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ANTITRUST ENFORCEMENT AND THE PATENT LAWS: "IT IS AS CRAFTSMEN THAT WE GET OUR SATISFACTIONS AND OUR PAY"

Remarks of

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It is most enjoyable to join you in such pleasant surroundings to discuss some of our mutual concerns -- specifically the interface of the patent and antitrust laws.

As I plunge into a somewhat philosophical discussion of these issues, I am reminded of the response given when the young student complained to the old professor about the dry, musty and complicated research topic assigned to him. The old professor smiled and said: "Ah, but just wait 'till you've thought on those issues in pleasant places," and, with his eyes twinkling, added: "and been paid for your thoughts!" Judge Learned Hand's comment of some two decades ago is still true: "It is as craftsmen that we get our satisfactions and our pay."

In no area is solid craftsmanship more needed than in the area of the antitrust-patent law interface. Rather than plunging into either a discussion of recent cases or an attempt to describe black-letter rules, let me discuss some conceptual points that need to be acknowledged in constructing a sound antitrust enforcement policy in the patent area. There are two polar positions that have been proffered to define the dynamics of the patent-antitrust law relationship. I believe neither accurately reflects reality. Some argue there is inherent and continuous conflict between the "monopoly" created by the patent laws and the concept of "free and unfettered" 1/ competition embodied in the antitrust laws. I believe this point of view is not only too simplistic, but is also fundamentally inaccurate. As I will attempt to amplify later, the achievement of some degree of market power is not inconsistent with the competitive process sought to be preserved and nurtured by the antitrust laws, nor should the market power that can arise from the grant of a patent necessarily be at odds with the competitive process.

Others argue there is no substantive conflict whatever between the patent and antitrust laws. Supporters of this view simultaneously extol the virtues of the patent system and the supremacy of competition as the ultimate rule guiding market conduct. Our presence here today is evidence that the coexistence of the patent system and the antitrust laws is not so peaceful. To employ the words of Justice Brennan in a different context, this extreme view of compatibility "blinks reality." 2/

My remarks here today will not resolve the penumbra of questions that surround the patent antitrust interface, but I hope they will be viewed as constructive and useful to you and others who are interested in knowing how the Antitrust Division is likely to proceed when it analyzes transactions involving patents under the Sherman Act.

First, there is probably little or no argument between us as to the basic purpose of the patent system. It has not changed since the authors of the Constitution drafted Article I Section 8. The promotion of the Progress of Science and the useful Arts is at least as important a goal today as it was one hundred and ninety years ago. If one reflects on the variety of major problems that now confront this nation, more often than not significant technological advances are needed before acceptable long-term solutions can be effected. The energy crisis, of course, comes first to mind, but the need for quantum technological advance extends to other basic societal needs, including health care, home construction, and food production.

Congress has chosen to implement the authority contained in Article I Section 8 of the Constitution by granting to the patent owner the exclusive right to practice the patented invention. The choice of this type of grant reflects a strong commitment to the promotion of invention, disclosure and technological progress. It seems that a significant level of inventive activity would result simply from the competitive forces of the marketplace, even in the absence of any subsidization through the patent system. 3/ A still greater level of such activity could have been achieved through the granting of a carrot far smaller than the right to exclude, such as a guarantee of reasonable royalties on

1/ Northern Pac. Rwy. Co. v. United States, 356 U.S. 1 (1958).

2/ Cohen v. Hurley, 366 U.S. 117, 157 (1961).

3/ In a competitive economic market system such as ours there are pressures on each firm to gain a competitive advantage over its competitors. One means of gaining such an advantage is to employ R&D to invent improvements in existing products or processes and be the first to employ them. For certain inventions the availability of this advantage is itself enough to propel the necessary R&D allocation. Such inventions would be produced by the competitive process itself even in the complete absence of any patent system.

all patented inventions. 4/ Nevertheless, Congress chose to seek a higher level of inventive activity by conferring more substantial rights on inventors and promoters of invention while at the same time restricting the grant to inventions that meet certain patentability standards and requiring the patentee to disclose publicly the discovery incorporated in the invention.

As a second major point I would like now to focus on this right to exclude, conferred by the patent law, and on how it affects the marketplace. The Antitrust Division recognizes that the grant of a patent does not necessarily, or even all that frequently, sweep the patentee onto easy street. Even when a patent may seem to have been the key to instant riches, closer examination will often reveal a combination of other talents, efforts and even lucky breaks that played a significant role in any particular patentee's success story.

In point of fact, a United States patent quite appropriately has no inherent value. Its worth -- like the worth of other assets in a free market economy -- is wholly determined by consumer votes cast in the marketplace. In our economy, as in our politics, it is the public that chooses winners and produces losers.

The marketing costs and risks faced by the firm seeking to market a patented invention are analogous to those confronted by a firm with an unpatented item to sell. The essential difference is that the patentee or licensed firm is protected against imitative competition. Frequently, however, this difference does not amount to much. If the patented invention is rejected in the marketplace, the right to prevent imitation is worthless. The patent itself, with its fancy blue ribbon and bright seal, is useful as window-dressing in a corporate annual report or as a morale booster for technical staff. But, it confers no market power.

Where the invention is marketable, the patent can confer market power. It allows the patentee to restrict output and obtain a "supracompetitive" price; that is, a price which is higher than an open market would have yielded. Sometimes, this will yield profits which exceed the amount that would otherwise have been necessary to induce the investment that resulted in the invention's discovery and commercialization. Where this is true, real wealth is conferred on the patentee.

In other situations the patentee's power to restrict output will not result in an ability to charge a higher price because of comparably priced substitutes. In such cases, the exclusionary right will permit only a sufficient yield to recover the patentee's investment.

Even where the patent confers substantial market power, consumers are potential beneficiaries of the patent grant. Competition can be increased through the introduction of a new product or the entry of a new competitor. In addition, costs can be reduced through the use of more efficient manufacturing processes.

It is often small competitors and potential entrants who benefit most from the patent grant. Such firms may have little or no ability otherwise to gain entry into an established market. Patent rights for these firms provide a competitive edge that can counter the larger, existing competitors' popular trade name, access to investment capital, or reliable marketing organization. The Antitrust Division considers these potential benefits attributable to the patent system when it decides on its policy options in the patent-intellectual property area.

This leads to a third major point that should seem obvious but occasionally needs restating. The lawful acquisition of a better market position and the temporary competitive advantage such a position may confer are not the enemies of the antitrust laws, nor should they be. It is the quest for a larger market share, and the expectation of realizing a competitive advantage that drives the free market system. Market power can often be a product of our competitive system. It is frequently conferred on those who can predict how the consumer vote-casting process is going to come out long before the actual votes are cast. The antitrust laws become concerned about market power when it is sustained over a long period of time or begins to interfere with the competitive system. Our national competition policy is also offended when market power results from lapses in the competitive system, as when output is restricted through collusive agreement, excessive government regulation or some other artificial device.

These major conceptual points lead to two interrelated conclusions. The first is that there is no reason for the competitive economy necessarily to fear the economic power which can flow from lawfully obtained patent monopolies. In fact, if we were starting from scratch there would be little reason for antitrust advocates to oppose the establishment of some type of patent reward system to encourage invention. Indeed, it would not surprise me if some antitrust advocates could actually find reason to support the establishment of a patent system that is in many ways analogous to the one we now have. Patents perform important and useful functions in the economy. So long as the market power they can confer is exercised reasonably, we should not expect the competitive applecart to be endangered by the existence and operation of the system.

My second conclusion relates to the philosophical debate about whether antitrust analysis ought to be generically different when applied to the use or abuse of patents that confer market power than when applied to the use or abuse of other types of market power. Some argue that transactions in patent rights should be held harmless from antitrust analysis; others argue that they should be subjected to more careful scrutiny and stricter standards.

4/ All firms like most individuals should be presumed to desire more money rather than less and this drive will typically be the paramount focus in a decision to allocate resources to R&D. Congress could have increased anticipated profits from R&D by means other than granting the right to exclude, such as through a financial grant from the government or perhaps the right to demand a reasonable royalty for a license under one's patent. This incentive would itself be sufficient to produce another class of inventions. See Scherer, the Economic Effects of Compulsory Patent Licensing.

I believe that since the market power conferred by the patent is not materially different from that embodied in other tangible or intellectual property rights, questions of abuse should be evaluated under the same general standards that are employed elsewhere.

Where do these conclusions lead me at the interface? First, the fraudulent procurement of patent rights offends the patent system and may often harm the free market economy. Where the fraud is intentional, the institution of criminal proceedings under Section 2 of the Sherman Act in a Walker Process type proceeding 5/ or under 18 U.S.C. § 1001 based on the submission of false statements to the Patent Office is appropriate. 6/

Second, in the licensing area such definitive statements are not as easily made. My earlier conclusions -- that patents *per se* pose no threat to the competitive system and that the right to exclude granted in a patent is not materially different from other forms of market power -- dictate that the analysis of patent licensing agreements for legality under Section 1 of the Sherman Act ought to be approximately the same as that applied to other forms of commercial arrangements. This process involves a careful assessment of the competitive purposes and effects of the agreements. 7/

I appreciate that this approach is not without its critics. 8/ A basic rationale common to some critics is the proposition that since the patent owner has the right to refuse to license the patent, there should be no restrictions desired by the parties with respect to the manufacture, use or sale of the patented invention because, whatever those restrictions are, they are less severe than the total exclusionary effect of the patent itself.

I respectfully submit that the error of this approach is its failure to take into account significant differences under patent and antitrust laws between unilateral and multilateral conduct. This distinction is not unique in its application to the patent property right, but applies with equal force to the exercise of other property rights. 9/

The critic's choice for a standard was, in fact, the standard employed at the turn of this century under the Button Fastener 10/ rule. However, that decision was specifically overruled and its reasoning rejected by the Supreme Court in 1917 in Motion Picture Patents Company v. Universal Film Manufacturing Company where the Court states:

> The defect in this thinking [in the Button Fastener case] springs from the substituting of inference and argument for the language of the statute and from failure to distinguish between the rights which are given to the inventor by the patent law and which he may assert against all the world through an infringement proceeding and rights which he may create for himself by private contract which, however, are subject to the rules of general as distinguished from those of the patent laws. 11/

The Supreme Court's interpretation in Motion Picture Patents of what is protected activity under the patent laws and what is subject to scrutiny under the general law, including antitrust, closely parallels in effect the choice made by Congress in drafting Section 1 of the Sherman Act.

Section 1 is aimed at conduct tending to unreasonably restrain competition. It reaches efforts to use market power of a kind that falls short of that power necessary to invoke the antimonopoly provisions of Section 2. 12/ However, purely unilateral conduct is excluded. Section 1 cannot be invoked absent concerted conduct in the form of a contract, combination, or conspiracy. It could be argued, as it is with respect to patents, that if a firm could exert market power unilaterally without being scrutinized under Section 1, why not permit the firm to obtain the financial benefits of its market power through concerted conduct. The answer is simply that Congress has concluded, correctly I submit, that concerted conduct represents such a significant potential for anticompetitive effect that it should be treated differently. "Competition not combination should be the rule of Trade." 13/ Thus, there is no inconsistency in evaluating patent licenses under Section 1, while certain unilateral conduct in enforcement of the patent's market power is placed outside its reach. Rather, this involves simply applying the same standard in patent cases as is applied under Section 1 in all other cases. 13a/

I want to state emphatically, however, that by suggesting that patent licensing arrangements should be analyzed under the same standards as other agreements, I do not mean to contend that the existence and nature of the patent grant ought to be ignored. The patent -- along with its right to exclude -- is an essential reference point in any Sherman Act analysis of a licensing agreement. One of the prime virtues of the Sherman Act is the fact that it is flexible enough to be applied sensibly in a myriad of varied fact situations. It is the theme of my remarks today that situations involving patents rarely present special problems requiring unique rules of application. Indeed, the quest for special rules can be counterproductive.

5/ Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172 (1965).

6/ See, e.g., United States v. Markham, 537 F.2d 187 (5th Cir. 1976).

7/ See, e.g., Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

8/ See, e.g., Bowes, The Misapplication of Antitrust Theory to Patent License Conditions.

9/ For example, state law protects rights in both real and personal property, yet the Clayton Act restricts the ability of some owners of such property to sell their property to some potential purchasers. Indeed, in some cases it is possible that a restricted purchaser is one willing to outbid others.

10/ Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co., 77 Fed. Rep. 288 (6th Cir. 1896).

11/ 243 U.S. 502, 514 (1917).

12/ United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 224 n. 59 (1940).

13/ National Cotton Oil Co. v. Texas, 197 U.S. 115, 129 (1905).

13a/ Of course, analysis may also turn on whether subdivision of the patent right is intended to facilitate a market division cartel among licensees, rather than merely reflecting the licensing purposes of the patentee.

This leads me -- not surprisingly -- to what some of you would call the infamous nine no-no's. 14/

In a number of speeches during the last ten years, Antitrust Division personnel have attempted to list those licensing practices that will most frequently raise serious antitrust questions. In most such presentations, nine practices have been listed, although they have not always been stated in identical words and despite the fact that the number could be expanded or contracted by grouping the practices into different categories, or subdividing them. The most important single concern of the Antitrust Division in this area, namely, whether one or more licenses are being used as part of a broader conspiracy to restrain significant actual or potential competition among affected firms, has apparently not directly been listed as one of the nine "no-no's".

While they are signals of possible concern, I do not view the nine no-no's in their entirety as black-letter law. If they have a fault it is that they have suggested to some -- quite inaccurately -- that the Antitrust Division's approach to the interface of patent and antitrust law is wooden, doctrinaire and perhaps even simplistic.

In the patent area our consideration of various situations takes full account of all facts, as well as relevant legal presumptions, pursuant to the principles underlying Section 1. A basic test, as recently enunciated by the Supreme Court in the Professional Engineers case, is whether the agreement, with its restrictive provision, can be justified on the basis that, in context, its net effect is procompetitive. The licensed patent is part of the context of any patent licensing situation. Also included in those factual surroundings are, among other factors, the present and potential competitive relationship of the parties, their market positions, the technological importance of the licensed invention, and its stage of development and commercialization. To the extent that the nine no-no's are interpreted to suggest that the existence of a patent is so predominant a part of the factual setting surrounding particular transactions that basic rules of antitrust analysis are ignored, they are misunderstood.

Of course, we are all aware that there are restraints which have been viewed severely by the courts where patents or copyrights are involved. Using the patent to require a licensee to purchase unpatented materials from the licensor or otherwise restrict the licensee's freedom to deal in products or services not within the scope of the patent are practices that are generally frowned upon. 15/ Requiring licensees to take unwanted licenses with desired ones or to pay royalties not reasonably related to the licensees' use of the patented invention are practices that, when mandatory or coerced, also are generally viewed unfavorably. Using the leverage of a patented manufacturing process to restrain commerce in unpatented end products has in a recent opinion been held to be a per se offense. 16/ It is my assumption that most of you would counsel your clients to avoid these types of arrangements without regard to whether they were included in a Justice Department list.

The important concept to keep in mind concerning all of the nine or more no-no's is that they draw whatever strength and sustenance they have from Section 1 of the Sherman Act. They must be read in pari materia with all relevent legal doctrines of the Sherman Act.

To summarize, the Antitrust Division is committed to the maintenance of our free market economy. The patent system is an integral part of our economic system. Its existence is not a threat to competition and can provide procompetitive benefits. The market power that a patent can confer on its owner can be abused, just as market power from other sources can be. In our surveillance efforts against such abuses, the reasonableness standard of Section 1 of the Sherman Act is our primary guide. Our analysis of each matter into which we inquire is fact specific. We consider the existence of a valid patent to be a potentially important part of the facts underlying licensing transactions.

It is our aim vigorously and fairly to prosecute violations of the antitrust laws, whether such violations involve patents or other factors. We hope we bring to the task that careful craftmanship that, in the end, does give us all "our satisfactions and our pay."

14/ Straight Talk from "Alice in Wonderland", Remarks by Bruce B. Wilson, Deputy Assistant Attorney General, before the American Patent Law Association, Washington, D.C., January 21, 1975.

15/ See, e.g., International Salt Co. v. United States, 332 U.S. 392 (1947).

16/ United States v. Studiengesellschaft Kohle, m.b.H., 1978-2 Trade Cases, ¶ 62,291.

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