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3 DEPARTMENT OF JUSTICE ANTITRUST DIVISION

4 and FEDERAL TRADE COMMISSION

5

6 Hearing on:

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8 COMPETITION AND INTELLECTUAL PROPERTY LAW

9 AND POLICY IN THE KNOWLEDGE BASED ECONOMY

10

11 Session 1: Analysis of Specific

12 Licensing Practices

13

14 Session 2: Practical Issues Encountered in

15 Antitrust Analysis: The Problem of Dealing

16 with Uncertain or Disputed Patent Rights

17

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19 Tuesday, May 14, 2002

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

21 333 Pennsylvania Avenue, N.W.

22 Washington, D.C.

1 MORNING SESSION PARTICIPATING PANELISTS:

2

3 Morning Session: Analysis of Specific Licensing

4 Practices

5

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7 Shereff Friedman, Washington, D.C.

8 Joseph Farrell, Professor of Economics and Chair

9 Of the Competition Policy Center,

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3 Afternoon Session: Practical Issues Encountered

4 In Antitrust Analysis: The Problem of

5 Dealing with Uncertain or Disputed

6 Patent Rights

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1 MORNING SESSION HEARING MODERATORS:

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3 Michael L. Katz, Deputy Assistant Attorney

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6 David T. Scheffman, Director, Bureau of

7 Economics, Federal Trade Commission

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12 AFTERNOON SESSION HEARING MODERATORS:

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14 William Stallings, Department of Justice

15 John Hoven, Department of Justice

16 Suzanne Michel, Federal Trade Commission

17 C. Edward Polk, Jr., U.S. Patent & Trademark

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1 MORNING SESSION

2 (9:00 a.m.)

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

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

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

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

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

7

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

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

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

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

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

8

1 other forms of property.

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

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

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



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

22 Before we begin, I have to go over a

9

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

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

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

10

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

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

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

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

11

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

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

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

13 and what is it about these theories that are  
14 potentially unique or of special interest in  
15 the field of intellectual property.

16 Let me start out first by focusing  
17 on what are sometimes called the newer bundling  
18 theories or conglomerate theories of bundling.  
19 And in those, an article by Mike Whinston  
20 certainly provides one of the first theories.  
21 And I'll be focusing on what may be the most  
22 commonly discussed variant of Whinston's model.

12

1 What Whinston does is he starts out  
2 looking at a market with a monopolist in both  
3 markets A and B. And the monopolist faces a  
4 problem. The problem it faces is that it expects  
5 entry in one of these markets. Let's call it  
6 market B. And it's trying to dissuade that  
7 entry.

8 Now, one way it might try to dissuade  
9 entry is to say, well, gee, if you come into  
10 my market B, I'm going to set extraordinarily  
11 aggressive prices and you'll make no money. The

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

13

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

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

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

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

14

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

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

10           And the existing monopoly is  
11 sustainable absent a browser because the software  
12 can't achieve compatibility with the competing  
13 operating system. So the solution to this  
14 problem again is achieved through bundling.

15           And what the monopolist does is it  
16 introduces its own browser, bundles its operating  
17 system to the browser, and by doing so it  
18 essentially -- it creates a type of chicken  
19 and egg problem in which now with the bundled  
20 browser, the new browser -- the entrant  
21 browser -- cannot achieve compatibility with  
22 the operating system.

15

1           That means that future software can't  
2 achieve compatibility with a rival operating  
3 system. And so again the bundling under this  
4 theory -- and I know I'm running through this  
5 awfully quickly -- but the bundling again  
6 dissuades entry into the monopoly market.

7           It's again a little bit different  
8 from the earlier variants of bundling theory.

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

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

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

22 And his results show that in fact with

16

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

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



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

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

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

17

1 because he doesn't own the beer firms.

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

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

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

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

18

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

5           So it's a model in which the bundling

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

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

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

1 products.

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

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

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

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

1 also issues of reducing double marginalization.

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

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

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

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

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

22 Certainly with a patent, depending on

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

3 nothing else, does that IP power then somehow at  
4 least get you over the first hurdle of most  
5 bundling theories?

6 Bundling theory says before we pass  
7 go, you need to show market power. The IP may  
8 provide that. You pass go and therefore, if  
9 nothing else, get a little more justification  
10 for concerns with bundling.

11 Cautioning however that this market  
12 power is just a necessary condition, not a  
13 sufficient condition, you still need to go  
14 through all the other steps of assessing whether  
15 or not these bundling theories apply even once  
16 you have market power.

17 I want to skip this last point  
18 about limited duration, just because I think  
19 I'm brushing up against time constraints, and  
20 talk about the incentives to block entry.

21 And here the point is that with so  
22 many -- with much of intellectual property --

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

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

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

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

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

1 back.

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

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

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

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



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

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

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

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

22           And lastly, just the caution that

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

4 (Applause.)

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

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

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

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

8           The rule would be wrong for reasons  
9 that we'll explore throughout the day today. But  
10 at least clients would be able to understand what  
11 they can and cannot do. Unfortunately the rules  
12 are totally far from clear. First of all, the  
13 agencies do not apply a per se rule. Some courts  
14 do. Some courts don't.

15           We have a statute that applies to  
16 patents but not other forms of intellectual  
17 property. Section 271(d) of the patent code  
18 applies a different standard to patent misuse  
19 defenses, and it's unclear whether that standard  
20 extends to antitrust violations arising out of  
21 patent based tying as well.

22           History and economic analysis tell us

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

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

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

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

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

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

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

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

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

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

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

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

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

30

1 have followed that as well.

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

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

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

19 Most clients are not quite that ready

20 to spend millions of dollars on legal fees. And  
21 the advice to them has to be the cautious advice  
22 which is, please, don't do it; the risk is too

31

1 great.

2 How do we get these conflicts  
3 fixed? Well, the best solution would be for  
4 the Supreme Court to address a case involving  
5 tying, involving intellectual property tying in  
6 particular, and deal with these issues once and  
7 for all.

8 But the Supreme Court, particularly in  
9 recent years, has truly abdicated the antitrust  
10 function. We have not seen the Supreme Court  
11 grant cert. in an antitrust case in three years.

12 The last opportunity to take a tying case was  
13 Microsoft. That case was turned down.

14 The Digidyne case many years ago  
15 spawned dissent from a denial of certiorari by  
16 Justices Blackmun and White. But still we have  
17 no answer from the Supreme Court. There are few  
18 cases in the courts of appeals that are really



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

32

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

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

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

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

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

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

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

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

17           That's a general standard that has a  
18 lot to commend it. But in this particular  
19 instance we had a very clean statute that could  
20 have helped the situation. In any event, it  
21 wasn't passed. There have been hearings again in  
22 November of this year in the House. There's no

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1 bill pending.

2           I think the odds on getting a  
3 legislative fix to the problem are small. If  
4 there is a legislative fix, one might speculate  
5 what might get appended to such legislation and  
6 whether that's something we really want at the  
7 end of the day.

8           So what's the good answer? I don't  
9 think there is a good answer. The best solution  
10 that I can propose particularly to the Department  
11 of Justice and Federal Trade Commission is to  
12 revive the amicus programs. Certainly Justice  
13 and FTC have been very active in their amicus  
14 programs in the past.

15           But actively seek out cases involving

16 bundling. Actively seek out cases involving  
17 intellectual property bundling in particular.  
18 Get in at the District Court level. Get in at  
19 the Circuit Court level. Try to find a case that  
20 can be taken up to the Supreme Court.  
21           And I think that is the prospect that  
22 holds out the most hope for addressing the legal

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1 problem that we face today. Thank you very much.

2           (Applause.)

3           MICHAEL KATZ: Thank you, Jonathan.

4 Actually without wanting to throw cold water on  
5 that, I know wherever I go I always carry a copy  
6 of Jefferson Parish with me.

7           And in their concurrence, Justices  
8 Brennan and Marshall actually noted or pretty  
9 strongly hinted that they thought the per se  
10 treatment was a silly way to go.

11           But they said, look, that's what we've  
12 done for years; Congress knows we do that; if  
13 Congress wants to change it, they will, and  
14 therefore we're going to keep doing it until

15 we're told by Congress not to, so that's at least  
16 two people's view on the division of labor  
17 between them.  
18 Let me start I guess in some sense  
19 with a ridiculous question, but that's the beauty  
20 of being a moderator. Does anybody think that  
21 Jefferson Parish provides a sound basis for the  
22 treatment of tying? Do we have any defenders up

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1 on the panel?  
2 JONATHAN JACOBSON: Let me say that  
3 the per se rule -- I'm probably one who thinks  
4 that it's less insane than others. I think it  
5 clearly creates far too many false positives.  
6 But the number of cases in which the  
7 defendant or practitioner cannot devise ways of  
8 achieving the same efficiencies without tying is  
9 relatively small. So the number of true false  
10 positives I think is not as egregious as most  
11 people think.  
12 Having said that, the rule plainly  
13 does not meet the standard for per se analysis,

14 always or almost always harmful to competition,

15 and therefore has little to commend it.

16 MICHAEL KATZ: Anybody else?

17 DAVID SIBLEY: Continuing in the same

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

19 you have to think about what the alternative is.

20 And one important element of the

21 alternative is how difficult and subtle would the

22 analysis have to be in order to disentangle the

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1 effects of tying if you really wanted to do a

2 rule of reason approach.

3 And I think the first presenter,

4 Dr. Vistnes, gave us a very good idea that that

5 analysis might have to be very subtle indeed.

6 MICHAEL KATZ: Let me ask a question

7 specifically about IP. In Jefferson Parish it

8 talks about a presumption that if a patent has

9 been granted that that gives the market power and

10 raises concerns about tying and IP because the

11 market power is there.

12 Something Greg Vistnes didn't touch

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

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

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

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

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

12 lower marginal price leads to better allocative  
13 efficiency.

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

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

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1 to consumers.

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

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



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

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

19           JOSEPH FARRELL: Unfortunately, yes.

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

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

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

9           I do believe, for example, let's

10 take Microsoft, that although there are clearly  
11 efficiencies in bundling the browser into the  
12 operating system, what are the efficiencies on  
13 precluding the use of alternative browsers  
14 through arrangements with OEMs, for example?

15 I think in that kind of context the  
16 use of the per se rule albeit wrong is not as  
17 harmful as we might otherwise expect. There are  
18 alternatives for Microsoft like telling -- like  
19 not telling Dell don't bundle Netscape into your  
20 startup screen.

21 Having said that, the per se rule  
22 creates enormous cost in terms of firms without

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1 market power and with intellectual property  
2 rights trying to figure out the best way to  
3 exploit those rights.

4 It can have a significant deterrent  
5 effect on small firms trying to enter a market  
6 where metering-based pricing through a tying  
7 arrangement may be the best way to exploit the  
8 intellectual property rights and achieve a

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

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

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

22 When you're looking at products that

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

7 But for some of these software

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

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

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

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

1 potential harmful effects of the tie-in doctrine  
2 on a lot of firms without any source of market  
3 power, what you're really saying is that product  
4 combination decisions like things that can be  
5 characterized as ties ought to be presumptively  
6 lawful, that there ought to be a presumption that

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

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

18           The real problem is that the rule is  
19 potentially applicable to an enormous range of  
20 harmless commercial decisions which nevertheless  
21 tend to attract involvement with law enforcement  
22 and the civil justice system. And that can

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1 impose an enormous cost and deadweight loss.

2           MICHAEL KATZ: We touched on a number  
3 of issues that we'll keep coming back to this  
4 morning. But in my role as moderator I'm going  
5 to just move us ahead blindly despite having a

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

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

8 Our next speaker is Gregory Sidak who

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

10 Economics Emeritus at the American Enterprise

11 Institute for Public Research and the president

12 and chief executive officer of Criterion

13 Economics LLC, an economic consulting firm based

14 in Washington, D.C.

15 I understand that Greg is going to

16 talk about some of the difficulties associated

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

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

19 talk about what the prices are.

20 And I think he's going to draw on

21 some of his considerable experience in telecom

22 regulation to talk about what can happen when you

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1 try to do that.

2 GREGORY SIDAK: Thank you. I do want

3 to say something very briefly about liability

4 rules before going on to the pricing issues which

5 I regard as more remedial in nature.

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

14 And I think that the Microsoft case is  
15 a good example of this. David Sibley's theory  
16 there of partial substitutes where products that  
17 were once complements could change in their  
18 relationship, a browser could become the basis  
19 for an eventual substitute to an operating  
20 system, is a very interesting idea.

21 Although I certainly have some  
22 critical views of the Microsoft case, I think

1 that the partial substitute theory of liability  
2 in a bundling context is something that should  
3 be taken seriously and is probably the most

4 provocative theory for a new cause of action in  
5 antitrust since the raising rivals' cost  
6 literature a decade or more earlier.

7           But that leads me to my next point.  
8 If we want to try to give some additional flesh  
9 to that theory, I think there needs to be more  
10 formal analysis by the economists of how the  
11 process occurs within consumer demand theory that  
12 a complement turns into a substitute.

13           And I think that's something that  
14 wasn't so clearly articulated in the Microsoft  
15 case and something that I think would be useful  
16 as a matter of academic research and policy  
17 analysis.

18           Having said that, let me turn to the  
19 remedy issue. So much of the discussion of tying  
20 issues focuses on whether there is or is not  
21 liability. But let's assume that you find  
22 liability. Then what?

1           Presumably the rule against tying does  
2 not mean that a firm cannot offer product A and



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

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

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

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

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

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

12 Simplify the facts.

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

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

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

9           The idea of long run incremental cost  
10 and the TELRIC rule was to figure out what that  
11 piece of the network would cost to replicate  
12 given an efficient design of the network at this  
13 point in time looking forward, and not to focus  
14 on historical cost.

15           So think about applying that in the  
16 tying case. Suppose we do have a situation  
17 where liability is found, particularly in an  
18 intellectual property situation. And the tying  
19 piece of intellectual property now has to be  
20 offered on an unbundled basis.

21           Well, one approach to doing the  
22 pricing is a top down approach where you take

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

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

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

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

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

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

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

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

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

1 where there are findings of liability, the TELRIC  
2 pricing approach is as likely as any to be  
3 adopted by an antitrust court because it has  
4 gotten the stamp of approval from the Supreme  
5 Court as being a reasonable approach to the  
6 pricing of unbundled elements.

7           And it seems to me that an antitrust  
8 court that has found that a firm has -- which has  
9 been an unregulated monopolist if you will and  
10 has been found to have violated the antitrust  
11 laws, it seems to me that that court is going to  
12 be very content to apply a TELRIC model which has  
13 been applied in a regulated industry context to a  
14 firm that hasn't been found to have violated the  
15 antitrust laws and has been subject to rate  
16 regulation over a period of years and enjoyed a  
17 statutory monopoly.

18           So I would guess that we will see  
19 pricing controversies of this sort in the future  
20 once -- if and when there are more findings of  
21 liability in this context.

22           MICHAEL KATZ: Thank you.

1 (Applause.)

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

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

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

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

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

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

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

12         And he's actually quoting from Judge  
13 Acker, but anyway, I'll explain all that in a  
14 minute. But I want to focus my remarks  
15 completely on essentially the third question that  
16 Michael Katz posed at the beginning of these  
17 hearings:

18         How can the courts deal with the  
19 complexity of the issues both to reach the right  
20 answers and to give private parties some ability  
21 to predict how their licensing practices will be



22 treated? The history of the evolution of the

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

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

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

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

21 eventually be abandoned. And I think they will.

22           It's true that twenty years ago no

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1 less an authority than Donald Turner was  
2 referring to the per se rule on tie-ins as  
3 "ridiculous". So if Donald Turner puts a  
4 shoulder to the wheel and we still can't get  
5 anywhere, I suppose there might be grounds for  
6 pessimism.

7           But I'm going to ignore them. I'm an  
8 optimist. And I think that eventually the real  
9 question will be how do we actually analyze, how  
10 do we bring to bear the proper expertise to  
11 evaluate the procompetitive and anticompetitive  
12 effects of tying, bundling, exclusive grantbacks,  
13 royalty terms -- royalty provisions that go  
14 beyond the term of an intellectual property  
15 grant, all the other areas that have been subject  
16 to per se rules either under antitrust or the  
17 misuse doctrine.

18           Now, I'm sure that the antitrust  
19 economists on this panel and in this room will be

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

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

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

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

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

19 expert testimony goes in federal civil trials.

20           And I think one of the remarkable

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

22 in antitrust cases following Daubert that

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1 reject -- where a trial judge sometimes rejects

2 testimony or an Appellate Court -- even more

3 embarrassing, an Appellate Court reverses a

4 decision to admit expert testimony.

5           And these courts are not afraid of

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

7 of the testimony has been rejected under the

8 Daubert rule in antitrust cases coming from

9 people who have tenured positions at leading

10 American universities. And a couple of them have

11 Nobel Prizes in economics.

12           So the courts are not shy about

13 exercising this discretion. But in addition

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

15 personal opinion that the Daubert court was

16 actually -- actually had a precursor in antitrust

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

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

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

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

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

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

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

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

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

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

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

16 evaluating the pro- and anticompetitive impact of  
17 all these various patent licensing practices, we  
18 are going to need institutions superior to those  
19 that we have now to generate improvements in the  
20 quality of economic analysis.

21           And I've outlined some things that  
22 I've thought of that might go in that direction

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1 somewhat along the lines that Justice Breyer has  
2 been suggesting in his public speeches and to  
3 some extent also in his opinions.

4           The National Academy of Sciences  
5 does appoint members in the category of economic  
6 science. They are an extremely distinguished  
7 group.

8           But the only stated criterion for  
9 membership is distinguished and continuing  
10 contributions to original research, not very  
11 specific from the standpoint of the objectives of  
12 antitrust litigation.

13           I've also sort of poked and prodded  
14 around the American Economic Association to see

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

19           They are not interested. The AEA is  
20 extremely sensitive to any activity that could be  
21 characterized as creating a professional barrier  
22 to entry. And so they are not interested in this

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1 little project. That's fine. But I think that  
2 there are some other avenues.

3           There's of course the ability to  
4 appoint an expert that every District Court has  
5 under Rule 706(a). Perhaps the continued  
6 implementation of the Daubert rule will lead to  
7 more frequent resort to that rule.

8           There are other devices that have been  
9 used, the use of a particularly skilled law clerk  
10 as in Judge Wyzanski's rulings in the United Shoe  
11 Machinery cases back in the 1950s where Carl  
12 Kaysen was his law clerk, not a very happy  
13 model to use.



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

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

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

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

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

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

17 MICHAEL KATZ: Thank you.

18 (Applause.)

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

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

3 People having Daubert motions brought  
4 against them successfully, certainly the legal  
5 profession seems to keep track of who's been  
6 Dauberted. Do you think that's going to start  
7 affecting the behavior of experts? And will it  
8 be a good effect?

9 TAD LIPSKY: I think it already has.  
10 But I would rather hear from other panelists on  
11 the issue.

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

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

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1 any consulting firm.

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

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

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

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

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

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

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

10 lawyers on each side.  
11           It's good to have someone bring in  
12 what's really the central content of an antitrust  
13 case and have the fact finder wrestle with  
14 different opinions. It is a benefit to the  
15 system. And I think Daubert is working well and  
16 is affecting the process and it will work itself  
17 out.

18           MICHAEL KATZ: I'll just throw in my  
19 own two cents worth. One thing that actually  
20 strikes me as a little peculiar about the entire  
21 gatekeeper role is that it seems to be saying  
22 that the jury is not competent to evaluate what

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1 the expert is saying about the antitrust case,  
2 which seems to me then raises a fundamental issue  
3 of what it is the jurors are competent to do in  
4 an antitrust case.

5           If they can't judge the truthfulness  
6 of the central witness, that seems to me actually  
7 a serious question whether they can do anything  
8 useful. But let's move on to some other topics.

9 JOSEPH FARRELL: Sorry. Can I have --

10 MICHAEL KATZ: Sure.

11 JOSEPH FARRELL: I'd just say I  
12 haven't followed this issue closely. But I have  
13 read one or two of the Daubert opinions. And  
14 in one case I was pretty unimpressed with the  
15 judge's reasoning behind excluding the witness'  
16 testimony.

17 So we shouldn't assume that this is  
18 going to be a very well functioning mechanism if  
19 it's mediated through penalty on being excluded  
20 as opposed to careful consideration of what the  
21 witness said and whether it made sense.

22 GREGORY SIDAk: I agree with that.

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1 I think that of the three well known cases that  
2 I'm aware of, one of them was an egregious false  
3 positive.

4 MICHAEL KATZ: Let me then go  
5 back to what Greg was saying about seeing the  
6 possibility of TELRIC now being used in antitrust  
7 cases as ensuring that understood bundling is

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

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

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

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

6           JOSEPH FARRELL: Well, let's see.

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

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

16 But I don't want to make too much of  
17 that because that might be heard as suggesting  
18 that you could do this well. And I'd just like  
19 to say the Telecommunications Act is not regular  
20 antitrust law. I don't think anybody thought it  
21 was. There's a reason it's a separate act.

22 It's kind of an emergency measure to

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1 de-monopolize an industry that is extraordinarily  
2 difficult, extraordinarily difficult to  
3 de-monopolize.

4 And when we talk about tying and  
5 bundling policy in general in antitrust, the goal



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

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

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

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

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

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

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

6 antitrust unbundling cases.

7 MICHAEL KATZ: Joe, let me put you on

8 the spot. For one thing we talked earlier about

9 marginal cost being zero.

10 And you said -- I took your answer to

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

12 use some sort of cost floor to judge whether the

13 behavior should be allowed under the antitrust

14 laws or not because you get a floor of

15 essentially zero.

16 And I thought you were saying that

17 that was too shortsighted a view of what should

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

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

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

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

22 alternative approach you would recommend?

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1 JOSEPH FARRELL: In the case of IP

2 bundling you mean?

3 MICHAEL KATZ: Yes, right.

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

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

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

1 does this structure get in the way.

2           So given that I find that initially

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

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

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

1           He also was my successor as chief

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

8 (Technical support discussion.)

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

15 (Technical support discussion.)

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

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

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

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

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

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

1 I'll be talking about that in a way.  
2 But my concern is really more with having signed  
3 a contract, can folks get out of it efficiently.  
4 So I guess I call this efficient withdrawal from  
5 an IP contract.

6 Suppose we have two firms that are  
7 considering licensing the current state of the  
8 art from an IP holder knowing that at some future  
9 date a new state of the art is going to arrive  
10 and there will be some IP holder that has that.

11 Now, their choices are: Don't  
12 license the current state of the art; go on with  
13 something kind of clunky and not very good and  
14 wait for the new IP to come along and sign with  
15 the new guy when he does come along;

16 Or to sign a contract with the owner  
17 of the current IP, and that contract might  
18 perhaps exceed the length of time that it would  
19 take for the new contract to arrive.

20 Now, if one does sign a contract with  
21 the current IP, then when the new one comes along  
22 a licensee might want to sort of get out of the

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

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

3 be a kind of classic IP issue. Economists all

4 the time talk rather blithely about new

5 technologies coming along, and of course people

6 sign up with the new technology.

7 But there isn't much thought given

8 to how long that takes; does the process of

9 switching customers from the old one to the new

10 one happen in a particularly good way.

11 And that's really what my talk is

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

13 whether they are IP or otherwise have abrogation

14 clauses. I've read a number.

15 And a lot of them say that if you walk

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

17 you have to compensate the current IP holder for

18 the direct and indirect harm caused by your

19 withdrawing from the contract which in many cases

20 is an unexceptional sort of idea.

21 But there may be cases in which that

22 leads to unexpected effects. Suppose, for



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

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

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

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

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

1 he is at an increasing rate.

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

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

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

18 Now, one benchmark economists always  
19 use and which to a large extent is embodied in a  
20 lot of antitrust principles as well is economic  
21 efficiency.

22 And in this case economic efficiency

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

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

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

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

22           So there's a coordination problem.

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

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

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

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

21 Why wait, because of time discounting.

22 Well, in this case they wait. And in

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

7 The result is they wait a long time.

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

12 You could rationally it turns out have  
13 a situation in which one of the two licensees  
14 doesn't sign with the current IP. He just waits  
15 for the new IP to show up and then puts all of  
16 his output into that.

17 In that case the one who has signed  
18 clearly will withdraw right away because there's  
19 no coordination problem then. But there's still

20 an economic cost because the one who did not sign  
21 the contract with the current IP uses a less than  
22 currently state of the art technology and until

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1 new IP comes along.

2 And he only does that because of his  
3 coordination problem that I've described. So  
4 whether one licensee signs the contract or both  
5 licensees sign the contract, there's still an  
6 economic cost.

7 Now, some implications here.  
8 Long-term contracts can be particularly  
9 exclusionary if the owner of the current IP  
10 enjoys economies of scale in the way that I've  
11 suggested here.

12 And the exclusion doesn't necessarily  
13 come about because of nefarious acts by the owner  
14 of the IP. It simply comes about because of the  
15 interaction of this abrogation clause which is  
16 quite a common one and the presence of scale  
17 economies.

18 The current IP owner doesn't actually

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

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

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

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

18 right away.

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

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1 that easy to do.

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

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

11           Now, if that's the way contracts look,  
12 that would get around all these problems.  
13 However, if you've read the Aghion and Bolton  
14 paper, it may give rise to other ones, i.e. the  
15 ones that Aghion and Bolton talked about.

16           So I guess that's all I'll say except



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

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

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

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

9 MICHAEL KATZ: Thank you.

10 (Applause.)

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

15 JOSEPH FARRELL: It's not my fancy

16 background to do the PowerPoint I'm happy to tell  
17 you. There we go. All right. Bundling, as I  
18 said earlier, is in some sense about two  
19 questions. And it's important not to confuse  
20 them.  
21 In the case of intellectual property  
22 bundling, it seems to me that the second question

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1 takes on a slightly different, perhaps very  
2 different slant from what it does in generic  
3 industries.  
4 So the competitive analysis of  
5 bundling is partly about how bundling affects  
6 users' -- buyers' -- willingness to go without  
7 the product, in other words, how it affects  
8 demand.  
9 And in that part of the analysis you  
10 think about the pro-efficiency benefits of  
11 reducing the marginal price towards marginal  
12 cost. And you perhaps also think about the  
13 effects on pricing decisions of existing firms of  
14 having the bundling.

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

21           So the second part -- now that's  
22 interesting and it's worth thinking about.

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1 And it's relevant certainly for the antitrust  
2 analysis. But it's not central to the antitrust  
3 analysis I think, if I can make that distinction.

4           What I think is more antitrust-like  
5 and also at least as relevant to the antitrust  
6 analysis is what effect does this practice  
7 have on somebody else, an existing rival or a  
8 potential entrant who might be interested in in  
9 some way in offering a better deal.

10           And can bundling be a barrier to  
11 entry? Can it cause rivals to exit? Can it  
12 cause rivals to raise their price and thus reduce  
13 their willingness if not their ability to offer a

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

9           And when that patent expired it looked

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

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

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

1 goods.

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

8           And so the intellectual property



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

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

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

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

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

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

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

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

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

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

10 (Applause.)

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

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

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

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

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

7 actually work.

8           JOSEPH FARRELL: In some cases it

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

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

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

12 Journal of Industrial Economics, 1992, Professor

13 Katz and Professor Shapiro published a paper,

14 "Product Introduction with Network

15 Externalities."

16           And buried in the appendix to that

17 paper and apparently unknown as far as I can tell

18 to both of its authors at this late date is the

19 answer to that question.

20           And it turns out that if you do a

21 sophisticated, sublime, perfect analysis of this

22 question, if the quality difference is large

1 enough that the superior technology will still

2 win even after losing one day's or one cohort's

3 or one generation's adoption, okay, and that may

4 be a large threshold or a small threshold

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

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

17           MICHAEL KATZ: While you're correcting  
18 my economics, I'll correct your grammar. I  
19 believe what's there is not the answer. It's an  
20 answer. It was in the appendix for a reason.

21           Let me ask Professor Sibley. You  
22 talked about the implications of your analysis.

1 If you could talk about the antitrust  
2 implications of your analysis or the policy  
3 implications as you see them. I guess I'd ask

4 about two parts to that as well.  
5 One is you were talking about if  
6 I understand correctly situations where these  
7 problems could arise in some sense innocently  
8 because the -- I take it the way you had it, if  
9 one thought about intent it was that the licensor  
10 just said, look, I want to internalize these  
11 effects; I'm being harmed if people pull off; I'm  
12 trying to internalize it, and lead to  
13 coordination problem, being completely innocent.

14 Certainly there's also the possibility  
15 that absent the underlying economies of scale or  
16 any sort of technological reason you just say,  
17 look, I'm going to have a big penalty for pulling  
18 off because I want to try to lock people in. I  
19 was wondering if you could address each of those  
20 situations.

21 DAVID SIBLEY: Sure. I don't want  
22 whether this exists, but there is the possibility

1 that the current IP owner might have said the  
2 first guy to leave has to buy me a new toaster or

3 some sort of penalty to being the first one to

4 leave.

5 I suppose it's -- this represents

6 thinking beyond what I've done. But in a court

7 setting one might find that claimed economies of

8 scale were sort of claimed basically to create

9 this coordination problem and in fact may be

10 rather slight.

11 It could also be the case that perhaps

12 if we wanted to look for possible malignant

13 intent by the owner he might do things which

14 would create those economies of scale whose only

15 intent would be to create this particular

16 coordination problem.

17 Apart from a particular wrinkle on

18 exit from contracts that I was talking about

19 today, I should point out that a lot of contracts

20 I've read do have other disincentives to people

21 leaving.

22 For example, if you were licensing a

1 technology to someone and you said that the basic

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

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

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

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

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



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

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

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

17           It's simply that because of this  
18 coordination problem if you leave it -- let them  
19 do it in a decentralized way -- they won't do it  
20 very efficiently. You could also get rid of this  
21 simply by having a dictator, someone saying you  
22 go first or never mind the contracts; here's what

1 you pay.

2 MICHAEL KATZ: I have another question

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

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

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

6 It seems like you have enunciated an

7 antitrust principle today or a policy basis which

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

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

10 tell anybody in advance what that is.

11 So let me ask how people would advise

12 their clients in that world. And obviously the

13 serious question is you have identified some of

14 the problems that have this sort of cost based

15 rule that clearly has a problem.

16 You've talked about how it makes a lot

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

18 a welfare standard, to ask does the practice harm

19 welfare or not.

20 But the serious issue as you know of

21 course is if things are that fact intensive and

22 that detailed, is there any way for the parties

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

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

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

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

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

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

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

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

10 It's my -- this goes back to the  
11 question that David asked earlier. It's my sense  
12 that at least in the case of bundling practices  
13 the degree of efficiency loss from not being able  
14 to tie as opposed to achieving the business  
15 objectives through some other means is rather  
16 limited. It's real.

17 It's particularly real in the case of  
18 the IP presumption where we're presuming market  
19 power for people that really just don't have any  
20 at all.

21 But in general if you follow the  
22 Brandeis approach in the tying context you will

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

4 MICHAEL KATZ: Greg Vistnes?

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

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

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

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

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

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

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

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

22 think he would that no agency for a long time

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

2 simply per se basis.

3 They would think that they had a

4 bona fide monopoly and a bona fide theory of

5 anticompetitive effects. And then intent

6 evidence is certainly of some relevance.

7 Jonathan, I'm curious when you talked

8 about counseling you didn't talk about who were

9 the likely plaintiffs here. Bringing an

10 antitrust case is very expensive.

11 So I presume one of the discussions is

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

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

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

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

16 you're probably not going to get sued.

17 Now, there are instances certainly of

18 those others where you are going to get sued

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

20 question solve a lot of the problem or not?

21 JONATHAN JACOBSON: Absolutely.

22 Absolutely. The rules on antitrust injury and

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1 standing limit the set of plaintiffs in the  
2 outset. The number of cases where the federal  
3 agencies get involved is very limited.

4 Unless you're dealing with a very high  
5 profile technology or you're really stupid, you  
6 are not going to get into federal agency  
7 difficulty on most counseling situations.

8 And the likelihood of getting sued is  
9 fairly small. So you can be fairly aggressive.

10 On the other hand, given the state of the law  
11 today you just can't advise a client that has an  
12 intellectual property right that it's okay to tie  
13 with a patent or copyright. It's just too  
14 dangerous.

15 TAD LIPSKY: And bear in mind I think  
16 that the practical impact of these rules is not  
17 necessarily felt strictly in the counseling  
18 situation.

19 I think the unfortunate aspect, the



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

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1 infringement suit.

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

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

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

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

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

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1 question about it. I certainly agree with what  
2 you're saying. I have in fact been involved in  
3 litigation where that's exactly what happened.  
4 It involved package licensing.

5           But all of that said, it seems like  
6 package licenses are actually fairly common. And  
7 so it seems like companies in fact are not being  
8 deterred from engaging in that form of bundling.  
9 I was wondering if you could sort of respond  
10 to that.

11           JONATHAN JACOBSON: Michael, I think  
12 you'll find that package licenses are extremely  
13 common, but the offer is not an all or nothing  
14 offer which will take the client out of the tying  
15 situation, an element of the offense being  
16 coercion.  
17           So I think most package licensing

18 contexts, at least that have been advised by  
19 counsel, involve an alternative other than the  
20 package license. Now, that invariably in a close  
21 case will get you into the issues that Greg was  
22 talking about earlier, you know, what's the

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1 price.

2 But one way to package licenses and  
3 not get immediately hauled into Federal District  
4 Court is to make sure there's an alternative  
5 available.

6 MICHAEL KATZ: As you were saying you  
7 immediately get into instead of saying it's a  
8 coercive package you hear that it's a coercive  
9 pricing. And you get in these endless debates  
10 about whether there are realistic alternatives  
11 or not.

12 JONATHAN JACOBSON: Yes, but the  
13 courts have really closed the door pretty much  
14 all the way on those claims, and the number of  
15 claims of that nature that succeed are small.  
16 They are very difficult to pursue. And the

17 safety net for the client is reasonably tight.

18 MICHAEL KATZ: So does that suggest in

19 fact for intellectual property that bundling is

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

21 careful to have it all realistic looking or

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

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1 for the individual prices that then you're home

2 free?

3 JONATHAN JACOBSON: Maybe not all the

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

5 efficiency in really insisting that the entire

6 package be taken as opposed to offering the

7 ability to take lesser included of the entire

8 package.

9 TAD LIPSKY: This is a comment and

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

11 the key precedent on this bundled pricing issue

12 has been -- for plaintiffs anyway -- the

13 SmithKline case in the Third Circuit which now

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

15 petition for rehearing -- I can't remember

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

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

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

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

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

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

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

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

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

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

13           And, Joe Farrell notwithstanding, the

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

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

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

22           It's very similar to the rationales

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

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

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



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

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

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

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1 a sense ought to take over the world.

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

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

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

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1           I think that is one of the problems  
2 at the root of the question of the legality of  
3 tie-outs. And I don't know what the solution is,  
4 but I think it's a problem that needs to be  
5 thought about.

6           MICHAEL KATZ: Then we will now take a  
7 short break for about 15 minutes. And when we  
8 come back, we will talk about patent extension.

9           (Recess.)

10           MICHAEL KATZ: What we're going to  
11 do up until noon for the remainder of this  
12 morning's session is talk about patent extension.

13           And the format is going to be that  
14 Rebecca Dick is going to make a presentation and  
15 then David Sibley and Joe Farrell are each going  
16 to have some comments from economists'  
17 perspectives on these issues as well.

18           Rebecca practices antitrust law at  
19 Swidler Berlin where she handles both merger and  
20 civil conduct matters and specializes in the  
21 intersection between intellectual property and  
22 antitrust.

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

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

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

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

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

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

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

4 Most patents and copyrights expire on  
5 time effectively and pass into the public domain  
6 or they are displaced even before that time in  
7 the marketplace by newer and better innovations.

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

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

22           Package or pool licenses which we've

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

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

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

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

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

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

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

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

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

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

22           The principal U.S. patents however on

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

5 know-how.

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

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

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

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

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

3           And then a second question certainly



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

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

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

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

1 could be predicted in terms of counseling  
2 clients.

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

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

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

1           But where the patent has already

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

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

12         A competing herbicide company,  
13 Chemical Products Technologies, filed a lawsuit  
14 alleging that in the waning months of the term of  
15 the patent, Monsanto went around to distributors  
16 who sell most of the herbicides that are sold.  
17 It's very hard to market allegedly to users,  
18 direct market to users in this business.

19         So Monsanto is alleged to have gone  
20 around to distributors and offered them volume  
21 discount and rebate arrangements that spanned the  
22 period of time from the last months of the life

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

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

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

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

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

1 patent.

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

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

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

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

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

1 to the venture that they will not compete against  
2 the venture, that they will devote all -- in the  
3 area of industrial effort that the joint venture  
4 is pursuing, that neither party to the venture  
5 will independently compete against it, that its  
6 undivided loyalty will be devoted to the venture.

7           And non-compete agreements often  
8 extend to IP that either is dedicated to the  
9 venture by one of the parties pre-existing IP or  
10 IP that the venture may develop on its own.

11           But in a circumstance where the other  
12 entity to the venture is a likely competitor, and  
13 in an extreme case this could lead to competitive  
14 problems, one of which is illustrated in the  
15 Department's LSL Biotechnologies case.

16           There was a joint venture aimed at  
17 developing a new tomato with a long shelf life.  
18 The goal was to develop a tomato that could be  
19 sold fresh in the markets in the wintertime that  
20 would taste a lot better than the tasteless  
21 rubber that's available now.

22           The joint venture developed such

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

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

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

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

22         And in any event the non-compete as

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

4           The Department's complaint alleges  
5 that the party that's foreclosed from selling in  
6 the United States, developing seeds for tomatoes  
7 to be grown and sold in the United States, is one  
8 of the firms worldwide most likely to develop an  
9 effective product.

10           It is a market in which there are very  
11 few competitors, a great deal of expertise is  
12 required, and the non-compete is having an actual  
13 effect on competition today. The case has not  
14 fared well in the courts however.

15           The District Court in Arizona  
16 dismissed the allegations relating to the sales  
17 of seeds in the United States for failure to  
18 properly allege the product in geographic  
19 markets, although the court did say that this  
20 part of the case was dismissed without prejudice  
21 and the court observed that it was likely that  
22 the Department could draft a complaint with



1 appropriate market definitions.

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

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

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

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

1 to effectuate the purposes of the joint venture.

2 Are there less restrictive, effective

3 alternatives?

4 And is it appropriate to weigh the

5 procompetitive effects of the venture against the

6 anticompetitive effects of the restriction? Is

7 the venture very narrow in scope and the

8 restriction enormous in scope?

9 Turning now to package or pool

10 licenses, as has been mentioned, it can be a very

11 efficient means for transferring IP rights. But

12 it can also offer opportunities to extend IP

13 rights, valuable IP rights.

14 It can kind of disguise the important

15 IP among a number of patents and make it hard for

16 licensees to either invent around or to determine

17 if the patent that they really need permission to

18 practice is about to expire.

19 One way in which a patent holder can

20 try to extend his patent's useful life is to

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

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

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

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

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

20           These were pools created by a number  
21 of different IP holders. Now, the requirement of  
22 having an independent expert doesn't fully

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1 address the problem because it examines only the  
2 necessity of the patent for making the product as  
3 the standard requires that it be made.

4           It doesn't look at the underlying  
5 design decision. But it does ensure that at  
6 least the patents named in the pool are necessary  
7 for making the product as designed.

8           Another way to use patent pools is to  
9 bundle -- as I mentioned at the outset here, is  
10 to bundle important IP with other patents and  
11 then refuse to provide licensees with a list of  
12 the covered products.

13           And this is alleged in the Echostar  
14 case against Gemstar which is currently pending.  
15 It's one of several pieces of litigation pending  
16 between those two companies.

17           But Echostar alleges that Gemstar has  
18 many, many patents, some important, and many that

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

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

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

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

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

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

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

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

17 strategic patent.

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

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1 possibility or likelihood of entry.

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

7           Again I think this is a difficult  
8 issue for the courts because as a practical  
9 matter many patent holders are unwilling to  
10 license their rights unless they get grantbacks  
11 on improvements.

12           And if the policy goal is to encourage  
13 licensing, this is likely to be an outcome that  
14 is a cost of that policy in favor of licensing.

15           I'd like to touch briefly on the

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

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

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1 And to some extent it has been successful. But  
2 it has been subject to manipulation by parties.  
3 And the FTC has filed what it calls two  
4 generations of cases. There has also been  
5 some private litigation.

6           The first generation cases involve --  
7 well, let me first summarize the statute. No new  
8 drug can be sold without FDA approval. Even if  
9 it's functionally similar to an already approved  
10 drug and it doesn't infringe on an existing  
11 patent, you still need FDA approval.

12           Under the Hatch-Waxman scheme, once a  
13 generic has applied for FDA approval a patent  
14 holder can allege infringement. And then there's



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

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

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

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

13           But it doesn't drop in a straight

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

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

22           In the first cases the FTC brought

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1 against two different pharmaceutical companies,  
2 each one faced a generic that was claiming to  
3 compete with one of its leading patented drugs.  
4 Each filed infringement litigation. Each then  
5 reached an agreement with the generic.

6           And the terms of these agreements vary  
7 to some extent. But in each case the generic  
8 agreed not to sell its own product until certain  
9 future events had taken place. And in the  
10 meantime the patent holder agreed to pay the  
11 generic millions of dollars.

12           Because the generic first in line had

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

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

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1 many months.

2           And the FTC in the year 2000  
3 challenged two of these arrangements. Both cases  
4 settled, one I believe right away and the other  
5 somewhat later. And there has since been a third  
6 case against Schering-Plough.

7           The FTC has said that it looks  
8 for three things when it's looking at these  
9 infringement settlements in cases involving a  
10 patent holder and generic.

11           First of all, it looks for reverse

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

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

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1 the generic.

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

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

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

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

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

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

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

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

10 antitrust perspective way to try to extend  
11 copyrights and patent rights is to get a law  
12 passed that does that.

13       The Disney Company recently heavily  
14 lobbied in support of the Sonny Bono Copyright  
15 Extension Act which extended rights -- certain  
16 rights for an additional twenty years. Otherwise  
17 Donald Duck and some other familiar characters  
18 would have gone into the public domain.

19       There is however a Constitutional  
20 issue with this statute. It's been upheld in the  
21 District Court and Court of Appeals levels. But  
22 cert. has been granted.

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1       The grounds really had to do with  
2 whether or not this is rewarding original works  
3 or is it rewarding works that have already been  
4 rewarded, are no longer original, and is it  
5 really rewarding progress in the useful arts or  
6 the status quo.

7       In terms of the future, certainly more  
8 cases to come. And I think particularly because

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

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

19 MICHAEL KATZ: Thank you.

20 (Applause.)

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

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

4 DAVID SIBLEY: I'll talk a bit  
5 about long-term contracts, something that Becky  
6 mentioned but not in detail. This by the way is  
7 an issue in at least one of the Gemstar/Echostar

8 cases.

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

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

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

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



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

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

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

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

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

13           And let's suppose that the entrant  
14 has -- let's suppose that the incumbent if he  
15 signs up five of the fifteen can exclude entry.  
16 Now, in this setting is exclusion profitable?  
17 Well, yes.

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

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1 which is there prospective gain from entry.  
2           He ends up making a profit of twenty.  
3 Now, exclusion won't always be profitable. We  
4 can cook up cases where it wouldn't. But note in

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

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

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

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

21       MICHAEL KATZ: Joe?

22       JOSEPH FARRELL: Well, I think a lot

1 of economists wonder what the legal restriction  
2 on patent extension is all about because there's  
3 another well known paper in the economics

4 literature by my colleagues Rich Gilbert and Carl  
5 Shapiro that argues -- they argue this in the  
6 context of intellectual property design rather  
7 than IP holder practices -- argues that it's good  
8 to have a long but small stream of royalties  
9 rather than a short and large stream of royalties  
10 because that collects the same IP rent with the  
11 same incentives for innovation but at a lower  
12 deadweight loss than the system we have.

13           And so that I think has led a number  
14 of economists to wonder what the lawyers think  
15 they are doing coming down on patent extension.

16           Now, David Sibley just described kind  
17 of a contrary modern view which is that there's  
18 such a thing as not just extension in the  
19 Gilbert-Shapiro sense where you're taking the  
20 same rents but over a longer period of time, but  
21 what I would call some version of leverage  
22 whereby taking them over a longer period of time

1 you actually increase the total amount that you  
2 get in an anticompetitive way.

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

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

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

16           Suppose that you have an IP settlement  
17 of the kind perhaps attacked by the FTC. And  
18 suppose you believe that the FTC was right that  
19 that was a nakedly anticompetitive deal ex post.

20           That is, there were no efficiency  
21 benefits from whatever else they were doing. It  
22 was just effectively extending the intellectual

1 property term from the statutory period to the

2 statutory period plus.

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

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

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

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

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

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

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

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

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

1 extension are not measured by the ex post  
2 increase in market power.

3           They are measured by what to an  
4 economist is at least for a modest increase a  
5 second order variation in the basic IP policy  
6 trade-off.

7           And I don't really now how to resolve  
8 this. I think there are elements of both the  
9 ex post X years of unnecessary monopoly, and the  
10 ex ante change in the IP policy trade-off.

11           And I think it's going to be very  
12 important for the consumers of these hearings to  
13 develop a coherent view on whether we're doing  
14 antitrust ex post and say you have that monopoly  
15 now stop because any further monopoly is totally  
16 unjustified, or whether we're integrating it with  
17 IP policy in which case you're really looking  
18 more at that second order effect.

19           MICHAEL KATZ: Thank you, all three of  
20 you. Let me -- I think we're running out of time  
21 and this is a city where it's important to have  
22 your power lunches, let me just summarize a few



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

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

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

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

22         They are forced to pay for things they

1 didn't really want or somehow this is dragging  
2 the terms out. And while one can construct at  
3 least theoretically situations where there are  
4 problems, I think in fact those are quite  
5 delicate and fairly subtle theories.

6         And I think what we're hearing today  
7 is the things that really matter, at least that  
8 economics would identify, are the effects on  
9 third parties.

10         So it arises either because there  
11 are multiple licensees and the actions of one  
12 licensee can affect the other, or because even if  
13 you have a single licensee you may still have  
14 consumers of the product that uses the patent.

15 And they certainly can be harmed.

16         And that's where one then gets into  
17 issues such as is intellectual property being  
18 just used as a cover or a sham for supporting a  
19 cartel. And that also is where one could be  
20 concerned about having running royalties that  
21 extend beyond the patent.

22         Because if what you have is the

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

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

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

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

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

1 that somehow the single buyer is being exploited  
2 or forced to buy things it doesn't want.

3           And even in the case where it's  
4 said that by having the package it's either  
5 diminishing the incentives to invent around or  
6 diminishing the incentives to challenge validity  
7 or enforceability, at least work I've done and  
8 others have done suggests that actually is very  
9 delicate.

10           I think Joe may disagree with me on  
11 how delicate it is. I believe he skipped over a  
12 slide where he talked about that. But it comes  
13 down to an issue of timing and commitment. And  
14 it's far from obvious -- I think Joe probably  
15 will agree with me on that.

16           It's far from obvious that the package  
17 licensing does have the effects that are claimed  
18 and there's really a lot more work to do there  
19 which will turn me to summary for the day. I  
20 think we probably have agreement across the panel  
21 and the audience that these are difficult issues

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

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

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

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

21 the IP hearings I think are pushing us forward.

22 And as I say, these are going to remain difficult

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1 issues.

2 But at least I think the more

3 egregious errors are going away and we're going

4 to be worrying about narrower and narrower

5 issues. So let me ask you all to join me in

6 thanking the panelists today. I will remind you

7 we will reconvene with a different moderator at

8 1:30. Thank you.

9 (Lunch recess.)

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1 AFTERNOON SESSION

2 (1:30 p.m.)

3 WILLIAM STALLINGS: Good afternoon and

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

5 for what we expect will be another interesting

6 session of these hearings. My name is Bill

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

8 Antitrust Division.

9 We're here today to discuss how to

10 handle antitrust analysis when dealing with

11 disputed or uncertain intellectual property

12 rights. This subject is particularly important

13 to the agencies as IP issues are arising in

14 antitrust investigations with more and more

15 frequency.

16 As Professor Shapiro stated, a

17 compelling case can be made that intellectual

18 property disputes are increasingly important in

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

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

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

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

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



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

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

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

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

16           The agencies may be concerned that the

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

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

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

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

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

16 agreement be treated as horizontal competitors if  
17 IP rights are in dispute?  
18 How should the agencies take into  
19 account a patent's presumption of validity?  
20 Should the agencies even question the relative  
21 strength of a patent portfolio? If so, using  
22 what standards? What is the impact on incentives

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1 to innovate from scrutinizing agreements  
2 involving disputed IP?  
3 How do we balance that impact  
4 against the incentives of parties to use such  
5 arrangements to achieve a potentially undeserved  
6 cartel outcome? And finally as a matter of  
7 resources what steps should the agencies take  
8 to resolve these issues?  
9 Joining me in representing the  
10 agencies is John Hoven from the division's  
11 economic analysis group, Suzanne Michel, counsel  
12 for intellectual property at the FTC, and Edward  
13 Polk, an assistant solicitor at the U.S. Patent  
14 and Trademark Office.

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

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

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1 antitrust and competition practice group.

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

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

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

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

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

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

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

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

13 2002 she was director of civil non-merger  
14 enforcement at the U.S. Department of Justice  
15 Antitrust Division. She was at the Antitrust  
16 Division in a number of capacities before that.

17 Salem Katsh is a partner with  
18 Shearman & Sterling in New York where his  
19 practice involves counseling and litigating  
20 intellectual property issues.

21 And finally Joseph Miller is an  
22 assistant professor of law at the Lewis & Clark

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1 Law School. He is formerly a trial attorney with  
2 the Antitrust Division where he worked on  
3 numerous cases involving the intersection of  
4 antitrust and intellectual property.

5 Before we get started into the  
6 discussion, there are a couple of brief  
7 housekeeping details. Our location here today in  
8 the Great Hall creates certain security concerns.  
9 The basic rule is that if you are not a DOJ  
10 employee you must be escorted around the  
11 building.

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

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

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

8           And because we want to leave plenty of  
9 time for discussion and because we have a large  
10 panel today, we have asked that each of the

11 panelists limit their presentations to ten  
12 minutes. Now let's turn to our first  
13 presentation from Doug Melamed.

14 DOUGLAS MELAMED: Thanks, Bill. I  
15 don't know how I was selected to speak first, but  
16 I think it's probably fitting because I really  
17 have more questions than answers and more  
18 problems than solutions to talk about.

19 My view which was I guess first  
20 implemented when I was actually acting AAG and  
21 asked M. J. Moltenbrey to chair a working group  
22 at the division to think about the intersection

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1 of antitrust and intellectual property issues.  
2 For the most part those issues are not  
3 conceptually novel.

4 That is to say, when you can assume  
5 the intellectual property to be property, I think  
6 as the guidelines say as a general matter the  
7 antitrust analysis is the same of that kind --  
8 with respect to that kind of property as it is  
9 with respect to any other kind of property,



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

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

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

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

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

9 cross license arrangements, and you name it.

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

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

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

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

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

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

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

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

7 to be earned, and both the putative challenger  
8 and the intellectual property holder might agree  
9 it is in their interest to share those profits  
10 and put an end to the intellectual property  
11 dispute.

12           So I think it's a conceptually serious  
13 and difficult problem. Based on my experience at  
14 the Division and some experience since then, I  
15 think it's one that has real impact in real  
16 markets because mergers are done where one party  
17 says the acquired firm couldn't have competed  
18 against me because of the strength of my patents,  
19 and one doesn't know if that's true.

20           Litigation is settled. Contracts are  
21 entered into on similar arguments and one doesn't  
22 know whether it's true.

1           Now, the easy case which has been  
2 the subject of the Abbott, Geneva, and  
3 Schering-Plough cases brought by the FTC is a  
4 case in which the agreement between the parties,  
5 in those cases litigation settlements, eliminates

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

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

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

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

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

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

9 But in the meantime, they would have  
10 competed. In that situation it seems to me it's  
11 fairly easy to say, gee, the agreement eliminated  
12 competition; what's the justification for that.

13 And maybe at this point some of the  
14 ideas that Joe Miller suggested in his paper -- I  
15 don't want to steal his thunder -- come into play  
16 and that is at the very at least you put on the  
17 IP holder the burden of demonstrating something  
18 like the showing that he has to make to get a  
19 preliminary injunction with respect to the likely  
20 strength and validity of his intellectual  
21 property.

22 Or you make the acquired firm or the

1 would be challenger do something akin to the  
2 failing firm defense to show that in fact there  
3 wouldn't have been competition. But that's a

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

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

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

21           For one thing, well counseled parties  
22 in most situations can avoid that by consummating

1 their merger or consummating their agreement  
2 before there's been a history of competition

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

8           So the hard question -- the hard case  
9 and the likely case I think is a case where  
10 there is a private agreement that eliminates  
11 competition that one suspects might have taken  
12 place, but you can't prove it actually would have  
13 taken place, although you think that if the IP  
14 were plainly invalid it would take place, and if  
15 the IP claim were upheld of course the parties  
16 wouldn't be entitled to the competition.

17           And there are it seems to me  
18 several unsatisfactory alternatives for dealing  
19 with this.

20           One is simply to say let the would be  
21 antitrust plaintiff prove that the intellectual  
22 property is not in fact sufficiently valid or

1 properly -- the scope of it is properly construed



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

10           And here as I suggested earlier there  
11 might be a circumstance where someone has a  
12 unique ability to challenge it because of its  
13 position in the industry, or a unique incentive  
14 to challenge it because of its uniqueness in the  
15 potential entry sense I suppose, capacity to  
16 compete against the IP holder.

17           And the legal analogy for that element  
18 would be the potential competition cases or  
19 vertical foreclosure cases where one basically  
20 says you can't buy off someone who's uniquely  
21 positioned to create a likelihood of competition  
22 in this marketplace.

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

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

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

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

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

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

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

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

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

7           WILLIAM STALLINGS: It would probably  
8 be easier.

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

19 just give consumers the benefit of competition.

20 Now, the fact is that there are

21 different dynamics in merger and non-merger

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

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

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

3 I know that when we litigated the

4 Intel case against the FTC we wanted to bring in

5 some patent issues because the FTC was taking the

6 position that certain patents were valid and

7 infringed.

8 And we ultimately got a stipulation

9 from the FTC that we would not litigate the

10 patent issues if they would not take the position

11 that certain patents were valid and had been

12 infringed.

13 I think in merger cases it is a lot

14 harder to force the agencies to deal with the IP

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

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

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

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

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

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

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

17 front.

18           The one practical suggestion that I  
19 have -- and it's worked once. Who knows if the  
20 stars will ever align again for that kind of  
21 solution to work?

22           It was where the infringing party

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1 agreed to waive attorney-client privilege  
2 vis-a-vis the agency, let the agency look at its  
3 files, and presumably be in a case where its  
4 lawyers have told it that it infringes and the  
5 patent is invalid.

6           And if the acquirer stipulates  
7 that it's not going to claim a waiver of the  
8 attorney-client privilege on that basis and there  
9 is no risk that a third party would claim waiver,  
10 that's potentially a way to get around this  
11 problem. But, as I said, the stars have to align  
12 and they very seldom do.

13           My imperfect solution is that the  
14 agencies need to get better IP capabilities.  
15 Litigate to the death can't be the only solution.

16 It's ironic because judges just absolutely hammer  
17 litigants to settle their disputes.  
18           And then they come before the  
19 agencies, and the agencies evince hostility  
20 toward any kind of resolution that enables the  
21 parties to share in the value over which they  
22 are fighting.

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1           And my bottom line is this.  
2 Particularly in merger cases the agencies are  
3 engaged in a predictive exercise. And it's a  
4 predictive exercise that has many uncertain  
5 dimensions. Bringing in predictions about the  
6 resolution of an IP dispute complicates the  
7 picture to be sure.

8           But it certainly is something that's  
9 going to lead the agencies at least in the  
10 direction of making the right decision more  
11 often. I'm not talking about a full-blown trial  
12 of patent cases. I realize that is impractical.

13           But to the extent that the cases  
14 bolster their IP capabilities, hire people who

15 understand patent cases, who know how to litigate  
16 patent cases, know how to evaluate patent claims,  
17 part of the predictive exercise can be evaluating  
18 the strength of the patents, the strength of the  
19 infringement claims, the strength of the claims  
20 of invalidity, and reaching some prediction about  
21 how the litigation would wind up if the parties  
22 were to litigate to the death.

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1           There are lots of other complicated  
2 issues that I have glossed over, things like not  
3 all patents where there is a determination of a  
4 valid patent that has been infringed result in an  
5 injunction. Lots of patent cases are resolved  
6 with licenses, where the licenses have been ones  
7 with running royalties or lump sum royalties.

8           Maybe the parties would have entered  
9 into a cross-license that would have enabled both  
10 of them to compete. Those are all legitimate  
11 questions for the enforcement agencies to ask in  
12 questioning whether the settlement through an  
13 acquisition is the only resolution.

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

21           (Applause.)

22           WILLIAM STALLINGS: Thank you. During

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

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



13 practice. Doug?

14 DOUGLAS MELAMED: My reaction is it is

15 probably easier to litigate a patent case and let

16 the Judge decide than it is to determine in the

17 absence of a decision what the probability is

18 that the Judge will decide your way.

19 And then in any event, I don't know

20 how you go to a Judge and say we're asking you to

21 make a decision about what the probabilities are

22 as to the truth of a matter in dispute.

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1 So I just don't see it as either

2 really economizing on the problem here which is

3 scarce capacity to evaluate the IP claim or as

4 lending itself in any easy way to the normal

5 litigation models that I think we apply in the

6 Antitrust Department.

7 WILLIAM STALLINGS: Salem?

8 SALEM KATSH: Well, I don't have a

9 comment on the two papers, so.

10 WILLIAM STALLINGS: We'll come back to

11 you.

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

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

22           Sometimes you can do that. Sometimes

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

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

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

11 marketplace despite claims of infringement and  
12 is willing to indemnify its customers.  
13 Or perhaps that's not an essential  
14 element if the customers are aware of the claim.  
15 And that gives you some bound on the competitors'  
16 and/or the customers' estimate of the probability  
17 that the patent will be found to be valid and  
18 infringed.

19 Now, whether you need to take that  
20 estimate out and plug it into a different formula  
21 or whether you can say in a qualitative way  
22 competition with indemnification is legitimate

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1 competition, I don't know. You have to think  
2 about that in a particular case.

3 WILLIAM STALLINGS: Salem?

4 SALEM KATSH: I just have a couple of  
5 comments on very good presentations. One is that  
6 I think it's important in terms of settlements of  
7 litigation to distinguish between that context  
8 and the merger context. You can prevent two  
9 ongoing companies from merging and they are left

10 where they are.

11           If you prevent the settlement from  
12 going through, then where are you? The defendant  
13 in many, many cases wants to settle because he  
14 can't afford the cost of litigation, because he's  
15 not in a sufficient -- his cost of capital is too  
16 high. He does not want to litigate.

17           And one of the problems I see in the  
18 proposals that are being put forward is the  
19 assumption that if a settlement is found to be  
20 anticompetitive that somehow the defendant can be  
21 imposed upon to continue to fight. And that is  
22 not -- that's not in my experience very normally

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1 the case.

2           In terms of Joe's mention of the  
3 attorney-client privilege, as somebody that has  
4 split his career between antitrust and patents  
5 and the last fifteen was focused on patents, I  
6 think the opinion that he mentioned, if it was  
7 an opinion by defendant's counsel that his client  
8 had a bad case, it's maybe the only such patent

9 opinion that's been written in history.  
10           There is no such thing as a written  
11 opinion given to a putative defendant that tells  
12 him he's in a dangerous position of infringement.  
13 And the reason for that is that those opinions  
14 are always written to ward off the possibility  
15 of willful infringement.  
16           They are always written that there's  
17 no infringement, that there's no invalidity. If  
18 they can't find a grounds for saying that it's  
19 not valid, they will leave it out of the opinion.  
20 And if they can't find anything to say, they  
21 won't say anything.  
22           JOSEPH KATTAN: You're right.

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1           SALEM KATSH: So I think the prospect  
2 of finding opinions is illusory.  
3           JOSEPH KATTAN: That was actually a  
4 real case.  
5           SALEM KATSH: And I take it there are  
6 exceptions to every rule. And finally I would  
7 just like to underscore that I agree that conduct

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

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

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

22 WILLIAM STALLINGS: One thing I forgot

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

5 MOLLY BOAST: I'd like to just make a  
6 practical comment in response to Joe's point

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

10 The practical comment is that at the  
11 Commission at least we did not turn a blind eye  
12 to the relative validity or strength of the  
13 patent -- the party's position in the patent  
14 dispute. We did in fact usually take a look at  
15 it. We were often unable to get a final answer.

16 But in at least one case that I can  
17 remember we told the parties what our take on  
18 the likelihood that they would prevail was and  
19 suggested that if they disagreed with that they  
20 seek mediation and resolve their dispute and come  
21 back to us with the results.

22 And they did that in the space of

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1 three weeks. And it turned out that the mediator  
2 agreed with us. And we then went forward and,  
3 you know, that was an effective market for  
4 purposes of the merger.

5 And I mention it simply because it

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

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

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

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

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



5 the other party whole.

6           The other thing that you are avoiding

7 is years of litigation. And there is a social

8 value in avoiding the years of litigation.

9           I understand that the agencies take

10 the position that they would -- the agencies

11 would like certainty on the antitrust side of

12 the ledger. And that is something that is a

13 legitimate consideration for an enforcement

14 agency.

15           On the other side of the ledger the

16 parties themselves value certainty, the ability

17 to go about your business knowing who your

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

19 confront this party that you think is a pirate

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

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

22 twenty-year monopoly that the patent granted you,

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1 assuming again that we are talking about a

2 fundamental patent.

3           There's a huge value in certainty

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

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

14 JOSEPH KATTAN: I don't think private  
15 parties are concerned with innovation incentives.  
16 I think they are concerned with their bottom  
17 line. So I wouldn't presume to suggest that any  
18 of my clients were concerned with preserving the  
19 incentives to innovate when they sued somebody  
20 for infringement.

21 MOLLY BOAST: No. But I was talking  
22 about the social costs in the broader context.

1 WILLIAM STALLINGS: Professor Farrell?

2 JOSEPH FARRELL: Well, let me pick up

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

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

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

22           That would be something that given our

1 knowledge of this illegitimate competition we

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

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

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

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

1 others do.

2           JOSEPH KATTAN: Yes. They are clearly  
3 hard cases. And the preponderance of cases are  
4 going to be difficult cases.

5           The question is then do we just make  
6 the assumption that all competition is legitimate  
7 and that an acquisition of an alleged infringer  
8 to the extent that standard antitrust analysis  
9 fully divorced from the IP dispute would tell us  
10 it's problematic should not be allowed?

11           Or should agencies at least internally  
12 try to make an effort to get a better handle on  
13 the parameters of the IP dispute and to try to  
14 make a cut as to whether there is a reasonable  
15 probability that the patent is valid, that it is  
16 infringed, and that the competition is, if you  
17 will, illegitimate, just as they make a  
18 prediction as to the likely effects of an  
19 increase in concentration on prices and  
20 innovation in a market?

21           Those predictions very often turn out  
22 to be incorrect. Much of the time they turn out

1 to be correct, and that's the nature of a  
2 prediction.

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

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

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

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

1 come up with some tentative thoughts.

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

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

13 The first is a question that I think  
14 can be readily disposed of, and that is do the  
15 positions that the FTC and Department of Justice  
16 guidelines for licensing intellectual property  
17 take on potential competition foreclose a  
18 challenge to parties where there is the  
19 absence of proving infringement.

20 Section 3.3 of the guidelines is much  
21 cited, and it says for analytical purposes the  
22 agencies ordinarily will treat a relationship

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

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

9         First of all, this passage occurs in  
10 the guideline sections that are really addressing  
11 relationships that have both horizontal and  
12 vertical components.

13         And the question there is how do you  
14 weigh the overall effects of these various  
15 arrangements; how do you assess the overall  
16 competitive effects. And I don't mean to be  
17 taking the position that that language ought to  
18 have no role in looking at a purely horizontal  
19 relationship.

20         But I certainly think that it has been  
21 given much more emphasis than what was intended  
22 when that language was included in the guidelines



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

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

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

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

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

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

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

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

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

21           And second suggesting somehow that

22 this judicially derived or now statutorily

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

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

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

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

20       Doug made the point at the beginning

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

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

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

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

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

20 of the patent itself.

21 And that may indeed be quite

22 uncertain. And so for this reason I think there

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1 ought to be little room for the argument frankly

2 that I was pushing Joe on, that a potential

3 infringer is competing illegally.

4 As I understand it -- and I am not the

5 IP lawyer that he and Salem are -- the patentee

6 has no right to exclude an infringer who is

7 competing unless and until the infringement is

8 proven. That is what the system is set up for.

9 And I completely take his point that

10 there are costs to the parties in terms of their

11 need for certainty and the likelihood that they

12 won't see this through to resolution.

13 But I don't see in the law or on any

14 policy basis a reason why somebody should have

15 something greater than the power to exclude once

16 you have proven your right to it.

17 And finally the power to exclude gives

18 the patentee the unilateral right to refuse to

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

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1 scope of the patent.

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

22           And this is something that in a merger

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

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

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

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

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

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

5           WILLIAM STALLINGS: Thank you.  
6 Professor Farrell?

7           (Applause.)

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

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

22           This perhaps is particularly crucial

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

5           My colleague, Mark Lemley, has a paper  
6 where he engages in some back of the envelope  
7 cost/benefit analysis and suggests that when you  
8 take into account subsequent litigation test of  
9 intellectual property, it may actually be quite  
10 rational for the initial patent examination to be  
11 relatively cursory.

12           So all this suggests that patent

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

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

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

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

11 So all of this is just some -- these

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

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

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

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

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

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

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

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

22           So even leaving aside anticompetitive

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

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

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

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

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

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1 to challenge is to ask what's the benefit, the  
2 net benefit from a successful challenge, because  
3 if you can say what the net benefit from a  
4 successful challenge is both to the challenger  
5 and to society as a whole, then you'll get the  
6 comparison between incentives to fight for that  
7 result.

8           So we can certainly say that if we

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

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

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

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



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

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

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

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

7 incentives.

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

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

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

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

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

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

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

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

4           It seems to me that competition policy

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

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

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

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

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

3           Invalidity or certain forms of

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

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

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

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

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

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

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

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

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

1 statutory lifetime.

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

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

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

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

22           And what I have here is an inverted

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

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

14 It's true that if Congress had chosen  
15 too strong an intellectual property protection  
16 system so that we were not starting from A but  
17 from B here on the right of the curve where it's  
18 already falling, then extending to B-prime would  
19 be seriously bad.

20 But it's also true that if we were on  
21 the left part of the curve starting at C where  
22 the curve is still increasing, then extending



1 from C to C-prime is actually good. So what do  
2 we do given that we don't really know where we  
3 are on this curve?

4 Well, I don't know, but in some sense  
5 it's not clear that we can do much other than  
6 assume that Congress didn't predictably get it  
7 wrong, in which case a patent extension of this  
8 kind involves a loss.

9 But the loss is not the whole  
10 deadweight loss or deadweight loss plus profits.  
11 It's rather the trade-off between that and the  
12 increased intellectual property protection.

13 So this, remember, is the case where  
14 we have uniform effect, not the case where we  
15 have no effect. And of course it's not a more  
16 complicated case because I can't handle that.

17 If we think about a successful  
18 challenge, that's running in the other direction.  
19 So a successful challenge takes us perhaps from  
20 A-prime to A, perhaps from C-prime to C, or  
21 perhaps from B-prime to B. And depending on  
22 where we think we are on the curve, that's going

1 to give you different effects.

2           So my bottom line here is in thinking  
3 about the incentive to challenge which as I say  
4 I think is a very important challenge in this  
5 intersection of antitrust and intellectual  
6 property, it's not clear that we're getting  
7 enough of the picture if we just look at the  
8 ex post effect in the market that we're  
9 talking about.

10           It's not clear that we shouldn't try  
11 to integrate this with intellectual property  
12 policy. Unfortunately if you do that the results  
13 are a lot less clearcut. So let's step back and  
14 say do we really have to do that integrating.

15           We don't have to do the integrating  
16 if we're willing to say in some rather absolute  
17 sense that we had the right intellectual property  
18 policy and so marginal extensions may be marginal  
19 but they're still bad.

20           You don't have to do it if you think  
21 that there is no effect, as you might think if  
22 this is an unpredictable extension of patent.

1 Or perhaps most interestingly you don't have to  
2 think, well, all of these curves are all very  
3 well. But they don't really deal -- and I think  
4 this is right.

5       They don't really deal with the fact  
6 that this is not a change in overall policy. And  
7 an increase in effective intellectual property  
8 protection as a change in overall policy might be  
9 one thing. This is not that.

10       It's the private parties deciding that  
11 they are going to grab more protection in this  
12 particular case. So I think that's an appealing  
13 argument, but I also don't know -- you know,  
14 suppose it is that. But suppose you have a  
15 pattern that allows that to happen.

16       In what substantive way exactly is  
17 that different from policy change? Or to put it  
18 another way, the policy change might itself be  
19 rules onsets, on other policies that allow  
20 this kind of thing to happen.

21       So like Doug I have a lot more  
22 questions than answers here. It just seems to me

1 that, A, we need to think more about incentives  
2 to challenge. And, B, I think it's a good idea  
3 to think about it in an integrated context rather  
4 than separately.

5 (Applause.)

6 WILLIAM STALLINGS: Thank you. I  
7 think right now we'll take a short break, and  
8 then we'll pick up on the other presentations and  
9 some more discussion after the break. If we  
10 could, reconvene at 3:10. Thank you.

11 (Recess.)

12 WILLIAM STALLINGS: I think we'll  
13 start back up with a presentation from Greg  
14 Vistnes.

15 GREGORY VISTNES: Normally I don't  
16 like to speak after so many others have spoken on  
17 the same subject in a panel like this because I'm  
18 afraid they will have taken all the good  
19 questions and good issues.

20 But fortunately on a panel talking  
21 about practical problems in IP there are  
22 certainly enough problems to go around for

1 everyone. So I think there will hopefully be at  
2 least some new things for me to be talking about.

3         What I want to talk about is -- and  
4 I've been evolving very much since I started  
5 trying to put together. To put it in the context  
6 of what Joe was saying earlier with the economist  
7 searching around for the keys, I am very much  
8 thinking that with some of these IP problems  
9 we're very much groping around in the dark.

10         It's just tough to find the keys out  
11 there. And I certainly don't want to go so far  
12 as to say we should move on over to where the  
13 lamp post is just because the light is  
14 better there.

15         But at the same time I think we need  
16 to recognize that it is so dark with some of the  
17 issues having to do with IP determination that we  
18 need to do something more in order to shed  
19 some light.

20         And certainly I have no disagreement  
21 with Joe that anything we can do to shed light to

22 get more expertise at the agencies to be able to

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1 better evaluate IP issues, that's got to

2 be better.

3 But at the same time I think that

4 that's going to be a pretty dim candle at the

5 end of the day and that somehow we need to be

6 worrying about how can we search more effectively

7 in the dark to try to get at some of the answers

8 for the IP issues.

9 Clearly the uncertainty having to

10 do with IP affects all different manners of

11 antitrust investigations whether we're talking

12 about patent pools, whether we're talking about

13 mergers between firms that may or may not be

14 rivals depending on the validity of their

15 patents, having to do with likelihood of entry,

16 all sorts of patent/IP type issues.

17 What I want to be discussing and far

18 less today than when I first started out to be

19 advocating a move towards rules, but to be at

20 least discussing the possibility of implementing

21 additional rules to try to help us find some

22 light in this dark area.

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1 I guess my basic tenet is that having  
2 been through at least a few of these both on the  
3 side of the government and on the other side  
4 although of course still with the government's  
5 end goals is that I don't think the agencies are  
6 well situated to determine the status of IP  
7 claims.

8 And that has nothing to do with the  
9 skills or the tenacity or the abilities of agency  
10 individuals. But it's simply that the agencies  
11 are responsible for far too many industries to be  
12 able to build up sufficient skill in this area.

13 I think that there far too often  
14 especially in the context of mergers substantial  
15 time constraints which preclude any significant  
16 light being shed on some of these issues.

17 And there are obviously going to be  
18 some significant information constraints which  
19 will prevent them from coming to the best

20 determination on IP issues.

21           Clearly at the end of the day an

22 agency decision is going to require some very

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1 subjective determinations. And as others have

2 pointed out, everything the agencies do has some

3 subjectivity about it.

4           But I think looking forward in the

5 area of patent or -- I keep calling it patent,

6 but IP validity involves much more subjectivity

7 than usual. Current IP status is not always

8 relevant even to what's going on depend on the

9 type of case.

10           It may be important to figure out what

11 the parties thought at the time they entered into

12 an agreement which could have been two or three

13 years in the past and try to figure out

14 information on that. That old information

15 will be even more difficult to do.

16           Some of the issues regarding the

17 agency determinations on IP status is any agency

18 decision about status on IP is going to pose



19 some problems. First of all, any decision, any  
20 determination the agencies come to is very  
21 clearly going to be subject to future challenges.  
22 Any IP determinations on even private

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1 contexts outside of the agencies coming to a  
2 decision is often subject to challenge. It's  
3 even more likely that what the agencies do will  
4 be subject to challenge when they have to do it  
5 under such time and information constraints.

6 Certainly once the agency makes its  
7 decision as time marches forward more information  
8 will come to light that additional information  
9 will likely affect the decisions that would be  
10 made which makes the challenge of an agency  
11 determination even more ripe. It makes it almost  
12 certain that challenges will come about.

13 I'm not so sure that those subsequent  
14 challenges of agency determinations on IP are  
15 necessarily good things for the agencies to the  
16 extent that their decisions on IP if they are  
17 continuously challenged and often overturned,

18 I think that takes away a certain amount of  
19 legitimacy of the agencies when they are acting  
20 in this area, especially if they are trying to  
21 break new ground.

22 And finally the question emerges how

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1 will agency determinations on IP status affect  
2 any parallel litigation that's going on outside  
3 the agency context, being in private litigation  
4 or in the patent dispute. Certainly decisions  
5 can be made on what I'm calling here expected  
6 values or probabilistic values.

7 Basically, hey, we take the best  
8 information we have and sort of you pay your  
9 money you take your chances. We figure that the  
10 patent validity is maybe 40 percent.

11 And we've put it into, whether  
12 explicitly or not, some sort of a probabilistic  
13 perspective. Yeah, we can do that. But there's  
14 so much barrier that's going to be associated  
15 that I don't think that's going to solve many of  
16 the problems.

17           So what I was at least thinking  
18 originally is to what extent can we be  
19 substituting rules for individual IP assessments.  
20 And clearly that's easier said than done.  
21           There are clearly certain benefits of  
22 rules. It reduces cost; it's for everybody.

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1 It increases certainty about the process. It  
2 increases speed of resolution. And hopefully it  
3 will avoid some parallel litigation of IP issues.  
4           Again there are also costs associated  
5 with implementing rules. Sometimes you are going  
6 to get an ex post bad call. That's clear under a  
7 per se type rule even. You always have to admit  
8 the possibility of a bad call.  
9           The rules will generally not even  
10 utilize all the available information. And  
11 defining rules may be very difficult given the  
12 complexity and the variety of the issues at hand.  
13           So like I said, easier said than done.  
14 There are certainly some goals that can be  
15 considered in trying to figure out how to

16 implement a rule.

17           And one is recognizing the rules

18 involve significant trade-offs, basically trying

19 to balance the harm from allowing bad conduct

20 versus preventing the blockading of preventing

21 good conduct.

22           You need to balance those two types of

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1 errors. The other balance that's going to be is

2 in timing of any type of decision on how the rule

3 works in that the longer you defer a decision the

4 greater the information that you're likely to

5 have. And that will more likely let you achieve

6 a better decision.

7           A deferred decision is not necessarily

8 a better decision overall though. Justice

9 delayed is justice denied I think is the saying.

10 The question arises is market power more likely

11 in markets with IP. And this goes towards how

12 you want to be setting up a rule and what sort

13 of things should rule be focusing on.

14           There is a question that if you think

15 that anticompetitive mischief is more likely,  
16 perhaps in designing a rule you want to be more  
17 conservative or more aggressive. I'm not sure  
18 what the right adjective is. But you want to be  
19 more inclined towards blocking behavior because  
20 you think it's simply more likely.

21           You may want to focus on rules that  
22 somehow reduce the uncertainty associated with

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1 IP issues. And that is, as you think of rules  
2 having two possible end results. One is you can  
3 either go for the grand slam and try to get the  
4 rule that gets the right answer every time or at  
5 least most of the time.

6           Alternatively you can try to come up  
7 with rules that basically reduce the uncertainty,  
8 in essence sort of focus the area of searching  
9 underneath the street lamp.

10           And maybe the best example I can think  
11 of here is when we're talking in the context of  
12 Hatch-Waxman cases where one of the rules is, for  
13 example, we don't like reverse payments.

14           Well, if you implement a rule we don't  
15 like reverse payments, then one way of getting  
16 around that rule is to say, well, let's sort of  
17 cloud the whole issue by having all sorts of  
18 side payments.

19           In other words, it won't be a payment  
20 purely to stay out, but we'll trade other sorts  
21 of licenses back and forth, just kind of muck up  
22 the whole water so you can't really tell if

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1 there's a reverse payment.

2           Well, the rule there if you reduce  
3 some of the uncertainty may be that in any  
4 situation where there is a patent involved and  
5 some uncertainty that a payment with respect to  
6 the patent has to be patent specific.

7           In essence you can't muck up the water  
8 with all these other side payments. I'm not sure  
9 that's going to be an implementable rule or a  
10 good rule, but at least it should hopefully give  
11 the concept of what I'm trying to get here.

12           A very important point which is quite

13 obvious is that I'm afraid often not fully taken  
14 into a context, a rule has been to resistant to  
15 gaming. Any rule you can come up with, there are  
16 going to be some huge incentives to get around  
17 that rule.

18           And again I'll go back to the example  
19 of a rule that says thou shalt not do reverse  
20 payments or backwards payments, whatever the  
21 language is on some of these patents in  
22 Hatch-Waxman.

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1           Well, if that's the rule, it's fairly  
2 easy to get around by, as I said, throwing in  
3 some other parts to the bargain so it's no longer  
4 so obvious that there is a reverse payment  
5 going on.

6           To the extent you can base your rules  
7 upon unambiguous conditions, that should be a  
8 useful guideline in trying to come up with rules,  
9 and again focus the rules on areas that are  
10 characterized by the greatest uncertainty.

11           Go where the bang for the buck is

12 greatest. Try to use the rules to again -- back  
13 to the street lamp example. Use the rules to  
14 push you to where you're then most likely to be  
15 able to find things using the candle that you  
16 have left available to you.

17         So in summary, the agencies I think  
18 should very much try to limit their role as much  
19 as possible in determining individual IP status.  
20 Again the more they can do to figuring it out the  
21 better. But I just don't ultimately have that  
22 much confidence they will get too far.

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1         And then try to design rules that  
2 address the inherent uncertainty associated with  
3 markets. Again anticipate strategic responses to  
4 any type of rule design.

5         And then the last question -- and I  
6 certainly don't have the answer -- is will the  
7 drawbacks associated with trying to implement  
8 some of these rules be greater than the benefit  
9 of the rules themselves. It's going to depend a  
10 lot on just exactly what the rules look like.



11 Thank you.

12 (Applause.)

13 WILLIAM STALLINGS: M. J. Moltenbrey?

14 M. J. MOLTENBREY: I find myself in

15 large agreement with a fair amount of what Greg

16 said. But I'm going to try not to repeat it too

17 much. I think we've already had this afternoon

18 a pretty good explanation of what the likely

19 problems are that we are looking for

20 solutions to.

21 Since this is supposed to be a panel

22 that focuses on the practical side of things, I'm

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1 just going to make a few points about what I see

2 as approaches that make sense for the agency

3 drawing mostly on my experience as an enforcer

4 and looking at some of these problems and trying

5 to figure out where resources should go and how

6 we should approach the problem.

7 The first thing I want to say is

8 that because we're looking at least in part for

9 practical responses, there doesn't have to be a

10 single answer. The question whether there should  
11 be -- for example, whether there should be rules  
12 that can be applied to simplify the analysis may  
13 make sense.

14 I don't think that -- I actually  
15 believe that there are some rules that can be  
16 applied that will simplify the analysis in some  
17 circumstances. But I don't take from that that  
18 the agency should never undertake their own  
19 independent analysis of the IP.

20 The basic problem that comes about  
21 here is -- the reason for the problems that we  
22 have here are that we rely -- our whole system

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1 relies on private agreements and private  
2 negotiation and private enforcement to limit the  
3 scope of patents and to prevent them from being  
4 used anticompetitively.

5 The problem comes up because the  
6 private incentives, the incentives of various  
7 private parties who are involved in various  
8 disputes are not aligned with those of consumers.

9           Often times what we have in other  
10 areas of law where we have a public policy we  
11 want enforced, a private party's incentives  
12 aren't going to line up perfectly as we have a  
13 public agency that's responsible for stepping  
14 into consumers' shoes and doing the enforcement.

15           Certainly that's what we have on the  
16 antitrust side with respect to at least certain  
17 problems. We know that private enforcement is  
18 not going to be a substitute for public  
19 enforcement.

20           To the extent the agencies can do it,  
21 can get the expertise, can get the resources and  
22 can challenge IP that is -- IP claims that are

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1 unduly restrictive to competition, I think they  
2 should do that and are perhaps in the best  
3 position right now of any agency or any system we  
4 have to have someone speak on behalf of consumers  
5 and represent their interests.

6           But recognizing that that's not an  
7 immediate and perfect solution, the next step is

8 to think about how antitrust rules and how -- how  
9 we should analyze certain agreements among IP  
10 holders and other parties, recognizing what their  
11 private incentives are, and trying to find a way  
12 to maximize those incentives towards serving the  
13 public good and deterring use of IP for  
14 anticompetitive purposes.

15         We talked today mostly about two  
16 different types of agreements. One is -- two  
17 types of issues. One is how to deal with  
18 uncertainty of IP rights in the merger context.

19         And I'm actually not going to offer  
20 too much there. I'm not sure that I have a lot  
21 of constructive solutions on that side. I think  
22 it's the trickiest problem. What I'm going to

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1 talk about instead are agreements between parties  
2 short of merger.

3         I think it's important to keep in  
4 mind that we tend to get distracted by this whole  
5 notion of settlements of lawsuits. There is no  
6 particular magic about an agreement between

7 parties being in settlement of a lawsuit in terms  
8 of what the competitive effects are, what the  
9 incentives are, and what the analysis is.

10           If I come up with evidence that I  
11 believe -- and decide that I'm in a position to  
12 perhaps enter a market by challenging either the  
13 validity of someone's patent or the scope of the  
14 claims that they have been making and thinking  
15 that I can compete, but I go to them and say,  
16 look, I've been thinking about entering this  
17 market; I'm not sure whether I need a license or  
18 not; perhaps you'd like to give me one on really  
19 favorable terms, and they enter into a license  
20 agreement that in some way is beneficial to both  
21 parties, I'm not sure that that should be looked  
22 at any differently than if they had first either

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1 started to manufacture the product and been sued  
2 or had gone in and sought declaratory judgment  
3 that the patent was invalid.

4           The basic competitive issues are  
5 the same in both cases. The fact that the one

6 agreement might be reached in settlement of a  
7 lawsuit and the other might be reached -- the  
8 same agreement might be reached before the  
9 dispute really becomes choate doesn't seem to  
10 be that important to me.

11           And when you think about it in those  
12 ways you understand two different things. One,  
13 this concern comes up much more broadly than just  
14 in -- worrying about patent settlements is a  
15 broad enough topic. But in fact the same  
16 concerns apply to almost any kind of licensing  
17 agreement or could apply to it.

18           So we're talking about more and more  
19 types of transactions that you might worry about  
20 here. But the second is that perhaps when you  
21 go about analyzing them we've been looking too  
22 broadly and been asking too hard of a question

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1 about what the agreement is that we should be  
2 challenging.

3           What I mean by that is it seems to me  
4 that people say perhaps one of the things we need

5 to do is do we need to ask the but-for question:

6           But for this settlement would there  
7 be competition in the end, with the notion being  
8 that -- what the agencies will then be trying to  
9 figure out is if they enjoin the settlement will  
10 ultimately this litigation be resolved in favor  
11 of the patent holder or the alleged infringer.

12           Perhaps the but-for question we should  
13 be asking is: But for the payment of certain  
14 incentives, but for the sharing of monopoly  
15 profits would this case be settled.

16           And we don't have to answer the  
17 ultimate question as to how the litigation would  
18 come out. It seems to me an appropriate rule in  
19 the context of agreements to license intellectual  
20 property or agreements not to produce potentially  
21 infringing products.

22           That rule has to be carefully

1 constructed not to disincentivize settlements of  
2 litigation.

3           We can't put the burden on alleged

4 infringers, on potential challenges, on new  
5 entrants to require them to challenge patents, to  
6 require them to challenge validity to say, no,  
7 you're not allowed to decide you're going to duck  
8 this particular problem and not take on the  
9 burden of defending consumer interests.

10           If you want to have a rule that  
11 says -- so that means that you don't want to  
12 ever have a rule that says you can't settle  
13 litigation; you're not allowed to get out of this  
14 litigation.

15           The question you then want to ask is  
16 why are they getting out of this litigation.  
17 If the only reason they are getting out of the  
18 litigation is because they are being compensated  
19 with a share of monopoly profits and that but for  
20 the sharing of those monopoly profits the answer  
21 continue the plight.

22           What the public agencies want to do

1 is say you can't have that payment, not you can't  
2 have that settlement. And so what you want to do



3 is separate those two out.

4 I agree with Greg that that buys a  
5 whole different set of practical problems. Yes,  
6 it is often going to be hard to determine whether  
7 or not a payment has taken place.

8 We've had some very obvious examples,  
9 and everyone is probably learning from those even  
10 as we speak that if you're going to pay an  
11 alleged infringer not to compete with you, you  
12 better do it in more disguised terms.

13 I don't think that having a rule that  
14 says you can't have such payments in certain  
15 circumstances solved every problem.

16 But I do think that in many  
17 circumstances the agencies are going to be better  
18 equipped to sort out those issues than they are  
19 to sort out the full underlying IP disputes that  
20 are going on, that sitting down and looking at a  
21 division of -- you know, at what the economic  
22 terms of a particular licensing agreement is

1 something more within the agencies' expertise

2 than doing the full-blown patent analysis

3 would be.

4 So where that leads me is that with

5 respect to agreements that are between parties

6 that lessen competition where you have disputed

7 IP rights is I'd ask a series of questions.

8 The first is: Is this an area where

9 we have market power? If there's no market power

10 involved, obviously whatever types of settlements

11 go on we should assume are not being motivated

12 for anticompetitive purposes and are in the

13 public interest.

14 The second is one that Doug mentioned:

15 Are there relatively few challenges. I would

16 probably broaden that somewhat simply to point

17 out that when you decide how many challenges are

18 out there in a market I think it's important to

19 bear in mind the realities of IP litigation.

20 And even if you have multiple parties

21 who are situated or perhaps have an incentive to

22 perhaps challenge the validity of IP they may not

1 be temporally equivalent.

2           If you have someone who's on the verge  
3 of going to trial who settles a case and there  
4 are three pending cases by -- three challenges by  
5 other parties out there but they are years away  
6 from resolution, I think there's a lot of  
7 potential harm there, notwithstanding the fact  
8 that the issues may ultimately be litigated.

9           And so I would look not only at who  
10 is a challenger but who is a challenger in the  
11 immediate term. And then I would look for a  
12 payment of -- a sharing of monopoly profit.  
13 One of the issues that I've toyed with a little  
14 bit -- I'm not sure that it works very well.

15           But it's to take those thoughts and  
16 put them into some kind of legal construct and  
17 say, gee, what is the legal analysis that leads  
18 to this result.

19           And I think there's an interesting  
20 lesson that can be learned by looking at  
21 conspiracy to monopolize a law. If you look at  
22 the analysis of agreements under section 2, the

1 analysis is a little different.

2           And I think a lot of it leads you to  
3 exactly that type of inquiry, which is do you see  
4 two parties who have an incentive to monopolize  
5 this market, and is that what this agreement is  
6 about, or is it really simply an agreement to  
7 avoid litigation. Those are my practical  
8 thoughts on some of the issues that came up  
9 today.

10           (Applause.)

11           WILLIAM STALLINGS: Well, I've heard  
12 from four panelists. I'd like to just open  
13 up the floor for discussion based on the  
14 presentations we heard earlier, if anyone has  
15 any comments.

16           SALEM KATSH: I'd like to ask M. J.  
17 a question about whether the market sharing of  
18 monopoly profits would be a -- whatever, red  
19 flag, yellow flag.

20           If one assumes that the plaintiff  
21 or the patent owner has a valid and infringed  
22 patent, why does it make a difference if he

1 decides to exploit it by sharing it with a  
2 licensee on terms and conditions that are  
3 acceptable to the patentee.

4 He may lack some capacity. He may not  
5 other things. Why would that -- why is that a  
6 solution rather than a sort of circular kind of  
7 problem?

8 M. J. MOLTENBREY: Well, my answer  
9 would be it goes back to the question that you're  
10 asking which is -- the question is but for that  
11 payment would the licensee be challenging the  
12 scope or validity of the patent.

13 And if the answer is yes, then the  
14 payment is not a payment to distribute the  
15 product, not a payment to produce it. It's a  
16 payment not to challenge the validity of patent.  
17 And that's what I would enjoin.

18 If the answer is I've chosen to share  
19 this and but for this payment I wouldn't be in a  
20 lawsuit with this person trying to prove this  
21 patent is invalid, I'd be out distributing  
22 someone else's product, then I don't think you

1 have any concern whatsoever about it.

2 I don't mean to be too dismissive  
3 of the difficulties of making those factual  
4 determinations in any given context. I just  
5 think that they may be easier determinations to  
6 make than the ultimate validity or scope of  
7 patent determinations.

8 WILLIAM STALLINGS: Joe Kattan?

9 JOSEPH KATTAN: The thing that worries  
10 me about rules is that they tend to be mechanisms  
11 by which enforcers shift the burden of proof to  
12 defendants.

13 When the IP guidelines talk about  
14 agreements raising antitrust concerns when they  
15 eliminate or reduce competition that would have  
16 taken place in the absence of the agreement, I  
17 think they are not simply stating an enforcement  
18 policy by which the government is going to be  
19 bound in litigation.

20 I think they are also stating the  
21 state of the law on the issue, which is that the  
22 plaintiff in an antitrust case has the burden of

1 showing that the agreement has created  
2 anticompetitive effects.  
3       If one wants to look at a rules regime  
4 in the IP context, one can look at the technology  
5 transfer block exemption the European Commission  
6 has adopted.

7       And I would ask the panelists here,  
8 particularly those who have spoken about rules,  
9 whether a regime like that which to me seems  
10 unduly rigid and has a lot of results that I  
11 think most people at this table would at least in  
12 some cases question as preferable to the rule of  
13 reason approach that we use here.

14       WILLIAM STALLINGS: Doug?

15       DOUGLAS MELAMED: I have a brief  
16 comment on what Joe said and then I want to go  
17 back to answer the question that was put to M. J.  
18 in a way that probably violates the subject of  
19 this conference which is to be practical.

20       I agree with Joe about rules. I think  
21 that if rules, whatever that means, are going to  
22 be attractive in this area what they should be

1 are ideas about how to think about the facts, to  
2 draw appropriate inferences from the facts in a  
3 rule of reason context.

4       They should not be formalistic rules  
5 for the reasons Joe has said. But I don't think  
6 that, you know, a rule or a notion that says if  
7 you identify parties that have -- to pick up on  
8 what M. J. said, parties that have market power,  
9 there is a bona fide uncertainty about the  
10 intellectual property.

11       And there's something fishy -- I'll  
12 come back to what that means in a minute -- about  
13 the nature of the deal between them that you  
14 can't from that infer that there is a sufficient  
15 harm to competition that you meet the  
16 requirements of the rule of reason.

17       I don't think that's a rule. I think  
18 that's simply a way of thinking about the facts.  
19 Now, for whatever it's worth it seems to me one  
20 way of looking at M.J.'s notion or at least my  
21 understanding of M.J.'s notion of is there market



22 power being shared is to think of the agreement

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1 whether it be a merger or a settlement agreement  
2 or a license agreement or whatever between the  
3 IP claimant and the putative infringer.

4 To think of it almost as an  
5 exclusionary agreement of the type in which a  
6 party with market power either induces an input  
7 supplier not to furnish that input to anybody  
8 else -- and here the analogy would be to pursue  
9 the IP litigation in a way that reduces entry  
10 barriers to everybody, and if you strike down or  
11 reconstrue the scope of the patent.

12 Or simply bribe them not to compete,  
13 you know, a BRI kind of case, kind of agreement.  
14 And it seems to me what you do there is you ask  
15 does this agreement have efficiency enhancing  
16 properties. Here you'd be saying did it simply  
17 economize on litigation costs.

18 Or you would be asking did it in fact  
19 increase the efficiency of the exploitation of  
20 the intellectual property because the licensee

21 really is much better able to build the machine

22 or to distribute the product or whatever it

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1 might be.

2           And then you ask the other question or

3 maybe it's the default to say maybe it doesn't

4 increase efficiency. Maybe all it does is bribe

5 the input supplier not to facilitate entry by

6 others or the would be rival not to compete.

7           And you identify that bribe by saying

8 we don't think efficiencies could possibly

9 explain the consideration in this contract after

10 looking at the facts; we don't see that enhanced

11 exploitation of the IP. We don't see that a

12 zillion dollars in consideration is simply

13 avoiding litigation cost.

14           And then you can infer if you

15 otherwise think the defendant has market power

16 that what he's doing is he's using some of that

17 market power to bribe the rival of the input

18 supplier not to facilitate or to provide

19 competition.

20           And by analogy to these vertical  
21 exclusionary cases or potential entry cases or  
22 market allocation cases, you can say that's an

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1 illegal agreement.

2           SUZANNE MICHEL: Let me ask a  
3 question. If one were to accept this concept  
4 that the antitrust plaintiffs might have a burden  
5 to show the but-for world, or if one were even  
6 interested in taking on the task of showing the  
7 probabilities that the patent was valid and  
8 infringed, what is the real question that we're  
9 trying to get at in that context?

10           And by that I mean are we trying to  
11 show outcome of particular litigation? Are we  
12 trying to show some more general -- make some  
13 more general determination of whether a  
14 particular patent is invalid from first  
15 principles, and infringed?

16           MOLLY BOAST: I will take a stab at  
17 that. I think I may well be wrong, but I think  
18 it flows really from Doug's point. And I think

19 what you are answering there is the question of  
20 whether there's an efficiency in the agreement.  
21 That is to say, is the licensing  
22 arrangement on whatever terms, you know, more

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1 efficient than the outcome of the litigation?

2 SALEM KATSH: I would answer it this  
3 way. If you get in a position of asking that  
4 question, I think you're asking the wrong  
5 question because it can't be answered.

6 SUZANNE MICHEL: And by that question  
7 do you mean the question on the outcome of the  
8 particular litigation?

9 SALEM KATSH: Right. The ability to  
10 quantify or on a qualitative basis assess the  
11 outcome of a patent case is impossible. Now, you  
12 can get a feel for it. Sure.

13 But I think to go back to Doug's point  
14 and M.J.'s, if you have an agreement that appears  
15 clearly to be in restraint of trade whether  
16 because it falls within the category of sharing  
17 market power or otherwise is subject to some

18 traditional antitrust principle, that is where --  
19 that is the question that should be asked it  
20 seems to me.

21           And then I would say that although the  
22 division does have the burden of proof I think

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1 that to say that a but-for -- I think that's more  
2 in the way of an affirmative defense than it is  
3 an element of the government's claim.

4           And I think that in that respect this  
5 entire discussion of presuming competition to be  
6 illegal, and that's something that the defendant  
7 has to establish, is striking from my point of  
8 view.

9           SUZANNE MICHEL: Would you say that  
10 the but-for world then is even a viable defense  
11 if you're talking about trying to show the  
12 outcome of particular litigation?

13           SALEM KATSH: It's a theoretical  
14 defense. But there are so many ins and outs with  
15 a patent you can't imagine what it's going to  
16 look like when it gets finished, and the process

17 of going up and down and how many years it's  
18 going to take, where the industry is going to go,  
19 what other products are going to come in.  
20 Right now you have an agreement.  
21 Now, if the agreement is distributing -- private  
22 agreement distributing incentives for production

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1 and marketing and it's being justified on the  
2 basis of the defendant is an illegal competitor,  
3 I just find that something that would be  
4 inherently suspicious to me. And I'd want  
5 really convincing proof.

6 WILLIAM STALLINGS: M. J.?

7 M. J. MOLTENBREY: I guess I would  
8 answer the question about what is it that  
9 you're -- what is the but-for world to say it  
10 might in different circumstances be any one  
11 of those.

12 But what happens is that your relief  
13 is different. The relief that you are seeking  
14 and that you would be entitled to get is going to  
15 be different.

16 I can imagine circumstances where you  
17 would be able to show -- and just to take an  
18 extreme, simple example, that a patent holder  
19 goes out and pays -- simply goes out and pays one  
20 of the few other firms that has underlying  
21 technology in the area and just walks in and says  
22 we're going to pay you a lot of money and you

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1 agree that you'll never challenge our patents.

2 And as long as you do that we're  
3 going to pay you a lot of money. And if that  
4 circumstance I can imagine challenging that.

5 There the challenge is to the payment, and it is  
6 to the agreement not to challenge.

7 And you're not making any  
8 determination about the validity or scope of the  
9 patent. I can imagine circumstances -- they may  
10 be rare -- where in fact you could not only as a  
11 theoretical -- on a theoretical level but on a  
12 practical level get evidence of the likely  
13 outcome of a particular case.

14 It may be very difficult and it might

15 depend a lot -- just to draw on some practical  
16 experience, it's a little harder to do that when  
17 you are looking at the early stages of litigation  
18 with years of discovery yet to go than it is when  
19 you're looking at a case that's been briefed on  
20 appeal and the issue that is raised on appeal is  
21 a very narrow legal one.

22           You may very well be able to make a

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1 determination about the likelihood of success  
2 there. And in that case again if you challenge  
3 that the relief you're getting may well be that  
4 particular agreement.

5           Whether or not that particular -- if  
6 it's the scope of the patent it will be whether  
7 that particular infringer is violating or not.

8           You may also have circumstances where  
9 the only alternative is to try the entire case,  
10 to put in the evidence. And the outcome is that  
11 the patent is invalid. The consequences and  
12 relief that you get from that are much, much  
13 broader. And obviously it is a much more



14 difficult case.  
15           But I don't think there is any reason  
16 to narrow it down and say there's only one way  
17 to get at it. I think you just -- you are  
18 challenging something slightly different and  
19 you're seeking slightly different relief in each  
20 case.

21           SUZANNE MICHEL: If our goal is to  
22 take on the -- or to try to show the likely

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1 outcome of particular litigation, to what extent  
2 then do we need to get into factors like who are  
3 the lawyers and who was the judge and what were  
4 his propensities and is this really a doable  
5 thing?

6           SALEM KATSH: Why is this different  
7 than where the defendant raises the defense of a  
8 natural monopoly, that nobody else can exist in  
9 this market, and the defendant agrees? Why you  
10 would put the burden on those parties to prove  
11 that, I don't see why this is any different.

12           And you would approach that with a

13 fair amount of skepticism. Now, I would modify  
14 my prior remarks by saying if the patent has a  
15 history of being successfully enforced and, you  
16 know, that would be a factor.

17           And in this connection, the so-called  
18 secondary consideration under the patent law, you  
19 know, long felt need, penicillin, breakthrough  
20 discoveries, commercial success, prior judgments,  
21 sure. You know, that kind of case is different.

22           But if you're talking about untested

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1 patents, then I think you're in a very difficult  
2 situation to ask the but-for question up front.

3           WILLIAM STALLINGS: I recognize  
4 Ed Polk.

5           EDWARD POLK: I guess I agree with  
6 what was said there as far as the situation where  
7 it's just a payment itself and not so much where  
8 the underlying patent needs to be challenged.

9           But if you have a situation where it  
10 is about the underlying patent and you are in a  
11 case where maybe but for that patent there

12 wouldn't be a market there, it seems to me that  
13 if you are just putting in rules where you don't  
14 want to undertake that analysis you're trying to  
15 get a speedier result possibly at the cost of the  
16 truth of what really are the facts of that  
17 situation.

18           Maybe it would be a good thing to  
19 actually go with that analysis, to come with the  
20 truthful result rather than the quick result.

21           WILLIAM STALLINGS: Joe Kattan?

22           JOSEPH KATTAN: It seems to me that to

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1 answer your question you need to ask the ultimate  
2 question which is what is the question we're  
3 trying to answer in an antitrust case, and that  
4 is whether the agreement creates, maintains,  
5 upgrades, preserves, or -- creates or preserves  
6 market power, and not whether the agreement is  
7 contributing to efficiency.

8           And the only way that you can  
9 determine whether the agreement is creating or  
10 maintaining market power is to look at what the

11 but-for world would have been like. And if in  
12 the but-for world you would not have had two  
13 parties competing with each other, I don't see  
14 how you can get to that ultimate result.

15 Now, it just so happens that a lot  
16 of patent cases get settled after you have had  
17 a Markman hearing. And after you have had the  
18 Markman hearing you frequently have a pretty good  
19 idea, not a dispositive idea, not something that  
20 you can take to the bank.

21 But you have a pretty good idea of  
22 where the case is going to wind up because the

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1 Judge has basically told you now here's how I'm  
2 going to be interpreting the claims of the  
3 patent.

4 And once you've got the claims of the  
5 patent interpreted, the rest of it is relatively  
6 speaking fairly mechanical. So it's a difficult  
7 issue.

8 But I think if we begin by saying are  
9 you contributing to efficiencies, then you're

10 saying defendant prove to me that you have had  
11 a good reason for entering into this agreement  
12 rather than, plaintiff, prove to me that this  
13 agreement creates market power, preserves market  
14 power, prevents its erosion.

15 WILLIAM STALLINGS: Doug?

16 DOUGLAS MELAMED: I think Ed's comment  
17 and maybe Joe's as well implicitly surface a  
18 critical premise in this discussion. I say  
19 premise. We can disagree about the premise.

20 Both of those comments it seems to me  
21 assume the correctness of a pitch that was made  
22 by a lawyer who came before the Division when I

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1 was there with a merger in which the acquiring  
2 firm had a passel, to say the least, of patents  
3 and bought a competitor, a firm where the two  
4 were actually competing.

5 They claimed that one or more of all  
6 of this mess of patents entitled it to prevent  
7 the acquired firm from continuing to compete with  
8 it. And the lawyers said, look, if the patents

9 are valid there's no lawful competition here. If  
10 the patents are invalid, there's no other entry  
11 barrier. There's no competitive concern.

12 So either way you guys should go away.

13 And if one accepts the notion that a patent is  
14 either valid or invalid and that the matter --  
15 the increase should be as to the truth of the  
16 matter, I think there's something to that  
17 analysis.

18 There's another way of thinking of  
19 patent law which I think has been alluded to by  
20 several people this morning but I think it ought  
21 to be surfaced.

22 And that is that the truth of the

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1 matter is that a patent gives you certain  
2 presumptive rights to act as if you own property.  
3 But you don't own that property until after the  
4 litigation process if any is completed and it is  
5 determined what the proper scope and validity of  
6 that patent is.

7 And if that -- if therefore the truth

8 of the matter is that you don't own a patent  
9 prior to the resolution of the litigation -- I  
10 mean you don't own a definitive right to exclude  
11 would-be rivals prior to the end of the  
12 litigation, then the but-for world or the truth  
13 of the matter that is pertinent might well be  
14 that there would have been competition or a  
15 likelihood of competition notwithstanding the  
16 patent claim and prior to the possible future  
17 resolution of its validity.

18           And that competition, it seems to me  
19 if you accept the premise that the intellectual  
20 property laws do not assume either validity or  
21 invalidity but rather assume uncertainty until a  
22 resolution, that competition is competition that

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1 the antitrust laws ought to be concerned about.

2           WILLIAM STALLINGS: I recognize Salem  
3 Katsh who is going to make a presentation.

4           SALEM KATSH: It just shows that  
5 eventually competition does induce innovation  
6 because this was done on a Macintosh and now it's

7 being shown on a PC.  
8 I want to run through the slides  
9 because I want to make sure I pick up on the  
10 points that may not have been covered. The first  
11 point I wanted to make -- and this goes to the  
12 question of whether we should start with a  
13 but-for test -- is to consider historically the  
14 relative importance and weight given to the  
15 patent laws and the antitrust laws.

16 And I think to the extent the agencies  
17 are waking up to this field today, they may well  
18 benefit from looking at what was considered  
19 axiomatic law when I started practicing sometime  
20 during the pendency of the IBM/Government case.  
21 I don't want to tell you exactly how old I am.

22 The patent clause in the Constitution

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1 doesn't say anything about licenses. It doesn't  
2 say anything about assignments. All it says is  
3 that the owner shall have the exclusive right to  
4 his discoveries.

5 The antitrust laws and the FTC act are



6 broad based commerce laws, powers, that were  
7 enacted to regulate contracts. The patent laws  
8 contain no provisions for balancing the relative  
9 innovative value of a patent to its competitive  
10 costs.

11           Every patent is of equal validity once  
12 it issues from the Patent Office regardless of  
13 whether it meets the margin of patentability by  
14 an inch or by fifteen yards.

15           The degree to which it passes the  
16 bar of patentability may be completely out of  
17 proportion to the amount of market power it  
18 lends itself to.

19           I'm not going to read these, but if  
20 you look at the Kodak/Goodyear case of the  
21 Federal Circuit, the SEM/Xerox case, and the  
22 FTC/DOJ guidelines, you'll see a completely

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1 different philosophy of enforcement theory.

2           The Federal Circuit was saying it  
3 didn't matter who owned the patent. The fact was  
4 that if the patent had not been transferred it

5 still could have been used to exclude

6 competition.

7           So they were assuming a hypothetical  
8 infringement action that would have been brought  
9 that would have been successful whether or not  
10 that would in fact have been the case.

11           I think that -- and I've tried to  
12 carefully look at the cases since these chestnuts  
13 back in the forties. I don't think the law has  
14 changed in terms of Supreme Court pronouncements  
15 about the relative status of the antitrust laws  
16 and the patent laws.

17           The contract which M. J. may have  
18 alluded to comes before the court. If it does in  
19 fact lend itself to the interpretation that it's  
20 in restraint of trade, it comes -- the patent  
21 aspect is subject to that principle of general  
22 law and does not override it.

1           So there are many cases where the  
2 Supreme Court has struck down pooling  
3 arrangements, cross-licensing arrangements

4 without regard to whether the patents were valid  
5 or invalid.

6 It is true that as a matter of relief  
7 or subsequently the patents could have been  
8 enforced. But that would have been on their own  
9 merits. The agreements that parties reach  
10 privately should not be subject to the control of  
11 a subsidiary body of jurisprudence.

12 Now, I used that little clip art thing  
13 to try and illustrate what to me is a practical  
14 reality that many may not completely understand.  
15 The black spider-type thing up with the little  
16 red dots, if you can make them out, going into  
17 the funnel is meant to represent the patent.

18 Now, there's been a lot of discussion  
19 about patents conferring market power. But in  
20 reality it's a firm that will have market power,  
21 a firm with plant, property, equipment,  
22 employees, know-how, trade secrets,

1 relationships, and so forth.

2 A patent is one component of the

3 firm's overall assets. And it is, as has been  
4 mentioned, simply a cause of action. One can  
5 call it a property right if one wants to, but all  
6 it means is that you can bring a lawsuit.

7         The patent lawyers are fond of always  
8 emphasizing that a patent does not give you the  
9 right to practice your own invention because  
10 there could be a patent that blocks you. All it  
11 gives you is a right to bring a cause of action.

12         And the misuse doctrine to the extent  
13 it still exists -- and there's maybe something  
14 left of it -- was a doctrine that was adopted by  
15 the Supreme Court based on the fact that the  
16 patent owner was appealing to the court of equity  
17 to exclude other people.

18         And the Court held that equitable  
19 principles -- irrespective of whether there was  
20 an antitrust violation, equitable principles came  
21 into play in terms of whether that patent would  
22 not be enforced.

2 situations beyond the patent case where defenses  
3 have relied upon private property rights, that  
4 the government was attempting to reallocate  
5 private wealth.

6           And they were subject to various  
7 defenses such as ruinous competition, failing  
8 company. There was the Fashion Originators Guild  
9 case where the owners of creative designs got  
10 together to police against pirating.

11           All of those were struck down -- I  
12 mean that case in particular was struck down as  
13 per se illegal because it was a resort to  
14 self-help.

15           And some of the arguments you hear  
16 about the presumptive legality and value of  
17 patents sound like similar arguments that have  
18 been treated with some skepticism by the  
19 agencies.

20           Now, the Xerox case in the Federal  
21 Circuit has thoroughly complicated the situation  
22 confronting both the private bar and the agencies

1 and does present a unique opportunity for the  
2 United States as a plaintiff, or the Federal  
3 Trade Commission, to take action so that their  
4 cases will not come before the Federal Circuit  
5 for review.

6 And I think this is a point that the  
7 Federal Circuit has basically adopted the  
8 syllogism that because the patent gives you the  
9 right to exclude, almost any condition that you  
10 attach to giving a license is immune from  
11 antitrust attack.

12 No weighing, no attempt to look at the  
13 but-for. The license agreement is per se valid  
14 unless you meet the requirements of Professional  
15 Real Estate and sham litigation, unless there is  
16 an enormous fraud on the Patent Office, or unless  
17 there is a tying arrangement.

18 Why the court threw in tying  
19 arrangement I'm not sure. It was in one portion  
20 of its opinion and it's not in many other  
21 articulations by the Federal Circuit where  
22 they've allowed only sham and fraud as the two

1 grounds for challenging a patent suit or a patent  
2 agreement.

3           Think about how the Supreme Court  
4 would have treated the argument in Aspen or  
5 Lorraine Journal if in Aspen they put forward as  
6 a defense that the ski company had a patent on  
7 the chair lifts used on Highlands Mountain.  
8 Anybody who thinks that the result would have  
9 been any different I think is wrong.

10           Aspen owned the three mountains and it  
11 was obliged to open its -- it was obliged to  
12 waive its right to sue for trespass. That is  
13 what antitrust courts do when there are found to  
14 be serious antitrust violations even in a single  
15 firm context.

16           In Lorraine Journal, the Journal  
17 established a policy of not carrying the  
18 advertisements of anybody who advertised with the  
19 new entrant, the radio station. Suppose the  
20 Journal had gotten a business method patent on  
21 how it ran advertisements?

22           So but for the infringement of the

1 patent -- in other words, they would have the  
2 absolute right to refuse to license their patent.  
3 And that would be somehow different from what  
4 they did which was to refuse to deal and share  
5 their property.

6 Now, the antitrust laws have always  
7 had difficulty regulating single firm conduct.  
8 It's no different today than it was in the days  
9 of the IBM cases that involved access to trade  
10 secret or copyrighted interface data.

11 The U.S. gave up on that. The  
12 European Commission did require certain  
13 compulsory licensing of vertical integration  
14 cases where a single firm takes action that has  
15 the potential of excluding competition in the  
16 primary market because it will require other  
17 competitors to vertically integrate into two  
18 markets.

19 In most of the Supreme Court cases  
20 involving patents -- and one of the last of the  
21 string was *Blacksaw* -- the Court again did not  
22 pay attention so much to the issue of patent



1 validity as to what the agreements were intended  
2 to do.

3           And when the Xerox court in the  
4 Federal Circuit says it's not going to consider  
5 scienter, it's not going to consider an objective  
6 intent, it's not going to consider the memos  
7 which talk about why a firm has entered into an  
8 agreement, they are basically immunizing from  
9 antitrust examination the bread and butter of  
10 antitrust cases where one does look to motive,  
11 one does look to intent, not as Phil or Rita used  
12 to say, because the chairman of IBM has bad  
13 thoughts about destroying competition, but no.

14           Was the company motivated to enter  
15 into this agreement because it felt that the  
16 other party was in fact violating the patents?  
17 Or does the discovery show other considerations,  
18 a fear of attack on the patents, sharing of  
19 monopoly power to buy off attack? Those issues  
20 would appear to be out of consideration as far as  
21 the Federal Circuit is concerned.

22           Now, on the settlement question -- and

1 I really wanted to get to this -- there is a big,  
2 big problem which nobody's mentioned. And maybe  
3 I'm missing something. But Professional Real  
4 Estate does say that if you bring a lawsuit you  
5 cannot be accused of violating the antitrust laws  
6 unless it's shown to be objectively baseless.

7 Now, that's going to be a very hard  
8 thing to show in virtually all cases. A  
9 settlement that is based on wanting to resolve a  
10 presumptively valid lawsuit is going to be hard  
11 to challenge it seems to me, despite whatever the  
12 settlement agreement says, if the defendant wants  
13 out of the litigation.

14 And the court is bound to find that  
15 the litigation was proper exercise of the patent  
16 owner's First Amendment rights. And I find this  
17 a real curve ball. In terms of examining license  
18 agreements there could be litigation. And then  
19 you'd be into a direct PRE situation where there  
20 is litigation, and you're in that.

21 So I think this is an area where a  
22 lot of work and thought needs to be devoted to

1 overcoming that if some of these agreements are  
2 to be challenged. Thank you very much.

3 (Applause.)

4 WILLIAM STALLINGS: I'd just like to  
5 note quickly that all these presentations will be  
6 on the FTC's website I think today. And we also  
7 have hard copy presentations of Joe Miller's  
8 paper in the back which is a good lead-in to  
9 recognizing Joe Miller.

10 JOSEPH MILLER: Thank you. And thank  
11 you for inviting me to talk to you all today. My  
12 idea is sort of that this is a good news, bad  
13 news situation when we ask what standards are we  
14 going to use when we're trying to examine the  
15 antitrust status of certain patent license  
16 settlement agreements.

17 Let me start with the bad news. It's  
18 good to get that out of the way first. The bad  
19 news is that I think resort to patent law  
20 standards is at some level ineradicable.

21 You are never going to get to a point

22 where you can avoid entirely looking at the

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1 merits of an underlying assertion about the  
2 scope of patent rights including validity or  
3 infringement, whichever is more important in  
4 any particular case.

5 I think it's true from first  
6 principles. The guidelines seem to suggest  
7 this is the case.

8 And I think more importantly the  
9 Business Review letters that people have alluded  
10 to that have dealt with patent pool issues, all  
11 three of which emphasize the importance of the  
12 role of an independent patent expert who is going  
13 to pass on the essentiality of patents, of given  
14 patents for the pool technology, emphasizes an  
15 acknowledgement that the merits of patent claims  
16 are important at some very basic level.

17 The good news is that patent law  
18 isn't merely a big pain in the neck for antitrust  
19 enforcement authorities. Patent law actually I  
20 think contains some important principles that the

21 antitrust enforcement agencies could use to their  
22 advantage when they are examining and perhaps

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1 then challenging certain patent license  
2 arrangements.

3 I've thought about two in particular,  
4 but I don't mean to suggest that these are the  
5 only two. I'm sure there are many more that  
6 people more creative and intelligent than I am  
7 will think of later.

8 I do think it's worth spending some  
9 mental energy on this though to try and come up  
10 with as many as one can. Let me mention the two  
11 that occurred to me.

12 One is the presumption of validity has  
13 been alluded to many times today. And Molly  
14 Boast quite correctly emphasized that the  
15 presumption of validity is merely a procedural  
16 device. And it's a procedural device of somewhat  
17 limited utility.

18 An important instance where it does  
19 not apply is when a patentee is seeking

20 preliminarily to enjoin rather than permanently  
21 to enjoin someone from competing with them in the  
22 marketplace.

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1           So when a patentee wants peremptorily  
2 to remove someone from the marketplace, they bear  
3 the burden showing that their patent will be  
4 sustained against the attacks that the defendant  
5 has signaled might be in the offing.

6           It seems to me that the antitrust  
7 agencies can and should be able to make the case  
8 that they ought to be no worse off with respect  
9 to someone who wants peremptorily to remove a  
10 competitor with a license than they would be if  
11 the person sought peremptorily to remove a  
12 competitor with a preliminary injunction.

13           There has also been a lot of talk  
14 today about shifting burdens. And I sense a  
15 distaste for it in certain respects, shifting the  
16 burden onto the parties who come forward with  
17 these arrangements.

18           But I do think they need to bear a lot

19 more of the burden, especially if they want to  
20 forestall much more drastic measures, about which  
21 more in a moment.  
22           The other procedural principle that

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1 I think is worth considering is the adverse  
2 inference that is drawn in patent infringement  
3 cases when a party who has been found to infringe  
4 is defending against the charge that their  
5 infringement was willful, that it was done with  
6 reckless disregard for the other person's  
7 patents.

8           Of course, when the person's intent  
9 about the patent rights becomes an issue, the  
10 natural thing for them to rely on is advice of  
11 counsel: I had a good faith basis for believing  
12 I didn't infringe or that the patent was invalid,  
13 therefore I did not act with reckless disregard;  
14 I acted with appropriate regard; I had good  
15 advice; it happened to be wrong, but don't sock  
16 me with treble damages.

17           It seems to me that there is an

18 argument to be made and it has several steps. I  
19 would commend the paper to you for it in detail.  
20 But there is an analogy to be made  
21 here through the failing firm defense that the  
22 accused infringer who says, look, I had to give

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1 in; I had to give my independence to the patent  
2 holder because I couldn't possibly compete  
3 lawfully, ought to be forced to disclose the good  
4 faith basis for that belief or suffer the same  
5 adverse inference, that they had no good faith  
6 basis for that belief.

7 Now, the point has been made that  
8 these legal opinions if they are negative  
9 opinions, if they are opinions that suggest that  
10 someone would be held liable for infringement  
11 of a valid patent, that they will not be  
12 written down.

13 My experience as a patent litigator  
14 indicates the truth of that statement that's been  
15 made by others. It almost certainly wouldn't be  
16 written down.



17           That doesn't mean it can't be  
18 disclosed. Conversations I'm sure would be had.  
19 They have to be had because companies need  
20 competent legal advice on how to proceed given  
21 the circumstances they are under.  
22           And the substance of those

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1 conversations could be relayed. Again if someone  
2 decides they don't want to, there is always an  
3 adverse inference to draw and I would recommend  
4 heartily that it be drawn.

5           Again, these are two procedural rules  
6 from patent law itself that I think the antitrust  
7 authorities could usefully deploy. I'm sure  
8 there are others.

9           But the complaint could rightly be  
10 made when one talks about these sorts of ideas  
11 that -- pick whichever cliché you like, nibbling  
12 around the edges, rearranging deck chairs on a  
13 sinking ship.

14           And I take those criticisms to heart.  
15 I think they have great merit. The reason that I

16 think they have great merit is because they don't  
17 attack the fundamental structural difficulty that  
18 we're confronting that Joe Farrell has alluded  
19 to, that Doug Melamed has alluded to and I think  
20 others have as well.

21           And that is the consequence of the  
22 legal rule that's been with us since a Supreme

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1 Court case called *Blonder-Tongue* that once a  
2 patent has been held invalid as to one person  
3 it's invalid as to the rest of the world.

4           That means that patent challenges have  
5 a public goods quality much like innovation  
6 itself. So if we're convinced that innovation  
7 needs patents because it will be undersupplied  
8 otherwise, we're probably equally likely to be  
9 convinced that patent challenges need some sort  
10 of boost or they're likely to be undersupplied.

11           I need to think a lot more about Joe  
12 Farrell's very, very provocative and important  
13 remarks here today about whether we can  
14 confidently state that the level of patent

15 challenges really is below the place we need it  
16 to be according to some particular social wealth  
17 or standard.

18           What I'm not going to wait to say  
19 though is some ideas about how we might change  
20 the law if we conclude it is below where it needs  
21 to be. What practical things might we do? Well,  
22 I think that at a bare minimum you would want to

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1 even out the patent law fee shifting regime.

2           Right now when you want to shift fees,  
3 when you want to make sure that someone who has  
4 one meritorious case gets their attorney fees  
5 compensated, it's very tilted toward the patentee  
6 who's successful and tilted very far away from  
7 the accused infringer who's successful.

8           It seems to me that if you thought  
9 that patent challenges were being undersupplied  
10 by the current set of legal rules that's the  
11 first place you would look. At least the legal  
12 fees, make the patentee pay them in other words,  
13 when an accused infringer successfully

14 invalidates a patent.

15           That would be particularly appropriate  
16 when they do so on grounds that the patentee  
17 could have avoided if he or she only took a  
18 little bit more time and care in figuring out  
19 whether the invention was patentable in the first  
20 place.

21           But what might you do that's even more  
22 bold than that? I think we have a laboratory for

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1 what you might do. It's the Hatch-Waxman Act.

2 Now, the Hatch-Waxman Act is not popular.

3           It's especially not popular in a room  
4 full of antitrust lawyers, for good reason,  
5 because it has a lot of pernicious aspects to it  
6 that have been manipulated with real abandon on  
7 the part of the main pharmaceutical  
8 manufacturers.

9           But it also has this very, very  
10 interesting suggestion for a device that might  
11 work quite well.

12           The 180-day semiexclusivity period,

13 this is a period that allows the first person who  
14 steps up to challenge the drug patent a six-month  
15 period after they succeed where they will be able  
16 to sell into the market and their only competitor  
17 will be the name manufacturer.

18           The other generics will have to wait.  
19 Now, the problem with this procedure as  
20 Hatch-Waxman enacted it was that it allowed the  
21 first generic to put a cork in the bottle and  
22 trap every generic behind it and sit around and

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1 wait and not really even enter.

2           If that got fixed -- and it seems that  
3 it is being fixed in some ways and might be fixed  
4 even more dramatically with some legislation  
5 that's on the Hill right now. If that were fixed  
6 I think what we'd see is here is a bounty being  
7 paid to the first challenger and only the first  
8 challenger.

9           Why is that important? Because it's  
10 a benefit that they will get that their  
11 competitors, who will also reap some benefits

12 from the invalidation of an invalid patent, will  
13 never get.  
14           So they get a reward that others won't  
15 get that's an incentive to undertake the  
16 challenge. It's sounding a lot like the patent  
17 regime itself, right? You reward someone in a  
18 way that won't be appropriated by people who are  
19 similarly situated.

20           So I think we have to think seriously  
21 about bounties that we give to people who  
22 successfully challenge invalid patents. I

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1 propose at the end of my paper an especially  
2 outrageous bounty. So I like to think big,  
3 right?

4           So my outrageous bounty is that the  
5 accused infringer receive the disgorged profits,  
6 all of them, that the patentee has earned under  
7 the patent to date.

8           This really evens the playing field  
9 considerably and it eliminates the very mechanism  
10 which people have referred to repeatedly here

11 today, this structural defect where the patentee  
12 can co-opt the accused infringer, align its  
13 incentives with the patentee's against the  
14 public.

15         If the accused infringer may be able  
16 to get all the profits, you offering to cut them  
17 in on a third or a half doesn't sound so great.  
18 They might decide, well, you know what, I'd  
19 rather shoot for the moon and get all your  
20 profits.

21         And so I think we need to think about  
22 a bounty system, how that might correct this

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1 market failure in patent challenges as a way to  
2 really attack central problems at the  
3 IP/antitrust intersection rather than sort of  
4 nibble here and nibble there with this or that  
5 procedural innovation.

6         As useful as those might be, I think  
7 they're not nearly as satisfying as something  
8 like the bounty proposal would be. Thanks.

9         (Applause.)

10 WILLIAM STALLINGS: Some reaction out  
11 of Professor Farrell?

12 JOSEPH FARRELL: Well, I think if one  
13 decided to take the view that one shouldn't  
14 incorporate incentives to innovate into the  
15 calculations of the gain from overturning invalid  
16 IP -- and as I discussed, it's not clear whether  
17 one should decide that.

18 But if one did decide that, then far  
19 from being outrageous your bounty would perhaps  
20 be inadequate because it only includes the  
21 profits and not the deadweight loss which is also  
22 harm caused by the illegitimate monopolization.

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1 And that of course in addition to  
2 getting the incentives to bring the suit, to  
3 bring the challenge a little higher, probably  
4 only a little higher, would also make it even  
5 more impossible for someone to offer part of the  
6 profits in return.

7 Let me take the opportunity to make a  
8 couple of general comments in response to



9 Mr. Katsh's observations. It seems to me that  
10 there are two fallacies floating around that he  
11 kind of mentioned I think in the spirit of  
12 attacking, but I would like to hear attacked more  
13 vigorously, and so I'll do it myself.

14           The first is that if there's no  
15 obligation to do X, then there shouldn't be  
16 limits on how you do X. I think this is a pretty  
17 well understood fallacy.

18           I don't have to hire an employee, but  
19 if I do hire an employee there are limits on what  
20 I can do, even things I can do that are disclosed  
21 to potential employees up front.

22           I don't have to enter a market, but if

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1 I do enter a market I'm not allowed then to  
2 collude with incumbents. There are lots of ways  
3 in which the syllogism you don't have to do X,  
4 therefore the law can't limit how you do X, is  
5 rejected.

6           The second widespread fallacy is in  
7 dismissing too quickly intent evidence. And this

8 is something I think antitrust practitioners are  
9 particularly fond of. It's certainly true that  
10 middle managers and perhaps others like to make  
11 loose statements about crushing the competition  
12 and so on.

13           And it's certainly true that we  
14 shouldn't base antitrust enforcement on those  
15 kinds of loose statements.

16           On the other hand, if you want to know  
17 what the real expected effects of a practice or a  
18 merger or a settlement are, I think it's likely  
19 to be pretty informative to find out the best  
20 considered opinion of those in the firm who know  
21 the most about that aspect of the business.

22           And just because we want to throw out

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1 cases based on these inflammatory kill the  
2 competition memos does not mean and shouldn't  
3 mean that we throw out the use of evidence about  
4 the most careful thinking within the firms, who  
5 know a lot more about it than we do.

6           JOSEPH MILLER: I've rarely been

7 accused of not sufficiently aggressively stating

8 my position. I accept your additions.

9 JOSEPH FARRELL: Thank you. I've

10 rarely been accused by the way for those who have

11 been here this morning of being to the right of

12 Greg Sidak. But he mentioned that.

13 DOUGLAS MELAMED: This is a

14 small comment maybe only in the nature of a

15 clarification about the bounty proposal. But I

16 wanted to note something and maybe ask a question

17 about it.

18 What Joe has focused on in his bounty

19 proposal is the enhanced incentive to the

20 challenger of the intellectual property. But of

21 course the bounty I take it is supposed to come

22 from the patentee. And therefore it imposes a

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1 cost on the patentee.

2 And we want to be careful I suppose

3 that we don't by imposing such a cost deter the

4 patentee from engaging in socially desirable

5 conduct.

6           So my question or clarification is  
7 this: I take it you do not mean by your bounty  
8 proposal to require forfeiture of all profits  
9 from the patentee's exploitation of the  
10 technology putatively covered by the patent, but  
11 rather simply those profits attributable to his  
12 now in turns out in hindsight wrongful assertion  
13 of a patent right to exclude rivals.

14           Otherwise it seems to me that you  
15 would be deterring procompetitive conduct if your  
16 bounty is paid by the patentee rather than the  
17 Treasury.

18           WILLIAM STALLINGS: Joe?

19           JOSEPH MILLER: I think I would agree  
20 with the second characterization that the profit  
21 would be the profit attributable to the wrongful  
22 reliance on the patent. I suspect however that

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1 in practice that the first would be the proxy for  
2 the second.

3           It would be difficult to disentangle  
4 the profit attributable to the misassertion of

5 the patent from profits attributable merely to  
6 practicing the technology.

7         The reason I went to patentee profits  
8 in the first place -- perhaps that would be  
9 helpful to lay on the table -- is a problem you  
10 confront in designing any bounty system, which is  
11 how big shall the bounty be.

12         That's just a design problem, right?  
13 And it seems to me that fixing any sum certain --  
14 let's make it 100,000, let's make it 5,000 -- is  
15 always going to have real underinclusive and  
16 overinclusive problems. So the better thing to  
17 do is to try and calibrate it directly to the  
18 value of the technology at issue in the case.

19         And so that's why I think you have to  
20 go to patentee profits measured somehow. But I  
21 accept your clarification. And it relates in a  
22 sense to Joe Farrell's comment about whether or

1 not we want to include the incentive to innovate  
2 in the way we think about whether these things  
3 are over- or underencouraged.

4 I certainly think we ought to try to  
5 incorporate the incentive to innovate in the way  
6 we think about whether these things are under or  
7 oversupplied. I would say this however in  
8 addition, that we should also try to incorporate  
9 all ways that people can protect their  
10 investments in innovations.

11 It is not merely the case that you  
12 have patents or copyrights or nothing at all.  
13 Many firms don't ever get any patents or have any  
14 copyrights. What they do is they rely on their  
15 lead time in the marketplace.

16 And there's been quite a bit of  
17 research about the different ways that firms  
18 recoup their investments in innovation. And I  
19 think that if a bounty proposal were employed in  
20 the patent system it might reduce the amount of  
21 patent seeking but I don't think it would reduce  
22 innovation seeking that is protected by other

1 mechanisms.

2 So that would also need to be part of

3 this very complex story that we should try to  
4 work out for the reasons that you stated earlier.

5 WILLIAM STALLINGS: Molly?

6 MOLLY BOAST: This is a little off  
7 point, the bounty point. But just as I sit and  
8 listen to this entire conversation and a fair  
9 degree of unanimity -- certainly there are people  
10 who don't agree.

11 But there's a growing number of people  
12 that seem to share a consensus that if we let too  
13 many abstract rules get in the way we will engage  
14 in underdeterrence in antitrust enforcement in  
15 this area, or alternatively put, perhaps we're  
16 already engaging in underdeterrence.

17 And that happens to be my own view.  
18 But I think in the search for rules and clarity  
19 and principles, that also propels us toward  
20 seeking more enforcement activity. It is not an  
21 appropriate approach it seems to me to stumble  
22 over some of these hard questions and then not go

2           It is better to take those to the  
3 courts. That's where the rules get made in this  
4 system. That's what antitrust enforcement is in  
5 this country. It's not a regulatory regime.  
6 It's a law enforcement regime. And we ought to  
7 be encouraging agencies to go forward.

8           WILLIAM STALLINGS: Salem?

9           SALEM KATSH: I just had one thought  
10 in listening to Professor Farrell. I'm wondering  
11 how he deals with that.

12           And this is the fact that before the  
13 Federal Circuit in '82 under the exact same legal  
14 standard, which is the Graham test of the Supreme  
15 Court in '65, between '65 and '82 somewhere  
16 around 70 percent of patents that came before the  
17 various Circuit Courts of Appeals were held  
18 invalid or not infringed.

19           After 1982 again under the same legal  
20 standard the percentages have reversed. And one  
21 of the problems I think that everybody here is  
22 confronting in terms of whether the system can be



1 tinkered with or whether some truly structural  
2 reform is necessary, is the question of how to  
3 deal with the uncertainty that now pervades the  
4 system when you're dealing with one court that  
5 will get every patent case if it has a discrete  
6 patent claim, and not only will it in general at  
7 the end of the day uphold 70 percent of the  
8 patents, but it will in the interim reverse  
9 almost 50 percent of the Markman determinations.

10           Which to Joe's point prevents the  
11 parties from relying on the Markman determination  
12 to get certainty before -- because if that were a  
13 real final resolution of the claim construction  
14 in 90 percent of the cases it would have a  
15 tremendous impact, a procompetitive impact.

16           But with the Court it's a brand-new  
17 ballgame, almost 60/40. So it's impossible for  
18 you to tell a client, look, you've lost in the  
19 District Court; now you better fold it in. It's  
20 quite the contrary.

21           WILLIAM STALLINGS: Joe, do you want  
22 to respond?

1           JOSEPH FARRELL: Well, to be honest  
2 I'm not quite sure what the question is here. I  
3 mean one thing I would say about the fraction to  
4 winners on each side is that's very apt of be a  
5 feature of the set of cases that get brought to  
6 that tribunal.

7           And so although I assume you can infer  
8 something from a big shift like that you have to  
9 be very careful about what you're inferring; that  
10 is, you're looking at a very selective sample.

11           I think what you're saying is  
12 settlements are made more difficult by the  
13 uncertainty that goes along with a dramatic  
14 change in policy, assuming there is such a  
15 change, and made more difficult also by the  
16 disrespect that's given to the Markman results.

17           I think it's true there's probably  
18 discouraged settlement. But I'm not sure what  
19 you're asking beyond that.

20           JOSEPH MILLER: I guess I was thinking  
21 out loud for a minute to M. J.'s point about  
22 profit sharing. If the uncertainty is so great,

1 confronting both parties as to what the final  
2 outcome will be, doesn't that just complicate the  
3 antitrust enforcement decision in terms of  
4 whether the way the case is settled is a fair  
5 allocation of risk even though it may amount a  
6 certain amount of profit or power sharing?

7           JOSEPH FARRELL: Yes. I think it  
8 does. I've never been an advocate for the  
9 antitrust agencies trying to judge whether a  
10 settlement is fair. I think one way to phrase  
11 what you're saying though is it makes it harder  
12 still to find triggers for thinking that a  
13 settlement is really a division of monopoly  
14 profits rather than a true settlement of the  
15 litigation risks.

16           I suppose it does because it does tell  
17 you that there is a bigger spectrum of agreements  
18 that might look good to both sides if they are  
19 taking different views about uncertainty.

20           The uncertainty in itself by the way  
21 has very little to do with difficulty of reaching  
22 settlements or any of those things. It's

1 difference of views that makes settlements hard  
2 to reach, not sheer uncertainty.

3           And certainly as matter of economic  
4 theory you have to ask how does the uncertainty  
5 create difference of views? I think in practice  
6 that's less of a point than it is in theory.

7           But I agree. There is one tool that  
8 you might have hoped could get you somewhere in  
9 analyzing and that maybe can't get you as far as  
10 you might have hoped. I guess I was never all  
11 that hopeful myself.

12           WILLIAM STALLINGS: If we can shift  
13 topics for one minute, we have heard some  
14 references to whether the Antitrust Division  
15 and the FTC have the resources to look at  
16 these issues.

17           I'm wondering about the panel's  
18 viewpoints on whether the agencies could work  
19 with the PTO in some manner in terms of  
20 re-examination procedures or other types of  
21 mechanisms to utilize the resources there. Joe?

22           JOSEPH MILLER: I think certainly in

1 the context of re-examination procedure -- and  
2 now we're really getting into some finer points  
3 of Patent Office administration which is what  
4 we're think about, because as I said, I think we  
5 need to as antitrust enforcement people -- or  
6 people who are involved in antitrust issues need  
7 to start thinking in a much more detailed way  
8 about substantive patent rules and procedural  
9 patent rules.

10           And so thinking about PTO procedure is  
11 a good way to start to do that. In the context  
12 of re-examination it is the case that the  
13 commissioner of the Patent Office is statutorily  
14 authorized to request re-examinations.

15           In fact it might even be to direct  
16 that there be a re-examination. I would have to  
17 go back and look. So re-examination is not  
18 merely something that a private party can  
19 instigate.

20           Now, it's true that the statute also  
21 creates a standard. There has to be a, quote,  
22 substantial new question of patentability. So

1 it's not like this is something you can just go  
2 do because you feel like it on a whim. You have  
3 to have a reason to do so.

4           But I think that if the agencies or  
5 one of the agencies went to the commissioner and  
6 said in this context there's all sorts of  
7 evidence that would suggest a substantial new  
8 question of patentability here; do you think that  
9 there is some ground for re-examination.

10           And if in the antitrust enforcement  
11 context it seemed to be useful and beneficial to  
12 really get to the heart of the matter I don't see  
13 why you should be shy about doing so, going to  
14 the patent office and asking for just that  
15 procedure.

16           M. J. MOLTENBREY: I think that  
17 promise underlying that question is an assumption  
18 that the agencies' difficulties in dealing with  
19 the IP issues stem solely from a lack of patent  
20 lawyers. I think the real situation is more  
21 complicated than that.

1 question that the agencies have to answer. And  
2 if the agency had an unlimited number of patent  
3 lawyers and made a determination on the scope and  
4 validity of the patent, how should that play into  
5 the antitrust analysis? Does the agency's own  
6 determination become the final determination?

7 I think the really hard question is  
8 the uncertainty of the IP rights, and in fact the  
9 nature of the IP rights and the but-for question  
10 presented. And is it even possible to get at  
11 those questions rather than solely a lack of  
12 patent lawyers?

13 WILLIAM STALLINGS: Salem?

14 SALEM KATSH: As somebody who's cut my  
15 teeth on patent law and technology without a  
16 technical background, which is why I infuriate  
17 the patent bar so much, the Federal Trade  
18 Commission and the Antitrust Division  
19 unquestionably can come to a qualitative decision  
20 about a patent within a matter of days or a

21 couple of weeks, having on staff appropriate

22 patent attorneys.

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1           You guys know industries. You look at  
2 products. So it's not technology that's your  
3 problem. It's patent law. And I know from my  
4 own background that it's very intimidating to for  
5 whatever reasons to say that you're going to have  
6 to pick up some patent law.

7           But patent law is not rocket science.  
8 And the actual analysis of whether a claim is  
9 strong in terms of prior art, of whether it's  
10 going to get a broad or lean interpretation,  
11 whether there's going to be a strong or mixed  
12 range of equivalents, those are issues where  
13 qualitative judgment can be made, yes.

14           A final determination on a but-for  
15 case, no. I don't think that's something that  
16 the agencies can shoot for. But, you know, I  
17 think that to have the expertise within the house  
18 and incorporate it in, it's just another body of  
19 law. It's not that bizarre.



20 M. J. MOLTENBREY: Salem, I think an  
21 interesting question that we have been trying to  
22 get at then is: Is in that case, that

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1 acknowledgement that we can't get at that but-for  
2 world, is where does the antitrust analysis go  
3 from there?

4 And that's the hard question I think  
5 when people talk about the agency not being able  
6 to come to a determination, that that's really  
7 more the heart of the matter than the inability  
8 to make the qualitative analysis that you talked  
9 about.

10 SALEM KATSH: But again, why is that  
11 different from being confronted with a natural  
12 monopoly defense or a failing company defense or  
13 some efficiency defense?

14 M. J. MOLTENBREY: Well, I think  
15 that's an interesting question in the sense that  
16 those defenses place the burden on the parties  
17 and not on the agency.

18 And much along the lines of what Joe

19 was talking about, the question might come down  
20 to who carries the burden because no one's going  
21 to be able to meet it anyway. And it becomes a  
22 default rule, which may be just the answer. I

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1 don't know.

2 WILLIAM STALLINGS: Doug?

3 DOUGLAS MELAMED: It seems to me

4 there's a legal problem too here. If you accept

5 the premise of the last couple of minutes that

6 the but-for world that we might be having to

7 investigate -- it involves a resolution of the

8 question is the patent valid.

9 If the antitrust laws require the

10 resolution of that question, there's no way it

11 seems to me to decide the antitrust question

12 without resolving that question in a patent

13 litigation because if the antitrust rule says

14 patentee is entitled to exclude the competition

15 if the patent is valid, then you have to make a

16 determination.

17 It doesn't matter what the antitrust

18 agency thinks. It doesn't even matter what the  
19 antitrust court thinks, unless it has proper  
20 jurisdiction over the patent issue.

21           It seems to me that unless you want  
22 antitrust to have to resolve all those issues in

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1 a proper patent case, that's another reason to  
2 look for decision tools, antitrust modes of  
3 analysis, that enable you to resolve a lot of  
4 competition questions without having to resolve  
5 that but-for world.

6           WILLIAM STALLINGS: Joe Kattan with  
7 the last comment?

8           JOSEPH KATTAN: I think that a very  
9 wise person said that a lot of antitrust law gets  
10 made not by litigation or doctrine these days,  
11 but by prosecutorial discretion.

12           And in the exercise of that  
13 prosecutorial discretion, it seems to me that the  
14 agencies can make the qualitative judgments that  
15 at least in certain cases and certainly in the  
16 merger context we're not going to bring a case,

17 which is based on a prediction of what the world  
18 would look like if the merger were to go forward  
19 or what the world would have looked like absent  
20 the agreement, when we have ability to make the  
21 qualitative judgment as to whether competition  
22 would have existed between the parties,

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1 legitimate competition given the patent position  
2 that has been asserted.

3 WILLIAM STALLINGS: Well, you've heard  
4 a lot today. The last thing, we've asked Joe  
5 Miller to try to wrap it up and put it all in  
6 context.

7 JOSEPH MILLER: And talk about  
8 dreaming the impossible dream. How would we  
9 summarize this? I think that some themes have  
10 emerged.

11 The notion that there is a particular  
12 structural problem with the very nature of patent  
13 challenges that sets off certain dynamics and has  
14 certain conclusions, that we need to think more  
15 about and try to struggle with because that may

16 be where the big payoffs are for increasing the  
17 amount of competition that should be taking place  
18 in the marketplace.

19 I think the theme that figuring out  
20 what the but-for world is, how to analyze it  
21 correctly, is a daunting challenge. You've heard  
22 a lot of different views about whether it's even

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1 something that's necessary to do.

2 And I'm probably at the other end of  
3 the spectrum which is I don't see how one can  
4 avoid doing it frankly. So this is still very  
5 much a contested question.

6 But I think what's not contested is  
7 that economic theory honed by experiences like  
8 the Hatch-Waxman Act cases are indicating to us  
9 plenty of contexts where even if we assume the  
10 patents are fully valid and fully infringed by a  
11 particular party, that the arrangement in  
12 question is anticompetitive and we need to push  
13 the forefront of that boundary, get it back as  
14 far as we can, so that we reduce the number of

15 instances where we do have to take on the merits  
16 of the underlying patent issues.

17           And also again, to sort of plug my own  
18 idea since I have the floor, is that we do have  
19 to start to think through on the assumption that  
20 we will not be able to eliminate the need to look  
21 at the merits of patent scope at the end of the  
22 day. Let's assume we just will never get there

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1 where we can eliminate it.

2           Let's embrace the thorn, the nettle,  
3 whatever, and say, okay, let's assume we're not  
4 going to be able to and let's start talking  
5 patent law seriously. Does this body of law have  
6 anything that will help us? If we're going to be  
7 playing on this field let's start learning what  
8 it's like to be playing on it.

9           And so I think that's why you've heard  
10 a number of people suggest that the agencies  
11 really could profitably invest in building some  
12 patent law expertise to try to deal with these  
13 issues in those terms as well. That's my

14 summary.

15 WILLIAM STALLINGS: Joe, thank you

16 very much. I'd like to thank all the panelists.

17 I appreciate your time and effort. Thank you all

18 for coming.

19 (Adjournment.)

20

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22