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TheAmerican
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January 3, 2005

Andrew J. Heimert, Executive Director & General Counsel
ANTITRUST MODERNIZATION COMMISSION
1120 G Street, N.W., Suite 810
Washington, D.C.

Re: Recommendations of the Intellectual Property Working Group.

Dear Mr. Heimert:

We write respectfully to urge the members of the Antitrust Modernization Commission ("AMC"), at the upcoming agenda-setting meeting of January 13, 2005,[1] to reject the recommendations of the Intellectual Property Working Group insofar as the Working Group does *not recommend* that the Commission study certain issues that are central to the interplay between the intellectual property and the antitrust laws.[2]

Under the current U.S. regime, businessmen, innovators, financiers, and other market participants have difficulty accurately evaluating the risks associated with innovation investments and standard setting activities. A major reason is inconsistent and thus unpredictable application of both IP and antitrust laws in ways that elude harmonization between them.

Consideration by the Commission of some of the issues disfavored by the IP Working Group would, in our view, benefit business, research, innovation, and the administration of justice by clarifying the boundaries of legal and pro-competitive conduct and identifying indicia of appropriate business practices in contexts in which IP plays an important role. Clear rules enable all participants to make a more informed evaluation of the risk of a given activity, and, ultimately, encourage firms to engage in vigorous and fair competition on the merits.

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[1] See "Notice," 6 Fed. Reg. 234, 70627, December 7, 2004. The Notice states that "[t]he purpose of the meeting is for the Antitrust Modernization Commission to determine issues for further Commission study, pursuant to its statutory mandate." *Id.*

[2] "Memorandum Re: Intellectual Property Issues Recommended for Commission Study," Intellectual Property Working Group (to All Commissioners), December 21, 2004, (hereinafter, "*Memorandum*").

2919 ELLICOTT ST, NW • WASHINGTON, DC 20008
PHONE: 202-276-6002 • FAX: 202-966-8711 • BFoer@antitrustinstitute.org
www.antitrustinstitute.org

We set forth below our reasons for disagreeing with the IP Working Group's rationale for its negative recommendation on Issues #3, #4, and #5, and the reasons we believe these issues warrant the Commission's attention.

1. IP-Antitrust Issues Recommended by the IP Working Group.

Commendably, the IP Working Group *Memorandum* does recommend two sets of issues which AAI believes (with one technical caveat) can and should be subjects for study by the AMC:

1. First, should industries involving significant technological innovation be treated differently under the antitrust laws? and,

2. Second, how does the current intellectual property regime affect competition?

Because the business environment related to IP has changed markedly over the past 25 years, the IP Working Group has, in our view, correctly identified the need to examine the effect of the current regime of intellectual property rights on competition (Issue #2). The AAI fully supports the Commission's efforts to do so.

With respect to the first issue, however, a caveat is necessary. Whether—at the moment—certain industries involve "significant technological innovation" and, as a result, should be treated differently under the antitrust laws, is not likely to yield useful information. In principle, the AAI disfavors any approach that requires a categorization of particular industries according to some perceived intensity or pace of its use of innovation or the identification of similar production technology criterion that call for different kinds or degrees of antitrust scrutiny for different groups of industries. Industries making intense use of innovation today may not be the innovative industries of the future. Technological innovation can significantly transform *any* industry, and a static exercise that singles out certain existing industries as "high tech" is thus not likely to be productive.

. However, the sub-issues identified under Issue #1 as phrased by the IP Working Group's *Memorandum*, such as how market power should be measured in matters involving intellectual property; what time horizons are appropriate to account for innovative development with market significance, and the nature and the optimal role of the concept of "innovation markets," are all issues worthy of study and relevant to understanding the interplay between intellectual property and antitrust. The AAI applauds the AMC's approach to these issues, while at the same time urges that these important questions not be identified with any proposal that suggests an agenda item that certain

"industries involving significant technological innovation" should enjoy special treatment under the antitrust laws.

2. An Effective Examination of the Effect of IP Law on Competition Cannot and Should Not Be Attempted without Full Consideration of the Potential Remedy of Compulsory Licensing in Appropriate Circumstances, or the Implications of Improper Conduct by Companies Involved in Standard-Setting Activities, and of the Potential for Useful Amendments to the Standard Development Organization Advancement Act.

Exclusion of Issue #3 from the Commission's agenda (relating to compulsory licensing), and Issues #4 and #5 (relating to the process of setting voluntary industry-wide technical standards), serves only to inhibit the full exploration of the effect of IP law on competition. Specific benefits of studying these issues in connection with the Commission's other work in the IP area can be achieved. We summarize these benefits in the remainder of this letter.

A. Compulsory Licensing May Constitute in Limited Circumstances the Most Efficient and Effective Remedy and Should Not Be Excluded from the Commission's Consideration in Connection with Intellectual Property.

The IP Working Group recognizes that considerable debate exists on whether and when licensing of intellectual property may appropriately be required. For example, the *Memorandum* refers to the relatively narrow "after-market" or "adjacent-market" problem at play in the conflict between *In re: Indep. Serv. Orgs. Antitrust Litigation.*, 203 F. 3d 1322 (Fed. Cir. 2000) ("*CSU*") and *Image Tech. Services, Inc. v. Eastman Kodak Co.,* 125 F.3d 1195 (9ththe Cir., 1997) ("*Kodak*").

AAI is sympathetic with the Commission's desire to avoid extensive entanglement in issues that may prove to be of limited practical usefulness. An extended discussion of the conflicting approaches in *CSU* and *Kodak*, particularly in light of the extensive scholarly commentary available on these cases, may well not represent an optimal expenditure of the Commission's time and resources.

However, the issue of compulsory licensing of intellectual property covers considerably more ground than the narrow issues framed by the *CSU-Kodak* conflict. Compulsory licensing (or "compulsory access" in adjacent fields) is, more commonly, a form of a remedy. Moreover, it can be allocatively efficient, and represent the best of a range of possible remedial alternatives.

Ordinarily, compulsory access suffers from an administrability problem, in which judicially forced dealing may require the court to set prices and oversee compliance with the terms of trade. This is often seen as outweighing any potential benefit of imposing the forced access remedy in the first place. But, this is not always the case, because some uses of intellectual property are sufficiently widespread, and are sufficiently "commoditized," that no serious dispute can exist about the terms of trade (*e.g.*, the rate of royalties) with the court required to expend little or no administrative effort.[3] Getting the remedies right is an essential part of the challenge of harmonizing the protection of competition under intellectual property and antitrust laws.

B. A Coherent Antitrust Analysis of Misleading and Other Abusive Conduct in Connection with Standard Setting Processes is Necessary for Continued Robust Technological Innovation and Interoperability.

The IP Working Group's Issue #4 (which they proposed for deletion) is: "How should antitrust law analyze misleading conduct and other possible abuses of standard setting processes?" With the obvious relevance of this question to current business and research practice, the need for immediate attention and guidance on this issue should be self-evident.

There is broad consensus throughout the IP, antitrust and associated communities that open standards enabling interoperability among both competing and complementary products employing new technologies are critical to the public policy objective of maximizing innovation and competition in technology markets over the decades ahead. There is also broad recognition that these objectives are undermined by patent claims that are not adequately disclosed or the cost implications of which are misunderstood when technical standards are under development. The proliferation of these situations involving an array of misleading and other abusive conduct by standard-setting participants with patent claims and the ensuing proliferation of patent holdup practices implemented after

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[3] In the non-intellectual property context, one example is the injunctive order—entered recently by the district court in Utah—requiring the dominant owner of a medical waste incinerator to accord access to competitive medical waste truckers at standard per-ton "tipping fees." This illustrates not only that "forced access" remedies can be a simple means of restoring competition injured by an antitrust violation, but also that the assumption in the formulation of Issue #3 is erroneous: It is incorrect to claim that "no such duty [to require compulsory access exists] for other types of property." See also Michael A. Carrier, "Cabining Intellectual Property Through A Property Paradigm," 54 Duke L. J. 1 (Oct., 2004).

competitors have become completely locked into the adopted standards is a serious public policy problem that defies an easy or readily discernible solution.

The IP Working Group recognizes the problem but recommends against Commission consideration on the grounds that (a) a "legislative solution . . . may be difficult to develop" and (b) "the solution may best be left to the marketplace's adapting to existing case law . . . and to future adjudicative proceedings capable of addressing the unique facts of each case." But the elusiveness of a legislative solution suggests an antitrust modernization challenge that the Commission should embrace rather than ignore; the marketplace has shown its inability to adapt to "existing case law" in any effective manner in the nine years since the FTC's Dell enforcement action highlighted the problem; and adjudicative proceedings have been demonstrably unsatisfactory mechanisms for the evolution of effective industry-wide or cross-industry consensus solutions. Sharp disagreements in this regard among a wide array of industry participants and academics were evident at the 2002 FTC/DOJ hearings on the intersection between competition and IP policies; the agencies' long delay in generating the promised joint hearings report suggests that they too have been unable to come to agreement over appropriate solutions.

In AAI's view, it would be decidedly in the public interest for this Commission now to deem these circumstances as an invitation to undertake a study of how standards development organizations ("SDOs") could most effectively reform and update their patent policies in ways that address patent holdup and related concerns. SDOs do not now appear possessed of the incentive or even the capability on their own to undertake a study of this sort; all indications are that they (or most of them) remain wedded to longstanding policies that actually enable rather than protect against anticompetitive abuses of standard-setting processes under their ineffectual watch.

Enforcement agency and other litigation responses to the described problems have focused exclusively on allegedly bad conduct by patent holders; the overarching institutional cause -- SDO policies that too easily allow the bad conduct to occur -- has yet to be addressed in any systematic way. We believe an appropriate initial premise for this Commission's study of the situation is to recognize the SDOs' own antitrust obligation to employ policies that will effectively safeguard against patent holders' anticompetitive manipulations of the standards development process. There is nothing new about the idea of holding an SDO liable under the antitrust laws for its allowance of anticompetitive conduct under its auspices; the Supreme Court established this principle in the *Hydrolevel*[4] decision 22 years ago. What is new, and warrants this Commission's

[4] *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982). See also *Allied Tube and Conduit Corp. v. Indian Head, Inc.,* 486 U.S. 492 (1988).

consideration, is the need for a thoughtful application of this principle to patent-related anticompetitive conduct. What is also looming on the horizon, if the United States does not rise to the challenge, are standard-setting reforms that may emanate from the European Union and elsewhere around the world but that may not be entirely compatible with U.S. competition policy preferences.

As already noted, solutions are elusive; neither new legislation nor more litigation is likely to provide optimal and effective SDO policies in this area, particularly since no one-size-fits-all rule will be suitable for the diverse multitude of standard-setting processes threatened by patent hold-up threats and outcomes. This Commission could promote and provide valuable guidance for SDO experimentation with new approaches, developing suggestions for "best practices" that meet legitimate needs of all stakeholders with an eye on protecting opportunities for both innovation and open competition in standards-driven markets throughout the economy. This could productively include addressing such admittedly challenging subjects as when and how disclosures should encompass pending patent applications as well as issued patents; participants' modifications of pending applications based on developments during a standard-setting process; fashioning meaningful definitions or acceptable understandings of what a "RAND" commitment entails and how it can be effectively enforced; and disclosures regarding actual license terms that a participant intends to seek if a proposed standard implicating its patent claims is adopted. The Commission would provide a considerable public service by undertaking to address these subjects from a competition policy perspective. The AMC's work could be seen as a careful step forward, illuminating whether there is any need for further regulatory intervention.

C. The Commission Should Not Exclude Modification of the Standard Development Organization Advancement Act as an Agenda Item for Discussion.

The IP Working Group recommends against considering modifications of the Standard Development Organization Advancement Act because (a) Congress having "so recently" acted, "it is unlikely that the Commission could make useful recommendations"; and (b) "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."

These comments appear to reflect a misunderstanding of Congressional intent with respect to problems at the intersection between patents and standard-setting processes. The legislative history reflects a desire to promote fresh thinking about more effective measures to ensure that patents are appropriately disclosed and considered before a proposed standard is adopted:

> The legislation . . . seeks to encourage disclosure by intellectual property rights owners of relevant intellectual property rights and proposed licensing terms. It further encourages discussion among intellectual property rights owners and other interested standards participants regarding the terms under which relevant intellectual property rights would be made available for use in conjunction with the standard or proposed standard.[5]

Moreover, the recent amendments to the Act to which the IP Working Group *Memorandum* refers merely codified well-established principles of antitrust as they relate to conduct of SDOs, as found in cases such as *Hydrolevel* and *Allied Tube.*[6] The current difficulties are created by the intersection of IP claims, standard setting, and the conduct of *participants*, which are largely unaddressed by *Hydrolevel, Allied Tube,* and the recent amendments.

The purpose of any new amendment to the Standard Development Organization Advancement Act should not, in our view, be any attempt to standardize the rules or procedures of the innumerable voluntary SDOs so that they occupy any kind of antitrust "safe harbor." As the Lemley study convincingly demonstrates,[7] there is little if any consistency among the rules and procedures of existing SDOs. To attempt to exogenously impose on SDOs standardized rules or a uniform approach—even were such a task feasible—would seem counterproductive. As advocated by thoughtful industry representatives in recent years, SDOs should be encouraged to experiment with diverse approaches to enabling more meaningful patent-related information disclosures during the course of standards development activity.[8] And, as noted above, the AMC could serve the public interest by its encouragement of that kind of experimentation and by providing guidance for it.

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[5] 150 Cong. Rec. H3656-H3657 (June 2, 2004).

[6] *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556 (1982). See also *Allied Tube and Conduit Corp. v. Indian Head, Inc.,* 486 U.S. 492 (1988).

[7] Mark A. Lemley, "Intellectual Property Rights and Standard-Setting Organizations," 90 Ca. L. Rev. 1889 (2002).

[8] See, *e.g.*, Statement of Scott K. Peterson, Hewlett-Packard Company, "Patents and Standard-Setting Processes," for the Joint FTC/DOJ Hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, April 18, 2002; Comments Regarding Commission Issues for Study, Sun Microsystems, Inc., September 30, 2002; and, Gil Ohana, Marc Hansen & Omar Shah, "Disclosure and Negotiation of Licensing Terms Prior to Adoption of Industry Standards: Preventing Another Patent Ambush?, 12 Eur. Comp. Rev. 644 (2003).

3. Programs for the Collection of Data Should Be Established

In the monograph by Jaffe and Lerner,[9] the authors note that

> [b]ased on a survey of intellectual property lawyers in 2000, the cost of defending a large (more than $25 million at risk) patent infringement suit is about $2 million to $4.5 million. For cases with less than $1 million at risk, the cost was $300,000 to $750,000 or about half the amount in dispute. Given these large costs, and the realization that cases seem to have increasingly favored patent holders, even targets that think they are not infringing have a strong economic incentive to give in rather than fight. This means there are probably many cases of stifled competition that we do not even know about.[10]

It would therefore be of central interest to know whether the *threat* of intellectual property litigation is having a chilling effect on innovation, and, *a fortiori*, a deleterious effect on competition. The AMC should encourage the study of IP litigation, and in particular patent infringement suits that are not tried to judgment. Such a study could aid greatly in the investigation of the effect of IP law on competition.

4, Conclusion.

For the foregoing reasons, we respectfully request the Commission not to adopt the negative agenda recommendations put forth by the IP Working Group and to otherwise proceed in a manner consistent with the argument and analysis set forth herein.

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[9] Adam B. Jaffe and Josh Lerner, *Innovations and Its Discontents: How Our Broken Patent System is Endangering Innovation and Progress, and What To Do About It* Princeton and Oxford: Princeton University Press ((2004)

[10] *Id.*, at 68.

Respectfully submitted,

JONATHAN L. RUBIN
Research Fellow
American Antitrust Institute
JRrubin@antitrustinstitute.org
(202) 415- 0616

ALBERT A. FOER, President,
American Antitrust Institute
Bfoer@antitrustinstitute.org
(202) 276-6002

cc (via e-mail): Deborah A. Garza, Chair
Jonathan R. Yarowsky, Vice-Chair
Bobby R. Burchfield, Commissioner
W. Stephen Cannon, Commissioner
Dennis W. Carlton, Commissioner
Makan Delrahim, Commissioner
Jonathan M. Jacobson, Commissioner
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John L. Warden, Commissioner