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Comments of the United States Council for International Business on the Joint Hearings of the Federal Trade Commission and the Department of Justice regarding Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy

July 12, 2002

The United States Council for International Business (USCIB) is pleased to have this opportunity to submit its views regarding the interface of antitrust and intellectual property law.

USCIB works to promote an open system of world trade, finance and investment in which business can flourish and contribute to economic growth, human welfare and protection of the environment. Representing some 300 U.S. companies, professional services firms and associations, it is the American affiliate of the International Chamber of Commerce, the Business and Industry Advisory Committee to the OECD and the International Organization of Employers. USCIB also facilitates international trade by working toward harmonization of international commercial practices in such areas as customs and arbitration.

This submission addresses six topics: refusals to license intellectual property, presumptions of market power, standard-setting organizations, practices of the U.S. Patent and Trademark Office, patent settlements and the worldwide proliferation of competition laws. These seemingly diverse topics are united by one overarching theme – that the protection of intellectual property, aided by clear and consistent laws, is vital to innovation.

I. Unilateral Refusals to License Intellectual Property Do Not Violate the Antitrust Laws

Given the numerous Supreme Court decisions stretching back for decades that uphold the right of an owner of a patent or copyright to refuse to license its intellectual property to others, it is particularly significant that the Antitrust Division and the Federal Trade Commission have chosen to devote an entire day of their joint hearings to this subject. USCIB believes that it is important for the U.S. antitrust agencies to clarify the law in this area to avoid any ambiguity with respect to the rights of intellectual property owners to decline to license their intellectual property to others. Certainty and clarity in this area are critical not only to avoid chilling the incentives to invest in the development of intellectual property through the in terrorem effect of treble damage class action litigation, but also because rules governing the appropriate treatment of limited license grants flow from the sound treatment of unilateral refusals to license intellectual property.

These comments will briefly discuss the previously well-established nature of the right to refuse to license intellectual property and the recent developments calling that right into question. The main section of the comments then addresses the deficiencies in the various rationales that have been advanced to argue that a unilateral refusal to license intellectual property may form the basis for finding a violation of Section 2 of the Sherman Act. As explained below, a key problem with concluding that the antitrust laws require the licensing of intellectual property is the need for courts to take on the unfamiliar role of utility regulators establishing "reasonable" license rates and setting other key licensing terms in order to make such a compulsory licensing requirement meaningful. Finally, the comments briefly discuss the related area of limited or restricted license grants addressed in the papers submitted by some participants in the May 1 panel on unilateral refusals to license.

A. There Is a Wealth of Support for the Right of an Owner of Intellectual Property Unilaterally to Refuse to License Others

The Constitution authorizes Congress to "promote the progress of science and the useful arts by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." U.S. Const. Art I §8, cl. 8. Pursuant to that authority, Congress in the Patent Act granted owners of patents "the right to exclude others from making, using, offering for sale, or selling the invention." 35 U.S.C. §154(a)(1).[1] The Copyright Act similarly provides copyright holders the exclusive right to reproduce and distribute their copyrighted works. 17 U.S.C. §§106, 501.

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[1] The 1988 Amendments to the Patent Act, codified at 35 U.S.C. §271(d) reinforced the right of patent holders to refuse to license their inventions without fear of liability. Section 271(d) provides that "[n]o patent owner entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of … having. … (4) refused to license or use any rights to the patent." The Federal Circuit's interpretation of Section 271(d)(4) as applying to bar antitrust claims as well as a misuse defense, Independent Service Organization Antitrust Litigation, 203 F.3d 1322, 1326 (Fed. Cir. 2000), is consistent with the holdings of a number of courts. See, e.g., Carpet Seaming Tape Licensing Corp. v. Best Seam, Inc., 616 F.2d 1133, 1143 (9th Cir. 1980); Polysius Corp. v. Fuller Co., 709 F. Supp. 560, 575 (E.D. Pa. 1989); Rohm & Haas Co. v. Dawson Chem. Co., 557 F. Supp. 739, 835 (S.D. Tex.) (§ 271 "necessarily extends into the antitrust arena" because "it would be superfluous to sanction and protect activity within one area of the law and concurrently prohibit and expose a patentee to damages by reason of another body of law."), rev'd on other grounds sub nom. Rohm & Haas Co. v. Crystal Chem. Co., 722 F.2d 1556 (Fed. Cir. 1983). Several commentators have noted that this reading is also consistent with established principles of statutory construction and with the legislative history of the Patent Act. See, e.g., Jonathan Gleklen, "Antitrust Liability for Unilateral Refusals to License Intellectual Property: Xerox and its Critics," Intell. Prop. News (ABA Section of Antitrust Law, Intell. Prop. Committee Spring 2001).

The Supreme Court has consistently held that the owner of intellectual property is under no obligation to license or otherwise provide that property to others. See, e.g., Stewart v. Abend, 495 U.S. 207, 228-29 (1990) (noting that "nothing in the copyright statutes would prevent an author from hoarding all of his works during the term of the copyright" and that "a copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work"); Dawson Chem. Co. v. Rohm & Haas Co., 448 U.S. 176, 215 (1980) (the "essence" of the patent grant is the "right to exclude others from profiting by the patented invention"); Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 135 (1969) (the "heart of [the patentee's] legal monopoly is the right to invoke the State's power to prevent others from utilizing his discovery without his consent"); Hartford-Empire Co. v. United States, 323 U.S. 386, 432-33 (1945) ("A patent owner is not in the position of a quasi-trustee for the public or under any obligation to see that the public acquires the free right to use its invention. He is under no obligation either to use it or to grant its use to others."); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 457 (1940) (holding that a patent owner has a legal "right to refuse to sell … [its] patented products"); Fox Film Corp. v. Doyal, 286 U.S. 123, 127 (1932) ("The owner of the copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property."); Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 429 (1909) (an intellectual property owner may refuse to license others "without question of motive").

Conduct that is authorized by the patent or copyright laws cannot constitute an antitrust violation. "The patent laws which give a 17-year monopoly on 'making, using, or selling the invention' are in pari material with the antitrust laws and modify them pro tanto." Simpson v. United Oil Co. of Calif., 377 U.S.13, 24 (1964). See also Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co., 324 U.S. 806, 816 (1945) ("[A] patent is an exception to the general rule against monopolies and to the right to access to a free and open market."); United States v. United Shoe Mach. Co., 247 U.S. 32, 57 (1918) (patentee's decision "to exclude others from the use of the invention … is not an offense against the Anti-Trust Act."). [2]

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[2] Numerous lower court cases have followed these Supreme Court decisions in ruling that a unilateral refusal to license intellectual property does not provide a basis for liability under the antitrust laws. See, e.g., Genentech, Inc. v. Eli Lilly & Co., 998 F.2d 931, 949 (Fed. Cir. 1993) (affirming dismissal of antitrust claims because patentee's exercise of the "right to select its licensees" does not violate the antitrust laws); Miller Insituform, Inc. v. Insituform of North America, Inc., 830 F.2d 606, 609 (6th Cir. 1987) (affirming dismissal of antitrust claims because "[a] patent holder who lawfully acquires a patent cannot be held liable under Section 2 of the Sherman Act for maintaining the monopoly power he lawfully acquired by refusing to license the patent to others"); United States v. Westinghouse Elec. Corp., 648 F.2d 642, 647 (9th Cir. 1981) (affirming dismissal of antitrust claims because "[t]he right to … refuse to license at all is the untrammeled right of the patentee") (internal citation and quotation omitted); SCM Corp. v. Xerox Corp., 645 F.2d 1195, 1209 (2d Cir. 1981) (rejecting antitrust claims because "Xerox's … refusal to license the [xerography] patents … was permissible under the patent laws and, therefore, did not give rise to any liability under § 2"); United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122, 1129 (D.C. Cir. 1981) (refusing to find antitrust liability because the defendant "sought nothing beyond what the patent … gave it. The patent gives it the unlimited right to exclude others from utilizing its process."); W.L. Gore & Assocs. v. Carlisle Corp., 529 F.2d 614, 623 (3d Cir. 1976) ("The right to refuse to license is the essence of the patent holder's right under the patent law which rewards invention disclosure by the grant of a limited monopoly in the exploitation of the invention.")

The two "modern" federal antitrust guidelines addressing the licensing of intellectual property are both consistent with the Supreme Court decisions cited above. These guidelines state that, even where the intellectual property confers market power on the owner, the owner may retain its exclusive right to use (or not use) the intellectual property. As Section 3.6 of the 1988 Antitrust Enforcement Guidelines for International Operations[3] explained:

> "Market power or even a monopoly that is the result of superior effort, acumen, foresight, or luck does not violate the antitrust laws. The owner of intellectual property is entitled to enjoy whatever market power the property itself may confer. Indeed, respecting the rights of the creator of intellectual property to enjoy the full value of that property provides incentive for the innovative effort required to create the property. And the results of that innovative effort both increase productive efficiency and expand society's knowledge and wealth."

Similarly, the 1995 Antitrust Guidelines for Licensing of Intellectual Property provide that the "Agencies will not require the owner of intellectual property to create competition in its own technology" (§3.1) and that even the creation of market power stemming from the ownership of intellectual property does not "impose on the intellectual property owner an obligation to license the use of that property to others." (§2.2)

B. Recent Developments Create Uncertainty Regarding Unilateral Refusals to License Intellectual Property

The Ninth Circuit in Image Technical Services, Inc. v. Eastman Kodak Co., 125 F.3d 1195 (9th Cir. 1997), became the first court to reject the "right of a patent or copyright holder to refuse to sell or license protected work." Id. at 1215. Reading a footnote in the Supreme Court's 1992 Kodak decision to apply not only to Section 1 tying claims but also to a Section 2 refusal to deal claim, the Ninth Circuit held that, absent a legitimate business justification for its actions, an owner of intellectual property engages in exclusionary conduct that could violate Section 2 if it refused to deal in order "to enhance a monopoly in another market" (i.e., a market other than the "primary" market for the patented product). Id. at 1215-19. Although it recognized a presumption that the "desire to profit from its intellectual property rights" constitutes a legitimate business justification, the Ninth Circuit ruled that this "presumption may also be rebutted by evidence of pretext" and found that evidence that Kodak's parts manager did not think about Kodak's patent rights when adopting its parts policy supported the jury's monopolization verdict for the plaintiff. Id. at 1219.

[3] The 1988 Antitrust Enforcement Guidelines for International Operations (hereinafter "1988 Guidelines") were replaced in April 1995 with new international guidelines that did not address intellectual property licensing agreements. The April 1995 Antitrust Guidelines for the Licensing of Intellectual Property (hereinafter "1995 Guidelines") superceded the intellectual property portions of the 1988 Guidelines. See 4 CCH Trade Regulation Reporter §13,107 at 20,589.

The uncertainty created by the Ninth Circuit's Kodak decision was exacerbated by the reaction of the Antitrust Division to the Federal Circuit's explicit rejection of that decision in Independent Service Organization Antitrust Litigation, 203 F.3d 1322 (Fed. Cir. 2000), (hereinafter "Xerox"). Rather than embracing the Federal Circuit's holding that "Xerox was under no obligation to sell or license its patented parts and did not violate the antitrust laws by refusing to do so" (id. at 1328), the amicus brief of the Department of Justice in Xerox, filed at the request of the Supreme Court, failed to take issue with the Ninth Circuit's Kodak decision and to endorse the Federal Circuit's holding in Xerox, and further confused the legal standard.[4] Rather than advocating the position set forth in the 1988 and 1995 Guidelines, the amicus brief sets out an opaque standard for determining when a "lawful monopolist could properly be held liable under Section 2 for a refusal to deal."[5] The brief, which was signed by senior Antitrust Division officials but not joined in by the Federal Trade Commission, stated that

> "[A] lawful monopolist could properly be held liable under Section 2 for a refusal to deal only if it had monopoly power and if its refusal to deal sacrificed profit available from exercising that monopoly power in order to exclude competition and thereby to create additional market power -- only if, in other words, it sought to enlarge its monopoly by "attempting to exclude rivals on some basis other than efficiency." Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985) (internal quotation marks omitted). Conduct generally does not violate Section 2 if it does not involve a sacrifice of profits in order to exclude competition and thereby create market power. See Robert H. Bork, The Antitrust Paradox 144 (2d ed. 1993) (defining

[4] The Chairman of the Federal Trade Commission criticized dicta in the Xerox decision that outlined three situations in which the limits of the "patentee's right to exclude" would be exceeded. See Robert Pitofsky, "Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property" at 5-7 (June 15, 2000) (while focusing on the "sweeping language" of the Federal Circuit's decision, Chairman Pitofsky also called the result into question by comparing the conduct at issue in Xerox to the "abrupt discontinuance of [a] previous business relationship found by the Supreme Court to be illegal in Aspen Skiing."). In a subsequent speech, Chairman Pitofsky clarified his concerns as limited to the dicta in the Xerox decision, deeming "undeniable" the holding that "an intellectual property holder does not have to license anyone in the first instance." See Robert Pitofsky, "Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy" at 6 (March 2, 2001) (both Pitofsky speeches can be found in the FTC website at http://www.ftc.speeches/). During the opening session of the recent hearings, former Chairman Pitofsky reiterated his March 2001 position that the Federal Circuit correctly held that Xerox had a right to refuse to license its intellectual property to others: "[I]t's a unanimous premise, and I agree with that, that the party holding the patent or a copyright for that matter doesn't have to license it. They can tuck it away. They can put it away. They can do it themselves. They have no obligation to license." Hearing transcript at 33 (February 6, 2002).

[5] The amicus brief filed by the United States in Xerox does not address the abundant case law discussing the rights of owners of intellectual property to exclude others. Instead, it pointedly equated intellectual property with "tangible property" and cited the dicta in United States v. Colgate, 250 U.S. 300, 307 (1919) that a party is free to decide independently whether and with whom it will deal in "the absence of any purpose to create or maintain a monopoly." As a result, although the amicus brief suggested that an objective standard unrelated to intent or motive should be employed in evaluating unilateral refusals to deal, the citation of the Colgate dicta could be read as embracing such a subjective standard.

> predation as conduct "that would not be considered profit maximizing except for the expectation" of a resulting reduction in competition). Accordingly, the antitrust laws usually permit monopolists, if lawful, broad license in refusing to deal with others."

No attempt was made in the amicus brief to explain how this standard applied to the facts of either the Kodak or Xerox cases or would be applied by the Antitrust Division in future cases.

C. None of the Proffered Rationales for Challenging Unilateral Refusals to License Intellectual Property Withstands Scrutiny

Various arguments have been advanced in support of the position that antitrust liability may be based on a refusal to license intellectual property. The Ninth Circuit in Kodak concluded that a refusal to license could form a basis for liability if the intellectual property owner was attempting to extend a dominant position in one antitrust market "into another market" and if the asserted business justification for the refusal to license was "pretextual." As noted above, the Justice Department's amicus brief in Xerox indicated that antitrust liability could be based on a refusal to license if the intellectual property owner was sacrificing monopoly profits from licensing in order to exclude rivals and gain additional monopoly power. A few of the witnesses at the May 1 session of the hearings devoted to refusals to deal, along with certain commentators, have equated intellectual property to tangible property and argued that the "essential facilities doctrine" and/or the Colgate "purpose" dicta provide a basis for imposing antitrust liability for mere refusals to license intellectual property. As explained below, none of these rationales survive critical scrutiny.

1. Extension of Market Power Into "Another Market"

The premise underlying the Ninth Circuit's Kodak decision – that a patent or copyright can be used only in one antitrust market – is flawed. As one of the participants in the May 1 panel explained, the "fundamental error here was the conclusion that antitrust theories relating to the improper extension of intellectual property rights from one market to the another are applicable to a unilateral refusal to deal in patented property, where the patent rights at issue can be said to encompass multiple antitrust markets."[6] There is simply no reason why the appropriate exercise of intellectual property rights should be limited to a single antitrust market. Since the concept of an "antitrust market" bears no relationship to the scope of a given invention as described in a patent's claims, it makes no sense to attempt to place an artificial "single antitrust market" limit on the exercise of the right to exclude others from use of one's intellectual property.

[6] Statement of Mark D. Whitener at 3-4 (May 1, 2002).

The flaws in the Ninth Circuit's "extension to another antitrust market" rationale in Kodak were exposed in the following excerpt from the amicus brief that the Intellectual Property Owners Association filed in the Supreme Court in support of the Federal Circuit's Xerox decision:

> A patentee or copyright holder should be free to exploit and extend the advantages conferred by the superior qualities of the invention and the exclusive right to use the invention in each and every application in which it is proved to have value, to the fullest extent permitted by the coverage of the patent or copyright. Indeed, intellectual property rights are pursued and valued precisely because they convey the right to exclude others from using the protected invention or work in all applications. Accordingly, in order to preserve this value, an intellectual property holder should be able to keep a protected innovation for itself and to obtain as profitable a position in as many economic markets as an innovation, measured by the patent or copyright itself, will permit. This case illustrates the application of this principle in the case of sequential equipment and service markets, but the principle applies with equal force to multiple parallel markets.
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> For example, the inventor of a revolutionary new material may well find that the material provides it with a decided edge – perhaps even a dominant position – in economically defined markets for various goods and services made with or using the material. Armed with its patent, the inventor may enter the markets for insulation, kitchen utensils, or boat repair by offering products and services based on this revolutionary material. The material's performance may be so extraordinary that, by force of consumer demand, the inventor is soon dominant in all the economic goods and services markets it enters, displacing competitors right and left.
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> When an innovation affects many economic markets, it is more important – not less so – to provide the innovator with the fullest measure of reward consistent with the scope of the intellectual property grant, thereby encouraging more private investment in experimentation and the expansion of knowledge. CSU [the plaintiff in Xerox], by contrast, would invert these incentives, punishing an innovator who patents inventions or copyrights works in direct proportion to the degree its innovation affects multiple economic markets: In CSU's world, the unlucky innovator faces a Hobson's choice

> of either confining the returns for the investment to one economic market (presumably chosen in advance), or risking an adverse treble damages award on a Sherman Act claim, along with a companion patent misuse finding that would prevent any enforcement of the patent at all. Such a rule would greatly diminish the incentives for the innovator of a sophisticated product to invest further in servicing and repair technologies for the product. Fortunately, this is not, and has never been, the law.[7]

2. Subjective Intent/Motive or Purpose to Create or Obtain a Monopoly

Both the Ninth Circuit's Kodak decision and the Colgate dicta premise antitrust liability on the subjective motivation of the intellectual property owner in refusing to license others. This approach is dangerous and unworkable. Since the grant of intellectual property rights is inherently exclusionary, it is an exercise in semantics to attempt to distinguish between a legitimate exercise of the right to exclude and an illegitimate attempt to obtain or maintain market power through denying competitors access to valuable intellectual property. See Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 64 (1993) ("[C]ondition[ing] a copyright upon a demonstrated lack of anticompetitive intent would upset the notion of copyright as a limited grant of monopoly privileges intended simultaneously to motivate the creative activity of authors and to give the public appropriate access to their work product.") (internal quotation and citation omitted). As members of the May 1 panel observed, such an approach should be rejected not only because it lacks predictability but also because it transforms every antitrust challenge to a refusal to license into a jury question subjecting owners of intellectual property to the prospect of costly litigation and potential treble damages verdicts.

Professor Shapiro explained that an attempt to distinguish the lawful exercise of valid patent rights from an improper intent to exclude rivals is "both economic nonsense and unworkable in practice." Carl Shapiro, "Competition Policy and Innovation" at 13 (OECD STI Working Paper/2002/11) (hereinafter "Shapiro"). He noted that the intent standard does not work because "[m]any companies apply for patents precisely to have the right to (at least threaten to) exclude competitors (from infringing) and precisely to capture a return on the R&D that led to the patents." Id. Jonathan Gleklen underscored the real world potential for abuse inherent in any standard based on the intellectual property owner's subjective motivation for refusing to license. "If an inquiry into subjective intent is permissible, no IP owner can refuse to license without facing discovery in an antitrust suit – and maybe a trial. Anyone can allege 'pretext' to survive

[7] In the context of a refusal to deal, the scope of the intellectual property is self-defining in the sense that as long as a license is needed for use of the intellectual property (or product made through its use) then the refusal is "within the scope of the intellectual property grant." Otherwise, the refusal would have no impact on others because they would be free to compete without infringing the intellectual property.

a motion to dismiss, and can likely develop evidence to survive summary judgment." See Gleklen supra n.1 at 8.

3. Essential Facility Doctrine

The "essential facility doctrine" has been severely criticized by scholars as just an "epithet" or "label" rather than an "independent tool of analysis" for determining when, if ever, a monopolist has a duty to deal with others. P. Areeda and H. Hovenkamp, Antitrust Law §736.1a at 619 (1995 Supplement). The shortcomings of the essential facility approach are readily apparent in the context of claims based on a refusal to "share" intellectual property.[8]

First, in order to be "essential," a monopolist's "facility" must "not only be desirable but critical, and not practically duplicable or otherwise obtainable." Id. §736.2 at 640. When applied to intellectual property, this factor has the perverse effect of placing only the most important innovations at risk – the very inventions that the intellectual property laws are designed to encourage by offering exclusive rights as an incentive to invest the resources required to make important scientific and technological breakthroughs. Moreover, the important policy of encouraging others to invest in new approaches to invent around existing patents would be undermined if companies could gain access to key inventions by claiming that they "need" a patented product or material in order to compete against the patent owner.

Second, a key limitation on most applications of the "essential facility doctrine" to tangible property is the requirement that providing access to others not interfere with the owner's legitimate use of its property. In one sense, of course, providing access to others undermines the expectation of exclusive use that is the essence of intellectual property. However, unlike physical property (such as a stadium or bridge or transmission line), intellectual property can always be shared with all interested parties without limiting the use of the intellectual property by its owner.

The combination of these two factors demonstrates that the doctrine has no application to monopolies based on intellectual property since it would have the counterproductive effect of neutralizing the very incentives underlying the intellectual property laws. In addition, as explained below, there is the overriding practical problem that courts are ill-equipped to prescribe the price and other key commercial terms on which "essential" intellectual property would be made available to others under the "essential facility doctrine."[9]

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8 See William J. Kolasky, "North Atlantic Competition Policy: Converging Toward What?" Address Before the BIICL Second Annual Int'l and Comparative Law Conference (May 17, 2002).

9 "[E]ndorsement of the essential facilities doctrine must be based on acceptance of the concept of full judicial regulation of natural monopolies if it is to be capable of improving consumer welfare even in theory." Abbott B. Lipsky, Jr. & J. Gregory Sidak, Essential Facilities, 51 Stan.L.Rev. 1187, 1222 (1999) (emphasis in original). Such regulation -- without specific legislative involvement in what is in reality a judicially crafted regulatory scheme -- raises a variety of issues and, for these and other reasons, appears "inherently inconsistent with intellectual property protection." Id. at 1219.

4. Sacrifice of Profits to Exclude Competition And Create Additional Market Power

The standard advocated by the United States in its amicus brief to the Supreme Court in Xerox focuses on the sacrifice of profits to create additional market power. Since the brief offered no explanation of how this standard is to be applied to refusals to deal, it is difficult to assess this standard. Nevertheless, several flaws are apparent.

First, this test focuses only on static efficiency – the impact of the refusal to license upon competition with the intellectual property owner – and ignores the long-term effects of a rule requiring licensing upon incentives to innovate and to disclose those innovations in patents. As the First Circuit noted in Data General Corp. v. Grumman Systems Support Corp., 36 F.3d 1147, 1186-87 (1st Cir. 1994), "in passing the Copyright Act, Congress itself made an empirical assumption that allowing copyright holders to collect license fees and exclude others from using their works creates a system of incentives that promotes consumer welfare in the long term by encouraging investment in the creation of desirable artistic and functional works of expression … We cannot require antitrust defendants to prove and reprove the merits of this legislative assumption in every case where a refusal to license a copyrighted work comes under attack."

Second, the standard appears to invite a case-by-case battle of economic experts that could undermine the benefits of certainty provided by a rule that permits refusals to license without risk of exposure to antitrust liability. In addition, as with each of the other proffered standards, the "Xerox amicus test" fails to come to grips with the problem of setting the appropriate license fee and determining the other terms on which the owner of intellectual property would be forced to license.

5. Practical Considerations Counsel Against Imposition of a Unilateral Duty to Deal

It is widely acknowledged that an owner of intellectual property "is perfectly free under the antitrust laws to charge monopoly prices." Brief of the United States as Amicus Curiae in Xerox at 5; see generally Brulotte v. Thys Co., 379 U.S. 29, 33 (1964) ("A patent empowers the owner to extract royalties as high as he can negotiate with the leverage of his monopoly."). In most (if not all) situations, an owner of intellectual property can accomplish the same result as a refusal to license by simply offering to license at a very high license fee. If such an offer sufficed to avoid potential antitrust liability for a refusal to deal, any duty to deal requirement would become a hollow gesture because it could be easily sidestepped by the intellectual property owner.

The alternative is to place judges in the position of setting "reasonable" license fees and defining other key terms on which compulsory licensing would be required. Because courts are not equipped to discharge these responsibilities, a "refusal to deal should not be considered unlawful and forced dealing should not be ordered unless the court can do so without becoming a day-to-day price control agency." P. Areeda and H.

Hovenkamp, supra, §736.2 at 641.[10] Even the much more limited fallback of ordering "nondiscriminatory" licensing is problematic, since it has no applicability unless there are some licensees and since an owner of intellectual property is generally viewed as free to set different license fees for the same intellectual property. See generally USM Corp. v. SPS Technologies, Inc., 694 F.2d 505, 512-13 (7th Cir. 1982) (noting that "there is no antitrust prohibition against a patent owner's using price discrimination to maximize his income from the patent.") Moreover, a nondiscriminatory license requirement risks deterring beneficial licensing altogether or encouraging higher license fees in anticipation of a potential order compelling the intellectual property owner to license others on similar terms.

D. The Related Issue of Limited License Grants

In the absence of a unilateral duty to license intellectual property, a limited license grant (i.e. granting a license for a defined field of use) that does not impose any other conditions or restrictions on the licensees should be viewed as beneficial and procompetitive. The 1988 and 1995 Guidelines discussed above recognize the procompetitive benefits of licensing. See 1988 Guidelines at §3.61; 1995 Guidelines at §2.3. As the 1995 Guidelines explain, a "non-exclusive license of intellectual property that does not contain any restraints on the competitive conduct of the licensor generally does not present antitrust concerns even if the parties to the license are in a horizontal relationship, because the non-exclusive license normally does not diminish competition that would occur in its absence." §4.1.2 at 16, see Shapiro at 18-19 ("restrictions that simply limit the extent of the grant to use the licensor's intellectual property … will not typically prevent competition that would have taken place in the absence of the license").

II. Legislation is Needed to Establish that Intellectual Property Rights Do Not Automatically Confer "Market Power"

The question of whether intellectual property rights automatically confer market power for purposes of antitrust analysis continues to be a problem for intellectual property owners because of outdated Supreme Court pronouncements. Federal antitrust authorities have properly rejected the view equating intellectual property with market power expressed in some old Supreme Court's decisions, but with the proliferation of antitrust remedies available to private individuals, and the concomitant rise in antitrust enforcement by states, the implications of the uncertainty created by these decisions has not diminished with time. USCIB therefore urges the Federal Trade Commission and the Department of Justice to support legislation that would make it clear that no presumption of "market power" can be made in an antitrust action based solely on a party's ownership of an intellectual property right.[11]

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[10] The Ninth Circuit overturned the district court's injunction requiring Kodak to sell at "reasonable prices," holding that this requirement "involves the court in a matter generally considered beyond our function, namely, direct price administration." Image Technical, 125 F.3d at 1225. The court thus held that "Kodak is entitled to monopoly prices on its patented and copyrighted parts." Id.

[11] We believe that in enacting 35 U.S.C. § 271(d)(5) Congress has already eliminated the presumption of market power in tying cases involving patents. That provision provides that "[n]o patent

Congress has been careful to strike a balance between the interests of innovators and those of consumers. Recognizing that innovation is an uncertain and often extremely costly process, [12] Congress has granted innovators certain limited bundles of rights,[13] the exercise of which may allow innovators to recoup those costs. Innovators may temporarily be able to charge higher prices for their specific innovation if it lacks effective substitutes, but consumers ultimately benefit through the wider variety of goods and services that are available as a result of more innovation.[14]

For many years, patents and copyrights were viewed by the antitrust enforcement agencies, and by the courts, as a unique form of property, warranting special treatment under antitrust laws. Typical of this suspicion is the Supreme Court's dictum in United States v. Loew's, Inc., 371 U.S. 38, 44 (1962), asserting that the economic power necessary to establish a tying claim is "presumed when the tying product is patented or copyrighted." The high water mark of this view was the infamous Antitrust Division speech listing the "Nine No-No's" of patent licensing.[15] While the

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owner otherwise entitled to relief for infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: . . . (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, *unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned*." (Emphasis added). Nevertheless, it remains important to eliminate the presumption of market power in all contexts, not just tying, and for copyrights as well as patents.

12 "[T]he federal patent system, and the constitutional grant of authority from which it is derived, are based on the recognition that '[I]nnovation is an uncertain business,' and that, '[t]o spur investment in it, inventors must be reasonably assured that they will be able to recoup their costs and earn a profit.'" *Market Power and Intellectual Property Litigation: Hearing before the House Judiciary Subcommittee on Courts, the Internet, and Intellectual Property*, 107th Cong. 18 (2001)(statement of Ronald E. Myrick, President of Intellectual Property Owners Association), quoting Rochelle C. Dreyfuss, Dethroning Lear: Licensee Estoppel and the Incentive to Innovate, 72 Va. L. Rev. 677, 679 (1986).

13 In the case of patents, the basic rights are set forth in 35 U.S.C. §154(a)(1) ("the right to exclude others from making, using, offering for sale, or selling the invention."). In the case of copyrights, the basic rights are set forth in 17 U.S.C. § 106 ("the owner of a copyright has the exclusive rights to do and authorize any of the following: (1) to reproduce the copyrighted working copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works , to perform the copyrighted work publicly; (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial graphic or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and, (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.").

14 See, e.g., Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 151 (1989) (Supreme Court recognized that current patent laws strike a "carefully crafted bargain" in order to maximize innovation and research and development by giving inventors right to exclusive use of patented inventions for a period of time while allowing consumers access to technology and thereby allowing additional follow on innovation and consequently competition).

15 Bruce B. Wilson, "Patent and Know-How License Agreements: Field of Use, Territorial, Price and Quantity Restrictions," Address Before the Fourth New England Antitrust Conference (Nov. 6, 1970).

Antitrust Division has long since repudiated the "Nine No-No's", intellectual property rights holders still are faced with statements by the Supreme Court like those in Loew's, supra, and in Jefferson Parish, where the Court in dictum stated that "if the government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." Jefferson Parish Hosp. Dist. No. 2. v. Hyde, 466 U.S. 2, 16 (1984). Although Justice O'Connor rejected this presumption in her concurring opinion, stating that "a patent holder has no market power in any relevant sense if there are close substitutes for the patented product", id. at 37, n.7, her views did not command a majority of the Court.

A number of lower court decisions since Jefferson Parish have accepted Justice O'Connor's position, and have concluded that there is no basis to presume the existence of market power simply because the defendant owns a patent or copyright.[16] Further, acknowledging competitive realities and the economic learning of the past several decades, the Antitrust Division and the Federal Trade Commission concluded in their 1995 Guidelines: "The Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although the intellectual property right confers the power to exclude with respect to the *specific* product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power." Id. § 2.2.

Thus, the Supreme Court's statements on this issue have begun to lose their intellectual force. But the landscape remains uncertain. The 1995 Guidelines are merely guidelines, and are not binding on the courts. Despite the cases that have questioned or rejected the presumption of market power arising from a patent or copyright, there remain other lower court cases that accept the market power presumption.[17] The Supreme Court could settle this uncertainty by granting *certiorari* in one of the many cases addressing the issue of a presumption of market power due solely to the ownership of intellectual property rights. It has had the opportunity to do so in a number of petitions since Jefferson Parish, but it has thus far declined to clarify this issue.[18]

The lack of a definitive Supreme Court decision eliminating the presumption of market power for intellectual property rights leaves this crucial intersection of antitrust and intellectual property law uncertain. The uncertainty is exacerbated by cases such as the Ninth Circuit's Kodak decision, holding that a seller that has market power can

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[16] E.g., Abbott Laboratories v. Brennan, 952 F.2d 1346, 1354-55 (Fed. Cir. 1991), cert. denied, 505 U.S. 1205 (1992); Mozart Co. v. Mercedes-Benz of N. Am., Inc., 833 F.2d 1342, 1346 n.4 (9th Cir. 1987), *cert. denied,* 488 U.S. 870 (1988); A.I. Root Co. v. Computer/Dynamics, Inc., 806 F. 2d 673 (6th Cir. 1986); Will v. Comprehensive Accounting Corp., 776 F.2d 665 (7th Cir. 1985).

[17] See, e.g., Digidyne v. Data General Corp., 734 F.2d 1336 (9th Cir. 1984), cert. denied, 473 U.S. 908 (1985).

[18] E.g., Data Gen. Corp. v. Digidyne Corp., 473 U.S. 908, 909 (1985) (White and Blackmun, JJ., dissenting from denial of certiorari) ("this case raises several substantial questions of antitrust law and policy, including . . . what effect should be given to the existence of a copyright or other legal monopoly in determining market power").

violate Section 2 of the Sherman Act by refusing to license a competitor if the seller's subjective intent is to eliminate a competitor. Image Technical Services, Inc. v. Eastman Kodak Co*.,* 125 F.3d 1195 (9th Cir. 1997). Further, in light of the numerous, and sometimes overlapping, antitrust remedies available in American courts – federal and state government civil claims, private federal class action cases, indirect purchaser claims under state law, *parens patriae* actions by the States, and even disgorgement remedies[19] – a presumption that increases the risk of antitrust litigation and liability attaches a significant disability to the statutory rights granted to patent and copyright holders.

In light of the continuing uncertainties, the potential chilling of innovation and the corresponding harm to consumers from reduced innovation, and the Supreme Court's apparent lack of interest in further addressing the presumption of market power, clarifying legislation would appear to be the best solution. Appropriate legislation will remove the existing cloud of uncertainty and will also ensure that this important area of law is not left to the vagaries of guidelines that may be issued by federal antitrust agencies under shifting policies brought on by future changes in administrations.

III. ISSUANCE OF GUIDELINES ON INTELLECTUAL PROPERTY IN STANDARD-SETTING WOULD BE PREMATURE AT THIS TIME

Several commentators have recently noted the lack of clear legal precedent in the standard-setting area, and suggested that competition could be enhanced if the FTC and DOJ were to issue guidelines setting forth principles governing the scope of permissible conduct with regard to intellectual property in the standard-setting context. Other commentators, taking the opposite view, have argued that adoption of guidelines by the agencies would in fact stifle competition.

USCIB endorses vigorous debate over whether such guidelines would be helpful and believes that there is some merit on both sides of the issue. There is widespread agreement that standard-setting can be procompetitive, and also that abuse of the standard-setting process can have anticompetitive effects. Thus, it is important both to avoid chilling participation in standard-setting through the adoption of overly restrictive guidelines, and also to protect—whether through guidelines or legal measures—against abuses of the standard-setting process.

USCIB believes that it is too early to say categorically that agency guidelines on standard-setting would never be appropriate. However, USCIB believes that the issuance of federal antitrust enforcement guidelines regarding intellectual property in standard-setting would be premature at this time. Moreover, further developments may well establish that standard-setting is an area in which industry self-regulation is most appropriate. Given the current lack of significant agency experience in this area and the lack of a clear consensus within the antitrust and intellectual property bars regarding the

[19] See Antitrust Remedies in the 21st Century: Too Many Actions? Too Much – or Still Too Little – Recovery? (Chair's Showcase Program, ABA Antitrust Section 50th Annual Spring Meeting, April 25, 2002).

proper framework for evaluating the role of intellectual property in standard-setting activities, adoption of guidelines by the Agencies at this time could have the unintended effect of chilling procompetitive participation in standard-setting organizations ("SSOs").

A. Recent Views Expressed on the Need for Guidelines

David Balto and Daniel Prywes recently urged the Federal Trade Commission to issue guidelines or a policy statement on standard-setting.[20] They contend that the business community would benefit from guidance on standard-setting issues because there is little recent guidance or case law in this area. Balto and Prywes identify a number of topics they believe should be addressed in guidelines, and offer substantive proposals for each. These topics include disclosure of patents implicating proposed standards, the duty to search for such patents, commitments to license, joint negotiation of license terms, licensing conditions, patent cross-licensing, patent pooling, and alternative dispute resolution.

In a comment on the Balto and Prywes recommendation, Bob Skitol agrees that the issue of guidelines on standard-setting is worthy of debate, but takes no position on whether such guidelines should be issued.[21] Nor does Skitol express a view on any of the substantive proposals made by Balto and Prywes. However, Skitol does insightfully state that "there is no neat one-size-fits-all rule or policy appropriate for the myriad of standard-setting circumstances with differing degrees of potential for antitrust trouble throughout today's high-technology landscape." USCIB agrees with this assessment, and believes this factual variability counsels against the desirability of issuing guidelines in the near term.

Several participants in these proceedings have rejected the need for Agency guidelines on standard-setting. Richard J. Holleman, Treasurer of the Institute of Electrical and Electronics Engineers, Inc. ("IEEE"), notes that SSOs are well aware of, and take steps to address, the competitive concerns related to standard-setting, including the use of patented technologies in a proposed standard.[22] He argues that SSOs have developed guidelines to ensure that the interests of all participants in the process are fairly represented, and antitrust counseling is already available from those familiar with the industry. Uniform guidelines, according to Holleman, could restrict the current flexibility of SSOs with respect to their standards and policies. He concludes that enforcement guidelines would likely "stifle competition, inhibit innovation and impede economic growth."[23]

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[20] David A. Balto and Daniel I. Prywes, "Standard-setting Disputes: The Need for FTC Guidelines," FTC Watch No. 585 at 14 (Mar. 25, 2002).

[21] Robert A. Skitol, "Comment on the Balto/Prywes Proposal," FTC Watch No. 585 at 16 (Mar. 25, 2002).

[22] Richard J. Holleman, "A Response: Government Guidelines Should Not Be Issued in Connection With Standard Setting," available at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%2022-23:.

[23] Id.

Amy A. Marasco, Vice President and General Counsel of American National Standards Institute ("ANSI"), also expresses concern that "one-size-fits-all guidelines" may inhibit competition or standard-setting. She points to the minimal government enforcement activity regarding SSOs to support her position that there is little need for agency guidelines. Instead, she prefers continued self-policing by standard-setting bodies, which she argues have an excellent track record in preventing intellectual property disputes among members. ANSI is also concerned that governmental guidelines could serve as a basis for disadvantaging U.S. companies participating in foreign SSOs.

A middle ground is staked out by Andrew Updegrove, who rejects the concept of "strict guidelines" but who nevertheless feels that the Agencies could provide some guidance to the industry. He calls for a continuing dialogue on standard-setting issues, such as the current hearings; an announcement that the rule of reason should govern any analysis of intellectual property policies for standard-setting; an identification of those aspects of standard-setting that are pro-competitive; and a statement on leaving the policies and requirements of SSOs to themselves.

As these comments demonstrate, there are a variety of views on the necessity of agency guidelines on standard setting. No one appears to dispute that businesses would benefit from a clearer understanding of the situations in which the federal antitrust agencies might view certain conduct as an anticompetitive abuse of the standard setting process. However, there clearly is strong disagreement about the necessity, and even the advisability, of formal agency guidelines on standard-setting.

B. SSOs Appear to be Dealing Successfully With the Issue of Intellectual Property in Standard-Setting

Many of our members participate in standard-setting organizations that have already developed guidelines to ensure fair and pro-competitive standards for their members. Issuing unduly rigid or premature agency guidelines could inhibit the flexibility of these organizations to experiment with differing methods of addressing the issue of standard setting.

- IEEE, a nonprofit, professional association in 150 countries, has more than 860 active standards in various technical areas and approximately 700 more under development. The organization has developed detailed policies and procedures for new standards, revisions and reaffirmations. IEEE has developed guidelines, *inter alia,* for use of patented technology in its standards.

- The JEDEC Solid State Technology Association (formerly known as the Joint Electron Device Engineering Council) develops standards for the semiconductor industry. Its *Manual of Organization and Procedure* lists proscribed activities and contains guidelines to ensure due process of members. The manual also provides standards for incorporating patented technology and requires the disclosure of known patents and patent applications that are or may be relevant to the work of the formulating committee.

- ANSI is a private, nonprofit organization that administers and coordinates the U.S. voluntary standardization and conformity assessment system. Its *Procedures for the Development and Coordination of American National Standards* include due process requirements for approval and withdrawal of standards, including ones relating to the inclusion of patents in standards.

These SSOs, and countless others, have adopted some form of policy that addresses the use of intellectual property in standards adopted by the SSO. However, as demonstrated by Mark Lemley in his submission to the agencies in connection with these hearings, the various SSOs take vastly different approaches to a number of issues related to intellectual property in the context of standard-setting, including whether the policy applies only to patented intellectual property or also to trademarks and copyrighted works; whether the participant has a duty to disclose the existence of intellectual property in its possession that may be implicated by a proposed standard; whether the participant has a duty to conduct a search to determine whether it has such intellectual property; whether the SSO will adopt a standard that implicates the intellectual property of a participant; and whether a participant with intellectual property that is implicated by an adopted standard must agree to license the intellectual property to other participants and if so, on what terms.[24] Given that these SSOs are effectively conducting real-world experiments on what policies do and do not work, the agencies should defer serious consideration of the issuance of guidelines until such time as a stronger consensus develops on effective policies.

C. Lack of Agency Familiarity With Myriad Factual Circumstances

Intellectual property in the standard-setting context is not an area where the agencies have a deep record of investigatory experience. The FTC recently filed an administrative complaint against Rambus Inc. alleging that the company monopolized the market for synchronous dynamic access memory chips by failing to disclose its ownership of certain patents and patent applications to an industry SSO (JEDEC) of which it was a member, in violation of the organization's rules. Prior to its complaint against Rambus, the FTC had brought only two actions involving intellectual property in the standard-setting context, <u>In re Dell</u>, 121 F.T.C. 616 (1996), and <u>In re American Society of Sanitary Engineering</u>, 106 F.T.C. 324 (1985). There have also been reports that the FTC is investigating standard-setting conduct by Sun and Unocal, although no complaints have yet been filed against these companies by the FTC.

It is noteworthy that although the FTC brought its action against Dell over five years ago, the FTC administrative complaint against Rambus marks the first action since <u>Dell</u> by either agency involving intellectual property in standard-setting. In the interim, in part in reaction to <u>Dell</u>, many SSOs have developed additional procedures and approaches to improve the fairness and transparency of standard-setting. These

[24] Mark A. Lemley, "Intellectual Property Rights and Standard Setting Organizations," available at http://www.ftc.gov/opp/intellect/detailsandparticipants.htm#May%2022-23:.

hearings on competition and intellectual property are helping to provide the agencies and the public with much needed information on developments percolating in important areas including standard-setting.

Given the agencies' limited experience with unilateral conduct involving intellectual property in the standard-setting context as compared to the collusive abuses of standard-setting processes that the agencies have looked to in the past, the agencies may presently lack sufficient familiarity with factual specifics of different standard-setting approaches, and with the potential abuse of the various specific standard-setting processes, to issue well-informed guidelines in this area. Previous guidelines issued by the agencies have been based on considerable experience with the underlying subject matter and have embraced widely accepted theories of law and economics. There may come a time when the agencies develop sufficient experience to position them to issue informative guidelines based on familiarity with the various procompetitive benefits of standard-setting and the potential anticompetitive abuses of the process. It may also become apparent that self-regulation is preferable and that no guidelines are necessary at all.

D. Conclusions

USCIB believes that the debate over whether the agencies should promulgate guidelines is to be applauded. Balto and Prywes have raised an important issue that warrants serious thought and discussion. Given the critical role that technology and information have come to and will continue to play in our economy, the need for standards as a means of facilitating competition and enhancing consumer welfare will only grow. However, issuance of standard-setting guidelines by the agencies would be premature. The presently limited case-specific and process-specific experience of the agencies and the courts in this area strongly counsels against the drafting of guidelines at this time. As the agencies and courts gain greater experience in these areas, the wisdom of guidelines can be better evaluated.

IV. Antitrust Law Should Not Be Used to Remedy Deficiencies in the Patent System

The United States Patent and Trademark Office (PTO) has been frequently criticized for its perceived inability to handle the overwhelming number of patent applications that it received in the course of the innovation explosion of the past decade. While this innovation helped drive the national economy into the greatest economic expansion in our history, questions arose as to the legitimacy of some seemingly ill-considered patents that had been granted by the PTO. Although such patents have the potential to chill innovation and harm competition, the remedy for this situation should not be sought through the antitrust laws. Rather, any corrections that could or should be made to the patent system should start at the patent office itself -- the single governmental agency that is most expert in dealing with complex scientific matters and the one that has proven, for the most part, its ability to react when necessary.[25]

The needed improvements are twofold. First, the funding of the patent office should be increased by ending the diversion of patent fees to finance other government programs. Second, the United States should conform to some of the best practices in the patent laws of other countries, most importantly the first-to-file standard that is dominant internationally.

A. The PTO Should be Allowed to Retain the Revenues that it Procures through User Fees

Over the past decade, Congress has removed almost $700 million[26] received by the PTO in the form of user fees and spent that money elsewhere. These funds are vitally needed to improve an overstressed and overworked patent examination system. Fortunately, the most recent budget proposal from the Bush administration indicates that the Patent and Trademark Office will indeed be given an increase for the coming budget year. However, a decade of inadequate funding has left the PTO with a backlog of pending cases, an undersized examining corps and the inability to appropriately handle much needed infrastructure improvements. In spite of these hardships, the PTO continues to provide quality and timely examinations in the vast majority of cases. Surveys have demonstrated an increased level of satisfaction from a user base that fully understands the limitations and constraints placed on the system by a lack of effective and appropriate government funding.

The diversion of patent fees is nothing more than an undeclared tax on innovation, the very activity encouraged by the Patent Clause of the Constitution. By securing its own revenue stream, the PTO could expend those resources on additional examiners and increased career development for the current corps of examiners. Patent examiners routinely resign from government service to obtain markedly higher salaries in the private sector. Indeed, among government service employees, it appears that only medical professionals in the Armed Forces can receive a greater increase in salary by leaving government service. An enhanced career plan for patent examiners will allow the patent office to maintain and promote those examiners who demonstrate the greatest skill and efficiency in making proper decisions during the examination process.

B. U.S. Patent Laws Should Conform to International Best Practices

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[25] For instance, when public outcry arose over the issuance of an overly broad "Y2K" computer software patent (United States Patent No. 5,806,063), then Commissioner Dickinson reacted to this concern and ordered a reexamination of the patent.

[26] See Statement of Michael K. Kirk, Executive Director, American Intellectual Property Law Association before the Subcommittee on the Courts, the Internet and Intellectual Property, Committee on the Judiciary, US House of Representatives at the Oversight Hearing on "The US Patent and Trademark Office: Operations and Fiscal Year 2003 Budget" April 11, 2002, at www.house.gov/judiciary/kirk041102.htm.

In addition to the problems caused by the lack of funding over the past several years, the work of the PTO examiner is made more difficult by the vagaries of US patent law itself. The United States patent system, with its continued focus on the date of invention, rather than the date of filing of an application, is out of step with best practices found everywhere else in the world. All other countries award a patent to the first inventor to file a patent application claiming the earliest possible priority date. Only in the United States does the system attempt to award a patent to the first person to invent. While this sounds like a laudable goal, in reality it forces upon the US applicant a set of prior art and patent defeating considerations that are overly complex and exceedingly expensive to maintain.

Of the hundreds of thousands of patent applications filed in the United States each year, fewer than one tenth of one percent are ever involved in a priority contest to try to determine which of two rival applicants was the first to invent the subject matter of a patent application.[27] The maintenance of this "interference" system casts a cloud over all other patents and patent applications in the United States. Even years after a patent has been issued and international commerce has committed itself to the exploitation of the US patent rights, "secret prior art" can be found that forces the issued US patent into an interference proceeding or district court litigation. Such uncertainties, arising from the manner in which the United States is forced to define prior art[28] can never arise in other patent systems that award the patent to the first inventor to file a patent application. In all other systems, the true prior art date arises only upon the disclosure of the invention to the public, not to some unknown and unknowable time in the past when another person may have also invented the subject matter of the claims. The United States government, with assistance from representatives of the PTO, should immediately seek to negotiate a patent law harmonization treaty that would bring the United States into line with the prior art systems of our trading partners around the world.

Such efforts could also be used to provide for simplified "best practices" in other areas of the patent law. The United States could move forward with a patent system based upon purely objective standards, rather than some of the more subjective aspects of US patent law. Adoption of best practices from other systems currently used by our international trading partners could allow the United States to adopt an "opposition" system, thereby allowing all interested members of the public to oppose the grant of a patent upon its issuance. Such systems in Europe and Japan enable the experts within the respective patent offices to make important determinations about the patentability of inventions based upon prior art and argument provided by opponents immediately upon grant of the patent. Allowing patent examiners and other patent experts to make such decisions would greatly reduce the number of cases later filed in Federal District Court by allowing all opponents to come forward and participate in an inexpensive and efficient opposition proceeding before the patent office.

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[27] The United States Patent and Trademark Office Annual Report for Fiscal Year 2000, states that there were 485,129 patent applications pending as of September 30, 2000. At the same time, there were 286 *inter partes* cases pending, only 0.06% of the total cases pending.

[28] 35 U.S.C. §102.

In conclusion, although random reports occasionally circulate within the popular press concerning issuance of questionable patents, it can be seen that the United States patent system is well positioned to fulfill its required functions into the new century. The system can be made better and more efficient by continued investment in the United States Patent and Trademark Office and careful consideration of the adoption of other patent "best practices" currently being used with success by our global trading partners. The public can be best served and confidence can be best maintained by encouraging the continued use of the patent system to protect innovation, investment and international commerce.

V. Patent Settlements Should Be Viewed Under a Rule of Reason Analysis

The Federal Trade Commission and the Department of Justice requested comments related to issues that arise when parties to a patent suit agree to settle such litigation. Settlements are often encouraged by the courts and by ongoing public policy concerns. Indeed, given the highly complex nature of patent litigation, the extraordinary costs in prosecuting any patent suit through the Federal Court system and the inherent uncertainties associated with exposing such a valuable asset to any risk, it is not surprising that the Federal Circuit continues to encourage litigants to settle patent disputes prior to adjudication.[29] The increased efficiencies and conservation of valuable judicial resources arising from voluntary settlements of patent disputes allow the expenditure of the private resources in other pro-competitive and innovative endeavors. The analysis of any private settlement between litigants in a patent action must take into account these varied and positive public policy considerations.

A duly issued United States patent is presumptively valid[30] and therefore confers upon the patent holder the right to exclude from the market any goods that infringe this presumptive right. In most cases, a single patent will not confer to the patent holder any market power in a properly defined relevant market. This is, of course, not always the case. For example, in the pharmaceutical industry, a new and improved drug may dominate a therapeutic class, and a single patent covering the active chemical compound or drug substance might thus afford market power.[31] The creation of these patent rights arose from Congressional action through the passage of the Patent Act. This action, and the market power it may sometimes confer, encourages the risk of investment that drives all innovative industry and further fuels economic growth both domestically and abroad.

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[29] See, e.g., Bradley v. Chiron Corp., 136 F.3d 1317 (Fed. Cir. 1998).

[30] 35 U.S.C. §282.

[31] However, a patent that confers an exclusive right to a single drug substance still promotes science and the useful arts. For instance, while a single patent covering fluoxetine hydrochloride protected this molecule from competition for the statutory term, the disclosure of this molecule and its medicinal activity fueled innovation throughout the pharmaceutical industry and brought forth to the market many other selective serotonin reuptake inhibitors currently sold for the treatment of many neurological disorders.

When the rights conferred by a patent are litigated, all parties to the litigation face significant risk. The patentee stands to lose significant revenue, perhaps even an entire franchise, if the patent is declared invalid or unenforceable. While a declaration of non-infringement does not necessarily cause the patentee to lose the entire value of the patent, the inability to enforce the patent beyond the scope of a more narrowly construed claim negatively impacts the value of those claims in maintaining what otherwise could have been an exclusive position in the marketplace.[32] In the same manner, the accused infringer stands to suffer an early preliminary injunction as well as liability for damages in the event the patent is declared not invalid and infringed. With liability awards often running into the millions of dollars and the cost of litigation growing at an alarming rate, prudent business leaders will always seek a more efficient and certain outcome via voluntary settlement. Removing the risks inherent in litigation allows the patentee to further invest in marketing the patented product or to invest in research and development of other product improvements or separate product lines. Upon settlement, if licensed, the accused infringer can compete in the marketplace without the concern of a future damage award or permanent injunction. If not licensed, the accused infringer can concentrate on designing around the patent without undergoing the continued expense of litigation.

The preeminent concepts of certainty and litigation risk-avoidance, within a public policy framework that encourages voluntary dispute settlement without consuming scarce judicial resources, act to foster the appropriate investment in intellectual property. The 1995 Guidelines recognize that litigation settlements are efficient and beneficial. [33] Litigation risks often occur at the most inopportune time in a product life cycle, exactly when the newest products are arriving in the marketplace. Entrepreneurs are willing to invest heavily in early and late phase product development, but few are willing to undergo a calculated risk on something as unpredictable as a patent trial. The ability to seek certainty and avoid litigation risk allows the prudent innovator and entrepreneur to invest in risks that are more foreseeable and controllable, the risks of developing and bringing new innovations to the market. Given the substantial and increasing costs and unpredictability of litigation, therefore, efforts to reduce those costs and uncertainties are extremely important to maintaining proper incentives for investment in the creation, transfer and use of intellectual property.

Recent FTC enforcement actions and judicial decisions in the pharmaceutical industry have cast a shadow over the ability of private litigants to settle intellectual property litigation without taking a risk that their settlement conduct will be deemed *per se* unlawful.[34] The assertions of *per se* liability and the peculiarities of the structure of the settlement agreements arose essentially from the type of patent litigation that is required by the Hatch-Waxman Act, where the generic patent challenger must first

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[32] The uncertainty related to claim construction and declarations of non-infringement is most troubling given that many claim construction decisions promulgated by the District Courts are overturned or revised by the Federal Circuit.

[33] The 1995 Federal Antitrust Guidelines for the Licensing of Intellectual Property, §5.5 (1995).

[34] Cardizem CD Antitrust Litigation, 105 F. Supp. 2d. 682 (E.D. Mich. 2000) and Terazosin Hydrochloride Antitrust Litigation, 164 F. Supp. 2d. 1340 (S.D. Fla. 2000).

commit an *artificial* act of infringement[35] that then provokes a lawsuit related to the specific drug product. Given the extraordinary expense and risk involved in drug product patent litigation, and given the encouragement of both the courts and ongoing public policy concerns, private litigants strive to settle such cases to avoid the inefficiencies of continued litigation. Allowing such settlements to be viewed under a regime of *per se* liability removes the incentive (perhaps even the ability) to settle such disputes, thereby forcing the litigants into a situation where patent disputes must become a fight to the finish. *Per se* liability should arise only when the parties to the agreement would have been competitors but for the terms of the agreement. In intellectual property litigation, the two parties cannot be viewed as competitors, particularly horizontal competitors, unless both parties can compete in the same market. Such competition is impossible when one party holds an exclusive intellectual property right and the other party is not a licensee to that right. Moreover, firms should not be viewed as horizontal competitors merely because the alleged infringer claimed that a patent was invalid, unenforceable, or not infringed. If the defendant's mere assertion that it has not infringed were enough to treat the parties as horizontal competitors, virtually every settlement of a patent case would have to be treated as an agreement between horizontal competitors.

A rule of reason approach is far superior in promoting innovation and competition. The parties to the intellectual property dispute are in the best position to determine the risks and benefits of settling the case. Possible outcomes from a patent trial could range from a total loss of the intellectual property right and immediate entrance into the market of the competing product to a total repudiation of the alleged infringer's defenses and the issuance of an injunction preventing continued or future unauthorized competition related to the subject matter of the litigation. Any antitrust analysis of a settlement agreement must begin with these two outcomes in mind. Because one likely result of the litigation would be a permanent injunction related to the infringing product, the antitrust analysis must take into account that any *limit on competition* could well have been a total *restriction on competition* had the patentee prevailed at trial. Any analysis that does not begin with this consideration would require a decision on the merits of the dispute after the private parties have agreed to settle the suit, and such a decision cannot be made by the judicial system while maintaining the strong public policy considerations favoring settlement of disputes.

Because all United States patents are presumptively valid upon issuance, a rule of reason analysis should be used when the settlement agreement accords no party any greater market power than what otherwise could have arisen had the litigation proceeded on through the Federal Court system. For instance, a settlement that is reasonably restricted to terms involving a field of use (the field in which the intellectual property right grants the exclusive right) or time (a delay in entry into the market that is no longer than the term of the intellectual property right) should not be treated as suspect.[36]

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[35] The act of filing an Abbreviated New Drug Application (ANDA) is an artificial act of infringement, which gives the proprietor the right to bring an infringement action, but for which there are no infringing sales and therefore no monetary damages that can be awarded. Thus, the only remedy is an equitable remedy (a permanent injunction) at the end of an extremely expensive and risky patent trial.

[36] See Commissioner Thomas B. Leary, "Antitrust Issues in the Settlement of Pharmaceutical Patent Disputes, Part II," Remarks to American Bar Association Antitrust Healthcare Program," May 17,

Market definition becomes critical when the rule of reason is applied. Certainty in patent settlements has been undermined by internally inconsistent positions on market definition, particularly by the Federal Trade Commission. Although the Commission has historically viewed product markets as including all competitors within a therapeutic class when reviewing proposed mergers in the pharmaceutical industry, it has limited the relevant market to a single drug when reviewing intellectual property settlements. The agencies should provide clear guidance on their approach to market definition in the settlement context.

In conclusion, USCIB strongly favors a rule of reason analysis related to settlement agreements between litigants in intellectual property disputes. Such an analysis should first consider the scope of the right conferred by the intellectual property and the time accorded such right. So long as the settlement agreement between the parties does not restrict competition outside the limited scope or limited time of the disputed intellectual property right, the agreement should be viewed under a rule of reason. Any other result will hinder such settlements, increase complexity and force litigants into extended and expensive litigation that consumes judicial resources and stifles innovation and competition.

VI. The Interface between Antitrust and Intellectual Property Should be Viewed in the Context of the Worldwide Proliferation of Competition Laws

The agencies' ongoing reevaluation of antitrust-intellectual property interface rules should consider and take account of the recent unprecedented global proliferation of competition laws. In the early 1980's, when U.S. antitrust and intellectual property rules experienced a significant reorientation[37], the U.S. antitrust laws were by far the most pervasive and actively enforced of any in the world. While enforcement of competition rules was attaining significance in the European Economic Community (the E.U.'s predecessor) and a handful of developed national jurisdictions (*e.g.*, Australia, Canada, Germany, United Kingdom), few other nations had antitrust laws and, among those that did, none could point to a record of consistent, longstanding and vigorous enforcement comparable to that of the United States. By contrast, about 100 jurisdictions now have actively enforced competition law schemes, and heightened interest in competition rules by leading multilateral public bodies such as OECD,

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2001. By contrast, when the agreement itself restricts competition beyond the scope of the right granted by the patent in dispute (either in time or beyond the scope of the patent claim) there is greater reason for antitrust scrutiny of the settlement agreement.

37 "Competition and Intellectual Property Policy: The Way Ahead", Prepared Remarks of Timothy J. Muris, Chairman, Federal Trade Commission, Before American Bar Association Antitrust Section Fall Forum, Washington, DC, November 15, 2001.

UNCTAD and WTO suggest continuing proliferation and strengthening of antitrust and competition rules worldwide.[38]

This unprecedented expansion of antitrust law has resulted in order-of-magnitude increases in compliance burdens and complexities. Aside from the sheer number of new antitrust-active jurisdictions, spillovers and externalities have become pervasive in antitrust. As the geographic scope of business activity has expanded, most industries assumed international scope, such that conduct and transactions occurring in one jurisdiction have effects in many jurisdictions. Because most antitrust enforcement authorities claim jurisdiction over firms and individuals engaging in conduct and transactions with local effects, an increasing proportion of business activity is potentially subject to the competition rules of many jurisdictions.

The resulting costs and complexities are well-illustrated by the current reality of structural transaction review. Following the antitrust-law proliferation described above, about seventy jurisdictions engage in some form of notification and approval process for structural transactions (mergers, acquisitions, *etc.*). It has become routine for structural transactions to require notification in dozens of jurisdictions, even where competitive effects in most or all of those jurisdictions seem unlikely. It is a costly and laborious process even to ascertain which of these seventy jurisdictions will require notification for any specific transaction. Compliance with distinct notification requirements, time tables, information demands and substantive standards can be exceedingly complex and costly, even where participating jurisdictions are trying to coordinate their efforts within the limits of applicable law. As the vast majority of notified transactions pose no competitive issues, many of these costs and complications seem unnecessary. As a result, numerous antitrust authorities and multilateral bodies concerned with competition rules have begun to focus on ways to streamline the structural transaction review process.[39]

A similar potential exists with regard to antitrust and intellectual property rules. Intellectual property is often transferred around the world by various means, including licensing, where its use can become important in bringing improved products, services and business methods to increased numbers of customers and consumers in many nations. The diffusion, licensing and exercise of intellectual property rights may become subject to antitrust rules in any of the 100 jurisdictions with actively enforced competition laws. The adverse economic consequences of applying differing competition rules to intellectual property in a large number of jurisdictions are potentially even greater than those resulting from multijurisdictional transaction review. Innovation is the most important single source of long-run growth in economic productivity, which is essential to meet fundamental global aspirations. Intellectual property is the primary incentive for private-sector innovation, which is the major source of innovation. Excessive legal

[38] *See* ABA Section of Antitrust Law, "Competition Laws Outside the United States" (2001).

[39] See, e.g., Business and Industry Advisory Committee to the OECD, and the International Chamber of Commerce, "Recommended Framework for Best Practices in Merger Control Procedures" (Oct. 4, 2001); and Charles A. James, "Antitrust in the 21st Century: Core Values and Convergence," Address Before the Program on Antitrust Policy in the 21st Century (May 15, 2002).

obstacles to the creation, transfer and use of intellectual property threaten to disrupt or retard the basic processes that sustain global economic progress.

The unique characteristics of intellectual property render it especially vulnerable to disruption by inappropriate competition rules. Where, for example, the competition authority of a single nation mistakenly impairs the value of intellectual property, the disincentive effect may be translated throughout the world as other innovators and potential innovators recognize the reduced rewards available for their own innovations, thus producing an economic calculus that leads to reductions in investments intended to stimulate innovation. Application of an effects test may render it impractical for innovators to avoid jurisdictions with rules that seem hostile to intellectual property dissemination or use, or that merely seem unpredictable. Where, for example, a jurisdiction is inclined to require mandatory disclosure or licensing of intellectual property as a competition-law remedy, it may not be possible to confine the effects of that disclosure or licensing to the subject jurisdiction. This creates a magnified spillover effect that may destroy the value of intellectual property worldwide.

The United States has had some direct experience with the adverse consequences of inappropriate antitrust rules towards intellectual property. Hostility to a broad variety of practices involving the licensing and use of intellectual property during the 1960's and 1970's led to widespread criticism that productivity improvements were being sacrificed for the sake of rigid and formalistic antitrust rules. As a leading commentator noted at the time,

> A study of the legal principles by which antitrust concepts are applied to the licensing of intellectual property reveals a set of rules which are arbitrary, formalistic, riddled with inconsistencies and substantively useless technicalities, and greatly in need of fundamental reassessment. . . .
>
> From the standpoint of any company whose commercial posture requires reliance on patent or copyright licensing in order to recoup the cost of developing new technology, the rigidity and arbitrariness of the licensing cases is most unfortunate. Although not well documented, these factors may act as a substantial deterrent to such investment.[40]

The significant intellectual property and antitrust-intellectual property reforms implemented in the United States must be accorded some role in the restoration of U.S. productivity growth to levels not seen since the 1960's. The period following these reforms – the mid-1980's to 1990's – included the longest period of sustained economic growth and the greatest creation of economic wealth in history. During that time, perceived threats to U.S. leadership in various high-technology sectors posed by aggressive and innovative foreign competitors – threats that dominated the U.S. discussions of international economic policy at the time – quietly receded.

[40] Robert P. Taylor, "Analyzing Licensee-Licensor Relationships: The Methodology Revisited", 53 Antitrust L.J. 577, 578-89 (1985) (footnote omitted).

The agencies should consider what actions might be taken in order to ensure that jurisdictions new to antitrust do not retrace the ground already explored at considerable cost by the United States in fashioning antitrust rules governing intellectual property. This could include international advocacy of competition law approaches based on economically rational foundations and appropriate respect for the paramount importance of innovation and the key role of intellectual property in providing incentives for innovation in modern free-market economic systems. The agencies should also consider whether special efforts can be made to streamline competition law enforcement involving intellectual property in the multijurisdictional context. Since antitrust remedies such as mandatory licensing of intellectual property or disclosure of protected information have rapid and irretrievable global consequences, the agencies should consider mechanisms to assure that individual jurisdictions do not render antitrust decisions without considering these consequences, which could have a profound adverse impact on innovation and the attainment of world economic growth objectives.