MEMORANDUM

From: Intellectual Property Working Group

To: All Commissioners

cc: Andrew J. Heimert and Commission Staff

Date: December 21, 2004

Re: Intellectual Property Issues Recommended for Commission Study

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The Antitrust Modernization Commission assigned to the Intellectual Property Working Group the responsibility to analyze antitrust issues relating to intellectual property, and, based on that analysis, to make recommendations to the Commission as to the issues within that category that warrant substantive review. This memorandum outlines those recommendations. The memorandum addresses first the issues the Working Group recommends for substantive consideration and then addresses those issues not recommended for further study at this time. In each instance, comments are provided to allow insight into the Working Group's analysis. The issues are listed in approximate order of priority that the Working Group believes each issue should have for Commission study.

This memorandum reflects the consensus of a majority of the Working Group members. Some members of the Working Group may disagree with a recommendation and/or with aspects of the discussion and comments associated with a recommendation. In addition, a recommendation that the Commission should not study a particular issue at this time does not constitute a recommendation on the merits of the issue, nor does it preclude the possibility that the Commission report ultimately will endorse any particular recommendation.

SUMMARY OF RECOMMENDATIONS

Issues recommended for study. The Working Group recommends that the Commission study the following issues:

1. **Should industries involving significant technological innovation be treated differently under the antitrust laws?**
2. **How does the current intellectual property regime affect competition?**

Issues not recommended for study. The Working Group recommends that the Commission not study the following issues:

3. **Should a duty to deal in intellectual property (*e.g.*, compulsory licensing) be implied in circumstances in which there is no such duty for other types of property?**
4. **How should antitrust law analyze misleading conduct and other possible abuses of standard setting processes?**
5. **Should the Standard Development Organization Advancement Act be modified?**
6. **How should the antitrust laws deal with the problems that can arise from patent rights "abuses," *e.g.*, efforts to inhibit competition from generic drug manufacturers?**
7. **Do the FTC and DOJ diverge on antitrust/IP interface issues, and should any such differences be reconciled?**
8. **Should the patent system be replaced with a system of government-granted prizes for innovation (coupled with government buy-outs of some patents)?**
9. **Should programs to collect data for use by researchers and firms be established or expanded?**

DISCUSSION OF RECOMMENDATIONS

Issues recommended for study

The Working Group recommends that the Commission study the following issues:

1. **Should industries involving significant technological innovation be treated differently under the antitrust laws?**

How does the fact that IP and innovation-driven industries depend on the opportunity to set prices above marginal costs to earn returns affect the significance of common benchmarks for market definition and market power? The Commission may be able to identify the appropriate analytical issues and address their significance for antitrust analysis, specifically considering the following issues:

a. Market power presumption. Should there be a presumption of market power in tying cases when there is a patent or copyright, as has been suggested by some courts? *See, e.g.*, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16 (1984); *United States v. Loew's, Inc.*, 371 U.S. 38 (1962); *MCA Television Ltd. v. Public Interest Corp.*, 171 F.3d 1265 (11th Cir. 1999). More generally, how should market power be measured in matters involving intellectual property?

b. Entry horizon. Should the two-year time horizon used in the *Horizontal Merger Guidelines* be lengthened so that the market includes all those who could enter with new products within three (or more) years? *See* U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* § 3.2 (Apr. 1997), *available at* http://www.usdoj.gov/atr/public/guidelines/hmg.htm. Because the purpose of granting patent rights is to provide incentives for innovation, should the time horizon be sufficiently long to include all innovations likely to erode current market power?

c. Innovation markets. What is meant by the term "innovation market"? Is a doctrine recognizing innovation markets necessary or useful in antitrust analysis? How should innovation markets be distinguished, for purposes of antitrust analysis, from related, but more conventional, markets for technology or future products? As part of its consideration of this issue, the Commission should examine the state of knowledge regarding the relationship between concentration and innovative activity.

Comments: Many commenters identified the application of antitrust law in the intellectual property context as an important area of study, including House Judiciary Committee Chairman James Sensenbrenner and the ABA Antitrust Section. Although antitrust law is designed to be of general applicability, special problems can arise in applying it with respect to intellectual property. Considerations that might militate for a different antitrust analysis include evidence that social returns to innovation exceed private returns, the intent of the patent laws to promote innovation by providing successful patentees with a temporary opportunity to exclude competition and set prices above marginal cost, and the nature of dynamic, innovation-driven competition. The Commission could provide useful guidance regarding the application of the antitrust laws in this context. As a general matter, however, it may be difficult for the Commission to develop effective legislative recommendations; rather, it would likely provide a favored approach for use by the agencies and/or courts.

Analysis of innovation markets has been used only infrequently in enforcement actions, but has received considerable attention. *Compare* U.S. Department of Justice & Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* § 3.2.3 (Apr. 1995), *available at* http://www.usdoj.gov/atr/public/guidelines/

ipguide.htm, *and* Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 ANTITRUST L.J. 569 (1995), *with* George A. Hay, *Innovations in Antitrust Enforcement*, 64 ANTITRUST L.J. 7 (1995), *and* Dennis W. Carlton, Antitrust Policy Toward Mergers When Firms Innovate: Should Antitrust Recognize The Doctrine Of Innovation Markets?, Testimony Before The Federal Trade Commission Hearings On Global And Innovation-Based Competition (Oct. 25, 1995), *available at* http://www.ftc.gov/opp/global/carlton.htm. Innovation market analysis applies approaches developed for the analysis of competitive behavior in service and goods markets to examine competition and innovative activity. Gilbert & Sunshine, *supra*, at 594-97. This raises basic questions regarding the application of antitrust analysis in the IP context, including whether innovative activity is systematically related to concentration. Therefore, it would be useful for the Commission to examine the relationship between concentration and innovative activity, and develop recommendations regarding the use of innovation markets in antitrust analysis.

2. **How does the current intellectual property regime affect competition?**

The Commission should study the following two questions to address this issue:

a. What are the general trends regarding patent procurement and enforcement? Some see a general trend — "explosions" in patent applications and granted patents, and escalations in success rates in defending litigated patents, patents pools, and worthless patents. Does the available evidence bear this out? Have trends in patent procurement and enforcement resulted in adverse effects on competition? In addressing this issue, the Commission should first

compile a bibliography of important recent work on this aspect of intellectual property with a brief summary.[1]

b. Are there ways in which the process of granting and enforcing patents could be improved to reduce adverse effects on competition? In addressing this question, the Commission should review the recommendations made in recent studies, such as the 2003 FTC Report and the National Research Council/National Academies of Sciences study.[2]

Comments: Issues surrounding the proliferation of patents and related matters were suggested for study by a substantial number of commenters, including the ABA Antitrust Section. Improvidently issued patents create property rights not intended by the patent laws. Assertion of such property rights may lessen competition unduly. It may also contribute to the formation of patent pools, which could promote cartel behavior among members or result in the exclusion of non-members from the market. *See, e.g.*, *Intellectual Property Guidelines*, *supra*, § 5.5 (Apr. 1995); Richard J. Gilbert, *Antitrust for Patent Pools: A Century of Policy Evolution*, 2004 STAN. TECH. L. REV. 3 (2004). The large impact patent policies have on competition and the economy was frequently cited as a strong reason for giving it priority for Commission study.

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[1] There has been a substantial amount of recent research worthy of review. *See, e.g.*, WILLIAM M. LANDES AND RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW (2003); ADAM B. JAFFE AND JOSHUA LERNER, INNOVATION AND ITS DISCONTENTS: HOW OUR BROKEN PATENT SYSTEM IS ENDANGERING INNOVATION AND PROGRESS, AND WHAT TO DO ABOUT IT (2004); STEPHEN A. MERRILL, RICHARD C. LEVIN & MARK B. MYERS, A PATENT SYSTEM FOR THE 21ST CENTURY (2004); Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (Oct. 2003), *available at* http://www.ftc.gov/os/2003/10/innovationrptsummary.pdf.

[2] Federal Trade Commission, *To Promote Innovation*, *supra*, Executive Summary 7-18; STEPHEN A. MERRILL ET AL., *supra*, 5-8.

Nevertheless, given the breadth of the Commission's likely agenda, some may doubt whether this set of issues should make the cut for ultimate Commission review. In particular, two considerations have been cited as reasons not to study the issue.

First, the Commission is charged with making recommendations on antitrust law, and, while antitrust law may be able to address some aspects of these problems, the main impact on competition likely arises from deficiencies in the patent issuance and enforcement system. Recommendations in this area therefore may carry limited weight. However, given the impact on competition, study and recommendations regarding patent law and policy may nevertheless prove helpful.

Second, the Federal Trade Commission and other expert bodies have recently studied and reported on these issues. *See, e.g.*, Federal Trade Commission, *To Promote Innovation*, *supra*; STEPHEN A. MERRILL ET AL., *supra*. The Commission should avoid repeating these efforts. However, by reviewing the recent literature on the subject, the Commission could improve understanding of these issues, identify gaps, and perform or recommend additional research where appropriate. It can also build on this work in developing legislative recommendations.

Issues not recommended for study

The Working Group recommends the Commission not study the following issues:

3. **Should a duty to deal in intellectual property (*e.g.*, compulsory licensing) be implied in circumstances in which there is no such duty for other types of property?**

There is substantial debate over whether and when licensing of intellectual property may appropriately be required under the antitrust laws, and in particular over the contrasting results in *In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000) ("*CSU*"), and *Image Tech. Services, Inc. v. Eastman Kodak Co.*, 125 F.3d 1195 (9th Cir. 1997). *See, e.g.*, 3 PHILLIP

E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 709b2 (2d ed. 2002) (criticizing the Ninth Circuit's approach in *Kodak*); Robert Pitofsky, *Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property*, 68 ANTITRUST L.J. 913, 919-23 (2001) (criticizing the Federal Circuit's approach in *CSU*). How should this debate be resolved?

Comments: While these decisions have attracted considerable attention from scholars, the limited circumstances in which this difficult issue may be posed do not often arise in antitrust cases. Moreover, resolution of the relatively small number of cases that do arise may turn on detailed factual issues rather than a reconciliation of the tension between *Kokak* and *CSU*. *See, e.g.*, *Telecom Technical Services Inc. v. Rolm Co.*, 388 F.3d 820 (11th Cir. 2004) (detailed examination of the restrictions on sales of replacement parts imposed by defendant revealed that consumers were not harmed). Given the limited topics that the Commission can study, these considerations lead the Working Group to recommend that the issue not be studied.

4. **How should antitrust law analyze misleading conduct and other possible abuses of standard-setting processes?**

Recent cases have identified a potential antitrust problem when parties to standard-setting processes allegedly made misleading statements about or failed to disclose the existence of intellectual property rights relevant to a standard under consideration and subsequently sought to assert their patent against those using that standard. *In re Dell Computer Corp*., 121 F.T.C. 616 (1996) (consent order); *In re Union Oil Company of California*, F.T.C. Docket No. 9305 (Nov. 25, 2003) (reversing and vacating Initial Decision), *available at* http://www.ftc.gov/os/adjpro/d9305/040706commissionopinion.pdf; *Rambus, Inc. v. Infineon Techs. AG*, 318 F.3d 1081 (Fed. Cir. 2003); *In re Rambus, Inc.*, F.T.C. Docket No. 9302 (Feb. 24, 2004) (Initial Decision), *available at* http://www.ftc.gov/os/adjpro/d9302/040223initialdecision.pdf. *See*

generally Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CAL. L. REV. 1889 (2002). How should such conduct be assessed?

Comments: A legislative solution to this issue may be difficult to develop, and the solution may best be left to the marketplace's adapting to existing case law (*e.g.*, by contract among the parties to the standard setting organization) and to future adjudicative proceedings capable of addressing the unique facts of each case.

5. **Should the Standard Development Organization Advancement Act be modified?**

The Standard Development Organization Advancement Act, Pub. L. No. 108-237, 118 Stat. 661 (2004) (codified at 15 U.S.C. § 4301), was intended to encourage the development of standards, by ensuring that the activities of standard development organizations are evaluated under the Rule of Reason and by limiting exposure to antitrust damages for organizations making appropriate filings.

Comments: Since Congress has so recently addressed this issue (passing the Act in 2004), it is unlikely that the Commission could make useful recommendations in this area. Furthermore, any perceived problems with the Act are likely to reflect a disagreement with the outcome of the legislative process, and not an observation of any real-world problems with the current operation of the Act.

6. **How should the antitrust laws deal with the problems that can arise from patent rights "abuses," *e.g.*, efforts to inhibit competition from generic drug manufacturers?**

A variety of alleged "abuses" have been identified. For example, recent FTC proceedings and private litigation have challenged allegedly "abusive" practices that have purportedly excluded or limited generic-drug competition. *See, e.g.*, *Andrx Pharms., Inc. v. Biovail Corp.*, 276 F.3d 1368 (Fed. Cir. 2002); *In re Buspirone Patent Litig.*, 185 F. Supp. 2d

363 (S.D.N.Y 2002); *In re Biovail Corp.*, F.T.C. Docket No. C-4060 (Oct. 2, 2002) (decision and order), *available at* http://www.ftc.gov/os/2002/10/biovaildo.pdf; *In re Bristol-Myers Squibb Co.*, F.T.C. Docket No. C-4076 (Apr. 14, 2003) (decision and order), *available at* http://www.ftc.gov/os/2003/04/bristolmyerssquibbdo.pdf. Do these problems warrant changes to antitrust enforcement?

Comments: Such "abuses" are best left to adjudicative bodies, which are able to consider all relevant facts in specific cases. Although the Commission could likely offer useful general commentary, courts and the enforcement agencies have already provided guidance in this area, for example regarding patent listings in the FDA Orange Book by innovator drug companies.

7. **Do the FTC and DOJ diverge on antitrust/IP interface issues, and should any such differences be reconciled?**

Comments: The Commission is not well suited to provide a comprehensive reconciliation of differences between the federal antitrust agencies. To the extent the Commission addresses similar issues, it will provide another viewpoint that both of the agencies would have the opportunity to consider.

8. **Should the patent system be replaced with a system of government-granted prizes for innovation (coupled with government buy-outs of some patents)?**

Comments: This issue relates principally to a wholesale replacement of the existing patent system, and only indirectly implicates antitrust issues. It is therefore well outside the scope of the Commission's mandate and expertise, and is not appropriate for study.

9. **Should programs to collect data for use by researchers and firms be established or expanded?**

Comments: The Commission has no unique ability to make recommendations regarding data collection and disclosure, whether by government agencies or private or non-profit

entities. To the extent that it examines issues and finds available data to be inadequate, the Commission can report on the need for more and better data.