

Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy: Practical Issues Encountered in Antitrust Analysis of Licensing Practices

Joint FTC/DOJ Hearings – May 14, 2002 – Afternoon Session

This Bitter Has Some Sweet: Antitrust Enforcement Benefits from Patent Law’s Procedural Rules

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The scheduling of these joint hearings shows that antitrust lawyers know they must scrutinize at least some patent licenses, and that the rising tide of issued patents makes the necessity for such scrutiny all the more pressing. Antitrust lawyers also worry, however, that antitrust enforcement in the area of patent licenses presents special difficulties – special because they appear rooted in a less familiar body of law (patent law) that accepts as routine the very agreements that agency lawyers want to scrutinize. In my remarks here, I do three things. *First*, I confirm the basis of antitrust agency fears. Antitrust cases about patent license agreements do turn, at some level, on the answer to the primary patent law question – namely, what is the scope, if any, of the patentee’s valid right to foreclose another’s conduct? *Second*, I suggest that, notwithstanding the first point, things are not as dire as they may seem. Although I was, for a brief time, an antitrust enforcement lawyer, I have spent far more time litigating patent infringement cases and studying patent law. As it turns out, some patent law rules can benefit the antitrust enforcement agencies by making the scrutiny or prosecution of patent license agreements more manageable. *Third*, I encourage the agencies to take a far more active interest in exploring the merits of and vocally advocating for major reforms to the patent law itself. The agencies’ valuable experiences and perspectives are largely missing from the public debates on patent law reform, to the continuing detriment of the competition law framework of which patent law is but one part.

I. Why Patent License Scrutiny Turns on Patent Law Rules

Many patent licenses are, from the antitrust law perspective, entirely wholesome. Perhaps, for example, the license merely clears the way for two firms to compete in the market for a product by giving each one access to the other’s complementary patented input.¹ Other patent licenses, by contrast, plainly retard competition in a product or technology market without enhancing efficiency at all. Perhaps, for

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¹ See USDOJ/FTC Antitrust Guidelines for the Licensing of Intellectual Property § 5.5 (1995) (“Cross-licensing . . . may provide procompetitive benefits by *integrating complementary technologies*, reducing transaction costs, *clearing blocking positions*, and avoiding costly infringement litigation.”) (emphasis added) [hereinafter *IP Guidelines*].

example, the license places one firm in control over the exploitation of two substitute technologies that had previously been independent – leading ultimately to higher product prices.²

When the antitrust enforcement authorities confront license agreements that are clearly pro- or anti-competitive, they can readily classify the licenses and respond accordingly. As we can all attest, however, life far more often presents us with facts in the mushy middle. The patents at issue may cover technologies that are substitutes in some respects but complements in others,³ or the parties' agreement may contain a "grant-back" clause that makes the balance of pro- and anti-competitive effects far more difficult to assess with confidence, or . . . and so on. For purposes of today's hearing, let us focus on one type of scenario from this mushy middle. Consider the situation where the scope of the patent rights at issue is unclear to a significant degree and, thus, the parties' relationship absent the license under review – primarily horizontal, primarily vertical, or hybrid? – is also unclear.⁴ How does one resolve that ambiguity about the underlying patent rights?

The question whether the parties' relationship (absent the license) is horizontal, vertical, or both is, of course, more than sport. Indeed, the agencies' joint *IP Guidelines* make the answer to this question a fundamental step in the antitrust inquiry:

As with other property transfers, antitrust analysis of intellectual property licensing arrangements examines whether the relationship among the parties to the arrangement is primarily horizontal or vertical in nature, or whether it has substantial aspects of both. . . . For analytical purposes, the Agencies ordinarily will treat a relationship between a licensor and its licensees, or between licensees, as horizontal when they would have been actual or likely potential competitors in a relevant market in the absence of the license.⁵

Similarly, each of the Antitrust Division's three recent "business review letters" regarding proposed patent pools explains that its favorable evaluation turns, at least in part, on the continuing use of an independent patent expert to determine whether the patents in the pool actually cover essential, complementary technologies.⁶ Thus, although one can (at least for a time) defer judgment about the way

² See *id.* at § 5.1 and Example 9; see also Joshua A. Newberg, *Antitrust, Patent Pools, and the Management of Uncertainty*, 3 ATLANTIC L.J. 1, 24-27 (2000) (describing FTC's enforcement action against the Summit/VISX patent pool for photorefractive keratectomy technology).

³ Professor Newberg suggests this may have been the case in the Summit/VISX matter. See Newberg, *Uncertainty*, *supra* note 2, at 27 ("Based on the uncertain claims of the pooled patents and the designs of the similar Summit and VISX machines, there may well have been a nontrivial basis for Summit to believe that it could have been blocked by one or more of VISX's patents and vice versa.").

⁴ I presuppose that the agency has some independent basis to believe the license agreement warrants scrutiny. I also put to one side license provisions that may raise concerns even if the patent at issue is assumed to be valid and infringed. See *IP Guidelines*, *supra* note 1, at § 5.2 (resale price maintenance), § 5.3 (tying), § 5.4 (exclusive dealing).

⁵ *Id.* at § 3.3; see also *id.* at Examples 5 & 6 (comparing horizontal and vertical relationships among hypothetical farm equipment makers who also own patents on disparate technologies).

⁶ Letter from Joel Klein, Acting Assistant Attorney General for Antitrust, U.S. Dept. of Justice, to Gerrard R. Beene, Sullivan & Cromwell 10 (June 26, 1997) ("The continuing role of an independent expert to assess essenti-

the patent(s) at issue in an agreement would structure competition between the parties absent the agreement, any useful antitrust analysis must eventually bring this matter to ground.⁷ How, then, to do so? How can the ambiguity about the scope of the critical patent rights be resolved?

To a patent lawyer, the question used to frame our discussion at this afternoon's hearing is quite revealing. The FTC press release poses the question thusly: "what standards should be used to determine whether the licensed intellectual property right would have foreclosed the licensee from being an actual or likely competitor with the licensor in the absence of the license"?⁸ To pose the question this way is to suggest that one hopes the answer may be something *other than* the perfectly obvious answer – namely, that the standards to use are the patent law rules that determine the scope of the patents in question. Such hopes, however, are vain. Economic theory honed by experience is teaching us which outward signs indicate that a particular license agreement warrants intense antitrust scrutiny,⁹ but only patent law rules can finally tell us whether, *e.g.*, a licensor's patent could *truly* have been used to oust a licensee from the market altogether (indicating a genuinely vertical relationship).

I know this answer – that patent law standards must be used to assess the asserted foreclosure of the licensee absent the license – may dishearten some who soldier in the trenches of antitrust enforcement. The feared scenario runs something like this:

Parties under investigation, knowing that the agency is not filled to the rafters with seasoned patent lawyers, try to shield a suspicious license agreement beneath a thicket of interrelated patents (each of which is dauntingly complex on its own), fairly daring the enforcement agency to

ality is an especially effective guarantor that the Portfolio patents are complements, not substitutes.”), at <http://www.usdoj.gov/atr/public/busreview/1170.htm>; Letter from Joel Klein, Assistant Attorney General for Antitrust, U.S. Dept. of Justice, to Gerrard Beeney, Sullivan & Cromswell 10 (Dec. 16, 1998) (“[S]o long as the patent expert applies this [essentiality] criterion scrupulously and independently, it is reasonable to expect that the Portfolio will combine complementary patent rights while not limiting competition between them and other patent rights for purposes of the licensed applications.”), at <http://www.usdoj.gov/atr/public/busreview/2121.htm>; Letter from Joel Klein, Assistant Attorney General for Antitrust, U.S. Dept. of Justice, to Carey Ramos, Paul Weiss Rifkind Wharton & Garrison 12 (June 10, 1999) (same), at <http://www.usdoj.gov/atr/public/busreview/2485.htm>.

⁷ By “useful,” I mean “able to support either the confident closing of an investigation or the filing of an antitrust enforcement action.”

⁸ Federal Trade Commission, *FTC/DOJ Hearings to Highlight the Intersection of Antitrust and Intellectual Property Law* 3 (Apr. 10, 2002), at <http://www.ftc.gov/opa/2002/04/iplaw2.htm>.

⁹ See, *e.g.*, Federal Trade Commission, *Prepared Statement Before the Committee on Commerce, Science, and Transportation, United States Senate* 8-9 (Apr. 23, 2002) (listing types of license provisions between name and generic drug makers that “have drawn antitrust scrutiny”), at <http://www.ftc.gov/os/2002/04/pharmtestimony.htm>; John H. Barton, *Antitrust Treatment of Oligopolies with Mutually Blocking Patent Portfolios*, 69 *Antitrust L.J.* 851 (2002) (exploring economic model for assessing competitive effects of concentrated patent holdings in oligopoly markets); Richard Gilbert, *The Evolution of Guidelines* 11-20 (Feb. 6, 2002) (suggesting criteria to identify license agreements warranting devotion of enforcement resources), at <http://www.ftc.gov/opp/intellect/guide1.pdf>; Carl Shapiro, *Antitrust Limits to Patent Settlements* 9 (May 1, 2001) (“A hallmark of these anti-competitive [patent license] agreements is that the patent holder agrees to share its monopoly profits with the challenger in order to induce the challenger to give up its fight.”), at <http://www.ftc.gov/opp/intellect/020502shapiro.pdf>.

embark on a substantive assessment of the true scope of those patent rights. The proponents of the license agreement argue that the agency must be prepared, if it files a challenge to the agreement, to prove as part of its case in chief either that the patents are invalid or that the licensee had commercially viable ways to enter the market without infringing the patents. The parties' favored cudgel here is the statutory presumption of validity that patents enjoy in routine infringement litigation.¹⁰ The agency takes the bait, and the investigation inevitably falters under the weight of the substantive patent analysis. Although the license agreement justifiably aroused suspicion of harm to competition, the agency cannot reach a solid conclusion on the merits, much less challenge the agreement in court.

But there is less cause for fear here than may at first appear.

The key is realizing that patent law contains not only *substantive* doctrines that define the scope of a patent owner's power to exclude others, but also critical *procedural* rules that go a long way toward determining the patentee's ability to foreclose competitors in the real world.¹¹ For example, patent law puts the burden on the patentee to make a strong showing of the patent's validity before forcing the peremptory removal of a competitor from the market. Other patent law procedural rules may also be used to advantage in antitrust enforcement; below, I describe at least one more that appears to offer help. In short, although the burden of applying patent law's substantive rules may at first taste bitter, the antitrust enforcement benefits from patent law's procedural rules may prove quite sweet.

II. Patent Licenses as Preliminary Injunctions and Failing-Firm Exits

Assume we are scrutinizing a patent license with one patentee and one licensee concerning one patent. We can evaluate the agreement for antitrust purposes by comparing its effects to the results that would obtain in various "but for" worlds. One highly relevant such world is the one that would exist if the parties had continued with their prior courses of conduct but without the license.

Perhaps the parties were actually competing in a product or service market, or in a market for licenses to their respective technologies. Perhaps they were not yet competing at all, although the second

¹⁰ See 35 U.S.C. § 282 ("A patent shall be presumed valid. Each claim of a patent (whether in independent, dependent, or multiple dependent form) shall be presumed valid independently of the validity of other claims; dependent or multiple dependent claims shall be presumed valid even though dependent upon an invalid claim.").

¹¹ Professor Shapiro, in his provocative paper exploring the merits of a "simple antitrust rule" that "a patent settlement cannot lead to lower expected consumer surplus than would have arisen from ongoing litigation," *Limits, supra* note 9, at 10, highlights the critical role that such procedural matters play in defining patent value:

A number of different rules can materially affect the value of the patent grant. Under what conditions can a patent holder obtain a preliminary injunction blocking another firm from producing products that allegedly infringe the patent? How long does patent litigation take, and what is the state of competition during the *interim* period while patent validity and infringement are being resolved in court?

Id. at 4 (footnote omitted).

party was taking concrete steps to enter the market in the near term. In any event, in our postulated “but for” world without the license agreement, the patentee may yet wish to eliminate its (actual or imminent) competitor as an independent actor in the market. Treating the license agreement as unavailable, we know that the patentee has only two options that rely on the patent right itself. The patentee can sue on the patent and oust its competitor (a) *temporarily*, by successfully moving for a preliminary injunction that bars the competitor’s activity until the suit is fully resolved; or (b) *permanently*, by securing a permanent injunction upon winning the suit after a full trial on the merits of all disputed infringement and validity issues (including through any appeal).¹²

When we compare the actual, agreement-containing world with this “but for,” agreement-lacking world, at least two things relevant to today’s discussion become apparent. First, by eliminating its competitor as an independent actor in the market *without the trouble of a full trial on the merits*, the patentee/licensor has obtained the functional equivalent of a preliminary injunction barring the competitor/licensee’s conduct. Second, to the extent that the parties defend the license from antitrust scrutiny by maintaining that it has not foreclosed any lawful competition, they rely, in effect, on a “failing firm”-type defense: “there has been no harm to competition,” the license proponents argue, “because the patentee’s valid and infringed patent would sooner or later force the competitor to exit the market anyway.” This defense of the license maps readily onto the failing firm defense to a merger, according to which, “[w]here the likely alternative to a merger is the elimination of the firm and its assets from the market, the merger will not violate” the antitrust laws.¹³

Our larger project, of course, is to consider how best to determine whether the patent at the center of the agreement we are scrutinizing would have foreclosed the licensee from being an actual or likely competitor with the licensor in the absence of the license. The foregoing aspects of the license agreement – that it is functionally a preliminary injunction against the licensee, and that it assumes the truth of a failing firm theory – suggest two corresponding procedural principals that should shape an antitrust agency’s investigation of the license, as well as any resulting challenge to the license. First, a patentee should be no better off when defending the presumptive scope of its licensed patent rights to an antitrust agency than it would be if it were attempting to obtain a preliminary injunction against the competitor. Second, an antitrust agency should be no worse off when assessing the erstwhile competitor’s good faith basis for sacrificing its independence to the patentee than it would be if it were challenging a merger defended on failing firm grounds. I consider the practical payoff of each principle in turn.

¹² A temporary foreclosure of competition may, of course, become permanent if a successful preliminary injunction motion is followed by the patentee’s victory in the full trial on the merits.

¹³ 1 ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 337 (4th ed. 1997).

A. When Proving Validity is the *Patentee's* Burden

My first suggested procedural principle is that a patentee should be no better off when defending the presumptive scope of its licensed patent rights to an antitrust agency than it would be if it were attempting to obtain a preliminary injunction against the competitor. What does this mean in practice?

The proponents of a dubious patent license agreement may urge that, because the patent enjoys a statutory presumption of validity under 35 U.S.C. § 282, the agency cannot challenge a license agreement as anticompetitive without proving by clear and convincing evidence that the patent is invalid. By doing so, these proponents both ignore the question of infringement altogether and demonstrate, as experienced patent litigators already know, that the statutory presumption of patent validity is repeated somewhat more often than it is understood. The presumption of validity is neither a by-product of Patent Office infallibility nor an impregnable substantive shield against serious validity challenges; it is, instead, simply “a procedural device.”¹⁴ As it turns out, license proponents who would shift to the agency the burden of proving invalidity (or noninfringement) also clearly urge a violation of my first suggested procedural principle.

When a patentee moves for a preliminary injunction in a routine patent infringement suit, it bears the burden of clearing the same four-part hurdle that faces essentially all preliminary injunction plaintiffs. Specifically, the patentee is not entitled to a preliminary injunction unless it can show “(1) a reasonable likelihood of success on the merits; (2) irreparable harm if an injunction is not granted; (3) a balance of hardships tipping in its favor; and (4) the injunction’s favorable impact on the public interest.”¹⁵ Importantly, the patentee’s burden to show a likelihood of success on the merits extends both to questions of infringement *and* validity.

Thus, for example, in the recent case overturning a preliminary injunction that had been granted to Amazon in its patent case against Barnes & Noble concerning “one click” ordering on the Web, the Federal Circuit explained that

Amazon must show that, in light of the presumptions that will inhere at trial on the merits, (1) Amazon will likely prove that BN infringes the ’411 patent, and (2) Amazon’s infringement claim will likely withstand BN’s challenges to the validity and enforceability of the ’411 patent. If BN raises a substantial question concerning either infringement or validity, *i.e.*, asserts an infringement or invalidity defense that the patentee cannot prove lacks substantial merit, the preliminary injunction should not issue.¹⁶

¹⁴ *Nutrition 21 v. United States*, 930 F.2d 867, 869 (Fed. Cir. 1991) (vacating preliminary injunction in patentee’s favor).

¹⁵ *Amazon.com, Inc. v. Barnesandnoble.com, Inc.*, 239 F.3d 1343, 1350 (Fed. Cir. 2001) (reversing grant of preliminary injunction in Amazon’s favor in a suit on its “one-click” patent).

¹⁶ *Id.* at 1350-51 (citation and internal quotation omitted).

Nor is the *Amazon* case unusual in this respect.¹⁷ In short, the patentee cannot peremptorily eliminate a competitor's marketplace independence with a preliminary injunction unless it "present[s] a clear case supporting the validity of the patent in suit."¹⁸

The consequences for the proponents of a dubious patent license agreement in an antitrust investigation are straightforward. Just as the patentee who wants a preliminary injunction must present a clear, detailed case supporting the validity and the infringement of the patent when substantial questions are raised on these points, so too must the proponents of what is functionally a preliminary injunction – the license agreement – present a clear, detailed case supporting the validity and the infringement of the patent when the antitrust agency shows a substantial reason to doubt either proposition. Professor Shapiro is thus quite correct to observe, in his own analysis of the appropriate antitrust limits to impose on patent license agreements, that "the patent holder is not 'entitled' to negotiate a monopoly outcome just because the patent holder *asserts* that its patent is valid and infringed by a particular rival."¹⁹

B. When Protecting Patent Counsel's Opinion Warrants an Adverse Inference

My second suggested procedural principle is that an antitrust agency should be no worse off when assessing the erstwhile competitor's good faith basis for sacrificing its independence to the patentee than it would be if it were challenging a merger defended on failing firm grounds. What does this mean in practice?

The theory that animates the failing firm defense, articulated in the first Supreme Court case that recognized it, is that it "does not substantially lessen competition or restrain commerce within the intention of the Clayton Act" to permit a merger when confronted with

the case of a corporation in failing circumstances, the recovery of which to a normal condition was, to say the least, in gravest doubt, selling its capital to the only available purchaser in order to avoid what its officers fairly concluded was a more disastrous fate.²⁰

If the proponents of a challenged merger wish to rely on a failing firm theory, they must plead and prove it as an affirmative defense. In other words, the burden is entirely on the merger proponents to prove the

¹⁷ See *Nutrition 21*, 930 F.2d at 869 ("[A]t the preliminary injunction stage, because of the extraordinary nature of the relief, the *patentee* carries the burden of showing likelihood of success on the merits with respect to the patent's validity, enforceability, and infringement") (emphasis in original, citations omitted); *New England Braiding Co. v. A.W. Chesterton Co.*, 970 F.3d 878, 882 (Fed. Cir. 1992) (affirming denial of patentee's preliminary injunction motion) ("the presumption [of validity] does not relieve a patentee who moves for a preliminary injunction from carrying the normal burden of demonstrating that it will likely succeed on all disputed liability issues at trial, even when the issue concerns the patent's validity").

¹⁸ *Amazon.com*, 239 F.3d at 1359.

¹⁹ Shapiro, *Limits*, *supra* note 9, at 10 (emphasis in original).

²⁰ *International Shoe Co. v. FTC*, 280 U.S. 291, 301, 302-03 (1930). See also *Dr. Pepper/Seven-Up Cos. v. FTC*, 991 F.2d 859, 864 (D.C. Cir. 1993) (remanding for further consideration of failing firm theory) ("the purpose of the Clayton Act is not served by prohibiting companies from purchasing failing competitors when there are no other alternatives").

requisite elements of the defense.²¹ As a general matter, then, it seems plain that the proponents of a challenged patent license agreement, to the extent that they wish to rely on the merits of the patentee's underlying claim to have been able to use its patent to foreclose the licensee's independent marketplace conduct, should bear the burden of establishing their underlying claim as an affirmative defense (as well as the risk of failing to do so). And this burden-shifting does not exhaust the value of the failing firm construct to antitrust enforcement in the patent license context.

More specifically, the requisite elements of the failing firm defense are that “the company to be acquired is in imminent danger of failure,” the failing firm has “no realistic prospect for a successful reorganization,” and “there is no viable alternative purchaser that poses less anticompetitive risk.”²² The third element, moreover, has been operationalized in a quite practical and – for purposes of scrutinizing patent license arrangements – suggestive way. Rejecting an absolutist approach, which would saddle the merger proponents with the difficult (if not impossible) task of proving the lack of any viable alternative purchaser anywhere, the courts have merely required proof of a good faith (albeit unsuccessful) effort on the near-failing target's part to locate an alternative buyer, a merger with which would pose a smaller threat to competition.²³

How does the failing firm defense advance the antitrust analysis of a patent license agreement? If we map the failing firm scenario onto the dubious patent license proponents in a more detailed way, treating the patentee as the acquiring firm and the licensee as the target firm, we see that the analog for proof of a good faith effort on the target's part to locate an alternative buyer would be proof of a good faith basis for the licensee's belief that it was certainly infringing a valid patent and thus had no viable alternative to sacrificing its independence to the patentee. The licensee's beliefs on this score are, of course, almost certain to have been shaped in substantial part by the legal advice that its patent counsel has rendered about the validity and enforceability of the licensed patent and the infringing nature of the licensee's conduct. As a result, requiring the licensee to offer proof justifying a good faith belief that it

²¹ See *United States v. General Dynamics Corp.*, 415 U.S. 486, 507 (1974); *Olin Corp. v. FTC*, 986 F.2d 1295, 1305 (9th Cir. 1993); *Dr. Pepper*, 991 F.2d at 864-65.

²² 1 ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 339 (4th ed. 1997). See also USDOJ/FTC Horizontal Merger Guidelines § 5.1 (1997) (setting forth essentially the same elements) [hereinafter *Merger Guidelines*].

²³ See *General Dynamics*, 415 U.S. at 507 (“A company invoking the [failing firm] defense has the burden of showing . . . that it tried and failed to merge with a company other than the acquiring one.”) (footnote omitted); *Dr. Pepper*, 991 F.2d at 865 (“the proponent of the acquisition must demonstrate that it has made a reasonable, good faith attempt to locate an alternative buyer”). See also *Merger Guidelines* § 5.1 (“the allegedly failing firm . . . has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger”) (footnote omitted).

had no alternative but to enter the license almost certainly forces the licensee to choose between asserting or waiving its evidentiary privilege in the substance of legal advice from its patent counsel.

Indeed, to a patent lawyer, proof of the sort called for here sounds a great deal like the inverse of the proof typically relied upon to rebut an allegation that one's patent infringement was willful – namely, a competent (usually written) legal opinion from one's patent counsel that provides a good faith basis for believing that the patent at issue “was not infringed or was invalid or unenforceable and would be so held if litigated.”²⁴ Rebutting a willfulness charge thus also typically puts a party (this time, the accused infringer) to the choice of asserting or waiving its evidentiary privilege in the substance of legal advice from its patent counsel. And, not surprisingly, the patent law's standard procedural response to an accused infringer's *refusal* to proffer the substance of its patent counsel's opinion is quite instructive here.

The court hearing a patent infringement case cannot force the accused infringer to waive its privilege in a noninfringement / invalidity opinion from its patent counsel. Nor, however, must it assume that the opinion provided a good faith basis for the infringer's continuing infringement.²⁵ Indeed, quite the opposite is true. As the Federal Circuit has explained,

[w]here the infringer fails to introduce an exculpatory opinion of counsel at trial, a court must be free to infer that either no opinion was obtained or, if an opinion were obtained, it was contrary to the infringer's desire to initiate or continue its use of the patentee's invention.²⁶

A similar adverse inference seems equally appropriate in the context of antitrust agency review of a dubious patent license agreement. Assuming that the proponents of the patent license agreement wish to rely on the merits of the patentee's underlying claim to have been able to use its patent to foreclose the licensee's independent marketplace conduct, and thus that the licensee must offer proof sufficient to justify a good faith belief that it was certainly infringing a valid patent and thus had no viable alternative to sacrificing its independence to the patentee, the antitrust agency (and any tribunal hearing an antitrust

²⁴ ROBERT L. HARMON, PATENTS AND THE FEDERAL CIRCUIT § 14.2 at 807 (5th ed. 2001). Genuine reliance on a competent opinion letter from patent counsel effectively neutralizes a willfulness allegation because, by definition, “[w]illfulness is shown when, upon consideration of the totality of the circumstances, clear and convincing evidence establishes that the infringer acted in disregard of the patent, that the infringer had no reasonable basis for believing it had a right to engage in the infringing acts.” *Electro Medical Sys. v. Cooper Life Sciences, Inc.*, 34 F.3d 1048, 1056 (Fed. Cir. 1994).

²⁵ See *L.A. Gear, Inc. v. Thom McCan Shoe Co.*, 988 F.2d 1117, 1126 (Fed. Cir. 1993) (reversing district court's finding that infringement was not willful) (“Although a party to litigation may indeed withhold disclosure of the advice given by its counsel, as a privileged communication, it will not be presumed that such withheld advice was favorable to the party's position.”).

²⁶ *Fromson v. Western Litho Plate & Supply Co.*, 853 F.2d 1568, 1572-73 (Fed. Cir. 1988). See also *L.A. Gear*, 988 F.2d at 1126 (“We have held that the assertion of privilege with respect to infringement and validity opinions of counsel may support the drawing of adverse inferences.”); HARMON, *supra* note 24, at 814 (“An accused infringer has the right to assert the attorney-client privilege. And when it refuses to produce an exculpatory opinion of counsel in response to a charge of willful infringement, an inference may be drawn that either no opinion was obtained or, if one was obtained, it was unfavorable.”).

challenge to the agreement) must be free to infer from the licensee's failure to offer an opinion from counsel showing the licensee's infringement of a valid patent either that no such opinion was obtained or, if an opinion was obtained, that it did not justify the licensee's conclusion that it had no viable alternative to sacrificing its independence to the patentee.

III. Why Antitrust Agencies Should Champion Patent Law Reforms

The bad news is that the merits of the patent underlying a license agreement go a long way to determining the lawfulness of the license's effects on competition. The good news is that the bad news does not make antitrust scrutiny of patent license agreements fruitless. But, notwithstanding the foregoing discussion of some antitrust enforcement benefits that might be derived from patent law's procedural rules, one could in fairness complain that I am re-arranging some deck chairs on a badly listing ship. Can we right ourselves more solidly in the waves of more and more patents from increasingly varied technological domains? Not until the antitrust enforcement agencies fully join the Patent Office at the wheel.

Joel Klein, during his tenure as the Assistant Attorney General for the Antitrust Division, described the basic danger that may lurk at the heart of any patent license agreement – namely, that the patentee and its erstwhile challenger have cut a deal to delay rightful competition, aligning their anticompetitive interests against the public's interests. This danger results from the basic legal rule, with us since the Supreme Court's decision in *Blonder-Tongue Laboratories v. University of Illinois Foundation*, that a patent held invalid as to one is invalid as to all.²⁷ According to Klein, "our principal concern is whether the patents or their owners are using the [license] arrangement to blunt competition that would otherwise take place – a *rather-switch-than-fight strategy*, if you will."²⁸ In other words,

settlements are often based on considerations that lead parties to give up rights that they might well vindicate if they went to the mat. And when intellectual property rights are at stake, the consequences of those compromises can align the settlers' interests against the interests of consumers.²⁹

²⁷ 402 U.S. 313 (1971). As Professor Thomas has explained, under *Blonder-Tongue* "[p]atents are declared invalid for all purposes, not vis-à-vis a particular individual. A prevailing opponent of a patent therefore cannot prevent others," including its own competitors, "from practicing the invention claimed in the invalidated patent." John R. Thomas, *Collusion and Collective Action in the Patent System: A Proposal for Patent Bounties*, 2001 U. Ill. L. Rev. 305, 333. The drawback of this regime, from an antitrust perspective, is "that a potential [patent] opponent cannot appropriate the benefits of a successful charge of patent invalidity to itself," as a result of which there are "fewer patent challenges than are socially optimal." *Id.* at 334.

²⁸ Joel Klein, *Cross-Licensing and Antitrust Law*, Address Before the American Intellectual Property Law Association 4 (May 2, 1997) (emphasis added), at <http://www.usdoj.gov/atr/public/speeches/1123.htm>.

²⁹ *Id.* at 3-4. Others have made the same observation. See, e.g., Robert J. Hoerner, *Antitrust Pitfalls in Patent Litigation Settlement Agreements*, 8 FED. CIR. B.J. 113, 114 (1998) ("When an alleged infringer decides that it is in his interest to settle a patent infringement litigation against him, his entire business outlook changes. Where before he wanted the patent held invalid, he now may want the patent held valid so that the patent owner can assert it against his competitors. Where before he wanted the patent given a narrow scope, he now may want the patent to be

In the face of this danger, which all patents on commercially significant technologies potentially present, the antitrust enforcement agencies can best promote both static and dynamic efficiency not merely by challenging individual anticompetitive license agreements, but also by identifying and supporting reforms to patent law that reduce every patentee's ability to use the promise of a cut of monopoly rents to tame a fierce rival into a placid licensee.

The antitrust agencies need not, and should not, start the process of formulating reforms from scratch. Indeed, as the testimony and other writings from assorted patent law professors at these hearings amply demonstrate, a number of concrete and valuable reform proposals have already been made:

- the statutory presumption of validity should be substantially weakened, if not eliminated outright;³⁰
- the fee-shifting rules should be changed to provide that a plaintiff patentee must pay the attorney fees of a successful accused infringer who prevails on grounds that demonstrate that the infringement claim should never have been brought in the first place;³¹
- a bounty system could be created at the patent application stage, encouraging parties who know about prior art that would defeat a pending patent application to submit that prior art to the patent office.³²

The presumption of validity needs change because, even when correctly used only as a procedural device, it naively assumes thorough Patent Office review for patentability and, consequently, too vigorously guards against erroneous invalidation of theoretically valid patents. There is also great merit in adopting a fee-shifting rule to cover the reasonable attorney fees of a defendant who demonstrates that the patentee should have avoided imposing an invalid patent on the public. Such a fee-shifting mechanism would

given a broad scope so that it can reach the products of his competitors. . . . And, he will want to do what he can to commit the patent owner to suing, and not licensing, his competition if they are arguably infringing.”); Shapiro, *Limits*, *supra* note 9, at 7 (“Settlements can deprive consumers not only of competition between the settling parties, but from other firms as well if an invalid patent is never actually challenged.”).

³⁰ See Jay P. Kesan, *Toward a Better Informed Patent System* 6 (Apr. 10, 2002) (“Eliminate [the] presumption of validity – [it] gives away a valuable residual right and currently [we] get very little in return.”), at <http://www.ftc.gov/opp/intellect/020410jaypkesan.pdf>; Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1528-29 (2001) (“At a bare minimum, the presumption of validity should be pared back so that it covers only prior art references and arguments actually considered by the examiner.”).

³¹ See Kesan, *Better Informed*, *supra* note 30, at 9 (“One-way, pro-defendant fee shifting if patents revoked or invalidated based on prior art categories that could have been reasonably discovered by the patentee.”); Lemley, *Rational Ignorance*, *supra* note 30, at 1530-31 (“[A]ccused infringers normally won’t get attorney’s fees unless they can prove that the suit was filed in bad faith. It may make sense to add some balance to the fee awards [on analogy to copyright law] . . . and therefore help shift some of the burden of determining validity away from accused infringers.”); Mark A. Lemley, *Reconceiving Patents in the Age of Venture Capital*, 4 J. SMALL & EMERGING BUS. L. 137, 146 (2000) (suggesting “a partial fee-shifting idea: grant fees to patent defendants who prevail in circumstances that show that the case should never have been filed”).

³² See Thomas, *Collusion*, *supra* note 27, at 342-50 (describing in detail a proposed bounty system).

encourage an accused infringer with a meritorious case to stay in the fight longer (*i.e.*, it would help the accused infringer to better resist the patentee's efforts to re-align the infringer's interests with its own), as well as force patent applicants further to internalize the full cost of vetting their innovations for genuine patentability.³³

I, for one, am skeptical that either a fee-shifting rule to benefit successful accused infringers or a bounty system at the *application* stage goes far enough in driving a wedge between patentees and the rivals they seek to oust or tame. Professor Thomas' application-stage bounty proposal does at least attempt, however, to overcome the collective action problem that deadens an infringer's incentive to challenge an invalid patent – the same collective action problem that is the linch-pin of a patentee's plan to co-opt its rival with a cut of the monopoly rent.³⁴ Thus, my current (though still developing) view is that a bounty mechanism should operate at the post-issuance patent litigation stage, rather than at the pre-issuance patent application stage.

A litigation-stage bounty mechanism would discourage shoddy prior art searches by patent applicants and encourage persistence on the part of accused infringers with strong evidence of invalidity. Specifically, an accused infringer who succeeds in negating a patent claim on grounds that show that the patentee could reasonably have avoided prompting the issuance of an invalid or unenforceable patent in the first place (in practice, proof of invalidating printed prior art that the patentee should have found or should have disclosed) would receive a bounty equal to all the profits the patentee had earned that were attributable to the invalid patent. The patentee would be required to disgorge those profits to the accused infringer as the bounty. This bounty would be available only to the first accused infringer(s) who obtain a final, unappealable judgment that the patent is invalid or unenforceable. Other parties who were, or would have been, accused infringers receive the benefit of unencumbered entry, but the successful patent attacker receives the bounty bonus.

My proposal, which would apply to all issued patents, is akin to the 6-month semi-exclusivity bounty for drug patents, which is provided to the first ANDA filer under the Hatch-Waxman regime for promoting entry by generic drug makers.³⁵ According to Alfred Engelberg, who served as the Generic Pharmaceutical Association's patent counsel during the formulation and passage of the Hatch-Waxman regime in 1984, the semi-exclusivity "provision was requested by the generic drug manufacturers to

³³ The other main component driving such internalization is the level set for patent application filing fees and patent maintenance fees, which are the sole source of funding for Patent Office operations.

³⁴ See *supra* notes 27-29 and accompanying text.

³⁵ See 21 U.S.C. § 355(j)(4)(B)(iv) (providing first ANDA filer with 6 months of semi-exclusivity). See also Alfred B. Engelberg, *Special Patent Provisions for Pharmaceuticals: Have They Outlived Their Usefulness?*, 39 IDEA 389, 403-04 (1999) (describes the first ANDA filer's semi-exclusivity as both "a 'bounty' provision" and "a significant incentive to challenge patents").

insure that the successful challenger of a patent would have an opportunity to recoup its litigation costs before other generic manufacturers could take advantage of the elimination of the patent as a barrier to competition.”³⁶ In other words, the Hatch-Waxman rules recognize and attempt to address precisely the collective action problem described by Professor Thomas.³⁷

The Hatch-Waxman regime is admittedly not a popular one at the moment, especially not in a room filled with antitrust lawyers. But the semi-exclusivity provision has been an excellent laboratory for patent law reform more generally, both for the good and the bad that it shows. The provision has led to a great deal of abuse because it allowed some generic drug makers to trap other generic drug makers behind an insuperable barrier to entry, induced to do so by large cash payments from the threatened name drug maker.³⁸ But it has also demonstrated the boon to competition when we provide market participants with a benefit for taking down invalid patents that they can appropriate to themselves, thus correcting the under-supply of patent challenges.

Perhaps my all-profits bounty proposal is too extreme. As I have said, it is still in the “development” stage. But my goal here is not to persuade you that some specific reform proposal is right in all its particulars and fully worthy of your support. Rather, my goal is to persuade you that the antitrust enforcement agencies cannot effectively discharge their mission to promote healthy competition in today’s markets without actively pressing for concrete changes to U.S. patent law that aim to break a patentee’s power to co-opt its rivals and thus prevent the successful validity and non-infringement challenges that knock down needless barriers to entry.

³⁶ Engelberg, *Special*, *supra* note 35, at 403-04; *see also id.* at 423 (“The entire purpose of the 180-day exclusivity provision, at the time it was drafted, was to insure that one generic competitor would not get a free ride on the litigation effort of another generic competitor until the party who had borne the cost and risk of litigation had a fair opportunity to recover its litigation costs.”).

³⁷ *See* Thomas, *Collusion*, *supra* note 27, at 333-34.

³⁸ *See* Engelberg, *Special*, *supra* note 35, at 416-17, 423-25 (describing numerous problems caused by the structure of the semi-exclusivity provision).