
PUBLIC CHOICE, PATENTS, AND THE FTC: COMMENTS ON THE COMMISSION'S OCTOBER 2003 REPORT ON THE INTERFACE BETWEEN PATENTS AND ANTITRUST

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In October, 2003, after conducting a year of joint hearings with the Department of Justice's ("DOJ") Antitrust Division "to develop a better understanding of how to manage the issues that arise at the intersection of antitrust and intellectual property law and policy,"¹ the Federal Trade Commission ("FTC") issued a report of over 300 pages that appears to represent only the patent portion of only its own (not the DOJ's) conclusions and recommendations.² The comments in this essay are based on the belief that the FTC is a well-intentioned, well-organized, and well-run government agency operating with the benefit of adequate resources including a well-intentioned, well-trained, and well-operating staff. Nevertheless, the comments hope to point out how even with precisely such seemingly optimal conditions at least in this case and for this form of action, "government is the problem."³ The FTC Report represents a substantial amount of action by one government agency that has been given no express role in administering patent laws and only a shared role in administering the antitrust laws.⁴ Its core recommendations largely increase the overall footprint of government in commerce, and have the paradoxical effect of generally frustrating the market entry that these laws are designed to facilitate.

Concerns that patent rights may somehow go too far are not new and not unique,⁵ even for new technical fields such as biotechnology,⁶ or special areas of public interest such as the environment.⁷ Indeed, the bottom line reason for the government to make available to market actors the right to exclude given by a patent is precisely because this right to exclude use protected by a property-like rule of exclusion turns out to be essential for ensuring maximal use of inventions that are indeed new and non-obvious.⁸ The patent right to exclude facilitates the complex coordination that is necessary to allow downstream commercialization of these inventions.⁹

To be sure, a number of difficult issues do arise at the interfaces patent law shares with other disciplines, such as contract law and antitrust law. But it is important to remember that these issues have long been present and have previously been considered, and indeed were the impetus for specific legislative deliberation and action in response – such as the present patent system itself in the form of the 1952 Patent Act.¹⁰ The approach Congress adopted focuses on the basics of both patent law and antitrust law; and such a "basics matters" approach best resolves these issues.¹¹

If it turns out that such a system based on the basics is not working as society perhaps would like, then it certainly makes sense to ask how it was designed to op-

erate in the first place, and what exactly is meant by the basics. Patent system critics express concern that the system may be in steep decline due to an increase in the number of patents issued by the U.S. Patent and Trademark Office that these critics suggest do not meet the proper patentability standards and, as a result, are too broad or too narrow, unduly tax and retard negotiations, or frustrate competition.¹²

But it turns out that no patent system could do a better job of examining patents for several reasons.¹³ Because the information needed to determine patentability over the prior art for making determinations of novelty under Section 102 and nonobviousness under Section 103 is diffuse throughout the market, even the best equipped, staffed, and funded patent office would not find it as easily and inexpensively as the private market. Indeed, the present Patent Office is not resource constrained – it turns a profit of roughly \$100 million annually. Moreover, more scrutinizing examination brings with it a host of other serious errors, such as the creation of various judge-made or agency-made legal theories like the so-called exclusions for patents in fields like biotechnology and high technology, which crept into the system under the Warren Court and had to be eliminated by the Burger Court.¹⁴

As discussed at length in other work, a more simple and more modest reform that would better address the pernicious impact of issued patents that are presumed to be valid but would be found invalid by a court is to just decrease or eliminate the presumption of validity and allow patent challengers to get enhanced damages or attorney fees from patentees who baselessly assert invalid patents.¹⁵ Although ultimately the subject of an empirical question for further research, the costs associated with these reform proposals are likely to be less than the costs under the existing system—costs associated with those pernicious issued patents presumed to be valid but likely to be held invalid if tested in court.¹⁶ The combined effect would be positive in several respects. For those patents that are pernicious under the present regime because of the litigation and *in terrorem* costs they impose on third parties, the proposed reforms would allow third parties to bear only the lower costs associated with markets for opinions of counsel on validity and infringement, including costs and benefits of the fee-shifting techniques. For those patents that have proper scope in that they avoid the prior art and satisfy the disclosure requirement, the proposed reforms would allow patentees to have essentially the same costs as under the present system associated with patent drafting and litigation, except that the costs of opinions will decrease slightly (or quality improve slightly) as the market for

them becomes more developed.¹⁷ Finally, one effect that may be seen as positive or negative, depending on point of view, is that there will be a slight decrease in the value of all patents due to the costs to patentees associated with the new need to litigate their own affirmative validity cases. Interestingly, all of these effects combine to yield a system that may be comparatively advantageous over the present system for small players in particular for several reasons: it will save them from the *in terrorem* effect of junk patents, it will save them their own patent prosecution costs, and they will have ready access to markets to facilitate with funding or strategic partnerships in their own litigation and commercialization efforts when needed. Therefore, those dissatisfied with the pernicious impact of invalid patents should favor a change in our system that makes it more like registration by adopting the proposed reforms of weakened or no presumption of validity, fee shifting, and enhanced reliance on opinions of counsel (for both patentees and competitors) rather than the more scrutinizing examination approaches offered by others.

These reforms proposed here stand largely in contrast to several of the recommendations in the recent FTC Report. To be sure, some of the FTC recommendations, such as publication of patents,¹⁸ make great sense because they will help the market best assess patents for both validity and infringement. Other FTC recommendations, such as elimination of the substantive presumption of validity and post-grant review of patents,¹⁹ may be consistent with the reforms proposed here and would be great if properly implemented.²⁰ But, the bulk of the recommendations should be avoided.

Most of the recommendations in the FTC Report should be avoided because they will frustrate the market entry that the competition laws – patent and antitrust – are designed to facilitate. These include the recommendations for a change in the patent-obtaining rules relating to nonobviousness, utility, and subject matter, as well as the vague concern about economic impact, a change in the patent enforcement rules relating to notice and so-called prior user rights, increased funding for the Patent Office, more involved examination, and increased deference to Patent Office decisions.²¹ The proposed changes on nonobviousness, utility, subject matter, economic impact, more involved examination, and deference, are entirely analogous to areas of judge-made and agency-made law that (1) were the driving forces behind and were reversed by the 1952 Act that was adopted by Congress; (2) were the driving forces behind and were reversed by the Burger Court cases; and (3) expose small and medium-sized patentees to the realization of concentrated public choice pressures that created these pernicious judge-made and agency-made laws in the first place.²² The proposed changes on increased funding would at worst raise the same objections and at best simply lead to waste because the information needed to determine validity over the prior art is more inexpensively provided by

private parties in litigation.²³ The proposed change to give prior user rights for parties who infringe claims that are disclosed in a published application but not actually added to the claims portion of a patent application until after publication should be avoided because they would totally pervert the nuanced and smooth interaction between patent law's disclosure rules and the notice function of patents.²⁴ Lastly, the proposed requirement for written notice or deliberate copying before a patentee could win enhanced damages for willful infringement should be avoided because they would make the patent right more like a liability rule and less like a property rule in ways that particularly favor bigger parties.²⁵

Interestingly, the recommendations in the FTC Report closely correlate to data recently gathered and reported by Iain M. Cockburn of the Boston University School of Management and the National Bureau of Economic Research and Rebecca Henderson of the Massachusetts Institute of Technology's Sloan School and also of the National Bureau of Economic Research.²⁶ This information was gathered from a survey conducted in the late summer of 2002 of senior intellectual property managers at large companies and was sponsored by the Intellectual Property Owners Association. This close correlation between the recommendations in the FTC Report and the results of the survey is consistent with the view that some leaders in the field think the agency "got it right." But this data does not speak to whether the agency "got it right" in the view of the same people at a different time or other people situated differently, such as those who work in small and medium-sized businesses, or those who endeavor to approach the issue without any specific client with a present specific agenda in mind. Indeed, the close correlation between the views of large patent holders and the FTC Report is totally consistent with a public choice agency capture story and only support the perception that the recommendations of the FTC Report will lead to a more Keiretsu-like approach for the U.S. patent system than ever before, in which large players could regularly trade large numbers of low value patents with each other while market entry is basically avoided.

In the final analysis, patents are rather simple things. They are rights to exclude over which private parties can bargain rather well. The rules on novelty and nonobviousness prevent valid patents from issuing on things others are otherwise doing or about to do. The disclosure rules help all market actors – patentees and their competitors – best order their affairs and bargain. Patent laws work best when kept simple. Sometimes less is more. That is certainly true for the laws regulating patents. The basic rules for obtaining and enforcing patents are time-tested; and they work. The problem with government here is that it is responding to requests to look in a piece-wise fashion at perceived problems with components of the patent system while overlooking that these problems were part of the larger deliberations that led to the nuanced statutory framework of the present

patent system – the 1952 Patent Act. When regulators are asked to so look, we should not be surprised to see them regulate more.²⁷ Although in this case the agency action may seem less like rent seeking on the part of the FTC because the bulk of its recommendations appear to give a greater role to the Patent Office, these recommendations can also be viewed as erecting more hurdles for the patent system generally, if not the Patent Office specifically, and the FTC has already shown its willingness to intervene when it perceives problems with patents.²⁸

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Footnotes

¹ See Notice of Public Hearings Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, 66 Fed. Reg. 58,146, 58,147 (Nov. 20, 2001) (announcing joint hearings and explaining the reasons for them); see also Press Release, Federal Trade Commission, Muris Announces Plans for Intellectual Property Hearings (Nov. 15, 2001) (collecting sources, including links to Federal Register Notice and to speech by Chairman Timothy Muris, and questioning these and other aspects of the patent system), available at <http://www.ftc.gov/opa/2001/11/iprelease.htm> (last visited Nov. 13, 2003).

² Fed. Trade Comm'n, To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy (2003) [hereinafter "FTC Report"], available at <http://www.ftc.gov/os/2003/10/innovationrpt.pdf> (last visited Nov. 13, 2003). For an excellent and easily accessible brief review of the report and its main recommendations see Constance K. Robinson, James L. Ewing, IV, and Peter M. Boyle, *IP and Antitrust: US antitrust enforcement agency proposes changes to US patent law*, COMPETITION LAW INSIGHT, 20 (Dec., 2003/Jan., 2004).

³ See Milton Friedman, *Why Government is the Problem*, Hoover Institution Essays on Public Policy (1993), 1:

This text leaves me two tasks: one easy, one difficult. The first task is to demonstrate that government is the problem; that's the easy task. The hard task is to understand why government is the problem. Why is it that able, public-spirited people produce such different results according to whether they operate in the political or economic market? Why is it that if a random sample of the people who read this essay and are not present in Washington were to replace those who are in Washington, our policies would likely not be improved? This is the real puzzle for me.

⁴ Indeed, for even the one government agency that is given by statute some limited role in administering the patent laws, the Patent and Trademark Office, the courts have recognized that it should not get deference on questions of law or policy because it is not vested with sufficient statutory authority. See *Merck & Co. v. Kessler*, 80 F.3d 1543, 1549–50 (Fed. Cir. 1996), in which the U.S. Court of Appeals for the Federal Circuit stated the following:

As we have previously held, the broadest of the [Patent Office]'s rulemaking powers—35 U.S.C. §6(a)—authorizes the Commissioner to promulgate regulations directed only to "the conduct of proceedings in the [Patent Office];" it does *not* grant the Commissioner the authority to issue substantive rules. Because Congress has not vested the Commissioner with any general substantive rulemaking power, the "Final Determination" at issue in this case cannot possibly have the "force and effect of law." Thus, the rule of controlling deference set forth in *Chevron* does not apply.

(footnotes and internal citations omitted) (holding that the Patent Office is not entitled to the deference given other administrative agencies, which are vested with sufficient power by Congress, under the U.S. Supreme Court's decision in *Chevron, USA, Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842–45 (1984)). See also Orin S. Kerr, *Rethinking Patent Law in the Administrative State*, 42 WM. & MARY L. REV. 127, 127–33 (2000) (arguing that administrative law doctrines should not apply to patent law); In re Lueders, 111 F.3d 1569, 1574–79 (Fed. Cir. 1997) (Rich, J.) (reviewing reasons for not applying enhanced deference to the Patent Office).

⁵ See, e.g., DONALD S. CHISUM, CRAIG ALLEN NARD, HERBERT F. SCHWARTZ, PAULINE NEWMAN, & F. SCOTT KIEFF, PRINCIPLES OF PATENT LAW 1-72 (2nd ed. 2001) (reviewing history, philosophy, and economics of patent law, and collecting sources).

⁶ See, e.g., F. Scott Kieff, *Facilitating Scientific Research: Intellectual Property Rights and the Norms of Science - A Response to Rai & Eisenberg*, 95 NW. U. L. REV. 691 (2001); F. SCOTT KIEFF, PERSPECTIVES ON PROPERTIES OF THE HUMAN GENOME PROJECT (Academic Press, an imprint of Elsevier) (2003).

⁷ See, e.g., F. Scott Kieff, *Patents for Environmentalists*, 9 WASH. U. J.L. & POL'Y 307 (2002).

⁸ F. Scott Kieff, *Property Rights and Property Rules for Commercializing Inventions*, 85 MINN. L. REV. 697 (2001) (discussing the core view by Judge Rich, the central framer of the present patent system, which is the 1952 Patent Act, that patents are best viewed and best used as tools for facilitating downstream commercialization of inventions rather than as tools for providing incentives to invent; and showing how this property right protected by a property rule of exclusion best achieves this goal).

⁹ *Id.*

¹⁰ F. Scott Kieff & Gerald J. Mossinghoff, *A Reemergence of Regulation at the Interface Between Patents and Antitrust*, 4 ENGAGE 97 (2003) (discussing history of patent and antitrust interface and the important legislative changes brought by the 1952 Act in response to the many complex issues at this interface).

¹¹ F. Scott Kieff & Troy Paredes, *The Basics Matter: At the Periphery of Intellectual Property*, STANFORD LAW SCHOOL JOHN M. OLIN PROGRAM IN LAW AND ECONOMICS WORKING PAPERS SERIES # 275, available at <http://olin.stanford.edu/workingpapers/index.html> (last visited Feb. 12, 2004) (explaining how a basics approach best resolves the seemingly complex problems at the interface between patents and antitrust, such as patent misuse, tying, etc.).

¹² For a collection of academic and popular literature making these criticisms, see Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1495 n.1 (2001). For a schedule of the commentators who testified before the FTC/DOJ joint hearings and the topics they covered see <http://www.ftc.gov/opp/intellect/detailsandparticipants.htm> (last visited Nov. 13, 2003).

¹³ See F. Scott Kieff, *The Case for Registering Patents and the Law and Economics of Present Patent-Obtaining Rules*, 45 B.C. L. REV. 55 (2003) (showing how the rules for patentability operate and why with a proper understanding of how they operate it makes better sense to move more towards a registration system than a more scrutinizing examination system) [hereinafter Kieff, *Registering Patents*];

F. Scott Kieff, *Comments Regarding Competition & Intellectual Property, Summary of Proposed Testimony* (same) available at <http://www.ftc.gov/os/comments/intelpropertycomments/harvardlaw.pdf> (2001) (last visited Nov. 13, 2003).

¹⁴ Examples of Burger Court fixes include *Diamond v. Diehr*, 450 U.S. 175, 187 (1981) (“A claim drawn to subject matter otherwise statutory does not become nonstatutory simply because it uses a mathematical formula, computer program, or digital computer.”) and *Diamond v. Chakrabarty*, 447 U.S. 303, 309–18 (1980) (holding living organisms not per se unpatentable). See also Kieff & Paredes, *supra* note 11 (reviewing several other one-off judge-made bodies of law at the interface between patents and antitrust).

¹⁵ See generally, Kieff, *Registering Patents*, *supra* note 13 (describing how markets for opinions of counsel and fee shifting techniques would operate).

¹⁶ Although these reforms are likely to lead to some duplication in the costs associated with searching the art and writing opinions, they will avoid much of the costs under the present system that are associated with litigation or its in terrorem effect. In addition, a broadening of the market for opinions of counsel for both patentees and competitors will help resolve several of the difficult questions associated with opinions of counsel for potential infringers under the present system. For example, the Federal Circuit recently decided to consider en banc the role of adverse inferences when attorney-client privilege or work product immunity is asserted to prevent disclosure of an opinion of counsel and when no opinion has been offered in a case. See *Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp.*, 344 F.3d 1336, 1336–37 (Fed. Cir. 2003) (per curiam). The privilege and immunity problems are sharpest when they relate to opinions by litigating counsel, and the presence of a broader market for opinions will make it less likely that the pertinent opinion will happen to be from litigating counsel. The problem of no opinion similarly will be mitigated as the broader market for opinions makes them more widely and cheaply available.

¹⁷ In addition, if we switched all the way to a registration system, the private costs as well as the public administrative costs associated with patent prosecution and examination would be eliminated for all patents.

¹⁸ See FTC Report, *supra* note 2, at 15–16 (Recommendation 7).

¹⁹ *Id.* at 7–10 (Recommendations 1–2).

²⁰ The elimination of the presumption of validity certainly makes sense for the reasons explored here. The various post grant review procedures that are suggested may not make sense for reasons explored at greater length in Kieff, *Registering Patents*, *supra* note 13, at 115–122.

²¹ See FTC Report, *supra* note 2, at 10–17 (Recommendations 3–6, 8–10). But see, Kieff, *Registering Patents*, *supra* note 13 at 122, n.291 (discussing FTC Report).

²² See Kieff *supra* note 13 at 105–122 (discussing the history and impact of these approaches and the reasons for eschewing each).

²³ *Id.* at 74–98.

²⁴ The disclosure rules allow a patentee to claim as broadly as the initially filed disclosure will support. However, during the back and forth process of patent prosecution and examination the scope of the presently active claims at any given time regularly fluctuates. This works when both the Patent Office and the applicant know that it is only the finally issued claims that will matter. But if it is the claims that get published during the interim that matter then this give and take process will not work. What is more, given a basic understanding of the disclosure rules no reasonable third party would think that an initially filed application would not eventually lead to the maximally supported claim scope. To the extent the prosecution and examination process takes longer than the 18-month publication window – it typically takes three years – this delay is most

often due to the Patent Office and indeed the applicant pays for it in that its patent term is measured from the filing date, not the issue date. Lastly, it is important to note that under a full registration system, none of these delays would be relevant.

²⁵ See Kieff *supra* note 8 (discussing the importance of enforcing patents with property rules not liability rules).

²⁶ The author is grateful to Iain and Rebecca for generously sharing the results of their data. Interview with Iain M. Cockburn, Professor of Finance and Economics, Boston University School of Management, in Boston, Mass. (Nov. 11, 2003).

²⁷ See Friedman, *supra* note 3, at 7–13:

The general rule is that government undertakes an activity that seems desirable at the time. Once the activity begins, whether it proves desirable or not, people in both the government and the private sector acquire a vested interest in it. If the initial reason for undertaking the activity disappears, they have a strong incentive to find another justification for its continued existence.

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Again, let me emphasize, the problem is not that bureaucrats are bad people. The problem, as Marxists would say, is with the system, not with the people.

²⁸ For an excellent and easily accessible review of other recent FTC activities see Stanley M. Gorinson, James L. Ewing, IV, and Peter M. Boyle, *Federal Antitrust Enforcers Focus on Intellectual Property Abuses*, *INTELLECTUAL PROPERTY LAW TODAY* 38 (Aug. 2003).