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2013 National Lawyers Convention: Intellectual Property: Intellectual Property, Free Markets, and Competition Policy

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**2013 NATIONAL LAWYERS CONVENTION:
INTELLECTUAL PROPERTY: INTELLECTUAL PROPERTY,
FREE MARKETS, AND COMPETITION POLICY**

Panelists:

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Richard A. Epstein, Laurence A. Tisch Professor of Law, New York University School of Law; and James Parker Hall Distinguished Service Professor of Law, University of Chicago Law School

Joshua D. Sarnoff, Professor of Law, DePaul University College of Law

Joshua D. Wright, Commissioner, Federal Trade Commissioner; and Professor of Law, George Mason University School of Law

Moderator:

Hon. Douglas H. Ginsburg, Senior Circuit Judge, U.S. Court of Appeals for the District of Columbia Circuit; and Professor of Law, George Mason University School of Law

Thursday, November 14, 2013
2 to 3:30 p.m.

The Mayflower Hotel
Washington, D.C.

JUDGE DOUGLAS H. GINSBURG: I'm Doug Ginsburg, and I'm just moderating this. Now that I've got you all moderated, we have a program with four speakers, and we are starting seven minutes late, but we have to end on time, so we are going to begin in one moment.

The biographies of our panelists are in your program materials, so we're not going to spend time on that. I can assure you that all of them, without any known exception, attended college and then also went to law school.

[Laughter.]

JUDGE DOUGLAS H. GINSBURG: Some of them did other things after that; others not. It doesn't matter. They're here now.

[Laughter.]

JUDGE DOUGLAS H. GINSBURG: We are going to go in alphabetical order—which means I’m out of turn already—starting with John Duffy. Maybe it’s by age. I don’t know, John.

[Laughter.]

JUDGE DOUGLAS H. GINSBURG: The microphone will expire in twelve minutes.

JOHN F. DUFFY: Twelve minutes, okay.

The topic of our panel today is competition in the patent system, and I want to begin with a very basic point about the patent system. It often is said—and you can find many, many sources that say this—that patent system is a restriction on competition, and I think that that is fundamentally wrong. The patent system provides a structure for competition, and that’s an enormously different function. It is not designed to create monopolies. There was a time, perhaps a brief period of time in England, when patents or letters patent were just given out on existing products and were designed to raise prices of existing products and benefit certain groups or individuals who curried favor with the Crown. But that’s not the way our patent system works.

Basic features of our patent system ensure that the system fosters competition. First of all, the system always permits free entry into the race to obtain patents. Patent systems encourage technological races to invent, and that is one of the major benefits of the patent system. There is a constant competition to get technology sooner. As my writings have emphasized, racing to obtain patent rights also has a benefit that many people forget about, which is that the sooner that the technology is patented, the sooner it enters into the public domain.¹

Patent terms are strictly limited, with rights terminating twenty years from filing of the patent application (with occasionally some additional time to make up for unreasonable administrative delays). Because the patent system awards rights to the inventor who is earliest to file, it also tends to award rights to the inventor whose patent rights will expire first. That means that the race to obtain patents is really a race to place things into the public domain as soon as possible and thereby to enrich the public domain as quickly as possible. The patent system is therefore not designed to restrict the public domain. It is instead designed to foster the enrichment of the public domain.

¹ John F. Duffy, *Rethinking the Prospect Theory of Patents*, 71 U. CHI. L. REV. 439, 444 (2004) (theorizing that a “race to claim patent rights becomes a race to diminish the patentee’s rents by dedicating the invention to the public sooner”).

The patent system's competitive structure has a very specific implication for current policy debates. There are some scholars who have tried to measure the benefits of the patent system by looking at the effect of patents on the profits of companies that obtain patents.² The conclusion of these scholars is that, in many fields, the costs of the patent system to companies—including litigation costs when they get sued for infringing other patents—outweigh any benefits that the companies receive from their patents. The implication drawn from the data is that the patent system is a failure for society. Those scholars, however, disclaim any attempt to measure the social benefits from the new inventions produced as a result of the patent system—i.e., the consumer surplus that arises because of the new inventions.³ It's very hard to measure a consumer surplus that arises from innovation, so the approach of ignoring consumer benefits is like the old joke about someone who, having lost a set of keys in one place, begins looking for the keys elsewhere because the light is better there.

The benefits of the patent system are never going to be found in the profits of private companies. That's not the right way to measure the benefits of the system because the patent system is not designed to benefit private firms.⁴ Whether a patent system exists or not, private firms in a competitive economy are most likely to obtain normal economic profits. Competition between the firms will destroy any potential super-competitive profits.

The beneficiaries of the patent system are not private companies. The beneficiaries are instead the public, which obtains better technology sooner, and the public domain, which obtains the technology when the patent expires. So that's something very important to remember in terms of thinking about the relationship between competition and the patent system. The patent system creates competition for patents, and that competition is directed toward enriching the public, and the public domain, with new technologies as soon as possible.

The second point I wanted to talk about today is a point that is frequently, and I think incorrectly, asserted about patents. Indeed, Justice Breyer made the assertion just a few years ago in an oral argument at the Supreme Court. He asserted that “There are actually four things in the patent law which everyone accepts.”⁵ He then listed favorable and negative things about the

² JAMES BESSEN & MICHAEL J. MEURER, *PATENT FAILURE: HOW JUDGES, BUREAUCRATS, AND LAWYERS PUT INNOVATORS AT RISK* (Princeton 2008).

³ *Id.* at 95 (specifically stating that the methodology does not attempt “to estimate the entirety of social benefits and social costs of the patent system”).

⁴ *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 511 (1917) (correctly observing that “the primary purpose of our patent laws is not the creation of private fortunes”).

⁵ Transcript of Oral Argument at 19, *Bilski v. Kappos*, 561 U.S. 593 (2010) (No. 08-964).

patent system, and one key negative he listed was that patents allow inventors to “charge a higher price.”⁶

RICHARD A. EPSTEIN: Oh, God.

JOHN F. DUFFY: Well, okay.

RICHARD A. EPSTEIN: Explain this.

JOHN F. DUFFY: I need to explain it. Okay. So this point is asserted very often, and the key flaw is this: the assertion that patents raise prices assumes that the patented technology would exist anyway, even if there were no patent system. But if the technology would exist anyway, then, of course, it is true that society should not allow a patent on that technology. In other words, if society could obtain some technological development without offering a patent for it, then society should not want to permit a patent on that development.

Now, in fact, current law has a doctrine codified in the statute, which says that if an invention is so easy to think up—so “obvious,” in the words of the statute—then the invention cannot be patented.⁷ The Supreme Court has held that the goal of this statutory “non-obviousness” requirement is to limit patents only to “those inventions which would not be disclosed or devised but for the inducement of a patent.”⁸

So the assertion that patents raise prices assumes that, without patents, the technology would have existed anyway, and that the patent raises the price of a technology that would otherwise have been available at a lower price. That assumption is, I think, fundamentally inconsistent with current statutory law and current Supreme Court precedent. I have a large article on this in the *Yale Law Journal* from a couple years ago playing out the implications of that insight and suggesting ways in which current doctrine could perhaps be modified to enforce the non-obviousness in better and more nuanced ways.⁹ But the point I want to emphasize here is that, when you hear the assertion that patents raise prices, you should realize that the assertion is making a fundamental error about the legal structure of the patent system. Moreover, that error is directly related to the relationship between competition and patents, for the patent system is directed not toward limiting competition (and thus raising prices) on technologies that society would have anyway,

⁶ *Id.*

⁷ 35 U.S.C. § 103 (2012).

⁸ *Graham v. John Deere Co. of Kan. City*, 383 U.S. 1, 11 (1966).

⁹ Michael Abramowicz & John F. Duffy, *The Inducement Standard of Patentability*, 120 *YALE L.J.* 1590 (2011).

but instead toward fostering competition to produce technologies that, without a patent system, society would not yet have.

The last point that I want to make in my dwindling number of minutes here is that, because the patent system is designed to induce the creation and disclosure of a certain kind of information, policymakers must appreciate both the type of information that the patent system is designed to produce, and the ways in which such information can be disclosed.

The patent system is designed to produce technical information that is relatively easy to disseminate. That sort of information can have large public benefits and also certain “public good” aspects. By public good aspects, I mean that the information is something that, in the absence of intellectual property rights, other people could relatively easily appropriate. The theory of the patent system is that, because such information can be relatively easily appropriated by others, the incentive to produce the information would be inefficiently low in the absence of intellectual property rights.

The Supreme Court and our current legal doctrine holds that the goal of the patent system is to foster the disclosure of this type of information—i.e., disclosure of information that would not be produced or would be held in secret in the absence of the patent system. Indeed, the Supreme Court has repeatedly stated that disclosure is the “quid pro quo” for obtaining property rights.¹⁰ I want to emphasize one important caveat: if disclosure is *the* goal, or even *one* of the goals, of today’s patent system (and I think it is at least *a* goal of the system), then our courts and other policymaking institutions need to have realistic conceptions of both *how* information can be disclosed and also *what type* of information *can* be disclosed through the patent system.

Information disclosure can actually be very, very difficult. Disclosure does not occur merely by handing someone a bunch of papers and saying, “the papers disclose the information so now you know it.” Meaningful disclosure of information requires teaching, and indeed patent lawyers and judges often talk in term about the “teachings” of a patent. An emphasis on teaching is correct, but judges and lawyers must appreciate that teaching is not easy. It’s time consuming. It’s difficult. I know this firsthand, because I’ve had the experience of going through an entire semester trying my best to teach the material from my casebook, and then at the end of the semester, I read the exams and realize that—

RICHARD A. EPSTEIN: Bad casebook.

¹⁰ See, e.g., *Universal Oil Prods. Co. v. Globe Oil & Refining Co.*, 322 U.S. 471, 484 (1944).

JOHN F. DUFFY: —I have not been entirely successful.

[Laughter.]

JOHN F. DUFFY: No, no. That’s my casebook. I wasn’t talking about your casebook.

RICHARD A. EPSTEIN: Oh. Oh.

JOHN F. DUFFY: Yours, I have no trouble with.

Given the difficulties of disclosure—of teaching—I think we do need some rethinking of precisely how patents lead to disclosure of information. Patent law once had an old doctrine, on which I have just written an article, called the paper patent doctrine.¹¹ Under that doctrine, generally speaking, mere paper patents—patents that were never practiced and that perhaps didn’t even teach very well within their paper pages—were disfavored in the patent system as compared to patents on inventions that had been practiced in a business where an inventor or an entrepreneur taught the invention to a workforce, and to the public, by example.

It turns out that this doctrine was not an anti-patent doctrine. It was an incredibly balanced doctrine. If you were to look at all appellate cases involving the doctrine—and there about 140 of such appellate cases—you would find that the cases divide almost equally, with about half of the cases involving accused infringers who were using the doctrine to challenge the validity of patents that were being asserted against them, and the other half involving inventors who were invoking the doctrine to sustain the validity of their own patents.

In the latter set of cases, an inventor was typically being confronted with a host of old prior art patents, and accused infringer or the Patent Office was asserting that the inventor’s claim to a patent was not valid because the invention was not novel or was obvious in light of the older patents. In such cases, the inventor could invoke the paper patent doctrine and argue that the prior art patents, if they had not been practiced, should be viewed as mere paper patents that should be interpreted narrowly and be viewed as disclosing little reliable information. In this way, the paper patent doctrine could be used not only in anti-patent ways (in questioning the scope and validity of paper patents asserted in infringement litigation), but also in pro-patent ways (in protecting the patent rights of inventors who actually achieved and practiced significant technological developments). Such a balanced approach

¹¹ John F. Duffy, *Reviving the Paper Patent Doctrine*, 98 CORNELL L. REV. 1359 (2013).

is what you'd expect of a rather fundamental doctrine that is designed neither to restrict nor to expand patent rights, but instead to define more precisely what patent rights are trying to incentivize.

The central insight of this doctrine, which has been lost to modern law, is that disclosure is difficult, and that the information that society is trying to develop with the patent system is not merely stacks of information in paper files at the Patent Office. Instead, the patent system is trying to develop innovative technologies being brought to practice—including new entrepreneurial technologies—and the dissemination and inculcation of that technological information among a skilled workforce. Those are the real goals of a patent system, not the mere production of paper patents.

I should note that the paper patent doctrine was very favorable to entrepreneurs. The doctrine helped people who actually went out and built a business not only because it made it easier for them to get their patents and easier to have the validity of their patents sustained, but also because it protected entrepreneurs from infringement suits by what today we might call “patent trolls.” By “trolls” here, I am referring to those (i) who obtain patent (perhaps after many years of prosecution in the Patent Office); (ii) who never practice the patents themselves or through their licensees; (iii) who wait for others to do the hard work of actually building successful products; and (iv) who then asserts against successful entrepreneurs the patents that were never been practiced according to their terms anywhere.

In the past, such successful entrepreneurs had a defense against such suits. They could use the paper patent doctrine to protect the fruits of their labors against unwarranted infringement suits. I think that doctrine should be revived, and the article I've written explains why in greater detail. And since I'm here at a conservative convention, I should emphasize that it is a conservative doctrine in the sense that it is an older doctrine forgotten by modern law. In my view, it reflects older wisdom, and it needs to be revived.

So those are my points, and my time is up, perfectly.

[Applause.]

JUDGE DOUGLAS H. GINSBURG: Richard Epstein, you're next. Richard has a lot to say and twelve minutes in which to say it. We'll see what happens.

RICHARD A. EPSTEIN: I want to thank my former student, Judge Douglas Ginsburg for being such a diligent moderator, and I want to thank John Duffy for using such a wonderful torts casebook.

It is a real honor to follow John because he is one of the few scholars who does not raise my blood pressure talking about patents. I count him as one of the elite.

I want to begin with the 1952 Patent Act, because I think the circumstances surrounding its adoption tell us a lot about how we should think about patent reform. The 1952 Patent Act is much better on substance than the peculiar 2011 confection called “the American Invents Act,” whose propaganda-like title conceals the sorry fact that most of the inventor groups were opposed to its adoption on many points, including its new “first to file” rule and its elaborate provisions dealing with patent reexamination and business method patents. It is striking to compare the processes by which the two statutes were passed.

The history of the 1952 act is simplicity personified.¹² In 1947, President Harry Truman appointed Pasquale Joseph Federico, then chief patent examiner of the United States, and Giles Rich, then the leader of the patent bar, to a committee of two members to draft a new patent act. The decision to draft it was driven by two considerations. First, the law had not been revised in a comprehensive fashion since 1836, and second, a number of decisions of the Supreme Court were widely regarded as being too anti-patent. The two men worked together for about five years, with little interference or guidance from outside. Their joint efforts yielded an excellent and balanced statute, which is in my view far superior to the 2011 Act. The process of its approval by Congress was simplicity itself. Representative Joseph Bryson, a Democrat from South Carolina, introduced the bill into Congress. It passed both houses unanimously and without debate, and was promptly signed into law by Truman. Its modest title indicates that the entire venture was regarded as largely technical. Federico continued to serve on the PTO. In 1956 Rich was appointed by Eisenhower for a seat on the United States Court of Custom and Patent Appeals, which in 1982 became part of the Court of Appeals for the Federal Circuit. The law went into effect 1953. At a guess, the cost of getting that law enacted had to have been trivial. All money well spent.

The passage of AIA in 2011 tells a different and more tragic story. Its complexity stands proof to the proposition that the more parties who have a say in the outcome of the law, the worse the legislation looks at the back end. Today, patent law is not a backwater of interest only to engineers and inventors. It has passed into the mainstream of American legal education. The scholarship on the topic is vast, and much of it is deeply critical of the patent-protective nature of the 1952 Act. The new academic concern meshes with the ever greater importance of patents, and so we see the emergence of a

¹² For the essentials, see *Giles Rich*, WIKIPEDIA, http://en.wikipedia.org/wiki/Giles_Rich (last visited Aug. 17, 2013).

potent public choice dynamic that was conspicuously absent in the run up to the 1952 Act. Coalitions start to form; experts, like myself, are asked to prepare exhaustive position papers on various aspects of the case, from an economic, legal and constitutional point of view. The lobbying on both sides of every issue is nonstop, and the legislation itself is so convoluted that we now have the privilege of litigating earlier patents under the 1952 Act, while having to prepare to file, and eventually litigate new patents under the AIA. The greater the stakes, the worse the statute. It's clear from my own involvement in this particular case that tens of millions, probably much more, were invested in the full time lobbying efforts on all sides of the issue. The proposition that we generally draw from this melee is that the ability or the conscientiousness or the effectiveness or the soundness of a statute is inverse to the amount of money that it takes to secure passage.

Now, the question then is “Why is it that the old guys got it right when the new guys get it wrong?” And, I think the way to sort out this morass is to take the three terms in sequence—intellectual property, free markets, and competition policy. They are clues to putting any sound patent system together.

I'm very much of the firm belief that you cannot do patent law unless you understand a great deal about property law more generally. I don't think intellectual property should be read one composite word—intellectual-property—that is somehow unrelated to property. I think intellectual property is a subset of standard property law. One of the insights that you draw from that is the question: “What do we mean by exclusive rights as an ownership matter as opposed to exclusive rights as a monopoly matter?” If you go to the real estate cases, you know, Richard Epstein owns a distinct apartment in downtown Chicago. In a Pickwickian sense, I own a monopoly on that particular condominium. But, on the other hand, there are lots of other residences, some condos and some not. These are similar enough that many are close substitutes for the condo that I own, so the exclusive rights to my own unit does not confer on me any kind of market power. More generally, the assertion that simply because you have a monopoly on a particular asset means that you have market power is demonstrably false with respect to real estate.

For many reasons, some of which John Duffy mentioned, it is also demonstrably wrong to assert that broad monopoly claim with respect to patents. One firm gets a patent on one statin, and it's in competition with a number of other drug companies, proprietary and generic, who produce drugs in exactly the same class. That competition across brands is going to force prices down. People desperately want to increase the level of profits that they get from their patents, so they will try to market them as quickly as possible. Generally speaking, as a matter of social welfare, it is better for a

patentee to garner monopoly rents for some short period, during which time consumers also share in the gains. Delaying entry results in either gains for incumbents in the same class or in the total loss of revenues for pioneer patents that open new fields. The sooner a drug is put on the market, the sooner actual and potential competitors gain from the various patent disclosures, which should increase the likelihood that a new competitor will enter the market. So, the proper way to control monopoly profits is through a system that is highly congenial to new entry.

But dangers lurk everywhere. In pharmaceuticals, the FDA poses a serious threat because of its elaborate requirements for clinical trials, which delay the entry of drugs that might be superior to those already on the market. Hence its licensing requirements create monopoly protection that is far more dangerous than those restraints created by the patent system. Yet all too often, the strong critics of the patent system pay scant attention to the impact of the FDA on market innovation.

So then the question is, “Well, how much of our understanding of general property rights helps in understanding patents?” The obvious carryover is the importance of exclusive rights for use, which is the hallmark of real and personal property. The complexity arises because the patent covers a subset of information—that which explains how some invention or device works—which once available can be used by others at zero cost, without denying its use to the original inventor. At some point the information can be included in the public domain, where access is open to all on equal terms.

The issue is what do we do with this insight. Well, the first point that becomes clear is that perpetual ownership, which is the appropriate solution for land, does not in fact offer an ideal model for intellectual property. The task, therefore, is to figure out what adaptations to the land model are necessary to deal with this issue. The basic rule in all cases is make as few adaptations and modifications of a fundamentally sound system in the law of real and personal property to remedy this defect.¹³ In practice, the single most adaptation is to set term limits on patent lives. The challenge is to determine the optimal length.

Generally speaking, that time period could be either too long or too short. For software, there is no need to worry about patent length. Even if that

¹³ For a more extended treatment, see RICHARD A. EPSTEIN, WHAT IS SO SPECIAL ABOUT INTANGIBLE PROPERTY? THE CASE FOR INTELLIGENT CARRYOVERS, COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY: REGULATING INNOVATION 42 (G. Manne & J. Wright eds. 2011); Richard A. Epstein, *The Disintegration of Intellectual Property? A Classical Liberal Response to a Premature Obituary*, 62 STAN. L. REV. 455 (2010), available at <http://www.stanfordlawreview.org/print/article/disintegration-intellectual-property-classical-liberal-response-premature-obituary>.

period were as little as five years, the short business half-lives would render it obsolete by the end of that truncated period. The key challenge therefore is how to get patent software into the market as quickly as possible. But, for pharmaceuticals, patents that are too short will stunt innovation and create major social costs. Generally speaking, therefore, the prudent strategy is to move toward the longer side of the patent spectrum. The problem here is more acute because of the FDA oversight as it interacts with the patent system, where in effect it shortens the life of valuable patents to around ten to twelve years, which is probably too short to create optimal incentives for innovation.

But once that fundamental decision is made on patent length the last thing to do is to become a Fancy Dan about the other patent attributes. Here are three important areas to which this insight applies. First, the rules with respect to patent acquisition. On this point, I think that some patent office examination is a perfectly good way to start. Indeed, the more reliable that examination, the more likely it is that the patent system will operate effectively downstream, both through licensing and further development. It is, therefore, high social folly that the major blockade in this system stems from insufficient funding of the PTO, which increases delays on the one hand and inaccuracies on the other. Yet to make this simple reform—by letting the PTO keep its own fees—does not require turning the system upside down with the American Invents Act. The correct level of appropriations that pays competitive salaries to hire decent patent examiners would do much to solve this problem.

The second challenge is to make sure that nobody has a built-in incentive to bypass the system of voluntary licenses. Accordingly, the traditional rule that allows the patentee to obtain an injunction unless the patentee did something to forfeit that right, by way of estoppel or laches or contract, was the right approach with respect to patent remedies. Indeed, ideally, the objective should not be to order injunctions but to have a system of rights that is so secure that it will no longer be necessary for anyone to get the injunction, because potential infringers will know that they are left worse off by seeking to go around the licensing system.

One common response to this position is that it creates some insoluble hold-up problem. But that approach overlooks the reverse hold-up problem, which is in my view every bit as severe. Historically, that has not proven to be too great a problem, but that is only because the injunction stopped widespread abuse before it happened. One of the major difficulties of the modern law in this area is it doesn't recognize that there are two forms of peril. Yet everybody who works with injunctions in real property cases knows that this problem in fact raises a serious issue. In addition, every real property lawyer knows that the remedial approach is not limited to the stark choice between

an injunction and damages. Oftentimes, the law develops a nuanced approach that starts with injunctions, but then limits their use (often by delay) and awards damages to soften the harshest aspects of the injunctive remedy, without creating a patent free-for-all. Yet too, criticisms of *eBay* are largely devoid of any analysis of how these intermediate solutions ought to work.¹⁴ A mistake.

The next feature of patent design is to ensure that patents can be freely licensed on what terms and conditions the parties see fit, subject only to general constraints of antitrust law and illegality. Essentially, any strong licensing system increases gains from trade, which in turn increases the gains from patenting in the first place. So, when the Supreme Court in cases like *Quanta v. LG* finds dubious reasons to impose a first-sale rule on licensing, it reduces the utility of the patent, which in turn dulls innovation.¹⁵

On these remedial issues, the real estate rules on injunctions, damages, leases and licenses work well. There is no reason not to follow them faithfully with intellectual property. It is always a dangerous approach to say that we have to weaken injunctions and undermine licenses to correct the supposed defects of the initial patenting system. The sad truth is that the two errors never cancel out. They cumulate, making the system worse off than before.

At this point, the advantages of a sound system compound. If the intellectual property law rules are sound, free markets will have greater scope, as competition policy can control any monopoly risk across patents. The key point here is not to worry whether any particular patent creates some mythical monopoly. The proper target of the antitrust laws is collusion between two patentees in order to raise price or reduce access. So, if all the statins manufacturers got together to restrict output and raise prices through, say, a single marketing agency, that's a serious antitrust violation. Indeed, for the most part, the patent pooling rules from the 1990s, which allow parties to pool complements but not substitutes, makes a very sensible accommodation.¹⁶ Pooling complements tends to eliminate double marginalization whereby multiple interrelated patents could blockade one another. In contrast, pooling substitutes is the path to cartel formation. The only measure that is needed to keep these markets in perfect equilibrium is to understand that the competition policy is just the plain old antitrust rule as applied to patents.

¹⁴ *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

¹⁵ *Quanta Computer, Inc. v. LG Elecs, Inc.*, 128 U.S. 617 (2008).

¹⁶ U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (Apr. 6, 1995), available at <http://www.justice.gov/atr/public/guidelines/0558.htm> (last visited Aug. 17, 2014).

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So what does this start to tell us? To me, it says that one of the great tragedies of modern times is we have too much scholarship with respect to intellectual property.

[Laughter.]

RICHARD A. EPSTEIN: The problem with this scholarship deepens because it becomes deeply introspective. It then puts this elegant structure under a microscope in order to examine its every pore and deformity. It thus blows up its inevitable weaknesses far out of proportion. What the critics need to do is to take a tranquilizer, to relax, and to look at the overall situation in order to realize that the obsession with patent trolls has been around for a generation. Yet on the ground, the patent system, at least until 2011, worked well. It is wrong to overstate the difficulties that are inherent in any system when its basic contours are consistent with fundamental economic logic of all property systems. The lack of an appreciation of how property functions generally has impaired our understanding of the patent system. Count me as a dissenter from the modern establishment consensus on patent law. Thank you.

[Applause.]

JOSHUA D. SARNOFF: So first, I want to thank the Federalist Society for inviting me. It's a particular privilege to be on the panel with such distinguished experts on these issues. I haven't written on those issues, so I won't refer you to my published works, but if you want to look at some of my published works on patent law, they indeed will raise your blood pressure. But, what I'm about to say will certainly raise Professor Epstein's, so hopefully, he can stay calm until everything is over.

I am going to actually start as my foil, the guy on my left, your right, Josh Wright, who is writing about the role of antitrust and regulating patent assertion, which he's commonly referred to as "patent trolls." Antitrust is not a form of comprehensive price regulation; rather, the antitrust laws are concerned with conduct that reduces competition. Changes in pricing incentives that do not arise from changes in competition are outside the appropriate scope of antitrust. And I am happy as an unrepentant liberal, adoptedly visiting Chicago, not a member of the Chicago School, to say that patent law and antitrust law are back in the business of price regulation. To quote the subtitle of my favorite movie, *Dr. Strangelove*: It's time to learn "to stop worrying and love the bomb."¹⁷

¹⁷ DR. STRANGELOVE OR: HOW I LEARNED TO STOP WORRYING AND LOVE THE BOMB (Columbia Pictures 1964).

So first, if you look at patent law doctrine itself, it turns out that in certain specific cases, judges are valuing the patent infringement right itself, and that requires court intervention and, thus, price regulation. When does this occur? Well, it typically occurs in the context where you have infringement by a direct competitor. Normally, we assume that in those circumstances, there is a premise of irreparable harm that should grant an injunction. And, this is why? Because in most circumstances outside the context of standards bodies, and a few other things like patent pools, which I'll come to later, we assume direct competitors will not license each other.

However, what is the damages remedy? Well, first, you get your damages for lost profits, but on top of that you get a remedy for reasonable royalties on the licenses you would have never made. This is not economic evaluation of harm to the patent holder, therefore, nor is it unjust enrichment, disgorgement of the patentee's profits. It's valuation of an intrusion on a government-granted legal right, which doesn't in fact harm the patent holder, except in regard to potential revenues they wouldn't have made anyway. So what are we doing? We're basically giving it to a jury, just like "what's an arm worth?" when there isn't a market there.

Of necessity, the government has to set a fair price. The fair price does so through a highly flawed jury system that looks to this counter-factual world of *ex ante* negotiations under the *Georgia Pacific* standard in a context where they assume royalty rates are going to be based on judgments about the patent itself.¹⁸ Well, the patent itself, for the purpose of this hypothetical and unrealistic royalty is assumed to be both valid and infringed. And of course, in any bilateral *ex ante* negotiation, there is some probability it will not be valid, nor will it be infringed. That just gets thrown out of this calculation when determining reasonableness, and we try to set a value on the product itself and a value for the patent. This is particularly difficult in regard to trying to figure out the inventive contribution of a small component to a larger system that's sold, and I'll come back to that later. It also raises the difficult issue of royalty stacking when multiple patents are involved in the ultimate products that are sold, but only one person is suing another.

Okay, so much for basic patent law. Let's turn to antitrust and its relation to the patent litigation system. We now have these settlements, particularly in the context of drugs, which Professor Epstein again pointed to, where pioneering and branded drugs are paying generic companies to stay off the market. It's through an advanced notice—advanced new drug application, they can get approval to get onto the market within thirty months unless there is an injunction out of the court to keep them off the market, and the patent

¹⁸ *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

suit is resolved. This is big money, and often these days, as the FTC has been complaining, big money is changing hands, because what they are effectively doing is delaying entry of the generic, keeping the super-monopoly prices, and therefore transferring some of the value—in some cases even more value than the generic could have made if they entered the market just to delay entry—which is bad both for competition and of course for consumers.

Obviously, this raises a difficult question: “What’s the appropriate way to look at these things?” And, some courts had adopted what was called the “scope of the patent” test for antitrust immunity, which said that if what was being done is exclusion that’s within the scope of the patent rights, then of course, you could settle on any terms you like. Thankfully, the Supreme Court has seen the wisdom of reversing that and gone to a difficult rule-of-reason analysis in the recent *Actavis* case under a Section 1, Sherman Act, restraint of trade approach.¹⁹

Questions will now obviously arise not just in the case where money goes back and forth to the generic, but also, you just simply have a pay-for-delay in the form of non-entry, and maybe the generic then will get back into the market at a later time, earlier than the patent would have expired. And somebody is going to have to value what were the comparative benefits of the settlement, what value changed hands. And who is going to do that valuation? The government, also known as people like the gentleman to my immediate left, your right—judges who are going to take these cases, who are going to have to make these difficult decisions.

So just to give you a concrete example from *Actavis*, Solvay, which had patented AndroGel sued Actavis, now Watson, certified under this paragraph four procedure that the patent was invalid. It got its ANDA approval after thirty months. Another generic, Paddock, filed an ANDA. Another generic called Par agreed to share litigation costs. They entered into a settlement. Actavis agreed not to enter in the market for about sixty-five months before patent expiration and to promote AndroGel. Paddock and Par made similar agreements. \$12 million went from Solvay to Paddock, \$60 million to Par, and somewhere between \$19 and \$30 million annually for nine years to Actavis.

Normally, when you don’t have the problem of delay onto the market because of the regulatory over-structure, people aren’t going to be spending money to have the person suing them go away. Normally, it goes the other way. Money changes hands the other way. In any event, the court says in the context of this stuff:

¹⁹ *FTC v. Actavis, Inc.*, 133 S. Ct. 2223 (2013).

Given these factors, it would be incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well [T]his court has indicated that patent and antitrust policies are both relevant in determining the 'scope of the patent monopoly'—and consequently antitrust law immunity—that is conferred by a patent Similarly, both within the settlement context and without, the court has struck down overly restrictive patent licensing agreements—irrespective of whether those agreements produce supra-patent-permitted revenues It would be difficult to reconcile the proposed right [to settle on any terms] with the patent-related policy of eliminating unwarranted patent grants so the public will now “continually be required to pay tribute to would-be monopolists”²⁰

So I'm going to hurry and leave most of the discussion, which I assume can be addressed by former Professor Wright, on the ways we are now going to have to make these difficult decisions. But the main thing is that courts are now going to have to balance two things: what the value was being exchanged, and they will inevitably have to weigh the likelihood that the patent challenge was going to be successful. And there is simply no way to avoid it, because you don't know whether or not what you were actually exchanging is a valid challenge which would have freed the public entirely or something else, which is an effort to basically restrict the market.

Finally, I'm going to turn to enforcing contractual standard-setting organization commitments for FRAND royalties. Again, as Josh Wright has argued, one needs to consider these commitments in the context of incomplete contracting that's sufficient, because of the lack of ability to determine prices *ex ante* and the need to coordinate technology. For these types of things, we now have a decision out of Judge Robart in the *Microsoft v. Motorola* case.²¹ I won't go through the facts. I'll just give you two basic premises. Motorola offered Microsoft royalties at 2.5% of the end price of the products. The judge ultimately set the royalties at .555 cents per unit, substantially lower. And the assumption that's behind this is that the FRAND royalty, as a contractual matter, required that the judges enforcing contracts determined what was a fair offer, because you had to have a good faith offer, and when the good faith offer had not been made, to actually set a reasonable royalty. That's what RAND stands for, and the court tries to lay out some

²⁰ *Id.* at 2231–33.

²¹ *Microsoft Corp. v. Motorola, Inc.*, 854 F. Supp. 2d 993 (W.D. Wash. 2012).

economic guideposts. What are these economic guideposts for RAND? Well, ultimately, we go back to the *Georgia Pacific* factors, which I started with, and so what you're going to have happen, of course, now is when these standard-setting bodies predictively and necessarily can't reach agreement, we'll now have to go to the judges to set what is supposed to be a multilateral decision, which includes royalty-stacking considerations, which includes the obligation to license in good faith in this *ex ante* negotiation. That judge-based determination will then inform what people do privately. So it's really the judges again determining what the fair price is, which will then filter into the market and filter back again.

So one thing that one could hope is that the private sector of these SSO bodies will take this on their own and take it out of the courts or put it into arbitration and take it out of the courts. Of course, when they take it on themselves, then we get price-fixing concerns. So there is no way to avoid this problem.

Finally, I just want to add that more attention may need to be given to market definition. There's some good recent scholarship, which seems to suggest that in IP areas, the entire market may actually be in the patent itself or the trademark, etc. The question comes up: How much would you pay to substitute Coke for Pepsi? And it turns out that it doesn't meet normal substitution analysis of a few cents or, you know, a couple of percentage points that people will substitute. People really care about Coke.

Given that, we need to think about what types of innovation-enhancing approaches we can have, and if the markets really are much narrower than we think, then we should be much more concerned about action within the scope of the patent right. That brings us back to misuse and other doctrines, which *Actavis* seems to suggest should be relooked at.

Finally, I'll end by quoting from some more recent scholarship from a guy named G.F. Hegel, "The differing interests of producers and consumers may come into collision with each other, and although a fair balance between them on the whole may be brought about automatically, still their adjustment also requires a control which stands above both and is consciously undertaken."²² Let's learn to love price regulation, because it's here anyway. We'll do it. Let's just try to do it better.

Thank you.

JUDGE DOUGLAS H. GINSBURG: Thank you, Josh.

²² GEORG W. F. HEGEL, *PHILOSOPHY OF RIGHT* § 236 (T. M. Knox trans., Oxford Univ. Press 1967).

[Applause.]

JUDGE DOUGLAS H. GINSBURG: Now for something completely different.

[Laughter.]

JOSHUA D. WRIGHT: Former Professor Wright on leave, which means I'm now a Commissioner of the Federal Trade Commission, and I see cameras, which usually means before I talk, I say something like the things I say attribute to people—don't attribute to people other than me at the Commission, especially the other commissioners.

JOSHUA D. SARNOFF: I always just say they're not even my own views.

[Laughter.]

JOSHUA D. WRIGHT: Yeah. So occasionally, I do that, and in this case and also when I have the pleasure of following Richard on a panel, I usually get to be brief, I say, "What Richard said," and I sit down. And, in this case and particularly the point about when it comes antitrust analysis of intellectual property rights, the economic tools that have been developed in standard antitrust analysis and the doctrines that have been developed in standard antitrust analysis, I think, are right for the job and do not call for any sort of particularized exception or special approach. And it may—for the record, the standard approach also works for Coke and Pepsi.

So instead of talking about the general relationship between antitrust and IP, I thought—because I would just say, "Hey, what Richard said," I thought I would talk about a couple of things going on in the intellectual property and antitrust sphere at the Federal Trade Commission, and in the interest of time, I will pick two.

The first is—there's been some mention of trolls, PAEs, whatever the moniker of the day is you would like to use, and the FTC, as some of you know, has sent out for public comment its notice and request for comments on a proposal to use its 6(b) authority to study patent assertion entities. The debate around PAEs is well known. Policymakers and commentators have been very critical. There is a great deal of scholarship surrounding patent trolls, some presuming they do more harm than good, some presuming they do more good than harm, far more of the former than the latter. This is a place where the Federal Trade Commission historically in areas that have been sort of devoid of empirical fact, but full of very strong priors has been, I think, productive in using its research authority and its capabilities, a

wonderful team of full-time economists over there, to get data and go to work and try to provide some answers that might be useful.

So, the types of things that the study tries to answer as laid out in the proposed notice are things I would categorize with my economist hat on as largely descriptive analysis: how are PAEs organized in terms of legal structure, differences in patterns and types of ownership compared to practicing entities, how does acquisition take place, what about comparing licensing activities, and, as one might guess in any sort of study, looking at those types of questions, maybe with an eye at getting toward the ultimate cost and benefits of those questions, the idea is to take and collect data with your group of interests, in this case PAEs, and also some other similarly situated firms. So, you might be able to make some comparisons that you can learn from and inform the public debate. Whether the data collected will ultimately prove useful for that purpose, the descriptive purpose, I'm quite sure it will, but more broadly than that, we'll see. This is the trick about collecting data.

The public comment period closes for that project on December 2nd, so your comments are welcome. And for now, I think with respect to the PAE study, I would simply say for the agency, one of the things that the Federal Trade Commission, when I had my professor hat on and spent a good amount of time criticizing a variety of their activities, studying stuff is something that the Commission does really well. Working with data and collecting data is something that they do well and are historically very careful with, and I think this is an area that—I think “devoid” is the word I used before, and I'll stick to it—an area that is fairly devoid of empirical work. So I think the Commission is well served to act here in terms of doing the study.

I will spend the rest of the time talking about reverse payments. So the Supreme Court handed down *Actavis* not too long ago. The backdrop, of course, was that the Federal Trade Commission had, for at least a decade starting with the former Chairman Muris and through Chairman Leibowitz and continuing now, long held the position that “pay-for-delay settlements,” I will call them, between brand and generic competitors, as Professor Sarnoff described them, were *per se* unlawful. That had been the position of the Commission for quite some time. It was a debated position. There were folks saying that the right way to approach reverse payment settlements was with the rule of reason, and folks taking a variety of intermediate positions between sort of the full-blown rule of reason and treatment of *per se* illegality.

The Supreme Court held that—and I think quite firmly and clearly—that reverse payments would be analyzed under the traditional rule of reason. The state of play prior to the decision was some circuits adopting the scope of the

patent test, which Josh described, so I'll move on from that other than to come back to one interesting point about the extent to which questions about the validity of the patent will arise within the standard antitrust analysis. This is, in my view—again, disclaimer thing, speaking for myself—this is, in my view, pretty clearly a partial victory and a partial defeat for the FTC. One of the positions taken through the scope of the patent test and other areas was that the settlement, reverse settlements ought to be *per se* lawful. To harken back to Richard's earlier comments, the standard antitrust analysis, that would almost certainly not be the case for any sort of horizontal agreement that had some of the features that these settlements can have. There's clearly some threat, potential threat to competition, the standard antitrust analysis when we have things that can potentially threaten competition, but may also be efficient, is to apply the rule of reason and to test the various anticompetitive and pro-competitive theories against the facts on the ground and ask whether the agreements actually confer some market power to the collective parties that would not exist otherwise.

The *Actavis* decision does precisely that. It rejects *per se* treatment. It rejects scope of the patent test or something close to *per se* legality, and so what we have is a decision that endorses the rule of reason. There is considerable debate over what precisely the contours of that rule-of-reason analysis will be. So many commentators, for example, have said, "Yes, the Supreme Court said this is not a so-called 'quick-look rule of reason,'" one of these intermediate forms where we may say we are doing the rule of reason but wink at each other and summarily condemn the restraint. The Supreme Court said, "We are not doing that thing. We are doing something else. We are doing the traditional rule of reason." They laid out some factors to consider, and one that got a lot of ink was the size of the payment, with an underlying theory of economic logic that the larger the payment, the weaker the underlying patent is likely to be, and so the Supreme Court said, "We'll look at the things we look at in a normal rule-of-reason analysis, but, hey, pay special attention to the size of the payment."

Some have said, "Ah, what they really meant is if the payment is big, we summarily condemn the agreement à la quick-look rule of reason." I think a closer read of the opinion, even a kind of, sort of, close read of the opinion suggests that that approach is wrong. I think, instead, what a move from *per se* legality or *per se* illegality towards the rule of reason means is something like what it is meant in every other area of antitrust law that has moved from *per se* treatment to the rule of reason: more rigorous economic analysis, more attention to economic evidence rather than less.

This, of course, will—and I don't think we actually disagree on this point at all—this will require looking at the size of the payment and deciding what inferences to draw from that to determine whether there has been harm to

competition. Whether one labels that price regulation, I think would be the thing that I would fight over, but I don't think there's much time to do that. The idea that an antitrust court sometimes looks at prices is different to say that we put in orders that fix prices or that—so far as I know, *Trinko*²³ and *NYNEX*²⁴ and *Rambus*²⁵ are all still the law of the land in the case of unilateral refusal to deal and throughout Section 2, which all say something akin to, “the monopolist gets the price the way it wants to price.”

Now, if it does something, which is monopoly power, to further harm competition, that's an antitrust problem. That analysis sometimes looks at prices, or prices relative to cost, or changes in prices. To infer whether market power has been achieved, I think follows from standard economic logic but doesn't require price regulation in the sense of the word that—at least as I understand it.

I think back to *Actavis* for two closing points. I think there are two really important live questions. Lower courts haven't got their hands on post-*Actavis* rule-of-reason reverse payment cases yet, and I think there are two important questions. The court says size of the payment really matters. So what constitutes, as the court said, a large and unjustified payment? The court says it makes it more likely a settlement is illegal, not necessarily illegal, but more likely.

So what is large and unjustified? You hand that part of the opinion to anybody who has done any economics or statistics in their life, they will say, “Large and unjustified compared to what? How are we going to measure largeness and the lack of justification?”

It is difficult for me to fathom that that analysis won't bring more economic rigor to understanding the incentives to enter these settlements than less. One thing you could do is compare to the expected litigation cost. You can try to. I think one easy prediction about the cases is that the settlements will get more complicated. They will have more features. It will be more difficult to tease out what is being paid for what. But exactly how courts will structure what to do with the size of the payment, I think is an open question. That's one of the very important ones that I think will be resolved fairly quickly.

The second interesting question—and Professor Sarnoff got at this a little bit—is what to do about patent validity within the antitrust analysis. There is a vigorous dissent in the opinion that adopts the logic—and there's certainly

²³ *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

²⁴ *NYNEX Corp., v. Discon, Inc.*, 525 U.S. 128 (1998).

²⁵ *Rambus Inc. v. Infineon Techs. AG*, 218 F.2d 1081 (Fed. Cir. 2003), *cert. denied*, 124 S. Ct. 227 (2003).

some intuitive appeal to it—that, were the patent valid, the patent holder has a right to exclude, and a lesser offense of paying somebody to delay entry is certainly sort of within the rights of a valid patent holder. So there could be no harm to competition in the sense meant by the antitrust laws if we knew with certainty that the patent was valid.

The majority rejects the scope of the patent test, and yet and still, under the more fulsome rule-of-reason analysis endorsed by the majority, I find—and this is my prediction—and five dollars may get you a cup of coffee—but my prediction is that lower courts adopting this more fulsome rule-of-reason analysis will be very much inclined to consider the potential validity of the patent, and with a Supreme Court decision that says, “Defendant, you are entitled to the full-blown rule of reason. You are entitled to put forth justifications for your settlement, justifications that may well include validity of the patent or other things,” it is hard for me to imagine that the ultimate equilibrium of the sort of rule that arises in the lower courts will be one that turns a blind eye to the potential validity of the patent. That, I think remains to be seen, but will be something that I think will be an important fork in the road for the development of these cases, and I’m sure one that the Commission itself will be watching closely as they’ve got a couple of pending cases and I am quite certain plan to bring a couple more.

So I will stop there.

[Applause.]

JUDGE DOUGLAS H. GINSBURG: Okay. John Duffy, my impersonation of a potted plant is over.

[Laughter.]

JUDGE DOUGLAS H. GINSBURG: If you want to take a minute or possibly two with cross-comments, you may do so.

JOHN F. DUFFY: I do have one cross-comment that I find irresistible, and I think everybody in this room is going to figure out why it’s irresistible, because I’m going to be on the right of Richard Epstein. I’m literally on his right, but I’m going to be also metaphorically on his right.

He said in his speech the one thing he would recommend is doubling the appropriation of the Patent and Trademark Office. That, I have to take issue with. I think it’s a standard liberal solution to say, when a government agency is not performing well: “What should we do with it? Oh, it would work very well if we just doubled the agency’s appropriation.”

Now, let me tell you what's wrong with the Patent and Trademark Office. Examiners spend on average about twenty hours looking over a patent application, but I don't think the amount of time devoted to examination is the real problem. Let's assume that twice that—forty hours—is what's necessary to examine an application. Still, even if the time spent on examination is doubled, that does not necessarily mean that the Patent Office will do a good job in examining the application.

Remember what the Patent Office provides is expert services—it provides an expert opinion. An issued patent is not for sure valid. It only has a presumption of validity. The agency's opinion gets some weight in court. Imagine now that you went into the private market to obtain an expert opinion, and you said, "I need about twenty, thirty, maybe forty hours' worth of your time." That person then replied, "Oh, I can do that for you. I will charge you a fair price, and I can do it in about 2016—that's when I think I'll get around to it." You would think, "What's going on here?" You would think, "Is this like the Soviet Union?" The only way this kind of poor service could possibly exist is if this is a monopolized entity. That's exactly what the Patent Office is in this country, though not in all other countries.

I have an article on this. It's called "Ending the Patenting Monopoly."²⁶ It's not entitled "Ending the *Patent Monopoly*," because I don't think there are patent monopolies, but instead "Ending the *Patenting Monopoly*," which is the USPTO. Other countries don't do it this way. To get an Israeli patent, for example, inventors can go to any one of thirteen patent offices throughout the world, and if they are able to convince one of those offices to issue a patent, then the Israeli patent office will issue immediately, by operation of law, an Israeli patent. That's a step towards competition. I think that our patent system could have full-blown privatization of the examination function, as I explain in my article. That's the free market solution—a competitive solution.

But if you want the liberal solution, you go to Richard.

JUDGE DOUGLAS H. GINSBURG: Why is that competitive? There are thirteen jurisdictions that could issue patents. How are they competing with each other?

JOHN F. DUFFY: Actually, in this article, my co-author and I show that there are clear examples where governmental patent offices are competing on price and quality of service with other patent offices.²⁷ But the ultimate

²⁶ Michael Abramowicz & John F. Duffy, *Ending the Patenting Monopoly*, 157 U. PA. L. REV. 1541 (2009).

²⁷ *Id.* at 1569–71 (providing examples of competition between and the patent offices of individual European countries and the European Patent Office).

recommendation of the article is that private entities should be allowed to perform the examination function, obviously with some sort of certification process to make sure that the private firms are producing quality opinions about validity. With that kind of minimal regulation of the private firms, we could have a sector in the economy that engages in examining patent applications and deciding whether claims to patents are valid or not.

In fact, even now, there is actually a growing set of technology companies that are trying to figure out whether issued patents are valid or not. There is a private demand for that because basically the Patent Office's opinion cannot be trusted. And so privatization of patenting could generate new technology, allow for entrepreneurship, and get rid of a government monopoly that is performing terribly. That's my solution, but if you want a standard liberal solution, which is to double the Patent Office's appropriation, you can talk to Richard here.

[Laughter.]

JUDGE DOUGLAS H. GINSBURG: Richard.

RICHARD A. EPSTEIN: Well, you are going to have to talk to Richard, and let me see if I can explain it in a little bit more detail, my position.

First of all, one of the things about situations when you create, quote/unquote, monopolies in the sense of exclusive rights is that it's very difficult to have competitive organizations to license them. It would be like having to go to thirteen rival parties in order to figure out whether or not a land title is valid.

The risk in this particular case is you get one country, which says, "We will now be the Schlock Patent Service. We will give you validity opinions. You have to license it within our system," and if it turns out that that guy has very inferior services, which are attractive to a plaintiff, what you do is you have a huge externality. So it is not at all clear to me that the multiplicity of parties is in fact going to be good. Sooner or later, you are going to have to focus on the question of validity.

Now, John may be right, and I was not—

JOHN F. DUFFY: That's the race-to-the-bottom theory, just to be clear.

RICHARD A. EPSTEIN: It is a race-to-the-bottom theory in this particular context, given the fact that the complication is going to be valid somewhere else. Now, if it turns out these guys have to live with their decision, so

Germany is doing it, I think it would be fine, but if it's the Bahamas or the Cayman Islands that are doing this, I'm going to get very suspicious.

The point about the money was—I'm sorry, I spoke too briefly—is obviously you have got to reform the particular operation of the PTO in order for the situation to improve, but there was this proposal with respect to the FDA in which if you paid an additional sum of money, you got an expedited examination, which as best I can tell seemed to work pretty well. Tom Philipson did a bunch of studies on the statute called PDUFA or the Prescription Drug User Fee Act and found that essentially the quality of the review did not go down as the speed of the review started to go up.²⁸

JUDGE DOUGLAS H. GINSBURG: Richard, why wouldn't crummy patent opinions from Cayman or wherever simply be a plaintiff magnet? So you wouldn't want that. You'd want one from Germany or the U.K.

RICHARD A. EPSTEIN: Well, I mean, it depends on exactly the quality of the review. I can perfectly believe that this system might work if the local country has to give full force and effect as it is to receive in the U.S. system. And obviously, the only way this system will work—and I think it's probably the right thing—is to say we care less about what the PTO does and more about the way in which the courts start to work. I raise this point, because as you well know, the current situation is to allow the PTO under the AIA to trump, at least in some circumstances, what it is a district court has done on the reexamination procedure. I fought that very seriously, because frankly, I think that's just the worst possible way to do it, given the way the adjudication is going through.

So, let me now just modify my system, which is I am perfectly willing to give more money if I think there is a bottleneck and delay, which is something that you referred to, but I am not willing to give it unconditionally. I would want to have some major structural reforms start to take place in there, and it's always the—it's not the "liberal solution," in any pejorative sense. There are certain other kinds of cases, I dare say, where we would like to put a little bit more money in the public side. Certainly, with respect to the enforcement of real estate titles, you would not want to have a shoddy system of recordation that could create all sorts of difficulties.

So let me put it to you this way and modify it, because I'm duly chastened—

[Laughter.]

²⁸ 21 U.S.C. § 379h(a)(2)(A), (a)(3)(A) (2012).

RICHARD A. EPSTEIN: —which is I am willing to spend money to make a system more cost effective, and I think one of the constant complaints with the patent office is that the money that they raise goes back into the general treasury. The delay becomes acute, and if in fact you could control the delay problem, it seems to me that that would be, independent of everything else, some kind of an improvement.

So I will put it this way. If you could keep quality and control delay and spend less money on it, I'm in favor of that too.

JUDGE DOUGLAS H. GINSBURG: Refinement noted. Josh?

JOSHUA D. SARNOFF: Sure. So let me pick up on this discussion and relate it back to *Actavis*. Prosecutors spent something between \$10,000 and \$100,000 acquiring patents. We litigate \$5 million to \$25 million over what they mean and whether they're valid and infringed. The solution is not simply to give more money to the Patent Office, although I'm actually in favor of that as well.

JUDGE DOUGLAS H. GINSBURG: How about judges?

[Laughter.]

JOSHUA D. SARNOFF: I'm absolutely in favor—

JUDGE DOUGLAS H. GINSBURG: The *Motorola Mobility* opinion is 207 pages. To set that price, I think we should get piecework here.

[Laughter.]

JOSHUA D. SARNOFF: You know, there's nothing that says you can't impose as part of the damages award something coming back to you. So, in any event—

JUDGE DOUGLAS H. GINSBURG: Now you tell me.

[Laughter.]

JOSHUA D. SARNOFF: I'll just give you one example, and here, I can refer you to my amicus brief in the *Phillips* case²⁹ dealing with claim construction. It's now effectively rewritten in somebody else's *cert.* petition in the *Biosig* case,³⁰ which addresses that the standard for whether a patent

²⁹ *Phillips v. AWH Corp*, 415 F.3d 1303 (Fed. Cir. 2005).

³⁰ *Nautilus, Inc. v. Biosig Instruments, Inc.*, 134 S. Ct. 2120 (2014) (overturning the insolubly ambiguous standard).

claim is valid is whether it is not insolubly ambiguous. It can be very ambiguous, just not insolubly ambiguous, which means that you can't know what the scope of the property right is and whether it's valid or infringed until after you pay this guy to resolve it in court. That is the basic difference between the patent system and most other forms of property system.

Okay. We're going to say you can define the boundary, so long as you can get to court and figure out where the boundaries are. If someone then asserts that claim in court, the problem is you've got a misuse of the patent right, where you ought to know that it actually doesn't cover the thing you're asserting.

This brings us back to how are we going to actually do the evaluations in the context of courts having to assess what value is being transferred. You're going to have to get, to some extent, into these difficult and costly questions, \$5 to \$25 million in litigation cost before trial, to figure out whether or not the patent was valid and infringed. It also turns out that the markets for generics versus the pioneers are not perfectly elastic. This is being done in many ways, including the agreements not to offer authorized generics by the manufacturer as a way of transferring value to the generics during the term. So you've got to think this through much more carefully, and this just makes it more costly, and once again, take a cut because it's going to come back to the courts. You are going to have value whether or not these patents with all of these complex doctrines are valid. But the best place to start on patent validity—which is something the AIA really didn't help at all with—is clarifying claim scope.

JUDGE DOUGLAS H. GINSBURG: Does the AIA provision allowing for post-issuance review have anything to contribute to this? If it comes into court, could I say I am going to send it over to PTO for a post-issuance review, or could I engage them as my expert?

JOHN F. DUFFY: So you have two different problems with that. The first is the one that Professor Epstein alludes to. If the court has already said, for example, that the patent claim is invalid, then bringing it back into the Patent Office and claiming it's valid seems troubling, same thing with the other way around.

JUDGE DOUGLAS H. GINSBURG: I am talking about in terms of trying to sort out a pay-for-delay case.

JOHN F. DUFFY: Right. One problem with that is that there's a different standard of claim interpretation that's currently being applied in the Patent Office on post-grant reviews. The Patent Office gives claims the broadest reasonable interpretation. That standard is supposed to allow for more claims

to be found invalid, but if they are upheld, then claims interpreted broadly are more likely to be infringed. So if the Patent Office is asked to evaluate the scope of claims, the Patent Office would have to adhere to the standards used in making judicial determinations of claim scope. Otherwise, there would be a disconnect between the judicial and administrative determinations.

JUDGE DOUGLAS H. GINSBURG: Because if they did say it's not valid even with a broad scope, that solves the problem.

JOHN F. DUFFY: No.

RICHARD A. EPSTEIN: Doug, it's worse than that. One of the problems is that the way in which you get federal judges today is kind of by a random draw, because people are very nervous about the self-selection.

If you go into the PTO under the AIA, as best I can tell by reading it, is the head of that court has complete discretion on appointing special judges on an *ad hoc* basis in order to hear these cases. I regard that provision actually as unconstitutional, because I think it's an open invitation for bias, if in fact you know what the patent is, you know what the claim is, and you know what your friends are. So I don't like that system of appointments. I would much rather them have a stable of judges in a given area or people who can do this, and then you pick them by lot in order to handle the case, because the effort to sort of match it by way of ability seems to me to be much too much open to real claims of bias, which are going to be very difficult to challenge after the fact.

JUDGE DOUGLAS H. GINSBURG: And bias, expertise. They get confused.

JOHN F. DUFFY: I'll just add one last thing. If it has to go to the court to figure out what the claim means, you're already too far in with too much money on the table.

JUDGE DOUGLAS H. GINSBURG: Commish?

JOSHUA D. WRIGHT: So I started, I talked mostly about PAEs, where I think the punch line is going to rule of reason as taking us back to sort of a normal antitrust mode. Let me make these remarks on something that I think is going the other direction, where I think antitrust law and the enforcement agencies are maybe—and at least there are the seeds of a departure from the normal situation in which the agencies treat patents as property. Indeed, that's the language that appears in our 1995 licensing guidelines on IP, and I think has been the traditional approach with horizontal agreements, with

whether or not patents confirm market power, which the Supreme Court gets right and says there is no presumption of that sort.

So, a couple of areas that I think are cause for concern that they are at least seeds that the antitrust agencies, including my employer, are maybe heading a different direction into a realm of special treatment for intellectual property rights. Most of this goes to the injunction issue that Richard started with. I think there has been some momentum inside the agencies for the view, and I think a view that is quite contrary to the position that would occur in the space of real property, that injunctions are suspect as a competitive matter, as an antitrust matter. So, if you run down the line, most of these examples are bootstrapping on the proposition that injunctions are competitively suspect. It's a proposition that I don't think has been established and cannot be established as a matter of economics or law. But, if you begin with that presumption, then you can start to read through some recent agency activity, settlements under the FTC Section 5 authority, a couple cases that occurred before.

I started—or else I'd just be reading my dissent—that have to do with assertions that the naked assertion of an injunction on a FRAND-encumbered SEP violates Section 5 of the FTC Act. Couldn't do it under the Sherman Act. Couldn't do it under the Sherman Act precisely because the conduct would not be unlawful.

Merger review in which the competitive problem identified is that the post-merger firm, because it's acquiring some IP, maybe it's acquiring some standard essential patents, well, it's more likely to seek injunctions. Well, so what's your antitrust theory of harm? More likely to seek injunctions. Injunctions are competitively suspect ergo the merger is more likely to harm competition. It makes the post-merger firm more of a competitive problem, bootstrapping on the problematic premise.

There are other examples, some popularity with the idea that a similar merger example that would instead be a transfer of patents from a practicing entity to a PAE would raise the same problems. Why? Because the PAE is more likely to go get an injunction.

And finally—and I think related to the first example of the FTC cases—that breach of a contract with an SSO instead is itself in particular breach of a contract involving a FRAND commitment are presumptively anticompetitive. Not presumptively inefficient, not presumptively breach of contract, not presumptively some sort of other problem or non-problem, but presumptively an antitrust violation, presumptively the result of the acquisition of market power.

I think putting some of those examples together, again, I think which all have this one premise in common, are importantly a departure from the standard approach or at least the beginnings thereof.

JUDGE DOUGLAS H. GINSBURG: Okay. We have fourteen minutes for some questions from you all. There is a microphone I see there in the center. Just tell us who you are.

RICHARD A. EPSTEIN: And why you're here.

JUDGE DOUGLAS H. GINSBURG: And even if you think we already know, it would be helpful.

ART MACOMBER: Good afternoon. Art Macomber. I'm a dirt lawyer from Coeur d'Alene, Idaho, and I'm seeing some market similarities between what we call in real property a "quiet title action," which sometimes goes along with a declaratory judgment, and I'm wondering if there's such a thing in patent law that we call "adverse possession," especially perhaps related to these paper patents that were mentioned, and how that gets resolved in the patent system.

JUDGE DOUGLAS H. GINSBURG: John, can you handle that briefly?

JOHN F. DUFFY: Sure. You want me to focus mainly on adverse possession? With respect to adverse possession, we haven't seen that really in patent law, I think, because adverse possession usually requires that someone have been in possession of the property in an open and notorious way for something along the lines of two decades, which is the term of the patent. Thus, the patent would expire anyway before adverse possession could occur, so I don't think we've seen that doctrine of real property migrate into patent law.

I will say that there is a very interesting Supreme Court case this term on copyright about whether the equitable doctrine of laches applies to copyright infringement claims.³¹ The statute of limitations for copyright is sort of a rolling statute of limitations, and there is an argument that laches might apply if a course of infringement has been going on for years and years. The Ninth Circuit held that the doctrine of laches did apply to bar an infringement claim against a defendant who had been distributing a film—the film *Raging Bull*, as a matter of fact—for years and years. The copyright holder in that case knew about the potential claim for copyright infringement but nonetheless let the infringement go on for years and years. The Ninth Circuit held that such a claim could be barred forever by the doctrine of laches.

³¹ See *Petrella v. MGM, Inc.*, 134 S. Ct. 1962 (2014).

So I guess that's the only place where I could see something like adverse possession applying in intellectual property. I don't know of anything in patent law that's similar, although laches occasionally has been seen in patent law too. So I guess that's where I'd look, not adverse possession. I'd look to the doctrine of laches to accomplish something similar.

RICHARD A. EPSTEIN: And just one sentence. The reason why that doctrine makes perfectly good sense is the issue of laches is something within the control of the patent holder; whereas, many of the other defenses under the *eBay* balancing tests are not.

JUDGE DOUGLAS H. GINSBURG: Josh?

JOSHUA D. SARNOFF: One thing is that because this is non-rivalrous property, you don't get the same context. What you do get under patent law is the denial of an injunction with a prospective royalty, effectively the same thing, in a non-rivalrous patent property situation.

JUDGE DOUGLAS H. GINSBURG: Interesting. Yes, sir.

SAM MIORELLI: I'm Sam Miorelli from Orlando. I'm a member of the Practice Groups' Executive Committee.

I'm wondering. A lot of this discussion has been about drugs, and increasingly, we're seeing these combination drugs where often something immediately goes generic, and you see it combined with something that's still patented, like Vytarin, but also especially in the HIV treatment where you have essentially a patient needs one drug out of—or three different classes of drugs. And, we're starting to see that if some of these have gone generic, the two or three manufacturers won't sell the generic as a generic, and they require it to be in a combination a drug, Atripla, Truvada, these other sorts of things. Essentially, they create a twenty- or thirty-year or presumably you could even see like a forty- or sixty-year patent on these drugs. You never see the public good, and I'm wondering how you see these sort of antitrust issues potentially affecting that practice.

JUDGE DOUGLAS H. GINSBURG: Would you say that's similar to evergreening and other ways, such as changing the shape, changing the color, what have you?

SAM MIORELLI: Exactly. You see a minor refinement, and maybe the slightly less refined version that was ninety-eight percent effective, you can't buy anymore, and now you have to get the ninety-nine percent effective

combined with these other presumably generic drugs but still at sky-high prices.

RICHARD A. EPSTEIN: And why is it that you can't buy the ninety-eight percent variety?

JUDGE DOUGLAS H. GINSBURG: It's dropped from the orange book.

RICHARD A. EPSTEIN: It's because it's dropped from the orange book, right?

JOHN F. DUFFY: It's government regulation.

RICHARD A. EPSTEIN: Yeah. And the point, it is not a patent problem. Look, the FDA is supposed to tell you whether a drug is safe and effective. Once it's safe and effective, it remains safe and effective, even after it's dropped from the orange book. So the standard rule of patents ought to apply, and the patent rule essentially is if you patent an improvement, you cannot prevent anybody from using the unimproved drug at whatever price you want, and so now it's the FDA in restraint of trade with its orange book regulations, and those ought to be changed forthwith.

JOHN F. DUFFY: And so the key there is not a patent problem. It is a health care problem involving the intricacies of health care regulation, which produced the opportunity for this. You don't see evergreening even discussed in any other area of technology.

JOSHUA D. SARNOFF: There are two other complexities. One is why the generics didn't move in to supply the third drug that went off the patent, and that's one concern that's maybe a regulatory concern. The other is whether or not they will sell—say there were three patented drugs all sold separately—whether the brand manufacturer will continue to sell them separately, so there is no benefit. That may raise some antitrust concerns, but the bigger question is usually why the doctors where there's no therapeutic increase are now requiring the branded drug. That's about bad medical practice and the need for a regulation of the health care industry.

RICHARD A. EPSTEIN: Well, maybe, but, I mean, the difficulty in some of those cases is that the small changes have huge impacts, and it's really very, very difficult to make some of these claims out until you actually know what's going on there. At this point, you get group buyers, HMOs, professional organizations, hospitals, and to somehow assume that these characters are buying products, which is more expensive, even though they know it's not better is, I think, a somewhat questionable one.

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JUDGE DOUGLAS H. GINSBURG: It does sound like the Soviet system.

RICHARD A. EPSTEIN: Oh, God, don't get me—

[Laughter.]

RICHARD A. EPSTEIN: The FDA is built like a Soviet tank. There's no question.

JUDGE DOUGLAS H. GINSBURG: Hey, listen, I tried to make the point in *Abigail Alliance*.³²

RICHARD A. EPSTEIN: Yes, we did. Some of us know. Amen, brother.

NICK CHIDIAC: Nick Chidiac. I'm the President of the George Washington University Chapter.

So, Professor Epstein, in your comments with the quality of the scholarship of the patents, it's been talked a lot about scholars' tendency to sort of zero in on some sort of pore in the system and sort of miss some of the larger, overarching effects. In regards to the reverse payment settlements, our analysis usually starts well after a drug company has done a lot of risk assessment, a lot of planning, a lot of investment, both developing the drug and taking it to market, and after generic firms have individually and probably decided whether to or not to file an ANDA. What are we missing in terms of the overall economic dynamics?

RICHARD A. EPSTEIN: Bright question. I have a modest proposal, which I have made on other occasions to the horrific response of everybody, which says let's assume that what you get from a successful challenge under title—paragraph 4 is a six month co-exclusivity period. My solution to all those problems is let them cartelize the market for the period in question.

JUDGE DOUGLAS H. GINSBURG: Just a second. We're into Hatch-Waxman now.³³ The first generic comes along, fails. Everyone else is precluded, right?

RICHARD A. EPSTEIN: Yes, for the six months.

And the reason is what you're doing is you've got two margins to worry about as well as administrative costs. The one margin is whether or not at the

³² *Abigail Alliance for Better Access to Developmental Drugs v. Eschenbach*, 469 F.3d 129 (D.C. Cir. 2006).

³³ Drug Price Competition and Patent Term Restoration Act, Pub. L. No. 98-417, 98 Stat. 1585 (1984).

time that the dispute is resolved there's going to be increased levels of competition, and my thing will preclude it. But on the other hand, you save a bushel-load of expenses, because nobody has a test worth the powder to blow it to hell on how you value the reverse settlement.

But on the other hand, there is another margin which if it turns out that you think that pharmaceutical patents are (a) very solid generally and (b) too short, adding six months to it may spur the initial creation, because even if you're challenged, it will be a little bit more valuable than before.

So given a full time evaluation, which is what you're talking about, I see very little reason to believe that we begin the analysis at the point of the dispute and think it's much more important to go back, and the best way to challenge a patent is to encourage new entry by a substitute commodity, and that can be done. If the new entrant knows that if his patent is challenged, and he works out a settlement, he knows that he also gets six months. It's a little bit of what John constantly wanted to say. It's that the action at the front end protects you at the back end.

JUDGE DOUGLAS H. GINSBURG: Next.

CRAIG FRATRIK: Hi. I'm Craig Fratrik, a student at Harvard Law School.

I wanted to defend the difference, because it seemed like there was a decent amount of agreement on intellectual property being a lot like real property, and so differences that came to my mind, as you all have covered, is the three-year waiting period to find out if you have the property is quite different than if I construct something, I own it, or it is relatively easy—if I sign the title to the land, then I know I own it right then.

And then the other big one was just locality. So it is relatively easy for you to look at your house that you're considering buying or investing retail in, look at the registry, and then see if you own it. And coming from the—I was a software programmer before—and coming from the software industry, it is literally impossible to build a relatively simple website and then know if you are infringing on someone else's property rights.

So given those constraints, isn't there some room left to distinguish intellectual property from real property?

RICHARD A. EPSTEIN: Well, this is my response to that question, since I think it's addressed to me. One of the reasons why we encourage patent pools amongst complementary goods and cross-licensing arrangements is to take these little bits of property and to make them into larger plots, to make

them usable. You don't have to do that with respect to land for the most part, except under very unusual circumstances. For example, if you want oil and gas leases, now the efficient magnitude is much larger than the farm, and you have a lot of the similar kinds of assembly problems that need responses.

And on the other point, I think again you're right. The attractiveness of a real property system is that metes and bounds give you solid boundaries over which you could work. Gary Libecap has done some wonderful work saying where they don't give you the standard coordinates with the surveyors but use landmarks and so forth, the value of the real estate goes down by thirty percent, precisely because of the insecurity of title.

And so Duffy may be right, or he may be wrong, on the question of how the examination ought to work, but the key point is that you want to have a system that gives you secure titles at the front end and allows for these cross-licensing arrangements, because if they are not secure, then forget about litigation. Think first about licensing. The amount that you could get on an insecure license or a mortgage or anything else is going to be very much less, just as is in real property.

JUDGE DOUGLAS H. GINSBURG: Josh Wright, briefly, and then one last question.

JOSHUA D. WRIGHT: With respect to the symmetry point on property and intellectual property, from an antitrust perspective, I think the answer is the benefit of the symmetry approach of having the antitrust analysis treat the two the same is not a claim that they are identical, and it's not something that hamstring the agencies to say we have to pretend that this property has all the same economic features as this one, no more than we do when we have a case where there is a regulatory institution in the background or this market is different than that market. So it's allowing one to take the facts on the ground but saying we don't need a special set of rules. We don't need a different framework for analyzing. Our analysis is: see whether the conduct at issue creates incentives that allow the acquisition of market power. Same question.

JUDGE DOUGLAS H. GINSBURG: We go off the air in one minute. Your question, sir.

ATTENDEE: I'm Dave Border from the D.C. Young Lawyers Chapter. My question is for Professor Epstein. Would you change the qualifications at the PTO to hire patent examiners, and for Professor Duffy, what would your private examiner certification look like?

RICHARD A. EPSTEIN: Okay. My answer to the question is I'm not a management consultant, and if the proposition is can we improve the Post Office, the answer is surely yes. And what's true of the Post Office is I also think is true with respect to the PTO. But, it's not going to be small incremental changes you need. You need to have somebody come in there with a new broom that will sweep clean.

JOHN F. DUFFY: And I think that new broom is privatization. I think you'll see a lot of different things. For example, I think you would not see unionization of many of the private examination shops—

RICHARD A. EPSTEIN: Oh. Oh, yeah. I—

JOHN F. DUFFY: Currently, the government agency's examination shop is largely unionized. I think that's one thing that—

RICHARD A. EPSTEIN: No, but that's unconstitutional, right? In any sensible world.

JUDGE DOUGLAS H. GINSBURG: We've had a terrific panel. Please thank them for me.

[Applause.]