Why An Antitrust Lawyer Cares About Patent Reform

AntitrustConnect Blog
November 16, 2012

David Balto (Law Offices of David A. Balto)

Please refer to this post as: David Balto, 'Why An Antitrust Lawyer Cares About Patent Reform', AntitrustConnect Blog, November 16 2012, http://antitrustconnect.com/2012/11/16/why-an-antitrust-lawyer-cares-about-patent-reform/

Since the advent of antitrust enforcement in the United States through the Sherman Act in 1890, antitrust law and patent law have endured an uneasy relationship. Initial cases treated patents as superior to competition. Patentees once were "the owner of a monopoly recognized by the Constitution and by the statutes of Congress." Gradually throughout the years our understanding of the intersection of intellectual property law and antitrust has evolved. We evolved to recognize that the scope of the patentee's power is limited, and "as long as the inventors kept within their statutory exclusive rights" they could placate the Sherman Act. Regulatory agencies now recognize patents as essentially comparable to other forms of property and while they do not presume market power, they instead focus on the net impact of a patentee's use of his patent. While this approach may or may not be most prudent, the key takeaway is that patentees are no longer above or outside the scope of antitrust law.

This evolution has led us to a new approach: antitrust law and patent law are complementary—not opposing—forces in the end goal of improving consumer welfare. Both antitrust law and patent law seek to enhance consumer welfare and promote innovation, but do so through very different mechanisms. Thus, when one system is broken, the other suffers. The patent system has been broken and in need of substantial reform for some time, but we are now experiencing the collateral effects on antitrust and competition law.

The concern over patents from a competition perspective is natural. The competitive process, free from artificial barriers, should lead to the best outcome

for consumers in terms of price, output, quality, and innovation. But when a firm can create an artificial barrier to the market, such as an improperly granted patent, no natural force of competition can overcome that barrier. That is why the false procurement of a patent can lead to antitrust liability.

The smartphone wars are emblematic of the patent system's dysfunction and the impact on antitrust, competition, and consumers. There are too many patents; many of which probably should not have been granted because they are either obvious, trivial, incremental, abstract, indefinite, mathematical laws of nature, or have only been theorized but not demonstrated. Recall that in patent law there is no independent innovator exception; the first mover gets everything. The breadth and number of patents turns virtually every market participant into an infringer and chills the very innovative spirit that patents are designed to foster. Many patents are broad, ambiguous, theoretical, and indefinite in scope. Patents can create an undue advantage for those imagining rather than inventing, which may reestablish the vanquished notion of patent protection equating market power.

Collaboration and collusion are twisted and inversed. Bona fide pro-consumer collaboration such as interoperability and the development of open source options are scrutinized while naked anticompetitive collusion such as joint patent aggregation, targeted licensing, and tag-team litigation goes unpunished. A single patentee can impede the entire open source movement by repetitive and costly litigation, and a group of competitors could be the death knell given their diversified patent portfolio and shared incentive to deny the entrance of a new market alternative. Those outside of the closed-system brotherhood face an uphill battle, and new entrants cannot hope to compete, conferring prolonged dominance on the incumbents.

There is a multitude of examples to examine and themes to discuss, and we will be doing so through this blog. At the onset, I would like to list a few of the most important competition themes:

The Distortion of Incentives—When both are functioning properly, antitrust and patent law properly incentivize market participants to create new and better products, produce them efficiently, market them honestly, and compete fairly to attract consumers through lower prices, improved quality, or other features that consumers value. The flaws of the current patent system over-emphasize the value of protectionism, and undervalue the benefits of competitive innovation. The

result is the distortion of incentives and the recalibration of priorities by market participants at every level, from concept inception to patent enforcement, in which the value of obtaining a patent overshadows the value of the innovation.

Compete Through Competition, Not Litigation—Antitrust law has long recognized that a firm should not be able to acquire an advantage in the market by administratively out-maneuvering its competition. However, the current patent system is encouraging this very result. The aggregation of hundreds if not thousands of patents by competitors enables them to wield patents as a means of raising rivals' costs. This litigation is often baseless, but the net effect is undeniable—competitors are more concerned with their next lawsuit then their next product.

Market Power—The possession of a patent is not supposed to create market power outside the bounds of what is being patented, much less durable market power. The current state of the patent system allows firms to grasp control of not only a market, but an entire industry. By obtaining a patent covering every conceivable nuance for any possible substitute product—usually as a result of merely recognizing the likelihood of the product's eventual existence—firms can control the market, charge monopoly rents, and prevent meaningful competition, all at the expense of consumers. This problem is amplified by the practice of patenting incremental steps. For example, if you had a product that consisted of A, B, C, D, and E—the owner of the patent for C can hold everyone up who wants to make product ABCDE. This would be in spite of the fact he does not have rights over A, B, D, or E. This problem is common in the tech industry. Moreover, the holder of patents ABCDE has five opportunities to attack competitors or thwart entrants. Considering that there are an estimated 250,000 patents covering the modern smartphone, it is clear that the first mover has both the incentive and ability to litigate competitors into oblivion.

Privateering—Perhaps the most troubling of the trends in the current state of the patent system, the prevalence of firms adopting the business model of aggregating patents and asserting them against legitimate competitors while insulating themselves from retaliation has escalated from problematic to endemic. This includes stand-alone trolls, who parasitically see all market participants as opportunities for extortion. But privateering goes beyond the shallow troll, and extends to legitimate market participants who either partner with trolls or use shell companies to accomplish the same harm. The privateering problem is

exacerbated when legitimate competitors enter this space because privateering becomes yet another way to target competitors.

Ultimately the Consumer Loses—Consumers will suffer the consequences of the broken patent system in a number of ways. Prices will continue to increase. One report estimates that patent trolls alone cost the economy $29 billion. As the smartphone wars continue, we see many strategies, justifications, explanations, and rationalizations offered by the players involved. But these companies can defer the cost of litigation to the consumer. Meanwhile, innovation will likely slow, as new entrants and entropic competitors fail to overcome barriers created by the patent system. The impact will likely expand beyond just mobile telecommunications devices and affect related industries. Further collusion by firms will become more prevalent, as firms learn to perceive patent wars as more important than competition.

David Balto is a former policy director of the Federal Trade Commission, attorney-adviser to Chairman Robert Pitofsky, and antitrust lawyer at the U.S. Department of Justice. He has been a senior fellow at the Center for American Progress and has worked with the International Center on Law and Economics, both of which receive funding from many organizations including Google. Mr. Balto has also published research and authored scholarship for Google on technology policy topics.