases -- that maybe like those cases we should  
4 jump immediately to the policy analysis sort of  
5 tied to what was said and ask the question of  
6 whether it makes good sense to have a special  
7 immunity.

8 I don't think you can get there by  
9 looking at the policies of the intellectual  
10 property laws. To be sure they are intended to  
11 create rewards to innovation by giving rights of  
12 ownership to the innovator. But those rewards  
13 are not intended to be infinite. They are not  
14 intended to be maximized.

15 We know that from the face of the  
16 intellectual property laws. They are limited in  
17 duration. They contain within them doctrines of  
18 patent misuse and copyright fair use. They  
19 prohibit tie-ins and other things more broadly  
20 than do the antitrust laws.

21 So it is clearly not a principle of  
22 intellectual property law that the owner of



1 intellectual property is entitled to maximize his  
2 returns, to use his property in whatever way  
3 maximizes his profits.

4           And so one I don't think can assume  
5 that there is an incompatibility between an  
6 antitrust regime that might prevent the IP holder  
7 from doing what he wants to do and the values and  
8 objectives of the intellectual property laws.

9           The real issue I believe is a question  
10 of whether antitrust analysis is up to the job  
11 of protecting the legitimate interests of  
12 intellectual property while at the same time  
13 serving its own interests in promoting  
14 competition.

15           Now, we're dealing when we talk about  
16 refusals to deal with that branch of antitrust  
17 which are the offenses of exclusion by which  
18 one refers to offenses in which one or more  
19 defendants seeks to weaken or exclude a firm that  
20 would otherwise be its rival and thereby getting  
21 market power to the detriment ultimately of  
22 consumers or suppliers.

1                   And although there are wrongly decided  
2    cased and old cases and inconsistent cases, I  
3    think there is an emerging consensus that the  
4    principle -- the basic antitrust principle  
5    applicable in all cases involving exclusion is  
6    something very similar to the Ordoover/Willig  
7    predation principle.

8                   It's expressed differently in  
9    different cases. But I think it comes down to  
10   something like this.

11                   Did the defendant engage in conduct  
12   that didn't make business sense for it or that  
13   was not profitable for it, but for the tendency  
14   of the conduct to weaken or exclude rivals and  
15   thereby enable the defendant to gain additional  
16   market power that it would otherwise not have,  
17   and to recoup its investment by exercising that  
18   market power and earning supercompetitive profits  
19   it would not otherwise be able to earn.

20                   I think that is -- that principle  
21   explains frankly both the section 1 and the  
22   section 2 violations that have exclusion as their

1 attribute. Tying would be an example of that.

2           The conduct in which Microsoft  
3 engaged, predatory pricing, all of that kind of  
4 conduct I think can be subsumed at some level of  
5 abstraction under that principle.

6           Now, that's a very conservative  
7 principle. It is a conservative principle  
8 because it means that in order for a firm to  
9 violate the antitrust laws in an offense of  
10 exclusion it has to engage in conduct which in  
11 a static sense is not efficient at the margin.

12           In a static sense the costs of the  
13 conduct are greater than the benefits of the  
14 conduct, and it's welfare reducing without regard  
15 to the welfare costs of recoupment.

16           And it's a conservative test because  
17 one can surely imagine situations in which a firm  
18 might for example invent a new process, patent,  
19 lower its production costs by 5 percent below  
20 those available elsewhere in the industry, drive  
21 its rivals out of business, raise its prices by  
22 50 percent, make huge profits.

1                   No one will enter because they know if  
2 they ever did, because this guy owns the process  
3 patent he'll undersell them. And long run  
4 welfare is diminished. And yet in our country,  
5 in the United States, perhaps not in Europe, I  
6 think we say that's okay.

7                   We want to have a very conservative  
8 law to guard against false positives, to guard  
9 against too much government intervention into the  
10 economy. And the defendant wins because his  
11 process patent was skilled foresight in industry.  
12 It was not -- it didn't violate the predatory  
13 rule.

14                   It wasn't inefficient conduct in the  
15 static sense. And we're not going to get into  
16 the long run, short run welfare trade-off.

17                   Notwithstanding the fact that this is  
18 I believe the prevailing principle and it is a  
19 conservative principle, I think the real  
20 controversies in antitrust today tend to come  
21 more from the right than from the left.

22                   They come from a variety of arguments

1 by defendants who argue for what I will call  
2 formalistic rules to guard against false  
3 positives in the enforcement of the antitrust  
4 laws. The Microsoft case was a wonderful example  
5 of this for depending on how you count them eight  
6 or ten such arguments.

7           Microsoft argued that product design  
8 should be safe harbor because even though we can  
9 all imagine a situation in which product design  
10 might be anticompetitive in the sense that I've  
11 used that word Microsoft said Courts are too  
12 likely to get it wrong. There are too likely to  
13 be false positives. There should be safe harbor.

14           Microsoft argued that in high-tech  
15 dynamic industries there should be different ways  
16 of measuring market power to guard against false  
17 positives. They argued that there should be  
18 mechanical measures for exclusive dealing.

19           And the government argued in that case  
20 that there should be -- by the way, this is a  
21 little different -- formalistic rules that could  
22 condemn tying without actually proving that you

1 satisfied the predation test.

2           The Court of appeals in Microsoft  
3 and I think in an exquisite expression of the  
4 emerging consensus in antitrust law rejected  
5 every single formalistic argument, plaintiff  
6 tying argument and padded Microsoft defense  
7 arguments and said, no, we're going to look at  
8 every allegation of exclusionary conduct from the  
9 bottom up looking at the facts and asking the  
10 question, is this conduct was conduct that made  
11 no business sense or served no legitimate purpose  
12 or wasn't profitable but for its tendency to  
13 exclude a rival, generate additional market  
14 power, and permit anticompetitive recoupment to  
15 the detriment of trading partners.

16           I believe that was the correct  
17 analysis. And the question is whether there's  
18 any reason why that analysis shouldn't be used in  
19 a refusal to deal case, and if there isn't why  
20 there is any reason why it should be used in most  
21 refusal to deal cases but not in refusal to deal  
22 cases involving intellectual property.

1                   I believe that the law is sufficiently  
2     tractable, and the tools and investigation  
3     notwithstanding the fact it won't be perfect are  
4     sufficiently suitable that we can use that  
5     predation test in a refusal to deal case so that  
6     if Microsoft, for example, had simply refused to  
7     give its APIs to Netscape and had used that  
8     particular device to do in Netscape we would have  
9     been able to say I don't care if it has the label  
10    refusal to deal.

11                  That sounds to me like anticompetitive  
12    conduct. And we could have analyzed it the way  
13    the Court analyzed the other conduct that was  
14    alleged and found to be anticompetitive in the  
15    Microsoft case. So the question then is what  
16    about IP. Should that lead to a different  
17    result?

18                  Well, it seems to me the answer there  
19    is no because there's nothing about IP that  
20    makes the refusal to deal test any more or less  
21    intractable. And there's nothing about IP that  
22    requires any greater protection for the rewards

1 to skillful foresight in industry. Consider the  
2 AT&T case.

3           Would that have been a -- and assume  
4 for the moment that Professor Baxter was correct,  
5 that that was a great antitrust case. Should the  
6 result in that case have been any different if  
7 AT&T's interfaces had been patented? And MCI  
8 could not have plugged into the AT&T system  
9 without getting a patent license.

10           Would it make any sense to say that's  
11 a different case because there's intellectual  
12 property there? Would it make any difference to  
13 say in the Microsoft case that Microsoft has to  
14 disclose its APIs except if they are copyrighted  
15 and then it doesn't have to disclose its APIs?

16           So the problem with an exception for  
17 intellectual property, one of them is you are  
18 going to have false negatives. You're going to  
19 have those occasional serious refusal to deal  
20 problems uncorrected because you happen to have  
21 intellectual property.

22           A second effect of a formalistic



1       exception that says we're going to have safe  
2       harbors here is that you are going to argue about  
3       the formalism. What happens when the plaintiff  
4       goes into Court and says this really isn't an  
5       unconditional refusal to deal?

6                   I know why he didn't license companies  
7       A, B, and C. It's because A, B, and C were doing  
8       business with its competitors. They didn't say  
9       that. They didn't write it into the contract.  
10      But it wasn't unconditional in fact. Maybe it's  
11      the kind of Lorain Journal story.

12                   Then we're going to have a lot of  
13      arguments not about the economic merits, not  
14      about the competitive effects of the conduct, but  
15      about whether or not the refusal to deal is truly  
16      analogous to the safe harbor refusal to deal or  
17      not analogous to it, in which case it's not --  
18      doesn't deserve to be in the safe harbor.

19                   And we're going to have the same  
20      morass here that we have in all the RPM and  
21      resale restriction cases where people argue about  
22      was there an agreement or was there simply a

1 subtle threat that was so effective that  
2 everybody complied with the wishes of the  
3 manufacturer.

4           And the third effect it seems to me  
5 of having a safe harbor for intellectual property  
6 in the refusal to deal area is that it will  
7 directly, explicitly, and foreseeably undermine  
8 the purposes of the intellectual property laws.  
9 It will do that by creating incentives to distort  
10 the innovation process.

11           Imagine you are a lawyer in a world in  
12 which CSU is unquestionably the law. And the  
13 AT&T of the future -- maybe it's AOL, who  
14 knows -- comes to you and says, I don't want to  
15 have to plug some competing ISP or some competing  
16 news service into my network.

17           But I'm afraid the government is  
18 poking around and someday they will bring an AT&T  
19 against me. And the answer your lawyer says is  
20 this. I have a great idea. Go to your engineers  
21 and tell them to develop interfaces such that the  
22 only way they can plug into your system is by

1 getting a patent license.

2           We'll litigate the question was that a  
3 sham. We'll litigate the argument that Professor  
4 Lemley has made that it's not really the IP. It  
5 is the network they are trying to get access to.  
6 But chances are you're going to pull that off, or  
7 if not it's certainly worth the gamble.

8           And, sure, I know you didn't design  
9 your system with patented interfaces before  
10 because it made no technological sense, but isn't  
11 that a small price to pay to avoid antitrust  
12 liability, of being busted up like AT&T?

13           So your client is going to say thanks  
14 for the advice. He's going to order his  
15 engineers to develop new networks with patented  
16 and copyrighted interfaces.

17           And the innovation process will be  
18 distorted all in the name of a safe harbor  
19 intended to protect the intellectual property  
20 process from the unfortunate incursions of  
21 antitrust. I don't have that lack of confidence  
22 in antitrust that I think some people in the

1 intellectual property community have.

2 I don't think we're going to have many  
3 plaintiffs winning refusal to deal cases. I  
4 think once they learn that the strike suits will  
5 dissipate as they have in other areas of  
6 antitrust.

7 But I don't think we should throw out  
8 of the arsenal of antitrust the opportunity to  
9 bring a refusal to deal case, to bring an  
10 exclusionary case against arguments that this is  
11 a refusal to deal as opposed to some other kind  
12 of exclusion.

13 This is intellectual property as  
14 opposed to some other kind of property. Let's  
15 get rid of the formalism. Let's let antitrust in  
16 this area as most other areas treat exclusionary  
17 practices from a fact based, ground up  
18 perspective without formalistic rules and  
19 safe harbors.

20 (Applause.)

21 HEWITT PATE: Thanks, Doug. I expect  
22 that will prompt a few questions. Maybe I'll

1 start with one which is about the statute, the  
2 271(d)(4) point. I take your point with respect  
3 to the general thrust of the 1998 amendments  
4 being to put intellectual property on the same  
5 footing.

6 But the amendments have a provision  
7 that relate to conditional licensing and would  
8 seem to immunize it from challenge unless a  
9 plaintiff can show market power. And so in that  
10 context I think it's clearly bringing IP on to  
11 the same footing away from a less favorable one.

12 But yet that part of the statute  
13 exists side by side with 271(d)(4) which seems  
14 to give a much more unambiguous approval to  
15 exclusive -- well, to blanket unconditional  
16 unilateral refusals to license.

17 Why isn't it a better reading to say  
18 the statute to refute this is greater, includes  
19 the lesser argument that, say, in the Townsend  
20 case people are trying to run to defend  
21 conditional licensing practices, but that really  
22 there is a difference where the refusal is a

1 blanket refusal, an unconditional refusal.

2 DOUGLAS MELAMED: That is the toughest  
3 question for my position. I agree. I'd just  
4 say two things about it. One, it doesn't say  
5 antitrust immunity. So on its face however  
6 broadly you read it, it does appear to be limited  
7 to IP defenses and the like.

8 Secondly, I think there is some  
9 reason from the legislative history to reach the  
10 conclusion that I reached. But rather than try  
11 to bluff you into thinking I remember what those  
12 arguments are, let me just refer you to the paper  
13 that was handed out here.

14 HEWITT PATE: Other comments?  
15 Questions? Responses?

16 CHRIS SPRIGMAN: I guess I'd ask Doug  
17 why he thinks that Aspen and Otter Tail can be  
18 read as incorporating the Willig/Ordovery test?  
19 If in fact they did, I might be more comfortable  
20 saying the same rules apply. But, you know,  
21 Aspen says excluding somebody on the basis of an  
22 efficiency.

1                   And you don't have an efficiency  
2                   defense for a refusal to license generally.  
3                   Generally it's, hey, they are my competitors. I  
4                   don't want to do business with them because if I  
5                   license I'm going to be able to sell my drug for  
6                   four dollars, not forty dollars.

7                   DOUGLAS MELAMED: Aspen may be a nutty  
8                   case on the facts. But Aspen did think that the  
9                   test it was applying was the sacrifice of profits  
10                  for strategic payoff. It talks about the  
11                  sacrifice of short-term profits. Whether it got  
12                  the economics right or wrong I'm not sure.

13                  But I do think it thought it was being  
14                  consistent with Ordoover/Willig. I don't know  
15                  which came first. But the language, the  
16                  methodology of the case I think purported to be  
17                  consistent with this predation principle.

18                  JONATHAN GLEKLEN: I think that point  
19                  would apply especially with respect to the  
20                  refusal to sell tickets for independent  
21                  combination with the tickets of other ski areas.

22                  That has been noted in, for example,

1 the Areeda Hovenkamp treatise as being a  
2 perfectly -- well, a pretty straightforward  
3 justification of the entire analysis, rather than  
4 the change in behavior which is as I think has  
5 been discussed here somewhat more problematic how  
6 you treat that.

7           HEWITT PATE: Doug, your proposal  
8 wouldn't seem to endorse a subjective or a  
9 pretext analysis. Is there anybody on the panel  
10 who thinks the Ninth Circuit was correct in  
11 making subjective intent or pretext a part of the  
12 analysis in this context? There was, but no  
13 longer. All right. Nobody else?

14           MARK WHITENER: Hugh, can I just make  
15 a couple of points in response to Doug? And I  
16 think you did the best job I've heard yet of  
17 defending the overall view that there is  
18 something to be said for a duty deal or license  
19 in some circumstances. But three quick points.

20           One, I think that we would be in a  
21 much better place if the debate were now confined  
22 to whether a refusal is really conditional



1 or not.

2 I think we can all agree that there  
3 are some kinds of practices that would in fact  
4 implicate exclusive dealing or tying or some  
5 other conduct that could be examined under the  
6 antitrust laws.

7 Second, you said I think that the  
8 ideas -- the principles underlying the IP laws  
9 are somehow themselves subverted if you have sort  
10 of broad based protection for a refusal to deal.

11 Mr. Polk this morning I think made a  
12 point that I think goes the opposite direction,  
13 which is that the principles of the antitrust  
14 laws are to some extent subverted if you find  
15 or leave open the possibility of liability for  
16 a refusal to deal because what happens in the  
17 absence of a right to demand access to  
18 intellectual property is people find other ways  
19 to skin a cat.

20 They innovate. They develop -- they  
21 invent around or they come up with an entirely  
22 new approach.

1                   And then finally in terms of sort of  
2     the analytical standard that you described, I  
3     still have trouble understanding in what case,  
4     under what facts a refusal to share intellectual  
5     property standing alone could be a problem.

6                   I can see how it might be described  
7     as a problem under your short run -- well, under  
8     your sacrifice of profits for anticompetitive  
9     gains. But I'm not sure how that applies  
10    in fact.

11                  If I'm sacrificing profits in some  
12    sense now by refusing to sell parts to ISOs  
13    because it might be as a matter of fact that  
14    if there were more people out there providing  
15    service my equipment revenues might go up.  
16    Somebody could argue that.

17                  But what I really don't want to do is  
18    have the ISO take my parts, have that facilitate  
19    their service, and have them learn how to be a  
20    better service competitor. And I don't want that  
21    to happen. Am I justified in preventing it?  
22    Ashish?

1           ASHISH ARORA: This goes to the second  
2 of Mark's points, and it's something I've been  
3 trying to puzzle over. There seems to be -- and  
4 maybe Jeff MacKie-Mason said this earlier. There  
5 are two ends of the table. From that end I hear  
6 conditional refusals are bad or could be bad.  
7 From this side I hear price discrimination.

8           And I'm trying to figure out whether  
9 these two statements -- that price discrimination  
10 is if not good, at least legitimate. I'm  
11 wondering if these two are in conflict or not.  
12 So it is as much a question for the two ends of  
13 the table as a kind of comment.

14           BENJAMIN KLEIN: I think they are two  
15 separate concepts. I don't think they are in  
16 conflict. I mean you can unilaterally set up a  
17 metering arrangement that's not conditional on  
18 anything.

19           ASHISH ARORA: Price discrimination  
20 means you are charging different prices to  
21 different people.

22           BENJAMIN KLEIN: Yes.

1                   ASHISH ARORA:  Conceivably that's  
2                   conditioned on something.  How are your  
3                   differentiating those people?  And so I'm not  
4                   sure.  Anyway, this is as much for my education  
5                   as anything.

6                   BENJAMIN KLEIN:  Probably the lawyers  
7                   should answer it because this whole thing about  
8                   what is conditional and what an agreement  
9                   consists of I always find somewhat fuzzy.  But  
10                  I don't see any conflict.

11                  CARL SHAPIRO:  I'm at this end of the  
12                  table, but I'm not a lawyer.  But I did bring  
13                  up -- emphasize the conditional.  It seems to me  
14                  that price discrimination is basically a method  
15                  of you're trying to maximize the value of your  
16                  property.

17                  This whole issue of conditional -- and  
18                  I and Mark had mentioned tie-in and exclusive  
19                  dealing or selective licensing.  I think of that.  
20                  And you are trying to set up incentives, let's  
21                  say, that will exclude competitors, that will  
22                  make -- by having conditions.

1                   You can have my property if you agree  
2                   not to deal with a competitor. Well, that's  
3                   another barrier to the competitor. That's  
4                   completely separate than price discrimination  
5                   which is here is how I choose to price my stuff.  
6                   Deal with whoever you want but these are my  
7                   prices. It's just orthogonal.

8                   JONATHAN GLEKLEN: I think the problem  
9                   in determining what's a conditional refusal to  
10                  deal with what's a unilateral refusal to deal  
11                  could arise in the following example.

12                  A licensor goes out and grants a whole  
13                  bunch of companies short-term licenses and then  
14                  at the end of the term it refuses to relicense  
15                  those who deal with its competitors. And that's  
16                  pretty transparent. Everybody knows what it is.

17                  And they make it known that, you know,  
18                  come talk to us again. Any time you want to go  
19                  talk to us again about re-upping. Is that  
20                  unilateral or is that conditional? And when Doug  
21                  says we're going to get into fights about those  
22                  issues, I think we will.

1                   CARL SHAPIRO:  If I may, I won't use  
2                   these terms unilateral versus agreement.  It  
3                   seems to me that is conditional.  I mean you just  
4                   said everybody knows it's conditioned.  Hey, the  
5                   reason I'm not granting you a license is because  
6                   you're dealing with this other guy who is my  
7                   competitor.

8                   Now, we might have factual disputes  
9                   about whether that's what's going on.  I think  
10                  that's unavoidable because the guy might say you  
11                  didn't give very good -- there may be some other  
12                  set of reasons and that may or may not be a smoke  
13                  screen for in fact you're dealing with my  
14                  competitor.

15                  But in your hypothetical where  
16                  everybody knows what's going on, that's basically  
17                  equivalent economically to an exclusive licensing  
18                  regime.  It's not in the agreement that you have  
19                  to be exclusive.  But everybody understands if  
20                  you are not I'm not going to re-up you.  So I  
21                  think that's straightforward.

22                  That's conditional.  That could well

1 be a problem. And of course the remedy for that  
2 is not to get into regulating the prices but to  
3 say, no, that's not a legitimate -- may not be a  
4 legitimate basis for refusing to deal.

5 BENJAMIN KLEIN: I mean de facto it is  
6 conditional the way I understand your example, or  
7 I guess your example. But we know that it  
8 doesn't meet the Monsanto criteria. And in the  
9 real world people know a lot of things.

10 And I don't think we want to infer  
11 agreements by figuring out what is in people's  
12 minds. I think we need some objective criteria  
13 about what it is -- I sound too much like a  
14 lawyer. I should stop.

15 DOUGLAS MELAMED: You're a good lawyer  
16 though.

17 CHRIS SPRIGMAN: Let me just respond  
18 to that though. It's pretty clear that the  
19 patent gives you a right to give field of use  
20 licenses. And I think you undercut that if you  
21 say I can't unilaterally refuse to license people  
22 who are going to practice it in the field of use

1 that I prefer to maintain for myself.

2           So Xerox's photoreceptors in the  
3 claims they note that the -- I'm sorry, the fuser  
4 rolls, note that the patented coating can also be  
5 useful in the field of cookware.

6           So Xerox says I'm going to license my  
7 patents to people who make cookware and I'm not  
8 going to license my patents to people who want to  
9 make parts or to people who want to use the parts  
10 to compete with me. That's a selective  
11 licensing.

12           Are you saying that -- you know, if  
13 the cookware manufacturer gets into the fuser  
14 roll business and I terminate his license or I  
15 don't renew it that that's anticompetitive?

16           CARL SHAPIRO: No. At least -- if  
17 you're looking at me the answer is certainly not.  
18 I'm not in any way trying to attack field of use  
19 restrictions. It's a question again about  
20 whether other competitors are excluded through  
21 arrangements with third parties that may lock  
22 them up.



1                   HEWITT PATE: Yeah. I don't think --  
2 well, is there anyone on the panel who has  
3 understood the discussion today to indicate that  
4 all conditional refusals are unlawful? Because I  
5 think what we have been saying is that -- or what  
6 I've been hearing is that perhaps unconditional  
7 refusals are on a different footing.

8                   But in that discussion I haven't heard  
9 anybody indicate that conditional refusals are  
10 bad necessarily because they are conditional.  
11 Other comments? Questions?

12                   CARL SHAPIRO: I just want to throw in  
13 one more thing. Doug, I just don't get how your  
14 whole approach is really workable. It seems to  
15 me you want to do some inquiry about whether  
16 these effects were anticompetitive and whether  
17 there was sacrifice.

18                   And I just don't know what that --  
19 what I think of as a standard case where I'm not  
20 licensing to you because if I do you're going to  
21 be a stronger competitor and that's going to  
22 lower prices and that's going to reduce my return

1 and I just don't want to do it. That's not going  
2 to happen right away.

3 It's going to happen over time. So  
4 what are you going to do with that case? You are  
5 going to do what? You are going to do some long  
6 run, short run trade-off? You're going to --  
7 what are you going to do?

8 DOUGLAS MELAMED: Well, wait a minute.  
9 As you stated, those words would have been  
10 Microsoft's defense to a refusal to let Netscape  
11 use its APIs.

12 And yet, Carl, I have a hunch that you  
13 would find a violation if Microsoft had refused  
14 to let Netscape use its APIs because you would  
15 have said what conceivable efficiency purpose,  
16 what benefit to consumers, what profit  
17 enhancement other than driving a competitor out  
18 of business and raising entry barriers or  
19 increasing market power is going on here.

20 HEWITT PATE: I'm not sure if Carl's  
21 name tag is really still up or not.

22 CARL SHAPIRO: You should be careful

1     about your hunches for one thing.  But maybe  
2     you're saying then if there was an ongoing  
3     historical pattern of disclosing the APIs then  
4     they might want to continue it.

5                     That seems to me different than saying  
6     just because somebody has interfaces and they are  
7     valuable that they should be disclosed.  So now  
8     you have retreated it seems to me into the  
9     category of ongoing patterns of dealing rather  
10    than a broader principle of imposing duties when  
11    there is not ongoing.

12                    DOUGLAS MELAMED:  I didn't mean to say  
13    as a matter of principle.  I'm saying plaintiff  
14    has an evidentiary burden.  He has to prove that  
15    this doesn't make any sense.  And obviously if  
16    there were an ongoing patent it would help him.  
17    But I wouldn't get there as a matter of  
18    principle.

19                    MARK WHITENER:  Well, I have no priors  
20    on Microsoft.  So it doesn't make any sense.  
21    What does that mean?  What you just described  
22    sounded to me like a pure simple refusal to share

1 intellectual property which I think as an  
2 actionable offense falls flat.

3           And I thought Carl made the -- in his  
4 point, counterpoint with himself on some of the  
5 issues -- the side that won out seems to me was  
6 the side that said you ought to be able to  
7 re-examine your decision making.

8           That is to say, the fact that you  
9 might have let something out of the bag before  
10 and licensed it or shared it shouldn't prevent  
11 you from later re-evaluating that decision. It  
12 may have some consequences in the market that  
13 people design around, lock in, whatever.

14           I'm not saying it's irrelevant. But  
15 it seems to me that for the most part you ought  
16 to be able to re-examine that question and make a  
17 new decision later based on the facts before you.

18           CHRIS SPRIGMAN: Doug, was your  
19 Microsoft hypothetical dependent on leveraging  
20 and that the operating system was going to be  
21 different from whatever market it is they were  
22 not disclosing the APIs?

1                   Because if not, I don't know how it's  
2                   any different from refusing to license my patent  
3                   to Viagra. I could get money for licensing my  
4                   patent to Viagra. And it's profitable for me not  
5                   to license that patent only because I get to keep  
6                   monopoly profits for the term of the patent.

7                   DOUGLAS MELAMED: Let me just say I'm  
8                   starting from the basic proposition that -- which  
9                   I thought everybody at least all the economists  
10                  here agreed on.

11                  And that is that unilateral  
12                  unconditional refusals to deal can under some  
13                  circumstances be anticompetitive. I believe  
14                  those circumstances all entail a sacrifice of  
15                  profits. I could be wrong about that being my  
16                  understanding.

17                  So all I'm really saying is not that  
18                  I'm the economist who can tell you the metes and  
19                  bounds of all of the -- when does anticompetitive  
20                  refusal to deal apply and when doesn't it, but  
21                  simply that we shouldn't be having a bunch of  
22                  legal rules that rule those off the table.

1           As for the Microsoft story, I was  
2     imagining the very same violation that every  
3     Judge has looked at found. A very conservative  
4     Court of Appeals found unanimously, and that is  
5     Microsoft sought to do in a competitor because  
6     the competitor threatened to lower barriers to  
7     entry to compete with its desktop monopoly.

8           And all I'm suggesting is if they had  
9     chosen instead of the variety of illegal things  
10    they chose an otherwise economically irrational  
11    decision not to let this particular competitor  
12    have access to its APIs.

13           And the fact finder could conclude  
14    as the fact finder did with all the things that  
15    Microsoft actually did that that refusal also  
16    served no legitimate purpose and was intended  
17    solely to insulate its desktop operating system  
18    from competition, that that should state a claim  
19    under the antitrust laws. That's all I'm saying.

20           BENJAMIN KLEIN: I think that what you  
21    are saying is that the once the market power gets  
22    to a significant level there is a different

1     burden. I mean you're really moving to an  
2     essential facility doctrine here. I know we hate  
3     that term. But somehow the APIs are an essential  
4     facility.

5                     That is the only way you can make  
6     sense of the argument because it does seem like  
7     legitimate business justification. Why should I  
8     license a competitor? I mean it has nothing to  
9     do with Ordoover/Willig. You just don't want to  
10    license a competitor and create competition.

11                    So I think you really are talking  
12    about an essential facility. And once you  
13    become a monopolist you might have additional  
14    obligations under the antitrust laws. I mean  
15    that's it. But I don't think it fits your  
16    framework.

17                    HEWITT PATE: Okay.

18                    CARL SHAPIRO: Well, we've cleared  
19    that up.

20                    HEWITT PATE: Now that we're cleared  
21    that up, I guess we're drawing to the end of our  
22    time. I'm not sure I'm in a position to sum up

1 accurately, particularly having gone AWOL for an  
2 hour or so.

3           But we have heard a lot of things,  
4 broad agreement that the CSU dicta is too broad  
5 and doesn't necessarily accurately reflect the  
6 state of the law at least as it relates to  
7 conditional refusals.

8           I think broad agreement with one  
9 exception that the pretext or subjective analysis  
10 doesn't really add anything to this. Some  
11 disagreement on whether IP is in some ways on a  
12 different footing than other property.

13           A consensus that unilateral refusals  
14 to deal are subject only to very narrow antitrust  
15 liability all around the table, but maybe a real  
16 disagreement about how narrow is narrow when you  
17 get down to it, and some objections to whether  
18 there should be liability at all chiefly because  
19 administrability and incentive reasons, perhaps  
20 because of the uncertainty created by private  
21 litigation.

22           We've heard about other possible



1 approaches revolving around price discrimination  
2 and otherwise. And I'm sure this is food for  
3 further thought and debate.

4 But I'd like to thank the organizers  
5 again and especially thank the panel members for  
6 what I think was a great presentation and invite  
7 all of you to be back tomorrow for settlements in  
8 the next installment of the hearings. Thanks  
9 very much.

10 (Conclusion.)

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