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DO INTELLECTUAL PROPERTY LAWS PROMOTE COMPETITION & INNOVATION?

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1. Dean Steinglass, Sally Weinberg Isenstadt, and the Members of Hahn Loeser and Parks, thank you for inviting me to Cleveland-Marshall.

2. To grab an audience's attention, I have been told, it helps to talk about four topics: (1) Religion, (2) royalty, (3) sex, and (4) mystery. I aim to please.

3. Here we go: (1) "My god, (2) said the queen; (3) I am pregnant. (4) How did that happen?"

4. If I were starting law school again, I would not only study antitrust, as I did, but also IP intellectual property law--especially patent and copyright law--as I did not.

5. Both legal domains are important to the" knowledge industries" of (1) computer and telecom software, (2) data collection, storage, processing, and dissemination, (3) media content and it is particularly important as well that they have become true global markets.

6. What used to be traditional industries, regional or at best, national, relatively slow to innovate, like farming, steel, and railroads, are increasingly becoming high tech, and also becoming international. Tractors now map and test soil properties on a farmer's field and then blend insecticides and nutrients for the optimum yield, sowing a different blend on each square yard of farmland based on its distinctive characteristics. New varieties of steel are produced in computerized mini mills at greatly reduced cost and railroads use sophisticated computer programming to route freight intermodally throughout and across the three nations of North America.

7. Today, innovation in intellectual capital, in technical knowledge, appears increasingly responsible for economic growth in the United States. Our increasing prosperity is our best means of being able to address our and the world's economic, social, health, and other problems, and reducing income disparities. Greater growth in innovation and productivity would also make possible the shift of a greater proportion of our workforce from marginal industries facing decreasing demand, especially in the face of global competition fueled by lower wage rates, shifting our people to high value added knowledge industries which can add to employment not only here, but also in Asia, Africa, and Latin America.

8. There is still disappointingly little we know about how best to promote innovation. Competition and intellectual property protection, for much of our nation's history, have been believed to be two of the most important drivers of innovation.

9. Competition is promoted by the deregulation of markets and the enforcement of antitrust laws against unlawful monopolizing conduct. There is considerable evidence that monopolies which foreclose competition in private markets tend to raise prices and reduce output. Many believe, and I am one of them, that they also retard innovation. For the first hundred years of American history, antitrust laws and the policy of discouraging governmental regulation were not a

significant part of our federal laws. Competition was first the subject of federal legislation in 1890. By the 1970s the Supreme Court gave U.S. antitrust laws the imprimatur of quasi-Constitutional standing. The Court called them the

> Magna Carta of free enterprise . . . as important to the preservation of economic freedom in our free enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete-to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster." *U.S. v. Topco Associates*, 405 U.S. 596, 610 (1972).

10. I will be discussing with you the interplay of intellectual property and competition. I will be talking only about two of the four intellectual property domains-patent and copyright. I will not be talking about trademarks and trade secrets, which are also intellectual property.

11. It was believed at the time our Republic was founded that patents protecting, for a limited time, useful and non-obvious inventions, and copyrights protecting for a limited time the writings and creative expressions of authors, were desirable to promote "progress" (*i.e.*, innovation) in science and the useful arts. This is expressed in Article 1, Section 8, of the U.S. Constitution.

12. The foregoing says that antitrust and intellectual property laws share a common end-promoting innovation. My focus here is on the problem that the means of enforcing our antitrust and intellectual property laws can and do raise an important conflict. Antitrust promotes innovation by removing barriers to freedom of choice, of use, of trade and of market access. It does this by preventing the formation of monopolies that dominate and distort markets, and undoing monopolies that have caused injury to competition and consumer welfare.

13. Intellectual property promotes innovation by rewarding those who create potentially useful knowledge. They are helped to exploit their creations with the grant of a right to exclude others from using or copying those inventions, without paying whatever price the holder of the intellectual property thinks she can command. Antitrust law permits monopolies-but only where they do not foreclose competition-except by the production of a superior product or service, *i.e.*, by innovation embraced in the marketplace. Otherwise, antitrust is hostile to monopolies. Intellectual property law welcomes monopolies and makes it legal for them to exclude competitors by subjecting those excluded who do not pay royalties, to the threat of heavy penalties for infringing those property rights-but only for a limited time and according to the defined boundaries of the property right.

14. Until 25 years ago, there was widespread agreement that these two bodies of law were often in conflict. In circumstances where this conflict was open and seemed economically significant, as when international and national cartels enforced the effectiveness of their price fixing by pooling patents among the cartel members and denying licenses to those competitors unwilling to play along, the U.S. government and the courts sometimes took away these intellectual property rights. Even though intellectual property is property, if the misuse of the intellectual property had caused significant anticompetitive harm, the property rights were extinguished so that the property holders could not recover the economic reward IP law had, they believed, promised them, and which the antitrust authorities said they abused. This happened with respect to shoe machinery, the manufacture of synthetic fibers, light bulbs, and copier and telephone equipment-among other industrial products.

15. For the past 25 years, however, intellectual property has become increasingly ascendant. Antitrust enforcement has been correspondingly diminished-where the use of intellectual property rights to foreclose competition in markets covered by patents and copyrights, conflicts with antitrust's concerns that competition not be unduly eroded. One reason for this shift is an increasing, almost reverential celebration of the validity of private property as a possession to be prized. It is comparable to the celebration of property in 19th Century England vividly portrayed by Trollope and Thackeray.

16. Another reason that the balance has shifted is that an increasingly influential school of economic thought believes that in high tech knowledge industries, like telephony and computer software and hardware, competition may, in fact, retard innovation. It is hypothesized that these "new" industries have characteristics different from traditional industries, like farming, steel, and railroads, which may make it desirable to promote intellectual property rights even at the expense of competition in the market. The theory is that in these sectors innovation creates less by incremental improvement, and more by major paradigm shift transformations. These paradigm shifts, some think, happen best when companies are allowed to recover monopoly profits to fund further innovation. Competition will come eventually from a new paradigm which makes the former technology obsolete as computers replaced typewriters.

17. It is also suggested that the tendency toward monopoly in these knowledge industries is inevitable because of the advantage that the "first mover" gets after a key patent or copyright, or set of rights, is obtained. First movers get a lead on the benefits of "network effects." It took AT&T some 40 years to establish its telephone monopoly. When it did so, after acquiring many rivals and driving others out of business, it succeeded because it had more subscribers in its network. Unlike modern times, if you had somebody else's telephone service and equipment you could not automatically participate in the AT&T network. There was no interoperability between competing networks. The more users AT&T had signed up, the more desirable its telephone service became.

18. It is this network effect which Microsoft used to such advantage late in the 20th Century, and continues to use today, in foreclosing computer software competition by making Windows and Office Productivity Suite non-interoperable with Netscape, WordPerfect, Lotus Notes, and Java, and other actual and potential software competitors. By asserting its right not to provide interoperability with competitors, Microsoft severely reduces the incentive that customers would use these competing products. Ninety-five percent of software users are already tied to Windows operating system software and Office Productivity Suite.

19. Fifty years ago, U.S. antitrust law and enforcement would probably have prevented Microsoft from engaging in this activity, after the conduct found to be illegal in the suit *United States v. Microsoft* as affirmed, en banc unanimously by the D.C. Circuit Court of Appeals. Microsoft would have had to license its file formats, royalty free, so that competing software products could integrate with Windows and Office. Microsoft would have been limited in the acquisitions of new patent and copyright technology it could make to enhance its market dominance. Today, however, Microsoft is promoting itself as an "intellectual property company."[1] It is claiming that it has a protected property right not to share its file formats with competitors so they can make their products work well with Microsoft products. By continuing to promote non-interoperability, Microsoft is seeking to extend its dominance into software markets adjacent to the markets for operating system and office suite software which it had come to dominate by the mid 1990s. Microsoft already dominates the browser and server software markets and has several other adjacent software markets within its sights.

20. If, to use Bert Foer's colorful language, innovation increases by "jerks" more than by "creeps," *i.e.*, by paradigm shifts rather than small, incremental improvements [HTTP://www.antitrustinstitute.org], some think the conflict between intellectual property and antitrust should be resolved in favor of protecting monopoly rights and reduced concerns about injured competition.

21. At present, there is no clear expert consensus other than that both intellectual property rights and antitrust enforcement are important and desirable-in balance-and that innovation would be impaired if one triumphed at the expense of the other. Nonetheless, I believe that innovation is better encouraged by competition than by the overbroad monopoly that is becoming more prevalent today.[2]

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1 I thank Professor Harry First of NYU Law School for alerting me to this statement in Bill Gates's testimony in 2002 in *New York v. Microsoft Corp.*- the appeal of the adequacy of the consent decree negotiated by the Department of Justice and Microsoft.

2 For a view of the contribution of antitrust and deregulation, as particularly important to innovation, see the chapter by F.M. Scherer entitled "Technological Innovation and Monopolization" in a forthcoming volume on antitrust law edited by Dale Collins for the American Bar Association Antitrust Section.

22. To review what has been said so far, innovation is more important than ever before but, if increasingly broad intellectual property rights create monopolies which foreclose competition, a newer development over the last 25 years, intellectual property may impede innovation.

23. Let me be clear. Some intellectual property protection is good for innovation. I have written and edited a few books, and a few dozen articles. Authorship of books and articles is not my day job. I do it for intellectual satisfaction and the chance to be recognized by some peers who share my arcane interests. I do not do it to make money. Without copyright protection, however, publishers wouldn't publish my work. They are out to make a profit. Without the copyright laws, they could not be assured that people would pay for any book they produced, beyond the first one sold, especially if it was then immediately copied onto a website and made universally available. The talent and hard work of J.K. Rowling, the author of Harry Potter, over many years, deserves substantial royalties. It would have been unfair if she had had to remain, as she started, a welfare mother, because there was no intellectual property law to protect the unique value of her creativity.

24. Most who have studied the matter also agree that without patent protection, few of the important medical devices and prescription medications which today save lives would have been so successfully developed and distributed. Innovation in culture and medicine continue to advance - in significant part because of intellectual property protection - this is a good thing.

25. But, contrary to the considerable wisdom of Mae West, who said "Too much of a good thing is never enough," too much intellectual property protection may do real harm.

26. When the first copyright law was passed in the United States in 1790, it created a 14-year period of copyright protection for maps, charts and books, renewable for one additional 14-year term - if the author was still alive. Recently, lobbied by corporate copyright holders like the Disney Corporation, the Congress extended the copyright protection for an additional twenty years, making it an infringement to use a picture of Mickey Mouse, or even a picture with a likeness of Mickey Mouse, for 70 years after the last surviving creator of Mickey Mouse has died. It is even possible that Disney could earn tens of millions of dollars of additional Mickey Mouse royalties for a total of 125 years. Will this windfall promote innovation in the creation of Mickey Mouse improvements or other enhanced cartoon characters? How will it promote consumer welfare?

27. Too much intellectual property protection can retard innovation. Consider the following lawsuit: Samsung made and used a TV commercial showing a robot in a blond wig and sequined gown, standing next to a Wheel-of-Fortune-like game board, with a caption reading "longest running game show 2012 AD." The point was to suggest that Samsung electronic products would still be working when Vanna White was replaced by a robot. Vanna White successfully brought an action under a California law making it illegal to misappropriate a person's "likeness" for commercial purposes. In dissent, a conservative 9th Circuit Court of Appeals Judge, Alex Kozinski, explained why too much intellectual property protection can harm innovation: "Private land, for instance, is far more useful if separated from other private land by public streets, roads and highways. Public parks, utility rights-of-way and sewers reduce the amount of land in private hands, but vastly enhance the value of the property that remains. So too it is with intellectual property. Overprotecting intellectual property is as harmful as under protecting it. Creativity is impossible without a rich public domain. Nothing today, likely nothing since we tamed fire, is genuinely new. Culture, like science and technology, grows by accretion, each new creator building on the works of those who came before. Overprotection stifles the very creative forces it's supposed to nurture." *White v. Samsung*, 989 F.2d 1512, 1513 (9th Cir. 1993).

28. Weakening the power of the antitrust remedies used fifty years ago to undo the injury arising from the use of intellectual property to foreclose competition today, is the belief that such remedies are too intrusive, too regulatory. It is now conventional to hear some antitrust experts say that over enforcement of antitrust does more harm to innovation than under enforcement. Why is there no comparable concern among these antitrust colleagues for "over-regulation" of intellectual property?

29. To the extent intellectual property is too long in duration, too broad in its protections, and insufficiently hardheaded about what is truly novel and deserving of protection against *e.g.*, parody, or creative tweaking, or justified use, it should be reviewed and reformed. The Patent and Trademark Office examines patent claims and approves innovative ones. In 1982, Congress made the processing of patents by that Office self-sustaining. The Office is funded entirely by the fees paid by patent applicants. Bonuses and raises are also dependent upon the number of patents an examiner approves. Now there is little incentive to limit patent rights to truly innovative technology. As one patent examiner is quoted as saying, "When I first started here, I was told, 'When in doubt, reject' … Now I am told, 'When in doubt, allow" and try to find a reason to allow."[3]

30. Consider two reported examples of intellectual property over-regulation: First, a child of five is reported to have received a patent for a "new" technique for swinging on a playground swing.[4] She can sue for infringement anyone whom she thinks is using this technique without her permission, make that person pay statutory damages for past violations, and charge future royalties for future infringing play activity. Second, it was reported in the Wall Street Journal that Washington Mutual Bank has received a business methods patent for a system "providing enhanced systems management, such as in branch banking." The innovation is to arrange bank tellers at individual work stations in a circle, each station connected to a central computer system, and the circle having a common cash drawer. Above the work stations posters are mounted advertising various bank services. We have all seen this kind of innovation in various retailing outlets. Does it enhance innovation to give Washington Mutual Bank a 20-year monopoly to prevent others from using a similar arrangement - without paying a hefty royalty?

31. I leave to others suggestions for the best ways to reduce the apparent current over-regulatory impact of U.S. intellectual property laws. Rather, I would like to return to the interplay between intellectual property and antitrust and suggest that in the service of promoting innovation more effectively, antitrust laws should be applied less deferentially to intellectual property laws.

32. The Federal Circuit Court of Appeals was established in 1982 to, among other things, hear appeals of patent and copyright trial court decisions. In the antitrust/intellectual property interface, this international property court has leaned heavily in the direction of expanding intellectual property and limiting antitrust regulation.

33. One of its most important decisions was issued in the year 2000. In a case involving the rights of independent service organizations to repair Xerox copiers using Xerox patented parts and copyrighted Xerox service manuals, the Federal Circuit opined that:

> the antitrust laws do not negate the patentee's right to exclude others from patent property …. The patentee's right to exclude is further supported by Section 271(d) of the Patent Act which states, in pertinent part, that '[n]o patent owner otherwise entitled to relief … shall be denied relief … or deemed guilty of … illegal extension of the patent right by reason of his having … refused to license or use any rights to the patent.[5]

34. This decision expresses a growing view in the United States that in any conflict between the intellectual property and antitrust laws, the intellectual property laws should trump. Property rights are deemed more fundamental than the rights of economic freedom in the market.

35. While this is an influential decision, there are two U.S. circuit courts which hold open the possibility that in certain (unspecified) circumstances, the patent holders' right to exclude under the patent laws should properly give way to an overriding goal of undoing excessive exclusionary conduct. *See Telecom Technical Services, Inc. v. Rolm Co*., 388 F.3d 820 (11th Cir. 2004). The *Xerox* decision is also contradicted by a decision in the same industry, in the Ninth Circuit,

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3 Hal Varian, "Economic Scene" column. New York Times October 21, 2004. Section C p.2.
4 *See generally*, Jaffe and Lerner, *Innovation and Its Discontents: How Our Broken Patent System Is Endangering Innovation and Progress and What to Do About It* PRINCETON U. PRESS: 2004.
5 *In re Independent Service Organizations Antitrust Litigation*, 203 F.3d 1322, 1325-26 (Fed. Cir. 2000).

involving Kodak copiers. *Image Technical Services v. Eastman Kodak*, 125 F.3d 195, 1219 (9th Cir. 1997), *cert. denied*, 523 U.S. 1094 (1998). *See also Data General Corp. v. Grumman*, 36 F.3d 1147, 1187 (1st Cir. 1994), where the first Circuit held out the possibility of a similar antitrust or misuse override of copyright laws.

36. It is universally agreed that lawful patents entitle patentees to monopoly profits from the practice of those patents - if there is some reasonable business justification to the practice. But it is much less clear that the Congress, let alone the Supreme Court interpreting Congressional patent legislation, has ever said that practicing a patent for no other significant purpose than to foreclose competition is protected conduct. Enforcing a patent right to obtain a reasonable royalty while trying to commercialize one's own invention should be a reasonable business purpose justifying the monopoly. But what if the only purpose in asserting the patent is to prevent competition?

37. Consider this example which happens in today's business environment: A and B presently compete in the market for fidgets. A licenses B to make and sell widgets, a complementary product in a market which is adjacent to fidgets. B is a patented new entrant in the widget market. If B sells widgets pursuant to this clause, it can sell to whomever it wants. There is a rule in patent law called the First Sale Doctrine. To limit the scope of the patent monopoly, the patent protection limiting licensee rights expires after the product containing the patented technology is sold by the licensee to a third party. The third party may use or resell the product as he wishes, without fear of an infringement suit. To avoid the First Sale Doctrine, in this license, the patentee limits the licensee's right to sell only to customers who have already licensed from A the right to use the technology. A patent holder generally has the right to separately license, or not, the making, the using or the selling of a patented product. The effect of this license is that B is not free to sell to new potential customers who are not already customers of A. B is severely constrained in his ability to compete in this new market for widgets.

38. The Federal Circuit would seem to say that even if this were anticompetitive foreclosure, A has the right under its patent grant to fully exclude B from access to new customers. The Ninth Circuit would perhaps disagree. The First and Eleventh Circuits might, or might not, decide that antitrust law properly trumps the intellectual property law here. We do not yet know.

39. Just a year ago, the European Court of Justice decided a case under the European Union Competition Law relevant to this issue. NDC Health and IMS Health were businesses engaged in tracking sales of pharmaceuticals and healthcare products throughout Germany. IMS had developed a grid structure for Germany divided into more than 1500 rectangles or "bricks." IMS's grid structure had become the industry standard to which clients had adapted their internal information and distribution systems at some cost. NDC sought to provide a competing tracking service but found it could only do so if it adopted a brick structure derived from the one IMS had developed. IMS sued in a German court. The court preliminarily enjoined even the derivative use of NDC's data structure as an infringement of IMS's copyright under German copyright law. The highest European court upheld the vacating of the German injunction. It held that a company which owns a copyright, and refuses to give access to a product or service protected by it, without which it is impossible to compete in a market, may have that right overridden if three conditions are all met. First, the refusal to license must be preventing the emergence of a new market for which there is potential consumer demand. Second, there is no reasonable business justification for this refusal. Third, the effect of the refusal must exclude competition from this secondary market.

40. If *Xerox* is the likely direction of U.S. law, it appears to be in conflict with European competition law. High tech markets are increasingly global markets. Will the U.S. and Europe move in different directions on the intellectual property/antitrust interface? If so, what issues will jurisdictional conflicts present to firms caught up in those disputes? How should they be resolved? A new and very interesting chapter in both intellectual property and antitrust law is opening before us.

CONCLUSION

41. Many law students underestimate the intellectual excitement and opportunities to improve our society which the study and practice of commercial law can provide. The proper limits of intellectual property rights and antitrust enforcement, and the proper balance between the two when they conflict, is fascinating and important. We are living at a time when these issues are subject to serious debate, and when the opportunity to innovate to improve society and to serve clients creatively in these fields is wide open. To answer the question posed in my topic: intellectual property laws can promote competition and innovation. However, if applied over broadly, they can undermine the former, without advancing the latter. We need to work collaboratively to balance the scope and enforcement of these two bodies of law so that property rights, competition and innovation are sensibly promoted.

42. I am sure Forrest Weinberg understood the pleasure and importance of both practicing and teaching commercial law. I suspect he would be drawn to issues like these and would have been stimulated by the way knowledge industries today are challenging traditional legal institutions, and these challenges are being made globally. He was a particular expert in the law of close corporations. Close corporations have been the primary form of business organization for innovators in Silicon Valley who started with an idea and built it or not, into an Intel or Cisco or Hewlett Packard. He taught bankruptcy and secured transactions. These domains are quite important to antitrust and intellectual property. Forrest Weinberg's life exemplifies the opportunities for each of us, especially now in antitrust and intellectual property, to do good while doing well as practicing lawyers.