

Antitrust Implications of Patent Settlements

Before DOJ/FTC Hearings on IP and Antitrust

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Why do firms settle patent litigation?

- Because the gains from settlement outweigh the costs of settlement
- Gains to whom?
 - three interested parties
 - plaintiff
 - defendant
 - customers

The gains from Settlement - Both Sides

- Reduces litigation risks and uncertainties
- All or nothing nature of patent litigation
- Avoids litigation expenses and distraction

The gains from Settlement - Plaintiff

- Compensation for infringement of intellectual property rights
- Obtain intellectual property in exchange
 - reduces IP risk to its own products
- Raise the costs of a competitor
- limit competition
- Leverages patent monopoly beyond its four corners
- Raise barriers to entry by third parties

The gains from Settlement -Defendant

- Remain a competitor in the the market
- Protect sunk investments related to patented technology
 - examples
- Protect customers (and goodwill) from liability for infringing through the use of defendant's product

The Gains from Settlement - Customers

- Increased competition and choices
- Avoids disruption from inability to use infringing product
- Cross licenses can reduce costs, spread technology and expand output
- Consumer welfare can be enhanced relative to litigation alternative

Anti-competitive or Pro-competitive?

- The gains from patent settlements to litigants can be either bad or good for customers
 - i.e. Patent settlements can be anti or pro-competitive.
- How can we tell the difference?

Sources of the problem

- Patent litigation often involves competitors
- Patent litigation often implicates the ability of one of the competitors to remain in the market
- Settlements often involve private agreements between competitors which directly implicate the extent of their competition going forward
- Historically, antitrust is quite suspicious of private arrangements governing the rules of competition
- Indeed, in many contexts, such agreements are deemed per se unlawful

Sources of the problem, cont'd

- More than in other contexts, it is hard to sort out the anti and pro-competitive elements of patent settlements
 - the field over which the patent precludes competition is difficult to determine
 - uncertainty is generally high
 - difficult for the agencies to sort out
 - “all or nothing” nature of patent litigation puts premium on settlement
 - uncertainty combined with draconian effect of injunction means that anti-competitive effects may be outweighed by pro-competitive benefits

Sources of the problem, cont'd

- All or nothing scenario creates tremendous leverage for Plaintiffs, even with low probability of success
- Defendant's willingness to settle is not necessarily a good proxy for consumer benefits

Since the “But For” world is particularly difficult to divine, it is more difficult than usual for the Agencies to second guess the effects of the private arrangement

Nonetheless, some aspects of patent settlements can be identified as more likely to raise competitive concerns than others

Consider the following generalizations:

- Settlements that enable continued competition are more likely to be pro-competitive than settlements that preclude competition going forward
 - *but* what about agreements that enable *future* competition?
- Settlements that license without restriction are more likely to be pro-competitive than settlements that confine competition through ancillary restraints

Consider the following generalizations, cont'd:

- Payments from infringer to patent holder are more likely to be pro-competitive than payments from patent holder to infringer,
 - (especially where coupled with delayed entry or other restrictions on competition)
- Cross licenses (with or without “true up” payment) are more likely to be pro-competitive than patent pools
 - Patent pool can create single source for previously competitive or substitutable technology

Consider the following generalizations, cont'd:

- Non-exclusive license more likely to be pro-competitive than exclusive license
 - Exclusive patent cross licenses can preclude competitors, to benefit of plaintiff and defendant
 - Eliminates competition in licensing
- Lump sum royalty is more likely to be pro-competitive than on-going royalty based on sales
 - Running royalty can raise costs and prices

The Dilemma

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

Example

- Monopolist in 5 markets
- Nascent competition by separate firms in each
- Significant advantages in offering all 5
- Barriers to entry in each very high
- Race to court house
- Settlement with merger ban



The End

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