DEPARTMENT OF JUSTICE

ANTITRUST, INNOVATION AND INTELLECTUAL PROPERTY

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I always love returning to Stanford. The school and the area evoke many pleasant and exciting personal memories. My introduction to antitrust law occurred here, in Bill Baxter's classroom. At least before the tremendous learning experience of this past 15 months, I could say that Bill taught me most of what I knew about antitrust law. Unfortunately, he couldn't teach me everything he knew.

Of course, it never occurred to me when I was in law school how important intellectual property would become to the economy and to the law -- and to me personally. Fortunately, the Stanford administration, led by Dean Terman of the engineering school, had more foresight. Together with visionary entrepreneurs, they developed the Stanford industrial park and put "Silicon Valley" on the map and in the world's lexicon. Silicon Valley is now a symbol across the world of the dynamism of the U.S. economy.

The vision that led to the creation of this national treasure is alive and well in the United States today. We are the world's leader in research and development, spending more than either Japan or the entire European Union on both total and industrial R&D. We should never forget, however, how easily dulled is our competitive edge. R&D is often vulnerable in a world of tight budgets and high interest rates. But it is our savings account for a competitive future, and we draw it down at our own peril.

The Clinton Administration has committed itself to maintaining the vigor of R&D in the U.S. economy, and that commitment has many dimensions. They include new grant programs for technology transfer -- such as the Technology Reinvestment Project, which leverages defense research dollars to manufacturing and education, promoting cooperative R&D between the national labs and the private sector to commercialize defense-oriented technologies and expanding the protection for U.S. intellectual property in other countries. On the last point, we have achieved tremendous progress through the intellectual property aspects of the Uruguay Round of the GATT negotiations and through bilateral discussions with Japan. These discussions have focused on harmonizing intellectual property protection around the globe. As a result of these various efforts to promote research and development, our total spending on industrial R&D has kept pace with the growth of the economy, despite a dramatic fall in defense-related R&D.

I am proud of the role that the Antitrust Division has played in promoting an innovative and dynamic U.S. economy. Some have argued that vigorous antitrust enforcement impedes innovation by preventing the concentration of assets necessary for effective research and development or by restricting practices that promote the use of R&D. More recently, the fashion has been to assert that

antitrust enforcement hurts America's international competitiveness -- that our firms are at a disadvantage in competing globally with companies who are allowed to form cartels in their home countries. I discussed this topic at some length in July in a speech before the Commonwealth Club in San Francisco. Some of you may have attended that speech or heard it over National Public Radio, so I won't repeat the arguments I made there.

But I will reiterate my conclusion. The U.S. economy today -- recently recognized by the World Economic Forum in Geneva as the world's most competitive -- is the most dynamic, creates the most jobs and produces the highest level of innovation precisely because we as a nation committed long ago to a policy of vigorous but sound antitrust enforcement. Moreover, I believe that antitrust enforcement will be as essential to innovation and economic growth in the 21st century as it has been in the 20th -- and that intelligent antitrust enforcement is a critical component of the fight to keep America competitive in high-tech markets. The fact that the pace of technological innovation is constantly accelerating makes it more, rather than less, important to sustain the right balance between reward and rivalry. The reality is that fear of being left behind is more likely to spur innovation than is complacency bred of stable market power.

Innovation itself, of course, can and does take many forms. The term is applied to basic scientific breakthroughs, important commercial inventions, product modifications and new production techniques. All are important to society. Whether in the form of improved product quality and variety, or production efficiency that allows lower prices, innovation is a powerful engine for enhanced consumer welfare. By prohibiting private restraints that impede entry or mute rivalry, antitrust enforcement seeks to create the conditions in which entrepreneurial initiative can flourish and in which opportunities for bringing innovations to market can continue to be exploited by the multitude of private actors in this most free of market economies. The task of antitrust is not to pick winners, but to make sure that private restraints do not narrow the potential sources of innovation. By promoting an economic climate that rewards efficient sources of innovation, be they small or large, antitrust preserves the fundamental values of freedom and opportunity that are and always have been the backbone of American economic success.

I do not lightly equate innovation with America's commitment to freedom and opportunity. Our history illustrates the symbiosis between America's inventive genius and her commitment to individual freedom and opportunity. The very spirit that impelled Ben Franklin to fly his kite in a thunderstorm also inspired him to declare defiantly: "They that can give up essential liberty to obtain

a little temporary safety deserve neither liberty nor safety." Franklin and the drafters of the Constitution, so sparing with the words they engraved in that remarkable document, were careful to endow Congress with the power "to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." (U.S. Constitution, Art. I, § 8.) Indeed, the roster of innovators who have flourished in the environment of American freedom is a veritable who's who of world technological progress: Eli Whitney and the cotton gin, Robert Fulton and the steam engine, Samuel Morse and the telegraph, Alexander Graham Bell and the telephone, Thomas Edison and the electric light -- to name just a very few.

The transcendence of American inventive genius continues, in no small measure due to the efforts of many here in Silicon Valley. Competition sparked by the break-up of AT&T has made the United States the world leader in the telecommunications revolution. Other countries are scrambling to catch up in that vital sector. American companies are in the forefront internationally of many other areas that depend on innovation; an abridged list includes aircraft, pharmaceuticals, computers (both hardware and software), medical equipment and entertainment.

But America's past innovative achievements can be mere prologue to advances yet to come. Already, as I noted, America leads the world in R&D expenditures. As we stand on the threshold of the 21st century, we should reaffirm that our competitive edge depends on our unique inventive genius, and that the prosperity of that genius in turn depends on intelligent and vigorous antitrust enforcement that protects the openness of the American market. A dynamic, open market characterized by rivalry and innovation will be the engine that powers the American economy into the next century.

Antitrust enforcement, though a necessary condition to innovation and global competitiveness, is not alone sufficient. Intellectual property protection is a vital, crucial partner in keeping markets open to innovative competitors. As I noted, the nation's founders recognized at the creation of the Republic the importance of intellectual property rights. Abraham Lincoln observed that intellectual property protection adds "the fuel of interest to the fire of genius." Quite simply, in addition to the assurance that they will not be unfairly excluded from the market, innovators also need to know that they can appropriate the value of their innovations once those innovations are introduced. I doubt that I need to convince anyone in this room that the recognition and enforcement of intellectual property rights serves to foster innovation and economic

advancement. I share that belief profoundly. Antitrust enforcement and the protection of intellectual property rights are means to a common end -- creating an environment that promotes the innovation necessary for economic success in an era characterized by rapid technological change.

I know that some used to think otherwise. Some of the old cases suggest that the purpose of antitrust is to prevent monopolies, whereas the purpose of the patent system is to create them. In this simplistic manner, one could posit a fundamental tension between the two rules of law. I doubt that anyone subscribes to that view anymore. If so, that person certainly is out of the mainstream, which recognizes that without enforceable intellectual property rights, the incentive to invest and innovate would be greatly diminished. Such a result, of course, would be contrary to the very purpose of the antitrust laws, which also is to promote the well-being of consumers by spurring efficiency, innovation and investment.

In expressing my support for strong intellectual property rights, I am by no means suggesting that one should confer intellectual property rights where they are inappropriate. The awarding of patent-like protection in the absence of an adequate showing of novelty and non-obviousness, for example, can harm competition without serving the interest of rewarding innovation. More important, inappropriate patent protection can stand in the way of subsequent innovation by blocking further developments, eliminating the incentives of subsequent innovators to engage in such innovation and raising the costs and risks of R&D generally. For this reason, we support the efforts of the Patent and Trademark Office to reexamine questionable patents and to ensure that its examiners have the appropriate background, training and databases to make correct decisions on patent applications in the first instance. We will continue to work closely with Commissioner Bruce Lehman to ensure that patents are used appropriately and competitively.

I have argued so far that our antitrust and intellectual property laws share a common objective: promoting innovation. But it is important to remember that intellectual property rights also can be improperly deployed to the detriment of competition and the goal of technological progress. For example, holders of intellectual property rights may use them improperly to coordinate a cartel and suppress competition in alternative technologies or associated markets, to raise barriers to entry in other markets, or to extend the period of exclusion beyond either the statutory term or a reasonable period of time (depending on the nature of the intellectual property right). If intellectual property owners step beyond the bounds of their property rights, the result may

be reduced output, unsanctioned monopoly profits and stifled innovation. These consequences matter, especially in the international context. They have a direct, detrimental impact on U.S. exports, as well as on the U.S. domestic economy.

Although antitrust enforcement and intellectual property rights are complementary, defining with any precision the manner in which the two dovetail is not always a simple task. When I first took office as Assistant Attorney General, many experienced practitioners suggested that the interrelationship between these policies was so important to our national well-being that the Antitrust Division should provide the business community with clearer guidance on these matters and devote more of its resources to intellectual property issues. After careful consideration, I agreed that such guidance would contribute greatly to promoting the common goals of antitrust and intellectual property. As a result, about nine months ago, we formed a Division Task Force chaired by Deputy Assistant Attorney General Richard Gilbert, who is here today, to formulate our policy and to draft new intellectual property Guidelines.

These Guidelines now have been published in draft form in the Federal Register. We are currently reviewing public comments -- many of which were supplied by those of you in this room -- with a view toward incorporating those that are well taken. And let me say as an aside how proud I am of the job that the Task Force did. Its members devoted countless hours to researching the subject, meeting with academics, practitioners and business people, and drafting the Guidelines. I think the resulting product is a tremendous achievement that will contribute to increased understanding and clarity in an area that, as I said, is not always subject to precise definition.

As an initial matter, I would like to highlight the three principles that form the foundation of the Guidelines. The first is that, for antitrust purposes, intellectual property is essentially comparable to any other form of property. Intellectual property rights confer certain rights to exclude. Patents confer rights to exclude others from making, using, or selling the invention claimed by the patent. Copyrights give the right to exclude others from copying original works of authorship embodied in a tangible medium of expression. Trade secret laws prevent the misappropriation of information whose economic value depends on its not being generally known. Each of these forms of property protection differs in purpose, extent and duration from the others. Each also differs from the laws against trespass that give a factory owner the right to exclude others from using his factory; determining the appropriate boundary is often more difficult for intellectual property rights than for conventional property. Yet, after careful analysis and many discussions with scholars, members of

the property bar and intellectual property owners, we have not been able to discern any important way in which these differences require the application of different antitrust principles. This is not because there are no differences among the various forms of property, but because the antitrust laws are sufficiently flexible to take those differences into account.

The second principle is that the Antitrust Division, in carrying out its enforcement duties, does not presume the existence of market power from the mere possession of an intellectual property right. Rather, we determine the existence of such power by evaluating the availability of close substitutes. If we were examining conduct involving word processing software, for example, the fact that the software was copyrighted would not justifying our ignoring the possibility that it competes with Microsoft Word and with Word Perfect. Moreover, if a specific form of intellectual property does confer a significant competitive advantage on its owner, that advantage standing alone is no more in conflict with the antitrust laws than one created by any other asset that enables its owner to earn supracompetitive profits. Judge Learned Hand's statement in the Alcoa case in 1945 that the Sherman Act is not violated by the attainment of power solely through "superior skill, foresight and industry" remains apt today with respect to the types of innovation protected by intellectual property rights.

Our third guiding principle is that licensing is important to the economy and that the antitrust laws should encourage procompetitive licensing. We recognize that licensing, cross-licensing or otherwise transferring intellectual property facilitates its integration with complementary factors of production and encourages the sharing of technology. Transfers of intellectual property can lead to a more efficient exploitation of intellectual property, benefiting consumers by accelerating the reduction of costs and the introduction of new products resulting from the intellectual property. Licensing arrangements can promote economic welfare by integrating complementary intellectual property and avoiding costly infringement litigation. By potentially increasing expected returns, licensing also can increase the incentive to invest in creating intellectual property. In addition, we also recognize that field-of-use, territorial and other limitations on intellectual property licenses may serve procompetitive ends in allowing the licensor to exploit its property as efficiently and effectively as possible. Consequently, in drafting the Guidelines we took pains to ensure that enforcement policies designed to prevent anticompetitive practices with respect to licensing did not inadvertently discourage the licensing itself.

These guiding principles do not differ substantially from the principles underlying the intellectual property portion of the 1988 Guidelines on International Operations. These shared principles represent a broad consensus that today exists concerning the interaction between antitrust and intellectual property. Within the context of this consensus, however, there are several respects in which the new Guidelines differ from the 1988 Guidelines, some of them explicitly informed by the principles I have cited.

First, the new Guidelines provide, for the first time, an explicit "safety zone," in which the Department will not challenge restrictions in licensing arrangements if the restraint is not of a type that normally warrants condemnation under the per se rule and if the licensor and its licensees collectively account for no more than 20 percent of each relevant market affected by the restraint. This safety zone provides certainty and simplicity for arrangements that account for a substantial portion of intellectual property licensing. It should be of particular assistance to smaller innovators, who contribute so much dynamism to our economy. The new "safety zone" is designed to foster and encourage the procompetitive licensing of intellectual property by making the rules of the road simple, clear and easy to follow for smaller companies and innovators -- thus encouraging the spread of innovation, the creation of jobs and economic growth.

Second, the new Guidelines address the conditions under which mergers and other contractual arrangements can have anticompetitive effects in an "innovation market." The concept of innovation markets is not a new one; indeed, the National Cooperative Research Act of 1984 as well as the 1988 Guidelines explicitly refer to research and development markets. These new Guidelines, however, represent the first effort to incorporate the analysis into the Department's statement of its enforcement intentions. As many of you know, the Department used innovation market analysis as a basis for challenging the proposed acquisition of General Motors' Allison Transmission Division by the German firm, ZF of Friedrichshafen. That merger, if allowed to occur, would have resulted in unacceptable concentration of the research and development assets necessary for innovation in the market for heavy duty automatic transmissions. The parties abandoned the transaction after the Department filed a complaint in federal district court in Delaware last November. In describing the relevance of innovation markets to analyzing intellectual property arrangements, the draft Guidelines explain that the Department will delineate an innovation market only if the ability to do research and development is closely linked to the possession of identifiable specific and scarce assets, as was the case with the GM-ZF transaction. Thus, these new Guidelines provide for the first time specific, delimiting circumstances in which the concept will be applied.

As such, we hope and believe the Guidelines can provide added clarity and guidance in what can be a difficult and confusing area.

Third, the draft Guidelines conform the method for selecting the appropriate mode of legal analysis to the approach actually used by the courts. The 1988 Guidelines essentially applied merger analysis to all licensing arrangements other than sham arrangements. The draft Guidelines explicitly recognize that there are bodies of law concerning categories of conduct such as horizontal market division, horizontal price fixing, resale price maintenance and group boycotts used by the courts to analyze antitrust issues, and discuss the manner in which these bodies of law would be applicable to restraints involving intellectual property.

To determine the appropriate mode of analysis, the Department will first ask if the restraint in question can be expected to contribute to an efficiency-producing integration of economic activity. If there is no efficiency-producing integration of economic activity and if the restraint is one that is otherwise appropriate for per se treatment, the Department will challenge the restraint under the per se rule. Otherwise, the Department will apply a rule of reason analysis. This approach reflects the analysis used by the Supreme Court in cases such as BMI and NCAA. In the vast majority of intellectual property licensing cases, it will result in the use of rule of reason analysis, because licensing arrangements typically involve vertical relationships that create significant integrative efficiencies and restraints associated with those arrangements usually will have sufficient relationship to the efficiency-producing integration.

Guidelines, of course, can only go so far in outlining the Department's enforcement intentions in the intellectual property area. Specific cases brought by the Department are another important source of guidance for practitioners and intellectual property owners. I already have mentioned the suit we filed against General Motors and ZF. I would like to discuss briefly three other recent cases that reinforce the analytical approach outlined in the draft Guidelines and that further reflect the Department's enforcement intentions and policies in the intellectual policy arena.

In May, the Department filed its first non-merger intellectual property case in 15 years when it sued Pilkington, the British glass manufacturer. Pilkington years ago licensed the major world float glass manufacturers to use its technology only in specified territories. These original licenses contained stringent territorial, use and sublicensing restrictions, together with grant-backs of

improvements developed by the licensees, that substantially limited competition among the licensees and Pilkington.

Pilkington's licenses were hybrid patent/know-how licenses that did not terminate on the expiration of the patents, but continued indefinitely until the licensee could prove that all of the licensed technology was publicly known. We concluded that Pilkington exaggerated what was "secret" as a way of deterring or inhibiting the ability of licensees and other rivals from inventing around whatever legitimate intellectual property rights it possessed. The complaint alleged that Pilkington also entered into other agreements, including export limitations, with its licensees outside of and apart from the licenses as a way of limiting and controlling competition in glass markets. By the time that the Department sued Pilkington, the company's principal float glass patents had long since expired and a substantial portion of its related know-how had become publicly known.

The licensing agreements prohibited United States companies from exporting their own glass manufacturing technology, thus preventing American companies from building glassmaking plants overseas. This prohibition hurt United States output, innovation and jobs. The proposed settlement would prohibit Pilkington from improperly using its intellectual property rights and would allow U.S. firms to compete for over 50 float glass plants that are expected to be built around the world. We estimate that this could result in an increase in U.S. export revenues of anywhere from $150 million to $1.25 billion over the next 6 years.

In July, the Department brought a second intellectual property case when it filed a complaint against, and a proposed settlement with, Microsoft. The complaint challenged licensing restrictions that Microsoft used to stifle innovation in the market for personal computer operating systems. An extensive investigation had concluded that Microsoft gained a dominant position in its market by developing operating systems that the public clearly wanted, but overstepped the boundaries of its intellectual property rights by employing various unlawful practices to cement its dominance and thwart innovative competitors.

According to the complaint, Microsoft used a number of restraints in its licensing agreements that had the intent and effect of foreclosing competition. Among those restraints were royalty schemes that essentially levied a tax on personal computer manufacturers who dealt with Microsoft's competitors and lengthy terms and huge minimum commitments that foreclosed potential competitors. The complaint also challenged Microsoft's attempts to get software developers to sign

non-disclosure agreements that would have had the effect of preventing the developers from writing applications programs for competing operating systems.

The proposed consent decree will end each and every one of these challenged practices. The consent decree also will have a prophylactic effect by prohibiting Microsoft from engaging in other practices that could produce anticompetitive effects similar to the challenged restraints. Such practices include charging licensees on a lump sum basis or tying sales of operating systems to other products.

The final case is the one filed against S.C. Johnson and Bayer in August. As with Pilkington and Microsoft, the complaint was accompanied by a proposed consent decree. A Bayer subsidiary, Miles, developed in the mid-1980s a new line of household insecticides that it intended to market under the brand name "Laser." The Laser products were to contain Cyfluthrin, a potent new active ingredient developed and patented by Bayer, and, we alleged, would have presented a serious competitive challenge to Johnson's dominance of the household insecticide market in the United States.

After Miles had substantially completed its preparations to enter the market in competition with Johnson, but before it did so, Bayer cancelled the Laser project. Instead, it agreed to sell the Laser-related product research and packaging design to Johnson and to license Cyfluthrin to Johnson. Although the agreement purported to be nonexclusive, the Department was prepared to show that Bayer subsequently refused to license Johnson's competitors to use the compound. Johnson also acquired the right of first refusal for any other active ingredient that Bayer later developed.

The anticompetitive effects of this licensing arrangement are clear. By agreeing not to enter the household insecticide market in the United States, Bayer helped insure Johnson's continued dominance of a highly concentrated market. Johnson accounts for somewhere between 45 and 60 percent of total market sales, while none of its major competitors has more than 12 percent. The complaint alleged that by purchasing some of the assets Bayer would have used in entering the market and obtaining what was in effect an exclusive license to Bayer's innovative active ingredient, Johnson effectively eliminated competition that could have helped drive down the price of household insecticides.

The proposed consent decree will enhance competition in the household insecticide market by ensuring that Johnson's competitors will have access to Cyfluthrin on terms and conditions that are at least as favorable as those accorded to Johnson. The proposed relief, among other things, also ensures that the Department will receive prior notice of any exclusive or co-exclusive license agreement between Johnson and any active ingredient manufacturer other than Bayer. The Department thus will have an opportunity to challenge any such agreement that it believes may substantially lessen competition in the household insecticides market.

Having noted these three enforcement efforts, let me reiterate that the vast majority of intellectual property licensing arrangements are procompetitive and do not present antitrust concerns. The draft Guidelines recognize and reflect that reality. Where, however, a licensing arrangement harms competition without promoting innovation or directly forecloses innovative competition -- as in the three cases just discussed -- we will not hesitate to take appropriate action. To that end, and to ensure that our evaluation of intellectual property licensing arrangements is appropriately sophisticated, we have added five lawyers with a background in intellectual property and intend to hire more. We currently have ten open IP investigations, several of them involving extremely large companies operating in world markets. In every case, if a violation is found, our goal will be the common goal of antitrust enforcement and intellectual property protection -- to foster a climate conducive to the innovation necessary for success in today's global economy.

Somebody once said that we should all be concerned about the future because we will have to spend the rest of our lives there. The Clinton Administration has committed itself to securing America's economic future by encouraging a dynamic, innovative marketplace -- one that complements protection of intellectual property rights with vigorous, intelligent antitrust enforcement. The challenges of international competition in this era of accelerating technological change are immense. But if we dedicate ourselves to promoting open, competitive markets that reward efficient innovation, America not only will survive those challenges, she will prosper.

Thank you.