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Patents and Antitrust
The FTC's Recent Report

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The long-awaited report recommends changes to the patent system to better promote competition and innovation.

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The dilemma at the interface of antitrust and patent law has plagued American jurisprudence for decades. During various periods of time, patent rights or antitrust had primacy. As our economy has become ever more technologically based and patents have become more critical to almost every industry, the impact of patents on competition warrants a re-assessment of patent law in light of antitrust policy. The U.S. antitrust agencies, the Federal Trade Commission (FTC) and the Department of Justice Antitrust Division have embarked upon that reassessment.

Commencing in February 2002 and continuing until November 2002, the agencies held 24 days of joint hearings around the country, eliciting testimony from industry leaders, academics, economists and the bar regarding patents, competition and innovation. In October 2003, as a result of those hearings, the FTC issued a detailed 300-page report entitled: "To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy." See www.ftc.gov/os/2003/10/innovationrpt.pdf. The FTC report analyzes the patent laws from a competition perspective and recommends changes to the patent system to better promote competition and innovation. This long-awaited FTC report focuses mainly on patent reform. The agencies are planning a later joint report examining the proper balance between antitrust policy and the patent system.

A common goal, but different perspectives

The theme of the hearings was that antitrust and patent law have the common goal of promoting innovation, but do so from different perspectives. The antitrust laws prohibit certain conduct that restrains competition, including certain exclusive arrangements. The patent laws reward innovation and permit exclusivity and certain practices that resemble conduct that the antitrust laws otherwise may forbid. The FTC report notes this tension between patent rights and antitrust policy. The hearings were aimed at identifying the optimal balance between patents and antitrust for the promotion of innovation.

In order to understand what is needed for innovation, the FTC report considers the role of competition and patents in various types of innovation. It explores "head start" innovation, " follow- on" innovation, follow-on innovation in the face of a blocking patent or multiple existing patents, transaction costs with multiple patents, patent thickets, patent extensions, group boycotts, licensing and patent flooding. Understanding the use and competitive abuse of these practices as they affect innovation may help guide proposals for reform.

The FTC report suggests that many changes are needed in the patent laws to avoid imbalance in the competitive arena. The recommendations focus on changes that would make it more difficult to obtain a patent and on changes that would make it easier to challenge patents that perhaps should not have issued.

Testimony from industry groups reveals differences in patent and competitive concerns among industries.

The agencies took systematic testimony from specified industry groups. They elicited testimony from the pharmaceutical, biotechnology and computer industries, including semiconductors, software and the Internet. Each had somewhat different views of the impact of the patent system on both innovation and competition. In the pharmaceutical industry, strong patent protection was thought necessary for innovation because of the high costs of research and the need for basic research and development. In biotechnology, patents are needed to attract venture capital. Moreover, representatives of these industries stated that patents are important to prevent "free riding" on very costly research and development. The report also notes that in these industries, disclosures in patents guide companies to do research in the unpatented areas.

In contrast, computer hardware manufacturers seem to find detection of patent infringement difficult and therefore such manufacturers often rely on trade secrets rather than patenting. Moreover, both hardware and software companies find themselves obtaining numerous "defensive" patents, and creating a "patent thicket" whereby overlapping patents make it difficult for anyone to commercialize innovation. The patent thicket makes licensing and cross-licensing more important in the computer industry. The antitrust interface with patent law is perhaps most significant with respect to licenses and cross-licenses. A license is essentially a contract that conveys rights and imposes restrictions that may be anti-competitive, but that generally are permitted by virtue of patents. Accordingly, the benefit to society that is engendered in the patent may be worthy of the restraints on trade.

The FTC report devotes three chapters to an analysis of patent law. The general message that the FTC distills from the hearings was that reforms to the patent system would ameliorate many of the unintended adverse effects that patents may have on innovation and competition. The report separately studies in great detail the criteria for patentability; the procedures in the Patent and Trademark Office

(PTO) to review patent applications and prior art; and the issues and results of patent litigation.

With respect to patentability, the FTC finds that many participants who testified at the hearings stated that patents might be too easily granted. One concern that seems to pervade all of the industries is that "poor patents" inhibit both innovation and competition. Basically, in addition to other criteria under the patent laws, a patent should not issue if there is prior art disclosing the invention sought to be patented, if the proposed invention would be "obvious" to "one skilled in the art" when reviewing a combination of prior art references or if the patent application does not fully disclose and "enable" one skilled in the art to practice the invention. The report describes changes in the approaches taken by the courts with respect to these patent issues.

Testimony at the hearings suggests that since the creation in 1982 of the U.S. Court of Appeals for the Federal Circuit, which hears all patent-related appeals, the standards for nonobviousness have been reduced, which has encouraged patents to issue that may really be obvious. Similarly, the FTC report notes that patents have issued that are broader than the invention that was actually disclosed and "enabled" by the inventor.

The anti-competitive effects can be far-reaching for patents issuing when no significant novel invention has been presented or when the patent is broader than appropriate. With important technology, a "poor quality" patent can prevent others from developing the most efficient technology, deter related innovation that might build on or include the patented technology and give the patentee an undeserved competitive advantage or market power. Conversely, issuing few or very narrow patents may subdivide technology, thereby contributing to patent thickets and the need for licenses under many patents to create a product.

The FTC report details the process of obtaining a patent to identify the factors or procedures that might be contributing to the issuance of "poor quality" patents. It concludes that the ex parte nature of the patent-application process and the limited opportunity for challenge or reexamination after the patent issues and before the patent is effective in a market contribute to the problems expressed by the participants at the hearings.

Finally, the FTC report studies patent litigation and in particular patent/ antitrust issues. After a brief review of antitrust goals relating to patents, the report considers ways in which patent law and policy can address competition concerns. The report mentions the antitrust role in patent issues and thus foreshadows the focus of the future joint report to be issued subsequently by the agencies.

Ten recommendations for patent reform

The executive summary of the October 2003 FTC report offers 10 recommendations for patent reform: Enact legislation to permit post-grant review and opposition to patents; apply a "preponderance of the evidence" standard for challenging patent validity; tighten standards for "obviousness" in determining patentability; provide adequate funding for the PTO; modify PTO rules in accordance with the PTO's 21st Century Strategic Plan; consider potential competitive harm before extending the scope of patentable subject matter; require publication of all patent applications 18 months after filing (including those that will be limited to the United States, which, currently, are not required to be published); create prior user rights to limit infringement claims that rely on claims in a continuing or other similar application; require actual notice or deliberate copying for willful infringement; and include economic and competition theory in patent law decision-making.

Contrary to expectations, neither the analysis in the FTC report nor the recommendations in the executive summary address proposed reforms or interpretations of the antitrust laws relevant to patents. That side apparently has been left for the agencies' joint report, expected early next year. When that report is issued, the agencies will have recommended revisions to both the patent and antitrust laws to promote innovation, consistent with the identified goals.