COMPETITION POLICY, PATENT LAW, AND INNOVATION:

WELCOMING REMARKS FOR THE PATENT REFORM CONFERENCE

by

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I am delighted to add my welcome to today's Patent Reform Conference, co-sponsored by the Federal Trade Commission; the National Academies' Board on Science, Technology and Economic Policy; and the American Intellectual Property Law Association. Each co-sponsor has a long tradition of involvement with innovation issues, and each has given considerable thought to the patent system and how it serves the nation's economy.

The FTC's interest in patent reform reflects the role that this agency plays in the shaping of competition policy. Our function is not simply to identify antitrust violations and challenge

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[1] The views stated here are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.

them. We also engage in competition policy research and development and advocate for governmental policies that enhance competition and benefit consumers. Some of the FTC's major accomplishments over the years derive from this function. For example, early studies helped to generate the Securities Act of 1933 and a forerunner of the Federal Communications Act of 1934. Much more recently, a 2002 FTC study on generic drug entry prior to patent expiration resulted in significant changes in the governing statutory and regulatory structure.

Our work in the patent reform arena is one of the latest examples of that effort. The FTC's recent attention to these issues dates from a series of hearings in 2002 that led to issuance of a major report in October 2003, "To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy." The FTC focused attention on patents because of their increasing number, their growing significance in the economy, and their recurring interaction with the competition work of the Commission. We hoped to contribute insights reflective of our special expertise, that is, a competition perspective on the patent system.

Through 24 days of hearings in 2003, with presentations by more than 300 panelists and numerous written comments, we confirmed that both patents and competition play essential roles in promoting innovation. Patents provide the property rights and protection against copying that foster incentives to innovate. They encourage public disclosure and dissemination of knowledge that otherwise might be kept as trade secrets. They make information and technology transferable, facilitating the sharing of knowledge that permits firms to specialize their research and production activities.

Competition, too, drives innovation. "If I don't invent," many firms fret, "my rivals will." Often, competition drives firms to race to be first to market with innovative products or

cost-saving processes. They seek first-mover and learning curve advantages over rivals as a means for securing returns on R&D efforts. Moreover, competing firms may approach research problems differently, increasing the chances of successful innovation. Indeed, competing follow-on innovators often contribute different insights and expertise in identifying and pursuing the next generation of innovation possibilities.

Competition's role in spurring innovation – what we often refer to as maintaining dynamic efficiency – has secured a central position in antitrust analysis. But as many patent specialists may remember, not so long ago, antitrust largely focused only on static efficiencies. The learning of recent decades, however, has it made clear that a broader lens, reaching issues of innovation and progress over time, is essential. Today, we care enormously about innovation and the competitive forces that drive it.

The patent and competition laws, thus share the same goal and so it should come as no surprise that the two systems typically work well together. Most patents do not yield market power that can impair competition. Often substitutes that prevent any anticompetitive effect are available. Further, if a patent is properly granted under appropriate standards of patentability, the incentives and other advantages it provides typically outweigh possible market power concerns. The FTC's Report strongly endorses a properly functioning patent system.

On the other hand, if a patent should not have been granted – either because of a flawed standard of patentability or because of examiner error – any ensuing harm to competition would be unwarranted. A patent that creates market power may raise price in the short run, and in the long run it can choke off rivalry that drives follow-on innovation. While these results are expected and tolerated if a patent has been properly granted, the results may be unacceptably

anticompetitive if the patent has not. And although licensing may facilitate the sharing of patented inventions, this may entail transaction costs that add burdens that in some industries can be significant.

As cited in the FTC Report, Professor Jonathan Levin, whose father will be talking to us later today, has identified three economic consequences that potentially flow from issuing questionable patents. First, such patents may discourage firms from conducting R&D in an area out of fear that they could infringe. This may slow follow-on innovation. Second, even if research goes forward, the patents may induce unnecessary licensing. This taxes consumers and distorts the incentive structure. Third, if, instead, the patent is challenged in court, the litigation costs are a drain on the system. This is not an attractive set of choices.

Issuing patents – like promoting competition – is not an end in itself. Both competition and patent policy are means to achieving public benefit, and if they are to continue to work together effectively to foster progress and enhance economic welfare over time, we need a balance. To ensure that the policies work in tandem, satisfactory mechanisms for challenging questionable patents are essential.

One of the chief recommendations in the FTC Report is that Congress should enact legislation establishing procedures for post-grant review by the Patent and Trademark Office. This seconded a proposal in the PTO's own 21st Century Strategic Plan. This is one of the principal proposals that you will be discussing today, and I would like to spend a few minutes addressing this issue from the competition perspective.

The Report reasons that some questionable patents inevitably will slip through the examination system. Extraordinary application levels, which reduce the average time available

to examiners, along with limitations inherent in an *ex parte* examination system, all but assure this. Litigation, the Report observes, weeds out invalid patents only slowly and at great cost; challengers cannot seek declaratory judgments until imminently threatened with suit. And you do not need me to tell you that patent litigation often is lengthy and expensive. Together, these considerations suggest that some unwarranted patents will be issued and will remain factors in the market for considerable time. They may create unnecessary market power and transaction costs and infect markets with risk, uncertainty, and distorted business planning.

A post-grant opposition system, the Report suggests, could offer a quicker, less costly means for resolving validity issues. Checking *all* patent applications for patentability would stretch limited resources, and frankly, there are just too many applications to achieve perfection in all cases. A post-grant opposition system could make better, more selective use of finite resources. It would enable market participants to identify commercially significant patents and to contribute their knowledge for assessing patent validity.

Establishing a successful post-grant review procedure requires steering between extremes. Post-grant review must offer sufficient value to challengers so that the procedure will be used, unlike the existing *inter partes* reexamination procedure that our hearing participants uniformly found disappointing. Broader subject matter; an opportunity to present affidavits, to cross-examine affiants, and to conduct carefully circumscribed discovery; and a corps of administrative patent judges to serve as decision makers all could add value. Yet if post-grant review simply duplicates litigation, the cost savings quickly evaporate. The Report acknowledges a tension between keeping costs low and outcomes speedy, while simultaneously providing sufficient scope and level of inquiry to ensure broad use. It seeks a middle ground, a

system that provides an early and effective review beneficial to competition and rational business planning, while sheltering patentees from harassment and impairment of legitimate patent rights.

Through today's session, we take another step in grappling with how such a system could work effectively. Much has happened since issuance of the FTC's report in October 2003. In 2004, the National Academies' STEP Board issued its own comprehensive report on the patent system. AIPLA, in turn, has worked hard to generate thoughtful commentaries on both reports, as well as a set of suggestions of its own. It is noteworthy that all three of today's co-sponsors have concluded that the patent system would benefit from some form of post-grant review.

Our challenge then has been to channel all of this thinking into a process that could bear fruit. The three groups together took the next step by co-sponsoring a series of Patent Reform Town Meetings. At sites around the country – in San Jose, Chicago, and Boston – we sought out opinions from practitioners, inventors, and the general public on post-grant review and a variety of other proposals for patent reform. These included a proposal to broaden current requirements for publishing patent applications 18 months after filing by removing an exemption for applications that are filed only domestically. This would reduce the potential for disruptive surprise from unanticipated patents while enhancing disclosure benefits to the public. The Town Meetings also addressed proposals that would permit firms to review others' patents without triggering a duty of care that might support claims of willful infringement. Our hearing panelists had expressed concern that firms were avoiding learning from patents for fear of exposure to enhanced damage claims. Both of these latter proposals reflect recommendations in the FTC's Report. Summaries of the Town Meetings, prepared by FTC staff, are available on the

Commission's web site.

Today's conference is the culmination of all of these efforts. In today's panels, we are going to discuss patent reform from a variety of perspectives – large industry, small entity, empirical and judicial. We have an outstanding set of panelists for these discussions. We will hear commentary and a summation from some of the leading experts in the field. And the Honorable Lamar Smith, Chairman of the House Subcommittee on Courts, the Internet, and Intellectual Property, will give the keynote address.

This spring, Congress, and Chairman Smith's subcommittee in particular, have actively pursued many of the ideas generated in the reports. Hearings in both the House and the Senate garnered testimony on many of those proposals and helped to identify how they might function in the varying contexts presented by different industries. Based on these hearings, Chairman Smith has now introduced legislation to enact the Patent Act of 2005, and we look forward to learning more today about that bill.

Our patent system is a critically important means for achieving progress and enhancing welfare over time. But it must be implemented to avoid the harm to competition that results from the granting of questionable patents. We hope that today's conference furthers the discourse and leads us closer to a patent system that preserves the balance between competition and patent policy in pursuit of our ultimate goals. Thank you.