Resolving the Patent-Antitrust Paradox:

Promoting Consumer Welfare Through Innovation

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It is often said that antitrust law and patent law are irreconcilable and in perpetual conflict when it comes to the promotion of competition. In fact, I have made such an observation myself in my previous scholarship.[1] This view is so widely held that it is viewed as almost a truism. But is it really true? Are the two legal regimes diametrically opposed to one another?

The answer to that question depends on what one views as the role of these legal regimes. Is it promotion of competition for the sake of competition, or is it promotion of overall consumer welfare? If it is merely the former, then at least in a number of instances strong patent rights may thwart competition (even though the relationship is not necessarily linear). If, however, the true goal of patent and antitrust law is consumer welfare writ large, then the two legal regimes can be seen as working in tandem, rather than in opposition. This is true even when the mechanisms supporting the promotion of consumer welfare are fundamentally different—public-ordering restrictions on certain competitive behaviors versus the private-ordering mechanisms that are the natural byproduct of securing a property right in innovation.

There is no doubt that competition is a primary force of advancing consumer welfare. As companies compete for consumers' dollars, they take steps to make their wares more attractive than those of their competitors. But the scope and avenues of competition should not be oversimplified to the point where it is viewed as merely a race between competitors to the lowest possible price. Quite the contrary. Competition is a dynamic and multi-faceted process that proceeds along multiple dimensions.[2]

Companies can (and do) compete on price over the essentially identical product, but they also compete on many other issues, such as product differentiation to serve multiple tastes, market-making (pioneering innovation), modes of delivery and distribution, reputation/quality/status, influencing consumer tastes, manufacturing and process innovations, and other dimensions of competition. In other words, the mere fact that only one company produces product X does not mean that the company exists in a world without competition. Competition is a dynamic process, and so lack of competition in one dimension, such as price, does not necessarily mean there is no competition in other dimensions. Moreover, competition (or lack thereof) across a particular dimension is not, by itself, determinative of overall consumer welfare.

The question then is how the legal system should be structured so as to promote overall consumer welfare. Given that consumer welfare is dynamic and can be enhanced through multiple modalities, it should be rather self-evident that a legal analysis that focuses on just one particular mode fails to account fully for the effect of business practices on consumer welfare. Yet, it seems that this is precisely the approach the Federal Trade Commission (FTC) is taking when faced with entities intent on exploiting their patent rights through licensing, litigation, or both.

The FTC's approach today to patent licensing and to the attendant patent infringement lawsuits is reminiscent of the now-abandoned, pre-1980s approach to antitrust law. For most of the twentieth century, American antitrust law focused primarily on specific *competitors* and whether various business practices by one party harmed that party's competitors. When such harm was discovered, it was presumed to be anti-competitive and thus deemed to be an *automatic* (*per se*) violation of the antitrust laws.[3]

In his seminal book, *The Antitrust Paradox: A Policy at War With Itself* (1978), Robert Bork rethought this early antitrust paradigm. He argued that the purpose of antitrust laws is not protection of competitors, but protection of *consumer welfare* through competition. From this perspective, the mere fact that a particular business practice may harm or exclude a competitor is not particularly problematic if, on balance, such practice has the effect of increasing consumer welfare (be it through lower prices or new and better goods and services). Bork's reconceptualization of the purpose of

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antitrust law has had a tremendous impact on how courts and enforcement agencies view the goals of antitrust law.[4]

Patented innovation and its commercialization should be analyzed under the same paradigm where the ultimate goal is consumer welfare. Patents by their very nature allow the patent owner to exclude competitors from the market for that particular product or process. But as courts have recognized over the last thirty years, mere exclusion of competitors is not automatically detrimental to consumer welfare. In fact, in enacting the Patent Act, Congress made an affirmative judgment that patents are needed to "promote the Progress of Science and useful Arts,"[5] and that such "Progress" is consumer welfare-enhancing. Although a patent *may* provide the patent owner with an opportunity to charge super-competitive prices to consumers, on balance consumers benefit from having access to new, innovative technology that is invented and commercialized as a result of the incentives created by patents. Patents spur innovation and bring consumer-desired improvements to the market. From pioneering pharmaceuticals to revolutionary electronic devices, patents have allowed consumers to increase their quality of life at a faster pace than would have been available absent patent-based protections.

(As an aside, it should be noted that patents do not *necessarily* enable the patent owner to charge super-competitive prices if other commercial firms sell substitutes in the marketplace. For example, a pharmaceutical company that invents a new and improved pain killer is still heavily constrained in what price it can charge by the availability of other pain killers on the market, such as aspirin, acetaminophen, naproxen, and the like).

Bork's insight about the true nature of antitrust law made it possible to recognize that patents are not antagonistic to competition, and are not in tension with antitrust law; rather, patents and other intellectual property rights simply advance competition on a different axis of analysis than does antitrust law. Whereas antitrust law seeks to promote competition mostly on price, patents promote competition by incentivizing new innovation, product differentiation, manufacturing and process innovations, and influencing consumer tastes. (On the issue of consumer taste, just look at what Apple has achieved in terms of the aesthetics in high-tech products.)

The FTC, however, seems to have forgotten this function of patents. The FTC has thus taken a rather strong stance about the (alleged) anticompetitive effects of settlements between patented brand name and generic pharmaceutical manufacturers,[6] it has expressed skepticism about the companies who have engaged in commercial innovation in patent aggregation and licensing (companies that it identifies as "patent assertion entities"),[7] and it has taken action against firms that own patents covering industry-wide standards (such as Bosch and Google).[8] In the FTC's view, each of these situations presents a significant problem for competition and for consumers due to the (alleged) effect on price of the activities in question. The FTC's skepticism of patents can essentially be summarized as the notion that since patents secure exclusive rights to make, use, or sell in the marketplace, and since exclusive rights are inimical to a competitive environment, any robust assertion of such rights is detrimental to consumer welfare.

The problem with the FTC's approach today is that it essentially looks at the economy as static and zero-sum, not as dynamic and expansive through innovation. Under the FTC's view, a patent simply locks up a market for a particular method or device, which forces competitors to either wait until the expiration of the patent or pay royalties to the patent owner with the cost being passed down to the consumer. Absent from this view is the understanding that patents themselves spur competition. In addition to the just-discussed function of providing rewards for innovation, patents also encourage individuals and companies to seek multiple solutions to the same problem, whether in new products or in new commercial arrangements that exploit such products. For example, by foreclosing (for a limited time) one particular avenue to competitors, patents encourage these competitors to "design around" and come up with new products. There was first Viagra, and now there is Cialis. This competition for better and cheaper solutions ultimately benefits consumers.

Consider the pharmaceutical market and the diversity of drugs available to treat a particular disease. For example, two pharmaceutical companies may make competing insulin products for the treatment of diabetes. (To be sure, these products are not perfect substitutes, as each has some particular advantages and disadvantages, as is true with all non-identical competing products. In the more mundane world, think Coke and Pepsi.) In a world where patent protections are weak, a competitor would be more likely to spend resources and time invalidating the existing patent on insulin so as to easily enter a proven, valuable market. With the easy loss of patent rights, profits per unit sold would decrease, and thus pharmaceutical companies would have less money to pay the high cost of new research and development. Instead of the uncertainty (and the potentially large pay-off) inherent in R&D, companies may settle for the certainty of low payoff. Indeed, this is not merely theory, as this is the business model of the companies producing generic medicines. Instead of seeking and inventing new pharmacological compounds, the generic industry contents itself with copying products already on the market and selling them at a lower price.

There is, of course, nothing wrong with copying. Multiple companies providing identical products to consumers generally results in competition on price, with consumers reaping the benefit of that competition. But copying alone cannot provide consumers with the benefits of new technological improvement.

That is where patent law comes in. Not only do patents spur innovation by rewarding those making scientific advances or discoveries, they push competitors to out-innovate each other and thus compete not solely on price, but also on such things as product features (what's touted every few months with each new smart phone), methods of commercializing their products (Apple Stores), and in other dimensions.

There can be little doubt that the patent laws serve this function. Although the United States has lost the leader's mantle in terms of total number of patented innovations per year (as counted by the number of patent applications filed either in the U.S. or abroad), the U.S. Patent and Trademark Office (PTO) continues to outpace every other patent office in terms of the number of applications filed. This indicates that both domestic and foreign industries view the United States as the primary market in which to sell their innovative products. In other words, American patent laws entice both domestic and foreign companies to seek patent protection here and thereafter to sell these new and innovative goods and services to the American consumer. The reason that these companies choose to disproportionately file their applications in the PTO is because of the robust protections that patents have provided to technological and commercial innovation in the United States.

A prospect of monetization is what drives inventors or firms working in the innovation industries to continue creating inventions and applying for patents, as opposed to keeping them secret.

Finally, patents serve a valuable role as a knowledge transfer medium. As a condition of obtaining a patent, an inventor must disclose how to make the claimed invention. This disclosure not only allows the public to copy the invention once the patent has expired, but, even more importantly, to build upon this knowledge during the patent term by creating additional innovations and improvements.

The incentive to disclose an invention in one's patent application is robust only when the ultimately-issued patent can be monetized in the marketplace. Absent the ability to commercialize and to profit from one's patented innovation, it is unlikely that inventions would be made publicly available. In other words, if the inventor knows that he will not be able to monetize his invention, he is less likely to disclose it in a patent application, and more likely to keep it as a trade secret or abandon it altogether. A prospect of monetization is what drives inventors or firms working in the innovation industries to continue creating inventions and applying for patents, as opposed to keeping them secret.

The range of means for monetizing patents is broad. Some inventors are able to monetize the invention by manufacturing the patented innovation, such as selling the product or service. Others sell their patented innovation to a third party that is either in a better position to manufacture the innovation, to license the innovation, or to use the patent's disclosure for creating additional innovation.[9] Regardless, consumer welfare is enhanced—consumers get access to new products or the information disclosed in the patent leads to new and improved products

and services. There is no reason to believe that one of these other approaches to monetizing the patent's value is unworthy of the law's respect.

With this understanding, we can turn to addressing the FTC's concerns about what it calls "patent assertion entities" (PAE). The FTC defines PAEs as entities that "purchas[e] patents from existing owners [] seeking to maximize revenues by licensing the intellectual property to (or litigating against) manufacturers who are already using the patented technology."[10]

It's clear, though, that PAEs serve two important functions. First, they allow inventors to monetize their inventions (and utilize profits for further inventive activities). This enhances the incentive to invent. Moreover, the PAE and all of its licensees acquire knowledge disclosed in the patent, allowing everyone to use that knowledge in creating further improvements to the state of the art. Second, by vigorously licensing or asserting their patent rights, the PAEs leverage the patent's function of providing an impetus for competitors to "design around," a competitive process made possible in part by the full disclosure in the patent of the valuable innovation. Indeed, the more robust the patent, and the more aggressively it is asserted, the more incentive there is to design around.

This means that, from the perspective of dynamic innovation and ultimate consumer welfare, it should not matter whether a patent is commercialized by the original inventor, by a licensee, or by a company that purchased the patent and either manufactures or further licenses the technology. Thus, the FTC's concern that PAEs reduce consumer welfare seems misplaced. Aggregation of patents by particular companies, whether they manufacture or license, may hurt some competitors in the short run, but in the long run it may well enhance consumer welfare by ensuring inventors are full incentivized to invent, by widely distributing knowledge contained in a publicly available patent, and by inducing competitors to out-innovate the patent owner.[11] In economic terms, static price-based competition may be temporarily forestalled by patents, but this does not mean that dynamic competition is absent and that consumers are not better off as a result.

None of this is to say that patent rights cannot be abused. A patent owner who knowingly attempts to enforce an invalid patent or a patent procured by fraud abuses his rights and is not—and should not—be immune from antitrust liability.[12] Neither should a patent owner who knowingly asserts a patent claim with respect to a product that he does not in good faith believe infringes. But antitrust liability should not arise merely because a patentee aggressively asserts valid patent rights in securing licenses or in suing infringers.

In summary, both antitrust law and patent law achieve the same overarching purpose – increased consumer welfare. Antitrust law does so by protecting competition, and patent law does so by promoting dynamic innovation along multiple dimensions. Accordingly, it must always be remembered that competition is not a static process of price wars over identical products sold in the marketplace. Rather, competition is a dynamic, multi-dimensional process, with companies competing over a variety of factors other than price. Thus, when faced with a situation where a patent owner is aggressively asserting its rights, the FTC should not be asking whether this is detrimental to *competition* over a specific product, but whether this is detrimental to *consumer welfare* in the broader innovation market made possible by the patent system. To fail to make this important distinction is to repeat the errors identified so well by Bork in the mistaken antitrust policy of the first half of the twentieth century.

ENDNOTES

1 *See* Gregory Dolin, *Reverse Settlements as Patent Invalidity Signals*, 24 HARV. J. L. & TECH. 281, 318 (2011) (observing that "courts and scholars have explicitly and repeatedly recognized, there is inherent and constant tension between antitrust law and patent law").

2 *See* Joshua D. Wright, *Antitrust, Multidimensional Competition, and Innovation: Do We Have an Antitrust-Relevant Theory of Competition*, in COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY: REGULATING INNOVATION 228-251 (Geoffrey A. Manne & Joshua D. Wright eds., 2011).

3 *See, e.g.,* United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

4 *See, e.g.*, Leegin Creative Leather Products, Inc. v. PSKS, Inc., 127 S. Ct. 2705 (2007); Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Company, Inc., 127 S. Ct. 1069 (2007); State Oil Co. v. Khan, 522 U.S. 3 (1997); Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

5 U.S. CONSTITUTION, Article I, Section 8, Clause 8.

6 *See* Federal Trade Commission v. Watson Pharmaceuticals, Inc., 677 F.3d 1298 (11th Cir. 2012), *cert granted*, Federal Trade Commission v. Actavis, 133 S.Ct. 787 (U.S. Dec. 7, 2012) (No. 12-416).

7 *See* Jon Leibowitz, *Opening Remarks for Patent Assertion Entity Activities Workshop* (Dec. 10, 2012), http://www.ftc.gov/speeches/leibowitz/121210paeworkshop.pdf.

8 *See* Leon B. Greenfield, Michelle D. Miller, Kenneth Merber, Randall M. Weinsten, *Bosch/SPX: FTC Sends Tough Message Regarding Standards-Essential Patents Through Merger Challenge* (Nov. 29, 2012), available at http://wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=10737418413; Glenn G. Lammi, *FTC's Standards-Essential Patent Settlement: The Real "Elephant" in the Room?*, FORBES, Jan. 8, 2013, *available at* http://www.forbes.com/sites/wlf/2013/01/08/ftcs-standards-essential-patent-settlement-the-real-elephant-in-the-room/.

9 *See, e.g.*, Nathan Myhrvold, *The Big Idea: Funding Eureka!*, HARVARD BUSINESS REVIEW (2010).

10 http://www.ftc.gov/opa/2012/11/paeworkshop.shtm.

11 On a related issue, see Cockburn, Iain M., Megan J. MacGarvie, and Elisabeth Müller. *Patent Thickets, Licensing and Innovative Performance,* 19 INDUSTRIAL AND CORPORATE CHANGE 899 (2010).

12 *See* Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp., 382 U.S. 172 (1965).

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