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Department of Justice

The National Productivity and Innovation
Act of 1983
An Effort to Improve the Legal Climate
for the Creation and Exploitation
of Intellectual Property

Remarks by

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These are exciting and dramatic days for practioners of the law of intellectual property. Until fairly recently, it seemed the creators of intellectual property were thwarted at every turn: judicial hostility often resulted in an unwarranted denial or limitation of protection for intellectual property; and when protection was granted, an overbroad application of the antitrust laws and the misuse doctrine often discouraged and even sanctioned the efficient exploitation of the property. Now, the pendulum appears to be swinging back. The benefits of protecting intellectual property, so obvious to our founding fathers as to be included in the Constitution's description of this nation's basic tenets, are once again being appreciated. And the errors of the pendulum's excess in deterring efficient exploitation of intellectual property are beginning to be acknowledged.

As a part of this new enlightenment, there are now before Congress a number of serious legislative proposals aimed at improving the legal climate for the creation and exploitation of new technologies. 1/ The Administration's bill, the National Productivity and Innovation Act of 1983 (H.R. 3878, S. 1841),

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1/ See, e.g., S. 1535 ("Ad Hoc" Bill on patent law reform); H.R. 3577 (expansion of process patent protection); S. 1306 (Patent Term Restoration Act); S. 875 (Trademark Counterfeiting Act); S. 1440 (trademarks becoming generic); S. 1201 (copyright protection for semiconductor chips); S. 32 (record rentals); S. 33 (video rentals).

represents the most comprehensive approach of all of the proposals. It would amend the patent, copyright, and antitrust laws to remove a variety of legal impediments to the creation and exploitation of intellectual property and would do so in a manner that would help all United States industries.

Today, I would like to describe the Administration's bill and respond to some questions that have been raised about it. However, first I would like to place the bill in perspective by briefly explaining the historic judicial hostility to intellectual property and the forces that I believe have begun to temper this hostility.

The hostility to intellectual property protection derived essentially from a misunderstanding of the manner in which intellectual property protection functions in a free market economy. The grant of protection to intellectual property typically involves a grant of some form of exclusive rights in the underlying concepts or technologies. The notion gained favor among the judiciary that this exclusivity is inherently at odds with a free market system. For example, the Supreme Court has depicted the patent grant as a "monopoly," 2/ the limits of

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2/ See, e.g., United States v. Line Material, Inc., 333 U.S. 287 (1948); Mercoid Corp. v. Mid-Continent Investment Co., 320 U.S. 661 (1944); Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940).

which are to be "narrowly and strictly confined." 3/ This view of an inherent inconsistency between intellectual property protection and competitive markets was summarized in a recent court of appeals decision: 4/

> [The patent grant] is in inevitable tension with the general hostility against monopoly expressed in the antitrust laws, 15 U.S.C. § 1 *et seq*. Therefore, courts normally construe patent rights narrowly in deference to the public interest in competition.

This hostility reached not only the scope of protection for intellectual property 5/ but also its exploitation. The Supreme Court warned of the "evils of an expansion of the patent monopoly by private engagements." 6/ Patent license arrangements were struck down under the antitrust laws and under the patent misuse doctrine without sufficient investigation into

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3/ Mercoid Corp. v. Mid-Continent Investment Co., 320 U.S. at 665.

4/ United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122, 1127 (D.C. Cir. 1981).

5/ Deepsouth Packing Co., Inc. v. Laitram Corp., 406 U.S. 518, rehearing denied, 409 U.S. 902 (1972); Leitch Manufacturing Co. v. Barber Co., 302 U.S. 458 (1938); B. B. Chemical Co. v. Ellis, 314 U.S. 495 (1942); Mercoid Corp. v. Mid-Continent Investment Co., 320 U.S. 661, rehearing denied, 321 U.S. 802 (1944); Mercoid Corp. v. Minneapolis-Honeywell Regulator Co., 320 U.S. 680, rehearing denied, 321 U.S. 802 (1944).

6/ Mercoid v. Mid-Continent Investment Co., 320 U.S. at 666.

the actual competitive effects of the arrangement. 7/ It was always in the name of competition and economic progress that the rights and abilities of the creators of new technologies were limited.

Voices argued that this view of the intellectual property-antitrust interface was analytically unsupportable; that this view impaired rather than promoted competition and deterred rather than advanced economic progress. Only recently, however, have these dissenting voices achieved any significant victories. 8/ In my opinion, the reason these voices have begun to be heard by the courts is that economic circumstances have forced a reevaluation of the logic of the prevailing view.

The economy of this country typically has relied heavily upon technological advancement. Over the last 80 years, the development of new technologies has accounted for almost half of

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7/ See, e.g., United States v. Line Material Inc., 333 U.S. 287 (1948); The Laitram Corp. v. King Crab, Inc., 244 F. Supp. 9, modification denied, 245 F. Supp. 1019 (D. Alaska 1965); Allied Research Products, Inc. v. Heatbath Corp., 300 F. Supp. 656 (N.D. Ill. 1969); American Photocopy Equipment Co. v. Rovico, Inc., 359 F.2d 745 (7th Cir. 1966). See generally "Competition Policy and the Patent Misuse Doctrine," Remarks by Roger B. Andewelt, Chief, Intellectual Property Section, Antitrust Division, Before the Bar Association for the District of Columbia, Patent, Trademark, and Copyright Section (November 3, 1982).

8/ See, e.g., Aronson v. Quick Point Pencil Co., 440 U.S. 257 (1979); Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, rehearing denied, 448 U.S. 917 (1980), on remand, 557 F. Supp. 739 (S.D.Tex. 1983).

the growth in our real per capita income. United States technology has set the standard in the international marketplace; United States consumers have benefitted quickly and dramatically from technological advancements by United States firms. Recently, however, this country's dominance in many areas of technology has begun to erode. United States industries no longer necessarily dominate all domestic and foreign high-technology markets. Indeed, for the first time in my memory, in a limited number of industries, foreign firms rather than United States firms have set the technological standard.

This limited erosion of the technological dominance of United States industry resulted in increased focus on the process of technological development and dissemination. Study of the factors influencing innovation in turn resulted in increased sensitivity to the crucial role played by intellectual property protection and exploitation in the innovation process. The tempering of the judicial hostility against intellectual property protection and exploitation that I mentioned is, I believe, a direct result of this increased sensitivity.

In fact, rather than being at odds with a competitive market system, a properly constructed system for protection of intellectual property is a crucial part of such a system. For example, intellectual property protection serves the procompetitive function of inducing investment in the discovery and development of new technologies. The essence of technology is information, and it generally is difficult to prevent others from using information once it is created. Therefore, absent a system for protecting intellectual property, "free riders" often could duplicate the information, and appropriate to themselves much of its value. This diversion of revenue from the creators of technology to "free riders" lowers the economic rewards of R&D, thereby lowering incentives to invest in R&D in the first place. Therefore, unless this "free rider" problem is addressed, such as through intellectual property protection, there would be suboptimal investment in the development of new technologies; this would lead to less technologies being developed, higher prices and fewer choices for consumers.

Intellectual property licensing, like intellectual property protection, also plays an important procompetitive role in a free market economy. Licensing permits intellectual property owners to combine their abilities with the abilities of others to bring goods and services which embody the new technology to the market place more quickly and at a lower cost than otherwise would be possible. Moreover, by so doing, licensing can increase the value of patents and thereby engender more investment in the development of new technologies.

Since I noted at the outset of this speech that these more enlightened economic interpretations of the intellectual property-antitrust interface seem to be gaining favor, the question arises as to whether any legislation in the area is necessary. Why not simply wait for the errors of the past to be corrected through the litigation process?

The simplest and perhaps the most compelling answer to this question is that technological advance is so important to our economic well being that we should quickly eliminate all irrational legal impediments once they are identified. A more complex answer involves the inherent difficulty of using the courts to correct unsound legal precedent. The doctrine of *stare decisis* is crucial to our legal system, in part, because it provides businessmen with the degree of predictability necessary to induce appropriate investments. However, where caselaw precedent is economically misguided and produces undesired economic effects, the doctrine of *stare decisis* serves to prevent its correction. It is true that courts occasionally overrule precedent and, indeed, the Supreme Court has overruled certain of its incorrect economic assumptions in cases concerning the reach of the antitrust laws. 9/ However, until economically counterproductive precedent is reversed, most businessmen can be expected to act consistent with the precedent and thereby refrain from engaging in conduct that is economically desirable and ultimately beneficial to consumers.

9/ *See*, Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), on remand, 461 F. Supp. 1046 (N.D.Cal. 1978), aff'd, 694 F.2d 1132 (9th Cir. 1982) overruling United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967).

The National Productivity and Innovation Act of 1983 is a comprehensive proposal aimed in significant part at dealing with this hostile precedent to intellectual property protection and exploitation. It seeks to create a legal environment that does not unreasonably discourage investment in new technologies and does not deter the efficient exploitation of these technologies.

The National Productivity and Innovation Act has five titles. Title I simply names the Act. Title II, the first substantive part, involves treatment of joint research and development ventures under the antitrust laws. Because joint activity can yield economies of scale and scope, R&D joint ventures can be a highly efficient means of discovering and developing new technologies. Antitrust caselaw precedent in the area is sparse and cannot be said to be hostile to the formation of R&D joint ventures. Nevertheless, the uncertainty involved has resulted in significant fear of antitrust suit which apparently has discouraged some firms from entering into beneficial joint ventures that they otherwise would have entered.

Title II of the Act addresses this problem through a two-part amendment to the antitrust laws. First, the courts could not apply *per se* theories to R&D joint ventures, rather the courts must consider the venture's procompetitive effects in deciding the ventures' legality under the antitrust laws. Second, treble antitrust damages would not be available against an R&D joint venture where the details of the venture have been fully disclosed to the public through notification to the

Department of Justice and the Federal Trade Commission. In situations where a venture so disclosed is later found to violate the antitrust laws, plaintiffs could recover only the actual damages caused by the illegal conduct, plus prejudgment interest.

This approach provides a simple and effective solution to the problem of excessive antitrust deterrence to joint R&D while maintaining adequate safeguards to deter anticompetitive joint ventures. The approach avoids the high costs associated with creating and administering a regulatory process for certification of R&D joint ventures which is envisioned in some of the bills. It also avoids the risk of encouraging anticompetitive behavior involved in certain other bills which would grant immunity from suit based upon standards for distinguishing procompetitive from anticompetitive joint ventures that are different from and not as effective as the existing antitrust standards.

Title III, which would modify the treatment of intellectual property licenses under the antitrust laws, takes an approach similar to Title II, except that there is no disclosure obligation. Intellectual property licenses could not be evaluated under the *per se* doctrine. In addition, only single damages plus prejudgment interest, rather than treble damages, would be available when a license is found to violate the antitrust laws.

The statutory rejection of the *per se* doctrine in evaluating intellectual property licenses is crucial to overcoming existing caselaw hostility to the patent grant and patent exploitation which I have described. It will serve as a dramatic signal to courts that the procompetitive benefits of both intellectual property protection and intellectual property licensing must be carefully considered when a license is subject to antitrust attack. This careful consideration should result in the court's adoption of a more enlightened view of the patent-antitrust interface. The availability of only single damages will encourage the dissemination of technology through licensing even in the face of existing hostile legal precedent.

Title IV also deals with intellectual property licensing, specifically the doctrines of patent and copyright misuse. As you all know, misuse is a judicially created doctrine that is invoked when patent or copyright licensing practices are deemed to be undesirable from a public policy standpoint. If a court finds that the patent or copyright holder's conduct constitutes misuse, the patent or copyright is unenforceable against anyone until the misuse has been eliminated and its effects purged from the marketplace. In view of the harshness of this sanction, patent and copyright owners can be expected to avoid entering into licenses that may be held to be misuse. However, courts often have condemned patent licensing practices as misuse on the ground that the conduct was anticompetitive or otherwise economically undesirable in situations where careful economic analysis demonstrates that the conduct, in fact, often is procompetitive. 10/ The misuse doctrine as currently enforced therefore serves to discourage procompetitive licensing.

Title IV is designed to address this problem by amending the patent and copyright laws. The appropriate mechanism for distinguishing between procompetitive and anticompetitive licensing practices is to test the practices under the antitrust laws; licenses that unreasonably restrain competition are unlawful under the antitrust laws while those that do not are not. Title IV leaves the sanction for misuse unchanged. However, it assures that courts will apply the appropriate economic analysis prior to condemning conduct as misuse on competition grounds by permitting a finding of such misuse only when the conduct violates the antitrust laws.

Title V of the Act also would amend the patent laws. It is intended to close a loophole in the United States patent laws that has impaired the ability of process patent holders to earn their rightful rewards, and thereby has reduced the incentives to create and develop more efficient ways to produce the goods consumers demand. Under current laws, the owner of a patent covering a process has significantly less protection against the unauthorized use of his invention than the owner of a patent covering a product. Where a product patent is involved, a firm

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10/ See n. 7, *supra*.

cannot avoid infringement by manufacturing the product overseas and then importing it into the United States. Where a process patent is involved, infringement can be avoided by practicing the process outside the United States and then shipping the resulting product into the United States. This loophole not only discourages firms from investing in R&D aimed at discovering new and better processes, but also encourages firms to manufacture outside the United States with foreign labor when a United States process patent is involved.

Title V seeks to eliminate both of these undesired effects by extending the coverage of the process patent to a product made by the patented process. The use or sale in the United States of a product made by a patented process would be an infringement of the process patent, regardless of where the process is practiced. In addition, Title V would create a presumption that the patented process was used in manufacturing a particular product whenever the patentee shows a substantial likelihood that the patented process was used and the patentee has exhausted reasonably available means for determining the process actually used.

The presumption is created essentially to prevent manifest injustice where the patentee cannot demonstrate what process actually was used to manufacture a product because the manufacturer of the goods is beyond United States service of process. The presumption is limited, however, to an admittedly narrow set of circumstances. A more easily available presumption was rejected because it would unreasonably discourage firms from distributing products made outside the United States by a process that does not infringe any United States process patent. The availability of a presumption increases the risk of suit against the distributor of such a product and thereby increases the costs associated with handling these products.

These four substantive provisions of the National Productivity and Innovation Act are the product of considerable study and thought. A substantial effort was made to evaluate the innovation process and draft a comprehensive bill that eliminates unwarranted legal impediments to investment in R&D. If adopted, the Act should go a long way toward improving the climate for investment in R&D.

The bill has been very well received by those involved in the innovation process. However, there have been some areas of concern expressed about the bill and I would like to address these concerns in the time remaining.

Up until now, the bill has not been treated on the Hill as a partisan proposal, and I remain hopeful that it will not. However, some may seek to characterize the bill as a partisan Republican Administration effort and urge that the bill be treated as such on the Hill. I certainly am not here as an expert on legislative politics, reelection politics, or any other type of politics, and therefore, I could not predict how much benefit would redound to either party if the bill is passed. I am a career government employee who has served under Republican and Democratic Administrations and my expertise lies not in partisan politics, but rather in the fields of intellectual property and antitrust law.

Looking at the bill through the perspective of my area of expertise, I am confident that the bill makes economic sense and is in the interest of the citizens of this nation. If adopted in its entirety, the bill should benefit consumers directly and dramatically by improving the climate for investment in R&D and by encouraging the more efficient use of existing intellectual property. This end obviously is fully consistent with the goals of both the Republican and Democratic parties.

Indeed, the basis for bipartisan support for the concepts in the bill seems already in place. There already appears to exist significant bipartisan support for amendment of the antitrust laws to deal with R&D joint ventures, the subject of Title II of the National Productivity and Innovation Act. Moreover, the past Democratic Administration took some important initial steps towards improving the environment for treatment of intellectual property, including support for legislation granting certain government contractors title to patents that result from government sponsored R&D, 11/ the *amicus* brief filed by the

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11/ Patent and Trademark Laws Amendments § 6(a), 35 U.S.C. § 200-211 (1980).

Department of Justice with the Supreme Court in Aronson v. Quick Point 12/ and the placing of at least the initial nails in the coffin of the Antitrust Division's infamous nine no-no's of patent licensing. 13/ The National Productivity and Innovation Act can be viewed as consistent with these efforts as well as a continuation of the dramatic steps well-known to you all, that the current Administration has taken in the intellectual property area. 14/ Intellectual property policy is not and should not be an issue that is inherently partisan in nature. This bill should be evaluated on its economic merits, and the merits are such that both parties should be able to support the basic concepts involved.

12/ Brief for the Department of Justice, Aronson v. Quick Point Pencil Co., 440 U.S. 257 (1979).

13/ "Antitrust Enforcement and the Patent Laws: 'It is As Craftsmen that We Get Our Satisfactions and Our Pay'," Remarks of Ky P. Ewing, Jr., Deputy Assistant Attorney General, Antitrust Division, Before the San Francisco Patent Law Association (May 5, 1979).

14/ See, e.g., President's Executive Memorandum of February 18, 1983 concerning Government Patent Policy (reprinted 25 Pat., Trademark & Copyright J. (BNA) 351 (Feb. 24, 1983); "Current Antitrust Division Views on Patent Licensing Practices," Remarks of Abbott B. Lipsky, Jr., Deputy Assistant Attorney General, Antitrust Division, Before the American Bar Association, Antitrust Section (November 5, 1981). The Administration's focus on the protection and exploitation of intellectual property has resulted in the formation of an Intellectual Property Working Group of the Cabinet Council on Commerce and Trade. This Group has made a series of recommendations which were adopted by the Administration aimed at fostering innovation through improving certain rights and abilities of intellectual property owners.

Another concern that has been voiced about the bill, which has come as quite a surprise to me, is the notion that the bill somehow will help big businesses more than it will help small businesses. It may be that this contention stems from a desire to politicize the bill. Again, however, I cannot speak to the politics of this contention, only to its economic merits. Responding to this contention on the merits, it seems unequivocably false. Indeed, on this issue I am probably preaching to the choir today, since this audience is sensitive to the functioning of intellectual property protection and licensing in our economy and therefore must appreciate how important these proposed amendments are to small businesses.

Small business has a special stake in a strong system for intellectual property protection because of the especial vulnerability to "free riders." If a technology is discovered that likely will appeal to consumers, existing big businesses frequently will have significant advantages over small businesses in bringing the technology quickly and efficiently to the marketplace. Larger businesses may have available production capacity, production expertise, a nationwide promotion and distribution force, and a nationwide reputation for quality. Duplication of these assets could be very costly and time consuming for a small business. Therefore, absent intellectual property protection, discoveries by small businesses would be especially vulnerable to "free riding" by large businesses.

Small business also has a special stake in establishing a more economically rational legal approach to exploitation of intellectual property though licensing. Small businesses would benefit especially both in their capacity as licensor and as licensee.

The ability to grant licenses under their patents is often an important option to small businesses. A small business often will not have available production capacity or expertise, sales and distribution force, etc., to exploit efficiently on its own all potential uses of a new technology. Often the most effective solution for such a patentee is to license firms that have certain needed skills. Licensing, therefore, in a sense is a means available to small business to get as big and as efficient in the manufacture and distribution of a product as a vertically integrated large business competitor may be on its own. Moreover, the small business may want to restrict the licensee in its use of the technology lest it be swamped by the licensee in the area the patentee intended to reserve for itself. An overly restrictive application of the antitrust laws or the misuse doctrine to intellectual property licenses therefore imposes additional costs on licensors and can put small business at an unnecessary competitive disadvantage with respect to their large competitors.

Titles III and IV also will benefit small business in their capacity as licensees. Small businesses often may be in the best position to develop particular applications of a new patented technology. However, they typically will not be in a position to obtain access to the patent by purchasing the patent outright or by offering the patentee a cross-license under important related technology. The small business, therefore, typically will seek access through an offer of royalty payments. However, patentees may be unwilling to grant unrestricted licenses because such a license may decrease the patentee's control over the patented technology and thereby decrease rather than increase the total return to the patentee from the patent. In such cases, the patentee will grant the small business a license only if it can include certain restraints or obligations in the license which will result in the patentee's net reward increasing rather than decreasing. Such provisions may be perfectly acceptable to the small business. Nevertheless, the patentee could not be expected to offer such a license if the provisions raise any serious antitrust or misuse concerns. Titles III and IV should diminish any concern that a procompetitive license will be deemed a misuse or an antitrust violation and thereby should result in an increased availability of licenses to small businesses.

Next, a small minority of the patent attorneys that have commented to me about the legislation have raised a third area of concern. They have suggested that the proposed change in the misuse doctrine may be unwise because the misuse doctrine is well established, has evolved steadily over a long period of time, and provides patentees with valuable predictability in drafting patent licenses. I vigorously disagree.

First, the misuse doctrine does not provide substantial predictability. In fact, the doctrine has been constantly expanding in directions that are less than predictable so as to proscribe an ever broadening area of conduct. The potential for further growth represents uncertainty rather than predictability and thereby discourages rather than encourages licensing.

Second, even if the precise reach of the misuse doctrine was predictable, can that predictability be described as beneficial? Clearly not. As I noted previously, the misuse precedent has discouraged potentially procompetitive behavior. A legal doctrine that prevents economically desirable conduct obviously can not be classified as beneficial simply because it is predictable.

Third, it is impossible to understand how this alleged predictability can be said to benefit intellectual property owners. At present, when licensing a patent or copyright, the intellectual property owner must avoid violation of both the antitrust laws and the misuse doctrine. The proposed change would eliminate most concern about the misuse doctrine. Predictability would be diminished only with respect to conduct that now must be avoided because it constitutes misuse, but that is of unclear lawfulness under a rule of reason antitrust analysis. However, to the extent that the intellectual property owner is uncertain as to whether specific conduct would violate the rule of reason antitrust standard, the intellectual property owner has the option of not engaging in the conduct. The net effect of the proposed change therefore is simply to increase the options available to intellectual property owners. It is difficult to understand how any increase in licensing options can be deemed inconsistent with the interests of intellectual property owners.

I recognize that there is one area where potential harm from the proposal may be predictable. To the extent that certain attorneys have gained reputations as gurus capable of shepherding their clients through the maze of the economically irrational misuse doctrine, these attorneys perhaps will be harmed financially as a result of the proposed simplification of existing rules. However, no one has ever suggested that such considerations have any place in the debate and to its credit, the patent bar always seems to have viewed proposed legislation from the perspective of its clients and of the interest of society in general. Again, if the argument is limited to the economic merits, I'm personally sure of a favorable outcome.

One final area of debate about the bill warrants very brief mention. The spector of compulsory licensing of patents has once again raised its ugly head. Representatives of a small minority of firms in the electronics industry have expressed the view that any modification of antitrust treatment of R&D

joint ventures should include a compulsory licensing provision. It is argued that such a provision will assure maximum dissemination of resulting technologies. If I were speaking before a less sophisticated audience, I would devote much more time to explaining why compulsory licensing is a step in the wrong direction. However, this audience has heard all the arguments. I am sure you recognize compulsory licensing for what it is -- a *de facto* repeal of the 17-year exclusive patent grant, which will discourage rather than encourage the creation of technology. If increased dissemination of technology is the goal, the proper approach is to enact Titles III and IV of the National Productivity and Innovation Act and remove undesired legal impediments to intellectual property licensing. Now is not the time to ignore the lessons of recent history; now is not the time to further undermine incentives for the creation of new technologies. It is now time to move forward and I submit that the National Productivity and Innovation Act is an important step in that direction.

That concludes my prepared statement. I will now answer any questions.