DEPARTMENT OF JUSTICE

RECENT DEVELOPMENTS IN ANTITRUST AND INTELLECTUAL PROPERTY LAW

THOMAS O. BARNETT
Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Presentation to the

American Conference Institute's Third Annual
In-House Counsel Forum on Pharmaceutical Antitrust
New York, New York

May 16, 2007

I. Introduction

Good morning and thank you for inviting me to New York. In agreeing to speak on my topic today – recent developments in antitrust and intellectual property law – I have a wide range of potential issues to discuss. For example, one month ago, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) issued a joint document, which we call the "IP2" Report,[1] covering six topics at the intersection of antitrust and intellectual property. The Supreme Court has taken an unusually large number of cases in the past two years in the field of antitrust, intellectual property, or both.[2] The DOJ has issued two business reviews on the subject of "ex ante" disclosure of patents and licensing terms in technology standard setting, the second of which was released on April 30, 2007.[3] And the

[1]U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT & INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION (April 17, 2007), http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf [hereinafter "IP2 REPORT"]. The shorthand title "IP2" is used to distinguish this from an earlier report issued by the FTC. *Cf.* FED. TRADE COMM'N, TO PROMOTE INNOVATION: THE PROPER BALANCE OF COMPETITION AND PATENT LAW AND POLICY (2003), http://www.ftc.gov/opa/2003/10/ipreport.pdf.

[2]*E.g.*, Illinois Tool Works Inc. v. Independent Ink, Inc., 126 S.Ct. 1281 (2006) (the mere fact that a tying product is patented does not support a presumption of market power in a patented product for purposes of an antitrust claim under the Sherman Act (abrogating Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488 (1942) (patent tying); Int'l Salt Co. v. United States, 332 U.S. 392 (1947) (patent tying))).

[3]Letter from Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, to Michael A. Lindsay, Esq. (April 30, 2007), http://www.usdoj.gov/atr/public/busreview/222978.pdf (business review issued to the Institute of Electrical and Electronics Engineers, Inc. (IEEE), which develops a wide range of technology standards); *see also* Letter from Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, to Robert A. Skitol, Esq. (Oct. 30, 2006), http://www.usdoj.gov/atr/public/busreview/219380.pdf (business review issued to the VMEbus

intersection of patent law and antitrust is a hot topic in the developing world, where several countries are in the process of creating or revising their antitrust regimes.

There are too many developments to cover in the available time today, so I have selected a few issues that should be of interest to this audience. First, I will discuss the importance of dynamic efficiency to economic growth, and explain why sound antitrust policy gives great weight to dynamic efficiency. Second, I will discuss some highlights from the IP2 Report. Third, I will discuss some recent Supreme Court cases, including *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[4] Finally, I will mention our efforts overseas to promote sound antitrust policy, particularly with regard to IP rights.

II. The Importance of Innovation and Dynamic Efficiency

Antitrust and intellectual property laws are complements because both seek to protect and encourage innovation and growth. To explain this observation, it is necessary to explain the concept of dynamic efficiency.

International Trade Association (VITA), which develops standards for certain computer bus architecture). *See also* Gerald F. Masoudi, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Enforcement and Standard Setting: The VITA and IEEE Letters and the "IP2" Report, Address at the Spring Meeting of the American Intellectual Property Law Association (Boston, Mass., May 10, 2007), http://www.usdoj.gov/atr/public/speeches/223363.pdf.

[4]No. 06-480 (U.S. argued Mar. 26, 2007).

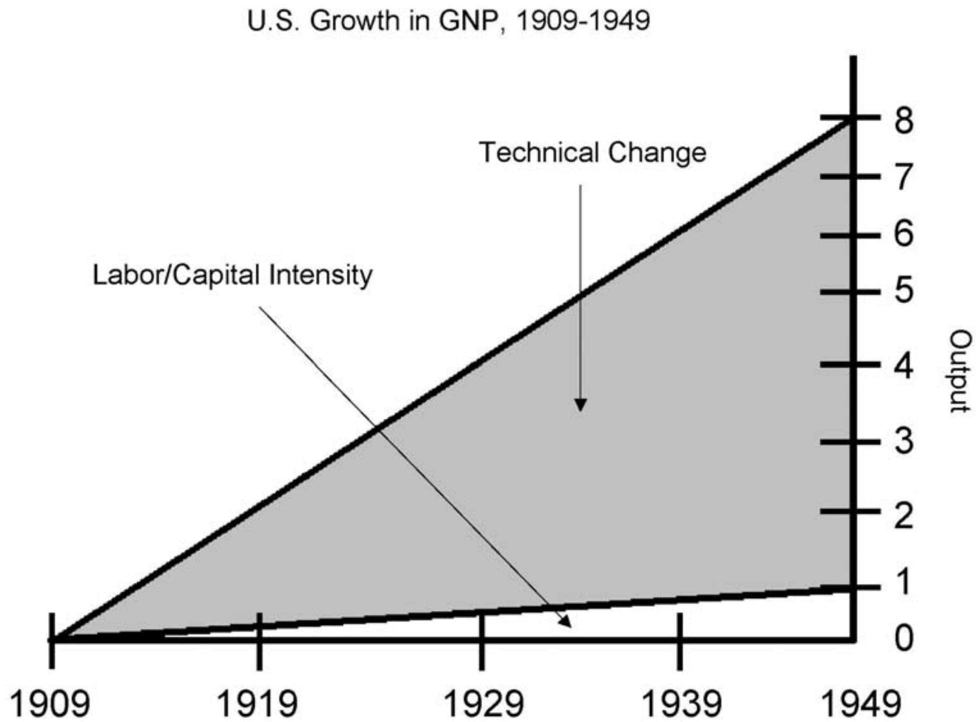
Efficiency is the measure of how much wealth is created in proportion to the inputs used; the more efficient a process, the more outputs it can create or the more inputs it can save for other uses, and the more wealth results. What I call static efficiency – essentially, the streamlining of production using existing methods – is perhaps the best known type, but by far the greater driver of growth is dynamic efficiency, which refers to gains that come from entirely new ways of producing products or services.[5] As an illustration, I direct you to the following chart derived from studies by Massachusetts Institute of Technology economist Robert Solow, who won a Nobel Prize for Economics[6] for his research into the degree to which economic growth results from static forces, represented here as labor and capital

---

[5]*See generally* Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, Interoperability Between Antitrust and Intellectual Property, Address at the George Mason University School of Law Symposium on Managing Antitrust Issues in the Global Marketplace 2-3 (Washington, D.C., Sept. 13, 2006), http://www.usdoj.gov/atr/public/speeches/218316.pdf.

[6]*See* Press Release, The Royal Swedish Academy of Sciences, The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1987 (Oct. 21, 1987), http://nobelprize.org/nobel_prizes/economics/laureates/1987/press.html.

intensity, and dynamic forces, represented here by Solow's term, "technical change."[7] The results are striking:[8]



[7]*See generally* Robert M. Solow, *A Contribution to the Theory of Economic Growth*, 70 Q. J. ECON. 65 (1956) (identifying flaws in then-current growth theory); Robert M. Solow, *Technical Change and the Aggregate Production Function*, 39 REV. ECON. & STAT. 312, 316 (1957).

[8]For purposes of illustration, I have designated the vertical axis as the log of output and not mapped variations by years. Output is growing exponentially and at varying rates each year, so that output on a standard graph would follow an irregular curve.

Solow found that between 1909 and 1949, gains from labor and capital intensity accounted for only one-eighth of United States GNP growth, while the remainder could be ascribed to an unmeasured force he termed "technical change." He ultimately inferred (I am now quoting from his prize lecture in 1987) that "the permanent rate of growth . . . is independent of the saving (investment) rate and depends entirely on the rate of technological progress in the broadest sense."[9] In other words, improvements to technology – new ways of producing, rather than just old methods done more intensely – create the vast majority of improvement in real societal wealth.[10]

Why does this matter to the antitrust-IP interface? Antitrust does not protect competition for its own sake; instead, it protects competition as a force that leads to increased efficiency, growth, and consumer welfare. It follows that if the research shows us that technical change (dynamic efficiency) accounts for a large share of

---

[9]Robert M. Solow, Growth Theory and After, Prize Lecture for the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1987 (Dec. 8, 1987), http://nobelprize.org/nobel_prizes/economics/laureates/1987/solow-lecture.html.

[10]Subsequent work on this model of economic growth shows that the percentages of growth vary but that technical change appears to account for half, three quarters, or more of economic growth in developed economies. *See, e.g.*, Michael J. Boskin & Lawrence J. Lau, *Capital, Technology, and Economic Growth, in* TECHNOLOGY AND THE WEALTH OF NATIONS 17 (Nathan Rosenberg et al. eds., 1992) (during the four decades following World War II, the estimated contribution of technical progress to economic growth was: United States–49%, Japan–55%, United Kingdom–73%, France–76%, and West Germany–78%).

efficiency, growth, and welfare gains, antitrust enforcers should seek to ensure that their actions promote – and not inadvertently reduce – the forces that lead to technical change in the long term. Intellectual property is such a beneficial force. In the drug industry, where the average approved new drug in the United States was backed by investment of nearly $900 million (when failures are accounted for and the investment was capitalized to the date of the drug's introduction),[11] patent protection – which authorizes a restraint on some forms of competition – is a necessary component of creating the incentives for technical change. Antitrust enforcers should aggressively pursue threats to competition, remembering that competition is itself a force for technical change, but should be careful that they do not chill innovation in the process.

III. The IP2 Report's Guidance on Bundling and Tying

The IP2 report consists of six chapters devoted to particular IP-related practices. Briefly, some of the highlights are as follows:

- *Chapter 1:* Antitrust liability for mere unilateral, unconditional refusals to license patents will not play a meaningful part in the interface between patent rights and antitrust protections. Conditional refusals to license, however, can be subject to antitrust liability if they cause competitive harm.

[11] Joseph A. DiMasi et al., *The Price of Innovation: New Estimates of Drug Development Costs*, 22 J. HEALTH ECON. 151 (2003).

- *Chapter 2:* Ex ante consideration of licensing terms by standard setting participants can be procompetitive and generally should be analyzed under the rule of reason.

- *Chapter 3:* Combining complementary patents in cross licenses or patent pools is generally procompetitive and typically will be analyzed on a rule-of-reason basis. The Agencies generally will not inquire into the reasonableness of royalties set.

- *Chapter 4:* The flexible rule of reason approach set forth in the Agencies' 1995 *Antitrust-IP Guidelines*[12] is fundamentally sound. The Agencies will continue to use it to assess the competitive effects of a range of licensing restraints, including non-assertion clauses, grantbacks, and reach-through royalty agreements.

- *Chapter 5:* Regarding IP-related bundling and tying, the *Antitrust-IP Guidelines* will continue to govern the Agencies' analysis, meaning that the Agencies will focus on seller market power, competitive effects in the tied product market, and efficiency justifications proffered in favor of the bundle or tie.

- *Chapter 6:* When licensing practices are alleged to extend a patent beyond its statutory term, the Agencies will apply standard antitrust analysis, which generally will mean the rule of reason, including consideration of whether the patent confers market power. In particular, the Agencies recognize that it may be efficient to collect royalties – or perhaps more accurately, to collect payments related to use of the formerly-patented invention – beyond the patent's term.

In my remarks today, I focus on bundling and tying. Supreme Court cases have held that at least some tying agreements involving market power in the tying

[12]U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 3.4 (1995), http://www.usdoj.gov/atr/public/guidelines/ipguide.pdf.

product were per se violations of the antitrust laws on the theory that tying serves little purpose except the suppression of competition. In particular, a company that adopts a tying arrangement in which the tying product is protected by a patent has faced a presumption of market power that increased the risk that the tie would be condemned as unlawful without regard to its actual effect on competition.

Economic scholarship and court decisions have chipped away at that logic and law. For example, in 2006, the Supreme Court held in *Illinois Tool Works Inc. v. Independent Ink, Inc.*[13] that the mere fact that a tying product is patented does not support a presumption of market power in a patented product. The IP2 report concludes that tying analysis is evolving with increasing support for application of the rule of reason – not the per se rule – to all tying claims.[14]

I turn now to bundling. Bundling is ubiquitous and frequently appears in highly competitive markets from firms that do not plausibly have market power. While not as likely to be condemned as tying, bundling and the related practice of bundled discounting sometimes also run afoul of the antitrust laws. In the 2003 decision *LePage's Inc. v. 3M*, the Court of Appeals for the Third Circuit – over a spirited dissent joined by then judge, now Justice Samuel Alito – held *en banc* that

[13] 126 S.Ct. 1281 (2006).

[14] *See* IP2 REPORT, *supra* note 1, at 114.

3M's bundled discounting of Scotch brand and store brand tape could violate the Sherman Act's monopolization provisions.[15] The case did not set forth a clear principle to guide future decisions.

The IP2 Report reviewed the law on bundling and came to a conclusion similar to that for tying: while the practice can harm competition in some situations, it is usually not anticompetitive, particulary when used by businesses that have no market power. The agencies ultimately concluded that, as a matter of prosecutorial discretion, they will apply the rule of reason when evaluating intellectual property bundling and tying arrangements.[16]

Is there a broader lesson to be learned from the IP2 report and cases such as *Illinois Tool*? I believe so. U.S. antitrust law is continuing its movement away from formalism in the non-criminal context and toward a case-by-case, effects-based approach that focuses on efficiency. The Supreme Court, in cases such as *Illinois Tool* and others, has shown a willingness to reexamine and replace old rules that are undercut by current economic analysis with its focus on advancing welfare in our society.

---

[15] 324 F.3d 141, 147-152 (3d Cir. 2003) (en banc).

[16] *See* IP2 REPORT, *supra* note 1, at 114.

IV. Supreme Court

The Supreme Court has decided to review an exceptional number of antitrust cases in the last several terms. I will discuss two: *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, which involves minimum (as opposed to maximum)[17] resale price maintenance (RPM), and *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., Inc.*[18]

Turning first to the *Leegin* case, RPM occurs when a manufacturer prohibits its resellers from selling below some minimum price. The manufacturer generally sets the minimum price so that resellers make enough profit to induce them to carry the product in the first instance, or actively promote it, or provide additional, otherwise un- or under-compensated services that (the manufacturer hopes) will increase the number of sales. Discounters, who wish to sell at a lower price (which may be without the desired promotional or support services), cannot do so if the RPM is enforced.

In 1911, the Supreme Court ruled in *Dr. Miles Medical Co. v. John D. Park & Sons Co.* that RPM, if imposed via an agreement between the manufacturer and

---

[17]Maximum resale price maintenance is subject to rule of reason analysis under the antitrust laws. *See* State Oil Co. v. Khan, 522 U.S. 3 (1997).

[18]127 S.Ct. 1069 (2007).

the reseller, constitutes a per se violation[19] of the Sherman Act. Since Sherman Act case law was at that time relatively undeveloped on this point, the Court observed that restraints on alienation were disfavored at common law, and expressed the view that RPM benefitted resellers, not the manufacturer, by protecting resellers from dealer-to-dealer competition in a fashion that amounted to price fixing.[20]

The Supreme Court soon limited *Dr. Miles* by holding in *U.S. v. Colgate & Co.* that manufacturers could still lawfully terminate dealers that failed to maintain minimum prices,[21] so long as there was no agreement. These holdings have led to the ubiquitous term "suggested retail price" and other measures such as minium advertised price programs to further manufacturer goals, but these measures are an imperfect and inefficient way to assert pricing control.

The *Leegin* case, now pending before the Supreme Court, squarely the raises the question of whether *Dr. Miles* should be overruled. Leegin is a manufacturer of women's fashion accessories, including leather handbags. PSKS, one of Leegin's many distributors, sold handbags below Leegin's suggested retail price, whereupon Leegin terminated its supply. PSKS sued, claiming that Leegin had

---

[19] 220 U.S. 373, 407-08 (1911).

[20] *Id.* at 404, 407-08.

[21] 250 U.S. 300, 306-07 (1919).

attempted to impose not merely a *Colgate*-compliant policy but a *Dr. Miles*-violating RPM agreement. A jury agreed with PSKS and the Court of Appeals for the Fifth Circuit affirmed, citing *Dr. Miles*.

The Supreme Court granted *certiorari* and, in January, the United States filed a brief as *amicus curiae* supporting the petitioner, Leegin, and urging that *Dr. Miles* be overruled.[22] The brief argues that RPM should be judged under a traditional rule of reason standard because, although it can sometimes be anticompetitive, RPM has many procompetitive uses. The brief noted a widespread economic consensus that RPM can enhance consumer welfare by, for example, reducing *intra*brand competition in order to promote *inter*brand competition and giving retailers an incentive to carry a product or offer services that will increase a manufacturer's sales.[23] Further, since their goal is increased sales volume, manufacturers generally have no incentive to encourage supracompetitive prices by retailers,[24] unless they are engaged in a manufacture-level cartel (which was not alleged in *Leegin*). Particularly where, as might well be

---

[22]Brief for the United States as Amicus Curiae Supporting Petitioner, Leegin Creative Leather Prods., Inc. v. PSKS, Inc. (U.S. argued Mar. 26, 2007), http://www.usdoj.gov/atr/cases/f221000/221027.pdf.

[23]*Id.* at 4.

[24]*Id.* at 18.

the case with Leegin, the manufacturer has a small share of the relevant market and no market power, it is difficult to conceive how an RPM agreement harms the competitive process in the market as a whole. The Supreme Court heard oral argument in the *Leegin* case in March of this year and has not yet ruled.

The Supreme Court has ruled in another case this term that does not directly address intellectual property rights, but is nonetheless worthy of mention in this context. In *Weyerhaeuser Co. v. Ross-Simmons Hardware Lumber Co., Inc.*, the Court addressed the standard for assessing a claim of predatory buying. The plaintiff was a sawmill operator that competed with Weyerhaeuser for the purchase of alder logs. The plaintiff complained that Weyerhaeuser had purchased more logs that "necessary" and paid an "unfairly" high price that made it difficult for plaintiff to compete. A jury found for the plaintiff and the Ninth Circuit affirmed. Consistent with the views expressed by the Department of Justice in an amicus filing, the Supreme Court reversed and held that a plaintiff alleging predatory buying must show that the defendant suffered some loss that could later be recouped, a standard analogous to the predatory selling standard set forth in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

The *Weyerhaeuser* decision is significant beyond its specific holding because it reflects the general trend in Section 2 law in the United States toward objective criteria focused on actual effects (as opposed to subjective standards and evidence of intent) for determining whether a company has committed a violation. For companies seeking to conform their behavior to the laws, it is far easier to determine whether they have suffered a loss that is likely to be recouped than it is to predict whether a jury will find that they purchased more inputs than were necessary and paid an unfairly high price with an improper intent.

V. Promoting Sound IP and Antitrust Policy Overseas

Until recently, antitrust was largely a phenomenon of a few Western democracies. No longer. There are now 100 members of the International Competition Network, including nations as geographically diverse as Argentina, South Africa, India, Japan, and Israel. This development has been a great benefit in our fight against international cartels, but it can present challenges to our efforts to promote convergence of antitrust law regarding mergers and non-merger civil conduct. For this reason, we routinely send Antitrust Division personnel to discuss antitrust law, both procedural and substantive, with competition officials in many nations around the world. We are usually accompanied by our colleagues at the FTC. The worldwide promotion of sound antitrust policy is a major focus of my tenure as head of the Division, and I know that Chairman Deborah Majoras of the FTC shares this focus.

One of the key issues that we regularly discuss is the intersection of antitrust law and intellectual property. In some quarters – and this is not limited to the developing world – there has taken root the idea that antitrust should be a tool for constraining the exercise of intellectual property rights, particularly the IP rights of foreign firms. I take a different view. There is no fundamental conflict between antitrust and IP principles because both bodies of law protect and encourage competition, innovation, and economic growth, as I explained above. Where conflicts are perceived, this is typically due to a misunderstanding of antitrust or IP law, and/or a myopic focus on short term, static effects without regard to longer term, dynamic effects. We are engaged in constant outreach to address these issues. The United States has made similar errors in its approach to antitrust, and our economy probably suffered for it. We seek to enable other countries to learn from our mistakes.

As an example, China is in the process of drafting major antitrust legislation.[25] We have devoted special attention to China in recent years and those

---

[25] *See* Gerald F. Masoudi, Deputy Assistant Att'y Gen., U.S. Dep't of Justice, Key Issues Regarding China's Antimonopoly Legislation, Address at the International Seminar on Review of Antimonopoly Law (Hangzou, China, May 19, 2006), http://www.usdoj.gov/atr/public/speeches/217612.pdf.

efforts have shown results.[26] The Chinese have shown a willingness to listen to our concerns and, through several revisions, have addressed some potential problems in their draft antimonopoly law. We also believe that implementation of the law after it is passed is extremely important. The statute necessarily sets forth general principles and leaves significant portions of the analysis to be developed through individual cases and/or regulations. Accordingly, we have already begun discussing with Chinese officials how we can help in the implementation phase of their antitrust regime.

We are engaged in similar dialogues with India, Brazil, and other nations, and we will continue to devote significant resources to outreach of this kind.

VI. Conclusion

Thank you again for the opportunity to speak to you today.

---

[26]We not only regularly send delegations to China, but also publish some of our materials in Chinese. *See* R. Hewitt Pate, Assistant Att'y Gen., U.S. Dep't of Justice, Promoting Economic Growth Through Competition and Innovation, Address at the Chinese Academy of Social Sciences, Institute of Law (Beijing, China, July 1, 2004), http://www.usdoj.gov/atr/public/speeches/204931.htm; Hill B. Wellford, Counsel to the Assistant Att'y Gen., U.S. Dep't of Justice, Antitrust Issues in Standard Setting, Address at the China Electronics Standardization Institute 2d Annual Seminar on IT Standardization and Intellectual Property (Beijing, China, March 29, 2007), http://www.usdoj.gov/atr/public/speeches/222236.htm.