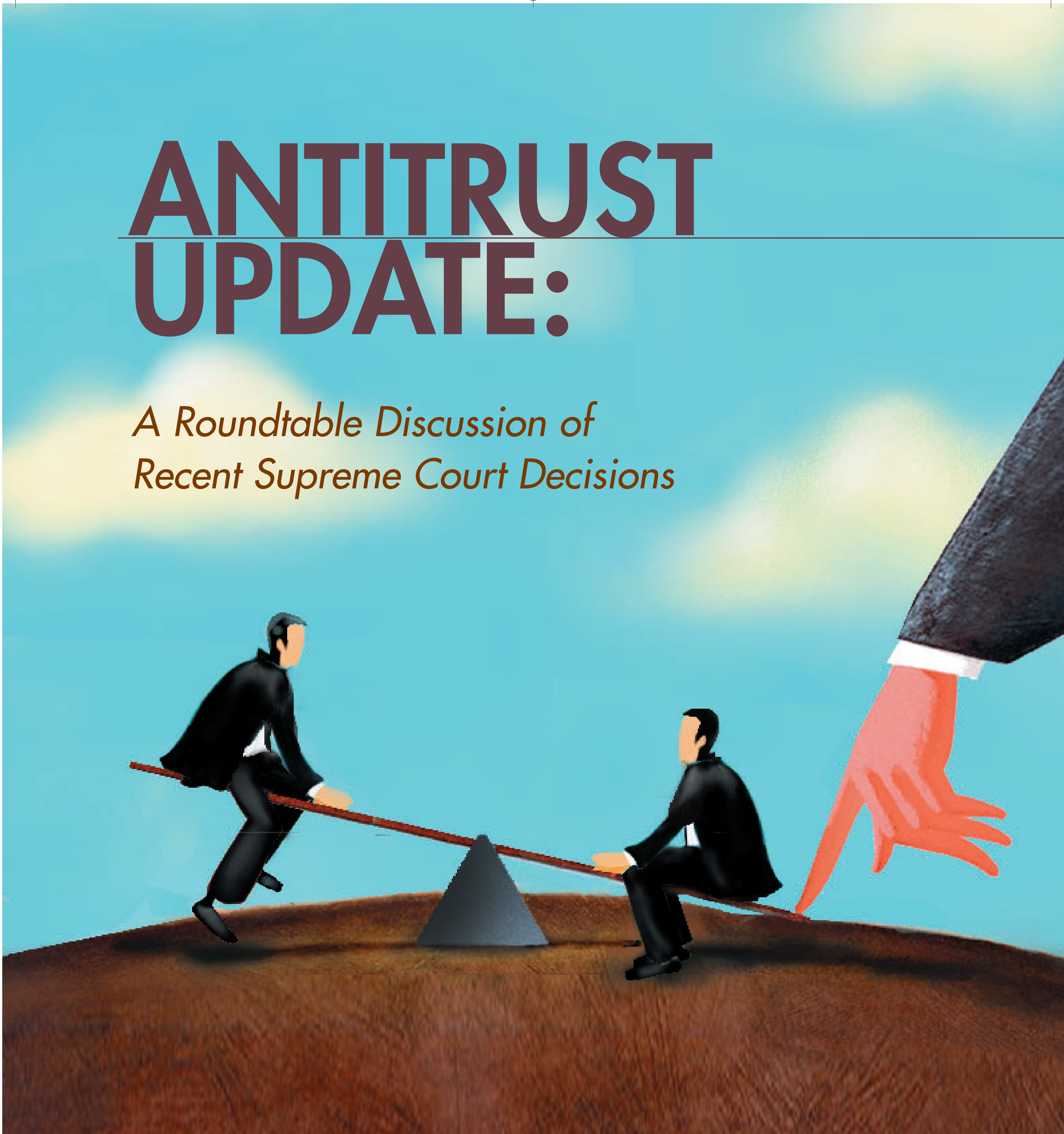
ANTITRUST UPDATE:

A Roundtable Discussion of Recent Supreme Court Decisions



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the PANELISTS

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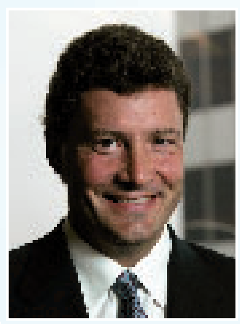

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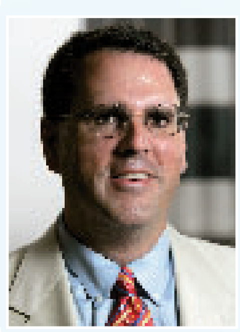

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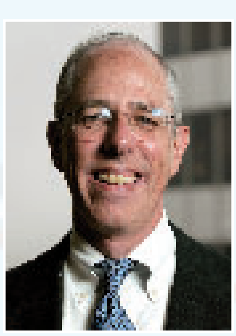

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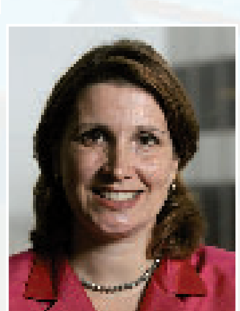

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TO THE READER:

This roundtable discussion focuses on antitrust issues, which recently took center stage before the U.S. Supreme Court. The court decided three cases and made a noteworthy refusal to hear a fourth. The cases highlight the peculiar estrangement between the FTC and the Department of Justice Antitrust Division. Additionally, there are percolating cases dealing with patent pools and standards-setting that have caught the eye of IP and antitrust lawyers, particularly in Silicon Valley. We've invited six noted practitioners to help us sort the future of some of these important antitrust issues.

They are George Cumming, a partner with Morgan Lewis & Bockius in San Francisco; Robert Freitas, a partner with Orrick, Herrington & Sutcliffe in Silicon Valley; Chad Hummel, a partner with Manatt, Phelps & Phillips in Los Angeles; Gil Ohana, Director of Antitrust and Competition with Cisco Systems in San Jose; Steve Smith, a partner with Morrison & Foerster in Washington, D.C.; and Julie Wood, counsel with O'Melveny & Myers in San Francisco.

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The National Law Journal, an ALM publication, organizes these events to create an open dialogue in which to discuss matters effecting the legal and corporate worlds. If you are interested in more information on these events, please contact Brian Corrigan at 212.545.6277 or bcorrigan@alm.com.

MODERATOR: Welcome to you all. The cases we will be covering today include, in order: *Texaco and Shell Oil v. Dagher*; *Illinois Tool Works v. Independent Ink.*; we'll also touch on *Volvo Trucks North America v. Reader-Simco*; and we'll round out our docket with a case the Supreme Court declined to take, *Schering-Plough v. FTC.* Finally, we'll ask our panelists what other cases they're watching and why.

Let's start with the Texaco case. George, lay out some of the facts for us and tell us briefly why it's so important.

MR. CUMMING: The Texaco case is pretty simple. In 1998, Shell and Texaco, who theretofore had been competitors in the gasoline business in the United States, decided that they didn't want to compete against one another anymore. So they formed two joint ventures, one in the West, one in the East, and they placed their refining and marketing assets in those joint ventures. Those joint ventures "took over," if you will, the marketing of gasoline produced previously by an independent Texaco and an independent Shell Oil Company. Because of the Hart-Scott-Rodino Act's application to joint ventures, the parties filed HSR notifications. The proposed transactions were then reviewed by the Federal Trade Commission as well as several states. Apart from a few minor divestitures that were requested and granted, the deal was approved, in the sense that regulators chose not to challenge it. I make that point because I was reading the transcript of oral argument in the U.S. Supreme Court, and Justice Ginsburg, at least, thought that there was positive approval by the regulators when in fact there isn't under Hart-Scott-Rodino. So the ventures went forward. This particular case challenges the western United States venture, which was a company called Equilon, equally owned by Shell and Texaco, and as we've said selling Shell and Texaco brand gasoline under common ownership.

The plaintiffs were Shell and Texaco dealers who were buying gasoline now from Equilon, and they sued. They didn't challenge the legality of the joint venture. Instead, they tried to take a shortcut and said that the arrangement was illegal because the joint venture was fixing prices, namely, the prices at which the dealer-plaintiffs bought from the joint venture. The District Court granted summary judgment. The Ninth Circuit reinstated the action, saying that price fixing is pretty awful and we don't grant summary judgments very often in antitrust cases. Texaco and Shell then petitioned for certiorari, I think with the support of the Antitrust Division and the Solicitor General, and cert was granted. The case was reversed. The Court held that as long as this joint venture was lawful, which it was because the plaintiffs chose not to attack it, it had the right to set its own prices. So the significance of this case is really two-fold. No. 1, it gets rid of concerns that people might otherwise have that if they form a joint venture between two companies that were previously competitors, that this can be attacked as price fixing, without either the federal or state regulators or private antitrust plaintiffs ever having to prove that the joint venture itself is unlawful under conventional merger law. Second, I think the case has some significance as part of a continuum of Supreme Court decisions now and then which really began, I think, with *Sylvania* in 1977, and continued in decisions such as *Jefferson Parish*, *Copperweld, State Oil v. Khan* and *Spectrum Sports*, where the court has largely been purging antitrust law of some bad virus that got in during the period of roughly the late 1930s until the early 1970s, in which labels substituted for economic analysis. Justice Powell's opinion for the court in *Sylvania* is really something of a sea change in saying, look, you have to take a took at the realities of markets, the realities of whether there is significant restraint and so forth and so on, you can't take these shortcuts. And I think that same theme pervades the other two cases that were decided by the court this term. So the *Dagher* case has a double significance. The cases this term reflect the opposite of what you might have thought to be either the good or the bad of the old days, which I think was when Potter Stewart dissented in a merger case, saying that the only consistency that he could find in the court's merger jurisprudence was that the government always won.

MR. SMITH: Picking up on George's comment, one of the things that we've seen in this trend of cases that you have described is a continuing constriction of the *per se* rule, and the court's unwillingness, for precisely the reasons you articulate, to find that circumstances the Court once thought were appropriate circumstances in which to apply the *per se* rule continue to be appropriate circumstances in which to apply that rule of liability. And the other thing that struck me about *Dagher*, in particular, which was important is the court's discussion of whether conduct that is regarded as being within the core activities of the venture can really even be subject to antitrust challenge. I think one of the significant points that came out of the court's decision, significant certainly for joint venture partners, is that those activities that are in the core, for example, setting the price of the joint venture products, is simply conduct that is outside the scope of the antitrust laws at this point.

MR. CUMMING: I think that's right, Steve. And I think it's interesting because there's quite a bit in the transcript of the oral argument that doesn't make it into the decision itself involving the *Citizen Publishing* case, where two newspapers joint ventured the publishing operation but stayed separate as to marketing, and then were caught playing games in terms of pricing, advertising and subscriptions in their remaining independent areas. I don't think that any of that is now permitted, certainly not by *Dagher*. As a result, you're right in focusing on the core purposes of the joint venture. You either attack the joint venture as unlawful under conventional merger analysis, or it's permitted to do those things for which it was formed.

MR. FREITAS: I think what's just been said is exactly the way we should look at these cases. There clearly is a long-term trend that, I agree, probably does begin with *Sylvania*, that shows the court getting away from what George called labels and working much harder with economic concepts. And I don't think that that trend is going to stop. These cases are right in the middle of what we've been seeing for a long time now.

MR. HUMMEL: So the question in my mind is what does that mean for civil litigants? It means, No. 1, it's going to be far more expensive to pursue these cases from a plaintiff's perspective.

MR. FREITAS: Sure.

MR. HUMMEL: You're going to have to prove market power. You're going to have to define and prove a market, and then prove market power in the market. You're not going to be able to rely on labels; you're not going to get the benefit of presumptions. One of the general themes in these cases, as you pointed out, is that we're getting away from labels. We're also moving away from presumptions. Not just the conclusion that conduct is illegal, but we are also moving away from presumptions of market power. So, antitrust cases are going to be even more expensive to discover, they're going to be very expensive in motion practice, and there will be further uses for economists. And you're exactly right. The courts in a summary judgment context are going to have to grapple with these very difficult economic issues. And juries, as difficult as that may sound, will have to do exactly the same once we move away from labels. The trend is toward realistic economic analysis. I'm curious about one point; I thought when I read the opinion that there was consensus that there was prior approval of this joint venture.

MR. CUMMING: It's a question of what it is that the FTC or the Justice Department would actually do.

MR. HUMMEL: Right.

MR. CUMMING: Under the Hart-Scott-Rodino Act, what they do ultimately is decide not to prosecute, not to bring an action to block a merger or joint venture. That's not positive approval, as it is in some jurisdictions, where in effect you get a government "free pass." Obviously, if the Federal Trade Commission with all of its resources has looked at this deal and decided that it isn't worth challenging, if I were Dagher's lawyer, I would say, "Gee, that doesn't sound like a very good way to spend my money, either, so I'll try the shortcut," which he did. And so the elimination of the shortcut may be one way to phrase what we're talking about.

MS. WOOD: It's interesting that while they did take a shortcut and the Supreme Court noted that there was no contention that they were challenging the legitimacy of the joint venture, in the briefs they actually did include a footnote where they said in the complaint that they were challenging the legitimacy of the joint venture. So it's interesting that they didn't push the point hard and instead raised it in a half-hearted manner, and the Supreme Court just washed right over it.

MR. CUMMING: I think that was true in the sense that at the end of the oral argument, plaintiff's counsel, who was Joe Alioto of San Francisco, was asked in essence if he went back to the District Court did he plan to challenge it the hard way, and he said sure. Brave man. It's clear that the case, for cert purposes, was taken on the assumption that the joint venture was not being challenged and had not been challenged in the District Court as part of the summary judgment process.

MS. WOOD: I think that's right. The Ninth Circuit decision noted there was a voluminous record supporting the efficiencies of the joint venture, and the Supreme Court relied on that for its decision.

MR. SMITH: Following up on Chad's point, another question is what if anything does *Dagher* have to say about the future of federal agency enforcement. The FTC and the Justice Department, as George pointed out, came out in support of the defendants in this case and as a general proposition apply rule of reason analysis certainly to joint ventures, but also to most other activities that they look at. That said, there are occasions where the agencies either take the position formally or suggest that *per se* analysis is appropriate even though the venture or alliance at issue is not a sham: although there was some debate about this, the *MathWorks* case in which the Justice Department obtained a consent decree, and I'm thinking also About *Three Tenors*, which ultimately the FTC decided on rule of reason grounds but suggested that *per se* analysis might be appropriate. So one question here is: do we think that *Dagher* is going to inform and alter the agency's approach to any of these questions going forward? From my view the answer is at the margin it will. I think it will be more difficult for the agencies to pursue cases like *MathWorks* or to pursue *per se* theories in cases like *Three Tenors* in light of the joint venture analysis in the decision.

MR. OHANA: One of the challenges in counseling in this area is the point that Steve made, which is that agreements not to compete have not fallen neatly into either a *per se* bucket or the rule of reason bucket. In fact, if you look at the history of the Antitrust Division's settlements in this area, for example, the *IBM/StorageTek* case in the late 1990s, the Division very much emphasized that they were going under a rule of reason theory. Then, fast forward to the *MathWorks* case that Steve mentioned, where the Division adopted a *per se* theory on facts that were fairly similar. To the extent that Dagher counsels that rule of reason is a better approach, I think that's good news.

MS. WOOD: I'm one of the vice chairs of the Antitrust Section's Trade Associations Committee. I think those of us who counsel trade associations breathed a sigh of relief after *Dagher* because I think that the court's language was very strong that they are going to presumptively apply the rule of reason. And that's going to be the increasing norm going forward.

MR. HUMMEL: You can read *Dagher* limited to its facts, however. And so the real challenge, it seems to me, is how do you counsel corporate clients who are considering joint ventures? It seems to me that the facts which were very important were this prior approval or at least the passing on it in advance by the agencies. It's very difficult to challenge the legality of conduct thereafter. That basically forced the conclusion that this was a legitimate and not a sham joint venture. And from there, you can, as you said, Steve, quickly reach the notion that the pricing activity which was challenged here was a core activity of this particular venture. This case certainly didn't get rid of the ancillary restraints doctrine, it just expressly said, "We're not applying it under these circumstances." So I still think, as you said, there is some uncertainty about how that will be analyzed. I don't think *per se* is gone, by any stretch of the imagination, if there's not prior approval, whatever that means, and if the activity is not core to the purpose of the venture.

MS. WOOD: I would add a third issue, and that's that it was key here that the joint venture was economically integrated and that they were no longer competitors.

MR. OHANA: On the prior approval point, one interesting interplay between *Dagher* and the decision to raise the Hart-Scott threshold a few years ago is that there may be situations in which you've got a non-reportable venture being formed. Are you better off in that circumstance self-reporting to the agencies and getting them to say something to memorialize the fact that they had a look at this and reviewed it to get the benefit of whatever approval in this context means relative to future private litigation? As George notes, it's an ambiguous approval.

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> "The ruling in *Texaco and Shell Oil v. Dagher* gets rid of concerns that people might otherwise have that if they form a joint venture between two companies that were previously competitors, that this can be attacked as price fixing, without either the federal or state regulators or private antitrust plaintiffs ever having to prove that the joint venture itself is unlawful under conventional merger law."

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"Will *Dagher* inform and alter the FTC's approach to any of these questions going forward? From my view the answer is, at the margin, it will. I think it will be more difficult for the agencies to pursue cases like *MathWorks*, or to pursue *per se* theories in cases like *Three Tenors*, in light of the joint venture analysis in the Court's decision."

MR. CUMMING: Maybe you should, because during oral argument Justice Ginsburg, who should know better, wondered how much deference should be given by the court to the agency, and the answer in this setting, as I think we all know, is none, other than it is a fact and there is evidence out there and that sort of thing. There is an additional reason that Steve is right in saying this may have some effect on the agencies at the margin. There was a lot of discussion in the lower courts and again in the oral argument about the fact that Equilon, this joint venture, was selling both Shell-branded and Texaco-branded gasoline. And some difference that I couldn't figure out was being made of that. Because at one point, plaintiff's counsel was asked would it be different if they sold under one brand, and he said yes. And this causes you to wonder what's being complained about here. But more importantly, the Supreme Court, although mentioning that in passing, did not detain itself with it. It just brushed it aside, and said this is a core activity of the joint venture, i.e., you can sell one brand, you can sell 20 brands. It doesn't make any difference as long as you are within that safe harbor of doing what the venture was formed to do.

MS. WOOD: The Supreme Court also didn't spend any time on the main concern in the Ninth Circuit about the timing issue, and whether or not the decision to price each brand at the same price was made before or after the joint venture was formed. I thought that it was pretty interesting that the Supreme Court didn't say anything on that point.

MODERATOR: Would it have mattered if the joint venture was formed for product development or exploration as opposed to refining and sales?

MR. OHANA: Critically, yes. Because then you really would have had an ancillary restraint issue in that there would be activity outside the scope of the venture that would be ancillary to the venture and you could then figure out whether it was a legitimate ancillary restraint. But that's a much worse case for Shell and Texaco than the case that was actually at issue with *Dagher*, where clearly refining and marketing were the core of the venture.

MR. HUMMEL: I think George asked a key question. What is really being complained about in this case? I think from the person on the street perspective the fact that Shell and Texaco got together and formed a venture to sell gas, when those are sort of the paradigmatic competitors in the country, it strikes us as problematic. But when there's a legitimate venture, not a sham joint venture, that has been pre-approved, where their pricing conduct is not ancillary to the core activity of the venture, i.e., refining and marketing, they're okay. But what is being complained about, George? How would you answer the question? What is so troubling?

MR. CUMMING: Again, this doesn't come out in the opinion, but in oral argument plaintiff's counsel said, "At a time when crude oil was in surplus, and there was excess refining capacity, prices went up dramatically." Well, yeah. Not because this joint venture was setting the prices of what it sold. That may have been a clue to whether or not, as you say, Chad, the joint venture should have been approved in the first place.

MR. HUMMEL: Right.

MR. CUMMING: Seems to me it was pretty close to thin ice. But the point is here I don't know what was being complained of. Both the plaintiff's counsel and the panel in the Ninth Circuit were taking a shortcut. And the rule is that you have to make square corners in antitrust. Justice Stevens said during the oral argument that it's ironic, in a sense, that these people can't conspire to fix prices if they're independent companies but they can do it if they form a joint venture. Well, that's all true, but it explains why mergers are treated differently than cartels.

MR. SMITH: The focus that the antitrust laws have on price is another reason why, Susan, I think it would be less likely that we would see this sort of challenge in the context of a case that involved a production joint venture. Price remains a core concern of the antitrust laws. It's the area in which the *per se* rule still is vibrant and attaches. It makes it easy, as George pointed out earlier, for plaintiffs to bring cases on a "shortcut basis." It is much more difficult for a plaintiff to demonstrate a production joint venture is a sham, that a production joint venture materially lessens competition, and that there is resulting damage to consumers. So I think it's less likely that you would see the kind of challenge we saw in *Dagher* in cases where the core of the venture is in a production or development context than where it is in a marketing or sales context.

MR. CUMMING: I agree.

MR. SMITH: It's much more likely in a production or development type of venture that the efficiencies case would be clearer as well.

MODERATOR: Let's move on to this case on tying. Chad, tell us about *Illinois Tool Works*.

MR. HUMMEL: *Illinois Tool Works* is a patent tying case decided in March of this year by the Supreme Court. We all know sitting around this table that tying is generally challenged under Section 1 of the Sherman Act, and it typically involves a situation where one party which has market power in a particular product uses that market power to coerce the sale of an unwanted or undesired second product over which that company or participant does not have market power. This is a case that dealt with a company that made piezoelectric printheads and cartridges. And it involved a situation where the company, Trident, whose parent was Illinois Tool Works, had a patent on the printhead but not on the ink that was intended to work with the printhead. And what the company did was say if you want our patented printhead, you've got to use our ink. Very simple, classic tying paradigm. The Supreme Court, in what I do consider in the patent tying area to be a landmark decision, eliminated its decades-old presumption, which had been articulated in several prior cases, including copyright cases, that market power does not arise presumptively from the mere ownership of intellectual property rights. In the unanimous opinion authored by Justice Stevens, the court held that in all antitrust cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product. The Court reasoned that the market power presumption in *Loew's* and *International Salt* finds no support in modern economic theory or antitrust enforcement policy, does not accord with the Court's modern tying jurisprudence, which is moving away from a *per se* analysis for tying cases, and lacks support in the Court's earlier patent cases. Importantly, and I think this is a critical hook for the Court in this decision, Congress in 1988 amended the Patent Act. The Patent Act dealt with a situation where a patent owner had impermissibly extended the scope of the patent in violation of what is known as the Patent Misuse Doctrine. Basically, if an infringer was sued, they could argue that the patent was unenforceable if the patent owner had engaged in what we're calling patent tying. Congress amended that statute to say that the infringer in that situation would have to prove that the patent owner had market power in the patented product. And what the Court did in *Illinois Tool Works* was adopt Congress' conclusion.

So, what's important from this case? Two things, I think. One, it is now in my view pretty firmly established that tying arrangements will be analyzed under a rule of reason. The Court has now essentially said that there are numerous potential pro-competitive benefits from tying arrangements, particularly if products are integrated, so that you can't clearly prove that there are two separate products. And two, in the patent context, the Court acknowledged the reality that a patent does not necessarily automatically confer market power.

Consistent with George's theme, this decision is important because it eliminates another "label." The label was that if you have a patent on a product, whether it be a piezoelectric printhead or a particular type of software that carries a patent, you had market power for tying purposes. No longer. With this decision, it will be legitimate in some circumstances to extend the scope of that power by requiring purchases of other products because courts will have to consider that the market in the tying product is broader than the patent grant and that there are actually competitors to the patented product that should be legitimately included in the market.

Now, the questions that are open from this decision include how far courts will be willing to extend this notion into areas other than patent law? Is the decision *United States v. Loew's*, which was a movie block-booking case, for example, that involved a unique copyrighted product, is that going to be revisited? Or is the notion that a copyrighted film, for example, is so unique that you can't coerce the sale of unwanted pictures simply if you want the blockbuster. Those are the questions that are left open. Many commentators in the wake of the *Illinois Tool Works* case, and certainly in the amicus brief, said that the presumption of market power from a copyrighted product should also be eliminated.

MR. FREITAS: Chad is right that the court did rely on section 271(d)(5) in arriving at the conclusion that the presumption would no longer be applied. But I think there's another theme in the case as well that there simply isn't a justification for adopting a presumption on the basis of patent ownership. Both ideas were there. I was a little surprised, actually, that the court chose to rely so much on the statute, on what Congress had done. Although when you look at the court's reasoning, and the court said it doesn't really make sense to think about something being criminal when it wouldn't support civil liability, I think that helps put in context why the court found it important to take a look at the statute. But I do think clearly the court is addressing the basic economic issues as well. And I think they do apply, that analysis does apply to copyrights as well as patents.

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> "Regarding tying, the focus under Section 1 is whether there's an unreasonable restraint of trade. In a patent misuse context the issue is very different. The issue is whether what the patent owner has done has unlawfully extended the scope of the patent grant. There's a long history in the case law that says you don't need an antitrust violation. When you look at tying, having a different test for tying as misuse as compared to tying as an antitrust violation presents the problematic opportunity for the arbitrage situation you describe."

MR. SMITH: One interesting question that comes up out of the court's invocation of the statute, that is, the amendment to the Patent Act in 271(d)(5), is the following question: Did the court implicitly decide the issue which it declined to decide explicitly as to whether a unilateral refusal to license a patent can be an antitrust violation? That's what the Federal Circuit held in the *Xerox* case. There's certainly room for argument, and I think strong argument, that the First Circuit has reached a different conclusion in *Data General*, and that there was a conflict there that the court declined to consider at the time. Think about the reasoning that you just laid out with respect to 271(d)(5). Now move up one paragraph in the amendments to the Patent Act. 271(d)(4) says it is not patent misuse for a patent holder to unilaterally refuse to license. Now, if Justice Stevens' analysis of why 271(d)(5), as you've laid it out, means that if conduct can't be patent misuse, it certainly can't be an antitrust violation, then doesn't that also mean that since the Patent Act now says it's not patent misuse to unilaterally refuse to license a patent, that can't be an antitrust violation?

MR. OHANA: Steve has moved the lens back one notch to the other 271(d) patent misuse exclusions. Let me pull it back another notch, which is the general subject of what we'll call the pas de deux between patent misuse and antitrust violations. The Supreme Court clearly was laying out its view that those two should be pretty consistent, which is a point the Federal Circuit has also made in a number of cases. And I think that's a good thing, because it avoids a kind of claim arbitrage among defendants responding to infringement litigation as to whether they bring the patent misuse defense or the antitrust counter claim. The theories should be the same.

MR. FREITAS: I think the issues are often different, though, because the focus under Section 1 is whether there's an unreasonable restraint of trade. That's what the issue is. That's what the concern is. In a patent misuse context the issue is very different, I think. The issue is whether what the patent owner has done has unlawfully extended the scope of the patent grant. There's a long history in the case law that says you don't need an antitrust violation. And I think at least in some kinds of cases, it makes sense to say that we don't require a violation of the antitrust laws to have patent misuse. For example, extending the temporal scope of a patent, and some of the other practices that have historically been recognized as misuse. I think properly they don't have any connection to antitrust law. So I think there is a role for, at least in some cases, a different test. But when you talk about the same practice, you look at tying, having a different test for tying as misuse as compared to tying as an antitrust violation, that does present the arbitrage situation you described. I think it is a problem.

MR. OHANA: I agree with that to an extent, because in the antitrust context you're typically going to have to prove whatever you have to prove to establish patent misuse, plus, particularly after *Illinois Tool Works*, some degree of market power for the patent. I guess the point I'd make is that if you look at the history of patent misuse cases, you can almost always find a corresponding antitrust case. You mentioned extending the temporal scope of the patent. The Justice Department dealt with that in *Pilkington* as an antitrust theory. So typically there's going to be some antitrust law to deal with things that are alleged as patent misuse also, and the savvy plaintiff, or in many cases, infringement defendant, is going to think of both and they ought to be consistent. Otherwise, you're left in litigation dealing with two slightly different litigation theories with separate discoveries, separate experts, et cetera.

MR. FREITAS: You do run into different concerns, though. For example the infringement defendant in many cases is concerned only with finding an excuse, finding a defense. And so a finding of misuse which is purgeable will help the defendant avoid liability, but it won't necessarily get damages or accomplish anything beyond that. So I think those different incentives will impact the way cases are litigated. As to the *Pilkington* example, sure, some forms of misuse can be identified as antitrust violations, but you need to prove so much more to turn a given practice into an antitrust violation. This simple focus on extending temporal scope, for example. The misuse angle there is much easier to establish than a Section 2 theory or any other antitrust violation.

MR. OHANA: This is going to foreshadow some of the stuff I'll talk about later with regard to standard-setting but the same exact issue comes up in the Rambus-type theories. Is this patent misuse? Are there estoppel defenses? Or is this an antitrust violation?

MR. SMITH: Judge Richard Posner said, and I think he's right, that it's too late in the day at this juncture to look at patent misuse and say that it can be informed by any principles other than antitrust principles. And the courts do us a disservice, I think, when they try to divorce those two doctrines. The way that I see the overall trend of the case law is toward a convergence. You see that in the Seventh Circuit, you see that in the Federal Circuit. And I think I'd be right in saying that for the type of conduct that the Supreme Court has said constitutes misuse, until the Court or Congress changes the law, those are going to remain off limits. But with respect to the rest of the law, I think we're going to see the lower courts bringing antitrust and misuse doctrine together.

MR. CUMMING: I agree with Steve. What the court recognized here is what lower court commentators have been saying for a long time, which is simply that patents or copyrights confer legal monopolies, if you will, but not necessarily economic monopolies. If you have a situation in which a patent or a copyright in fact is the core of a legal monopoly, then misuse really focuses upon efforts to extend that monopoly, if you will, into adjacent markets, as in Microsoft, or extending the life of the monopoly beyond the grant given by Congress. I agree with Steve and the others that kind of analysis almost inevitably has to be informed by antitrust, because you are talking about a circumstance of a monopoly, which might be a Section 2 violation but for the patent, and it's obviously in the interests of everyone to reward artists and inventors, but not over reward them by giving them the monopolies that aren't earned by the works that they create.

MR. FREITAS: But a concern clearly is present, in at least some situations, where the extension does not take us to a place where we would say a Section 2 case could be made or a Section 1 case could be made depending on the kind of practice that we're describing. The focus there is that when someone has a patent, they have limited rights and if they're taking what they have beyond that, putting aside the question of whether that results in an antitrust violation, there's something that is worth looking at from the misuse perspective in many cases.

MR. HUMMEL: From the perspective of a trial lawyer who gets in the trenches and fights these cases out a little bit, is that it was anomalous. It was more difficult prior to this decision to prove a patent misuse defense, far more difficult to discover and prove that, which, by the way, was tried to a court — not a jury — because it's an equitable defense of unenforceability, than it was to prove a tying claim. Proving a tying counterclaim was easier. So from a practical perspective, companies can take some comfort that patent holders can now sue infringers, clear infringers on strong patents, and not fear the inevitable counterclaim for tying. You always face the patent misuse defense, and inevitably where you got that defense, you also got the tying counterclaim. Now as you pointed out, and I think it's correct, the litigation is going to be much more focused and much more consistent and much more difficult for the infringer to have the threat of treble damages looming over the patent holder's head than simply a defense. I think that's a really important distinction that's been drawn by this case.

MR. CUMMING: I think that's true. Let me go back to a couple of points that we touched on at the beginning. How does this impact copyrights? All of the old cases said if you have a patent or a copyright you presumptively have market power. I think this decision by its very nature implicates that presumption in a copyright situation, or at least puts the burden on the plaintiff to show that somehow a distinction between patents and copyrights can and should be drawn and that one should presume market power in the case of a copyright but not in the case of a patent.

MS. WOOD: I agree. And in further support, the Supreme Court relied heavily here on the antitrust guidelines for the licensing of intellectual property. And the guidelines here also apply equally to patents and copyrights — that there's no presumption. I would cite that as additional grounds that the decision here is going to apply equally to copyrights.

MR. HUMMEL: I am going to disagree with that and throw a contrary view out. I don't think that anyone at this table would say that a Hollywood movie studio could today with impunity say that we've got one blockbuster film coming out this summer and if you, exhibitor, are going to take this blockbuster, you've got to take our five dogs. I don't think that a studio would say that today. And the reason is that copyright is actually different. A film is unique, a book is unique. If you look back on the old *Loew's* case, they didn't focus on market tying of the product there, it was the uniqueness of the product. It doesn't necessarily confer power, but it's the uniqueness that allows you to coerce the purchase of an unwanted product. I want to throw that out there. I happen to be on the side of defending these cases, but I'm interested in your thoughts on what the distinction is.

MS. WOOD: The reason why the guidelines apply equally to patents and copyrights is they say there's just no presumption of economic power, of market power. You can still bring a case.

MR. HUMMEL: Sure.

MS. WOOD: The problem is the plaintiff is going to have to prove that there's some market power. I don't think that there's any uniqueness. I think that you're still going to have to go about it in the same manner.

MR. HUMMEL: Let me ask a question. If you have a unique copyrighted product, you won't have "market power." I'll use the film industry as an example. You come to market with a blockbuster film, you don't have power over commercial films, but you have the power of complete exclusion over that one film that is going to make $300 million this summer. But the fact that you don't have market power over films doesn't mean that you can block-book with the single film. I'm trying to grapple with that notion.

MR. OHANA: At the time the restriction is imposed by the studio you don't know that the film is going to make $300 million, but the only time you're ever going to get a claim later is when the film did make $300 million.

MR. HUMMEL: But you wouldn't say based on this decision that the studio can block-book today. Nobody at this table would say that.

MR. CUMMING: : I think that's right. But there is a rejoinder, which is economist George Stigler's famous article showing that the Court's rationale in *Loew's* makes no economic sense. Suppose the studio charges theatre owners $300 million for the blockbuster and five dogs. It does so because the studio believes that theatres will make more than $300 million from ticket sales on the blockbuster alone. The dogs are dogs, nobody will pay a dime to see them, and the package isn't worth more to theatre operators just because five dogs are included. But now, says the Court, you can't do that. You must offer the blockbuster and the dogs separately. But at what prices? Why should the studio charge less than $250 million for the blockbuster alone, because that remains what it's worth to theatre operators? How are consumers worse off under the blockbuster and five-dog package than they are if the studio charges $250 million for the blockbuster alone? So when you ask the central question of antitrust—does this arrangement harm consumer welfare? — the answer may be "no." Again, the overarching point is that facile labels are not a good substitute for informed economic analysis.

MS. WOOD: All of this comes back to the original point that you have to look at the actual market reality.

MR. HUMMEL: Right.

MS. WOOD: That's the underlying trend in all of these cases.

MR. SMITH: Let's talk for a minute about the first conclusion you drew, which is that *Independent Ink* stands for the proposition that tying claims will be evaluated under the rule of reason. Now, I happen to agree with that conclusion as a legal matter, but let me put out to the panel the question of whether *Independent Ink* really says that. So Justice Stevens, who of course was the author of *Jefferson Parish*, says that even though there's no presumption any longer that a patent confers market power, the evaluation of tying claims should proceed under the *Jefferson Parish* standard. Now, the *Jefferson Parish* standard says once the plaintiff establishes market power then the tie is *per se* unlawful, presumably meaning, you cannot come in with a business justification under the rule of reason and prevail. Now, that said, Chad, to your point, the opinion embraces the pro-competitive effects of tying. And the rest of the Supreme Court's jurisprudence for the last 30 years teaches us that once you have a category of conduct that is recognized as having pro-competitive effects, the *per se* rule should not apply. It should only apply to that category of conduct that we know, without further inquiry, has anticompetitive effects. And certainly the other authorities on which Justice Stevens relies — Justice O'Connor's concurrence in *Jefferson Parish*, the guidelines, the scholarly criticism — all say that tying should be evaluated under the rule of reason. So my question is: do you think when Justice Stevens said we ought to go back to *Jefferson Parish*, he was thinking that once you establish market power, tying is *per se* unlawful?

MR. OHANA: I think what matters is less what was in Justice Stevens' mind than how lower courts have read *Jefferson Parish*. They focus on the O'Connor concurrence, not the opinion of the other four justices in the majority. You need look no further than the D.C. Circuit opinion on *Microsoft*, where that's very much the opinion on the tying claims. So whether or not *Jefferson Parish* truly establishes it, the way the lower courts are dealing with tying claims is very much now rule of reason.

MR. CUMMING: The other point is that as Judge Joseph T. Sneed said for the Ninth Circuit a few years ago in some Mercedes-Benz litigation, this *per se* rule of tying isn't really the same as the *per se* rule against price fixing, meaning there is no possible defense. It's really a burden-shifting rule. If the plaintiff establishes market power sufficient to qualify under *Jefferson Parish*, which means something above 40 percent, although I don't know how far above, then the burden shifts to the defendant to offer a legitimate business justification for the practice. And the plaintiff in that circumstance, if you think about it in terms of the way the jury would be instructed, the plaintiff does not have to defeat the business justification, the defendant rather has to establish it in terms of the burden of proof.

MR. HUMMEL: As a practical matter in these technology tying cases, the legitimate business justification defense blends with the defense that these are single products or integrated products. Tying requires two products and as these cases are litigated, the legitimate business justification defense almost always boils down to we're really selling a single product.

MODERATOR: Gil, how does the *Volvo* case fit in with these other two cases that we've been discussing?

MR. OHANA: I think it's consistent with what George said earlier about moving away from labels. The case is a pretty straightforward Robinson-Patman case. A truck dealer feels discriminated against by Volvo because it did not receive the same pricing that other truck dealers had received, but those truck dealers received better pricing in deals in which the plaintiff didn't compete. Nevertheless, it brought a Robinson-Patman case and, it won in the Eighth Circuit. The Supreme Court said the plaintiff in this case hasn't proven that it was discriminated against in specific sales opportunities where it was provided worse pricing than the other Volvo dealers and therefore it shouldn't win its Robinson-Patman claim. And I think that makes a lot of sense.

MR. SMITH: The other interesting question about *Volvo* is: why did the Court include Part Four of the opinion? Part Four was unnecessary to the narrow holding on the facts. What Part Four says is that the Robinson-Patman Act ought to be read to serve the broader purposes of the antitrust laws. That is, it ought to be read to ensure competition, not individual competitors, are protected.

MR. OHANA: Though it didn't do something that I think a lot of people have wanted the Supreme Court to do for a while, which is get rid of the *Morton Salt* inference of injury to competition, an issue that has been raised in cases that have gone up to the Court before and the Supreme Court so far has sidestepped. It would be great if they would tackle that issue at some point.

MR. FREITAS: I look at *Volvo* as a reaffirmation of *Morton Salt*.

OHANA: Which is unfortunate.

MODERATOR: Let's move on to a case the Supreme Court did not hear, *Schering-Plough v. FTC*. Steve, lay this one out for us.

MR. SMITH: The facts here are more complicated than the other three cases we've talked about so far, but I'm going to try to simplify them. *Schering-Plough* involved FTC challenges to patent settlement agreements between Schering, which is a manufacturer of a patented prescription drug, and two manufacturers of generic versions of that drug. The agreements resolved patent infringement litigation brought by Schering against the generics. The settlements contained two basic elements. First, generic manufacturers agreed to delay the date on which they would begin selling their generic versions of

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"What matters is less what was in Justice Stevens' mind than how lower courts have read *Jefferson Parish*. They focus on the O'Connor concurrence, not the opinion of the other four justices in the majority. You need look no further than the D.C. Circuit opinion on *Microsoft*, where that's very much the opinion on the tying claims. So whether or not *Jefferson Parish* truly establishes it, the way the lower courts are dealing with tying claims is very much now rule of reason."

Schering's drug, although the parties agreed the generics would begin selling before Schering's patent expired. Second, Schering agreed to make substantial payments to each generic, although there was a dispute between the FTC and the parties as to whether those payments were to compensate those generics for delay of entry or whether they were related to other elements of the settlement. For example, one of the generics had agreed to license several of its products to Schering. The FTC staff challenged the settlements on the ground that the so-called "reverse payments" from Schering to the generics were, in substance, unlawful payments not to enter into the market and compete, and that in the absence of those payments the generics would have entered the market earlier. After an evidentiary hearing, an FTC Administrative Law Judge found no violation of the antitrust laws, but the full Commission reversed. The case goes up to the Eleventh Circuit. The Eleventh Circuit, in turn, reverses the Commission, finding that the settlements were lawful because the compromise that was struck was within the potential exclusionary scope of the patent. The Federal Trade Commission then exercised its authority to represent itself before the Supreme Court and petitioned for certiorari. The court invited the Solicitor General to file an amicus brief in the case, which the Solicitor General did, and recommended that the court decline to take the case. In June of this year, the Supreme Court denied certiorari.

The case raises a number of interesting questions, but maybe we should start here: for those of us who counsel clients on a day-to-day basis, what is the significance of this case for those clients? What are you now telling your clients that they should or should not be doing in the wake of the Eleventh Circuit decision in Schering?

MS. WOOD: I would counsel clients the same for a couple of reasons. Namely, that FTC Commissioner Jon Leibowitz, before the decision by the Supreme Court not to take the case, had stated that the FTC plans to take additional cases in the hopes of creating a split in the circuits or to encourage Congress to act. So given that overlying possibility, I would caution against any change in counseling clients because there's still that potential threat of an enforcement action.

MR. FREITAS: I think there's plenty of encouragement from the case, but one thing that would support what Julie said is that the commission was insisting that there was a *quid pro quo*, that the money was being paid for delay. And there was a dispute about the timing of when the entry would have occurred absent the settlement. There is a very important finding of fact that was made by the ALJ that has a big impact here and that is there was no *quid pro quo*. That was a specific finding, which makes it very difficult to sustain the commission's view that there was a *quid pro quo*. So I think that perhaps cuts back on the value of the case. The other thing that is very important is the court's insistence that the fact that a patent carries a right to exclude must be central to the analysis. Now that may seem obvious, but when you contrast it with the commission's attempt to focus on the exact timing of the entry and whether it would have been sooner or later, I think that is a very important difference, and something that provides a lot of encouragement toward similar deals being approved or not challenged in the future.

MR. SMITH: It strikes me that there's a couple of things that clients need to think about in this context when faced with suits that give rise to potential settlements like this. One is that early antitrust counseling and intervention seems to be very important, because what the FTC is saying in these cases is that the subjective intent of the parties in striking the settlement is a critical element in their judgment as to whether there is a *quid pro quo*, to make Bob's point, and whether or not the settlement ultimately is anticompetitive. That means clients have to start thinking from the moment that the potential infringement action arises and they're evaluating patent validity, the infringement action, and the likelihood that they'll prevail, about how they are going to address those questions internally, what sort of documents they're going to produce, what sort of exchanges they're going to have within the company, outside the company, because all of that becomes evidence that's relevant to at least the FTC's view as to how the lawfulness of the ultimate settlement ought to be assessed. The second point is that I think clients will need to consider seriously whether, once they settle the suit, they want to take that settlement to court and ask the judge to review the settlement and approve it rather than doing it strictly as a private matter. Because getting court approval is going to give you a measure, and I would say a very strong if not dispositive measure, of *Noerr-Pennington* immunity from subsequent challenge. Now that's another subject of debate that's taking place both with the FTC and in the court; that is, does *Noerr-Pennington* extend that far? But I think one of the lessons not just of *Schering*, but also, for example, *Medimmune v. Genentech* and *Celltech*, is that in a world in which you have court approval, it's going to be much more difficult for an agency or private parties to attack that settlement.

MR. CUMMING: Well, it's interesting to me because the Solicitor General's brief says two things to the court. No. 1, this is an area in which there can be serious anticompetitive concerns, but No. 2, this case isn't cert-worthy because it's too fact-bound in whether there was a *quid pro quo* or not. I think all of us know of some earlier cases under Hatch-Waxman in which the existence of a *quid pro quo* was pretty obvious. That statute seems to generate more ways to dodge things than anything short of the Internal Revenue Act, but the point is in terms of counseling clients, No. 1, I think you have an obligation to make sure they are up to some good instead of no good, more so than in most cases. And No. 2, if in fact the major point is that there is no *quid pro quo* of an evil type and it's within the scope and you're actually getting something for the money you pay, you need to help them establish that clearly in the settlement documents, as clearly as possible on the record of the case. And I agree with Steve, if you can get judicial assistance in that endeavor, even if it's not binding, even if it's not subject to *Noerr-Pennington*, you may have a situation like the *Texaco* case that we talked about earlier, where the fact that an independent agency or judge has reviewed the deal and said this doesn't bother me would be of value down the road.

MR. FREITAS: A couple other things about the record there. It appears that counsel did what George is saying should have been done and looked very carefully at what was presented. So you see expert testimony about the settlement range, and I think this is a very important point that comes out of the case also, the focus on the quality of the patent, the quality of the defenses, and building from those things, whether the settlement was within a reasonable range that one would expect given the nature of the patent and the defenses. And with a record like that it becomes far more difficult to simplify it as a *quid pro quo* or to say it's anticompetitive when there is a specific record that this is a real settlement or there is a real cross-license.

MR. HUMMEL: Following up on Steve's point, which was to get early antitrust advice when you're counseling clients, I think this is a perfect example of where you need both antitrust advice and patent advice very early on. Because what's clear to me, and I absolutely agree with the Eleventh Circuit opinion in this case, I think they got it exactly right, is that the focus really is on the strength of the patent. This was a settlement that didn't extend the scope of the patent either temporally or subject matter-wise beyond what the company had. And if you assume that it's a valid enforceable patent, then the company that is bringing the infringement action can legitimately take into account such things as cost of prosecution of these infringement actions in deciding to pay and delay entry. Judge Posner wrote a very thoughtful hypothetical on this. It's cited in the Eleventh Circuit opinion, which I agree with completely. But it emphasizes George's point that if these are very specific fact-intensive inquiries, if these settlements are challenged, they will go into subjective assessments of the strength of the patent. In the litigation you're possibly going to get into the noninfringement opinions, the validity opinions, those types of things that were prepared in connection with the patent itself. You're going to get into the strength of litigation positions of the parties and subjective use of those litigation positions, and you're obviously going to look at that time as to whether the scope of the patent is being extended or not. I think that's the critical inquiry that comes out of the opinion.

MR. OHANA: Just to play devil's advocate for a moment, you said you liked the Eleventh Circuit opinion. What if the patent holder has documents that say "we think this patent is weak, we think we're going to lose the infringement case, but it's really important for us to keep our profits up and generic entry is going to erode them." So we're going to pay off the generic to stay out. That's what the documents say, and there is a payment. Is the Eleventh Circuit still right?

MR. HUMMEL: I don't think the Eleventh Circuit would reach the same conclusion.

MR. OHANA: Why? The settlement is still within the scope of the patent.

MR. HUMMEL: It's within the scope of the patent, but you've got a patent holder that subjectively doesn't believe in the value of their patent as an exclusionary device.

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> "The plaintiffs in *Bell Atlantic v. Twombly* are bumping up against Rule 11, not just Rule 8, and that's a problem. Last time I checked, parallel conduct was legal. You had to prove a combination or conspiracy. You had to meet the *Matsushita* test, and you ought to be able to plead that. And if you can't, you ought to be out. Allowing a plaintiff or plaintiffs to proceed without even an allegation of conduct that would violate Section 1 strikes me as a no-brainer."

MR. OHANA: They're just saying it's uncertain. They've got a patent, they've got the presumption of validity. Litigation is risky, so to avoid the risk they want to buy off the generic. Is the Eleventh Circuit still right?

MR. HUMMEL: The holding I believe would be different in that circumstance. I think you would have a different analysis. Which is why it's a fact-specific analysis, which is why, in my view, cert was appropriately denied.

MR. SMITH: I just don't think that it ought to be the legal standard. That is, I think the FTC is wrong in going down the path of trying to assess the subjective views of parties in litigation as to where that litigation is likely to come out. Gil, you work in a company. I'd be interested to know when Cisco, and we won't get into a specific patent, but when you're evaluating the strength of intellectual property positions the company holds, is there only one view within the company as to how strong or weak a particular intellectual property position may be? With my clients there is often a variety of opinions.

MR. OHANA: I think that's exactly right. And it points out the problem with the FTC's position. It also supports the approach that the Solicitor General recommended in its brief about the need for the adjudication of the merits of the patent, but also the point that this adjudication can be a kind of a mini-trial. In its brief and in the positions FTC staff took during the Part Three administrative process, the FTC tried very hard to avoid any adjudication of the underlying patent case. I'm not sure why, but the FTC tried very hard to avoid that route.

MR. FREITAS: I think it's very difficult to put too much stock on the subjective intent of the patentee. If you do that you run into the same kinds of issues that you run into in other areas in antitrust law where intent can get blown out of proportion. It can be made too important in the context of the objective facts. And as the Eleventh Circuit pointed out, there is a policy favoring settlement. It's a good thing, in most cases, when people make settlements. I think it was a great idea to present the expert testimony about the range of settlement. In my view, that's a very important objective fact that's helpful in assessing the competitive impact of the settlement.

MR. HUMMEL: You could almost import the sham litigation test from *Columbia Pictures* into this context where you have both an objective and a subjective prong. In the sham litigation context, in order to prove that suing is not *Noerr* immune, you have to show that the lawsuit is both objectively baseless and subjectively designed to harm competition. You could put that same type of analysis on this type of case. And that may be what you're arguing for.

MR. CUMMING: That is what I was going to mention, with the addition that I am not particularly favorable to subjective kinds of evaluations for many of the reasons that were said in the *Columbia* case, and particularly because I think you pay penalties for going to outside patent counsel and getting honest evaluations of strength and weakness in this sort of thing. And there's no guarantee anymore that all of that is going to remain privileged.

MR. HUMMEL: Right.

MR. CUMMING: So it seems to me there are some rather extreme penalties that one has to pay. Let me ask you this question, though, to move it one step forward. The Hatch-Waxman Act is unusual in that if you block one generic you effectively block them all; you pay one generic to delay entry. So do the concerns that have been expressed even by the Solicitor General in the brief for the United States extend to areas of ordinary patent settlements where taking the alleged infringer out of play by a settlement may or may not have some consequences as to anyone else?

MR. OHANA: You're right, I think Hatch-Waxman changes the legal analysis a great deal.

MR. CUMMING: I think it does, but it kind of took me to something that UC Berkeley Professor Carl Shapiro was talking about just essentially a few years ago starting the debate. Suppose that you have infringement litigation between the only two parties that have any real incentive to challenge one other, and usually they start throwing each other's patent portfolios up and so forth, and they decide to settle by means of a cross-license. Now you have removed the possibility of litigation to challenge the validity of those patents, and if you're concerned, as many people are, that there is some junk out there, is that a concern, and if it is, how to remedy it? Can you have kind of a mini-trial before an agency, for example?

MR. OHANA: I think it depends a lot on what the terms of the cross-license are. If all that's happened between the companies is that they've bought peace and they're each now able to have design freedom in developing and marketing their own products, that's good.

MR. CUMMING: The concern that's been expressed is that if A and B are the only people in this field, and they settle, then so far as one patent may be invalid or subject to limitations, there's nobody left to challenge it as a practical matter. Should the agencies be concerned about that? Although I think one of the things that you come to as a conclusion, if I can jump forward, is do they have the resources or should antitrust just declare a stymie in this kind of situation.

MR. SMITH: Asking the agencies to undertake another kind of reporting regime in which patent settlements have to be reported and reviewed, with the agencies then deciding whether or not to use their prosecutorial discretion, is putting more burden on the system than private parties and the government itself can afford. Beyond that, it seems to me that private plaintiffs and private counsel still retain a significant incentive in your hypothetical to bring a challenge if the facts are as stark and give rise to the anticompetitive effects that you've described. And we've certainly seen it already in the context of the pharmaceutical industry, and we haven't seen the plaintiffs shying away from attacking other industries where they think the case is strong. And that of course has been the traditional justification for private causes of action under the antitrust laws and treble damages; to ensure that plaintiffs act as private attorneys general.

MR. CUMMING: And we harness a resource and so forth to the cause. Yes, I think that's true, and I think as a practical matter that's probably where these kinds of challenges are going to be raised.

MR. HUMMEL: Steve, you mentioned in your introduction the concept of judicial approval of settlements, and that such approval might confer at least a possible *Noerr-Pennington* defense. But what do you have in mind in terms of actual judicial approval? What sort of analysis should courts undertake in approving these settlements? Similar to something that an agency might do, or something less?

MR. SMITH: That is, in some sense, the $64,000 question for the parties, because it's going to be up to the parties to go to the court in the first instance and say, "Your Honor, we have a settlement and we would like you to review and enter judgment based on the settlement agreement." And then the question becomes, in order to get the maximum value for that approach, what do you as parties ask the court to do? From my perspective, I think what you would want to do is to actually propose findings of fact to the court and ask the court to hold a hearing and make those findings. Now, there are others who go beyond that and say if you really want to try to increase your level of protection, you ought to ask the court to open up the hearing and invite other parties who may have a stake in the matter, outside the alleged infringer and patent holder, to participate. And obviously, as we all know as private lawyers, that can be a dangerous proposition, and I don't know that I would necessarily advocate it. Nevertheless, it would provide an additional level of protection in a subsequent litigation challenge.

MS. WOOD: I query whether or not the courts are going to be willing to do that. I mean, what's the legitimate case or controversy, and what are the guidelines? Unlike the FTC, the courts don't have economists that they can use to facilitate the process. I think it's a fantastic idea in theory, but I'm wondering whether or not a court would legitimately accept it.

MR. OHANA: If you go down the road of having an open hearing and inviting affected parties to participate, what if the FTC shows up?

MR. FREITAS: I think it would be difficult to get a court to make meaningful findings about the subjective intent of the parties, to the extent that is going to be important in the analysis. If I was a judge and litigants came to me with a settlement and asked for findings about what their intent was in entering into it, I'd say you've got to be kidding. Looking at the variety of objective factors I think might work and especially when the court, which presumably would be expert in assessing things like patent quality, defense quality, arm's length nature of the litigation, I think there's a role the court might be willing to fill in many cases. But in most cases, judges would stay very far away from that.

MR. SMITH: I agree with that. And as I said earlier, I don't think that a subjective approach is the right legal standard that ought to be applied.

MR. FREITAS: Agreed.

MR. SMITH: I think what you'd really be looking to do is to ask the court to make some fundamental findings that would then enable you to say, given those factual findings, this settlement is within the scope of the patent's exclusionary scope, if you will, and within the range of reasonable compromise. Because at the end of the day under the Eleventh Circuit and Second Circuit precedents, if you're able to establish those two points you're likely to prevail on the merits. And then you have the additional layer of protection that this is a judgment entered by the court, so if it has alleged anticompetitive effects, it's the court's action. It's not the action of the private parties that's giving rise to those effects. And that of course is the core of the *Noerr-Pennington* immunity.

MR. HUMMEL: Let me make one quick point about that. It would be nice to stay away from a subjective analysis. In virtually all patent cases now, one of the significant defenses is inequitable conduct in obtaining the patent, which invariably involves a subjective analysis. So if you're evaluating the enforceability as opposed to the validity of the patent, in other words, you've got a company seeking to enforce through litigation what it knows to be a patent that it obtained without a particular disclosure to the patent office and the disclosure was potentially intentional. Under Judge Posner's analysis, you have to get to a subjective factor. So in a theoretical world it might be great to say let's not have a court reach anything except the objective test, but the defense that I see raised time and time and time again depends upon a subjective analysis; and thus it becomes difficult. It is a quagmire in terms of having a court analyze these things to get approval. That's why I ask the question. I just see countless issues arising and making this very difficult.

MR. FREITAS: That's a problem, but in many cases the inequitable conduct issues do also have a very important objective component as well.

MR. HUMMEL: With the disclosure.

MR. FREITAS: Sure. And what the significance of the prior art might be and it's not purely subjective, but that could be an issue.

MR. SMITH: So let me pose another hypothetical about the scope of the *Noerr-Pennington* doctrine, which is simply this: Suppose the parties went to the judge and conceded the weakness of the patent and in effect conceded that the payment was being made, even though it was within the scope of the patent right, to delay entry. Assume the worst possible facts in that record and let's now assume that the judge goes ahead and enters the settlement as a judgment of the court. Is that going to be subject to *Noerr-Pennington*? I think the answer is yes.

MR. HUMMEL: I believe that an exception to Noerr-Pennington immunity is sham litigation. So you would have an argument if you were a plaintiff challenging judicially an approved settlement that the judicial approval was obtained by sham, right?

MR. SMITH: But not in my hypothetical, where the parties have made full disclosure. Now, it may well be the judge wouldn't accept it, and I think that's a fair point. But if it's a law school hypothetical, it can be a law school hypothetical.

MR. HUMMEL: So you have conceded to the judge that the settlement is a sham and you are asking him or her to bless it.

MR. SMITH: Right.

MR. HUMMEL: You have conceded the weakness of the patent, you don't think it's valid or enforceable or there's no infringement, and I'm going to make a payment to delay entry. And a court blesses that?

MR. SMITH: Right. In another context, in the legislative context, you could bribe officials, at least so says *Columbia*, to take certain actions and you would still get *Noerr-Pennington* immunity. So I don't know why this wouldn't be entitled to it.

MR. FREITAS: Things are different in the adjudication context. I don't think the judge would approve it.

MODERATOR: Let's talk about some of the other cases that you're watching around the country. Gil, I know there are a few that have caught your eye.

MR. OHANAS: There are two I'd like to mention. The first is also in the last year, a Federal Circuit case called *Phillips v. Trade Commission*, involving the very interesting question of essential or nonessential patents being included within a block license or patent pool. In a series of business review letters in the late 1990s and early part of this decade, the Justice Department took a pretty strong view that a patent pool that included both essential and nonessential patents could very well raise antitrust concerns. Phillips went ahead and did just that; created a block license for some of its CD patents that included both essential and nonessential patents. It then sued to enforce those patents in a 337 proceeding before the ITC and was met with a patent misuse defense, which was successful before the ITC administrative law judge. The ITC decision was then appealed to the Federal Circuit, and the Federal Circuit essentially said, "This is patent-to-patent tying and patent-to-patent tying is okay." The case is significant for technology companies that are often involved in issues regarding pool formation, and the case at least under U.S. law stands for the proposition that it may be less risky to include nonessential patents in a pool than we thought.

MR. SMITH: One thing about *Phillips* that I think is interesting is: does the analysis in the case really reflect the point that George made earlier, the Stiglerian point about whether you really can extract any greater value for your essential patent by including nonessential patents with it? The court said, no, you

can't do that. And so that in turn may also give our hypothetical studios a little bit more comfort about block-booking, because how is block-booking really different from tying essential and nonessential patents together?

MR. CUMMING: I think that's right. And it sort of reminds us in all of this discussion that you have to go back to asking the question how is consumer welfare significantly harmed by this arrangement, and sometimes the answer may well be, "I can't figure out how it is." That's the question that I have about the essential and nonessential patents.

MR. FREITAS: I'll refrain from more detailed comment about *Phillips* because I represent some parties adverse to Phillips in a related case. But I will note one thing about the case that is interesting, and that is the ALJ and the commission found that Phillips had market power, and although the Federal Circuit did not sustain most of the rest of what the commission did, the Federal Circuit did sustain the commission's finding of market power. And I think that's interesting, because it shows that even under stricter requirements, it's not out of the question that an IP owner or another defendant will be found to have market power in the tying product market.

MR. OHANA: It's also interesting in the temporal sense, because the Federal Circuit said that whatever Phillips' market power may have been at the time that it filed the patents or first created the package license, what mattered was whether the patent subsequently acquired market power, which is very interesting from a counseling perspective, because it's the things you do before patents have issued and before they have come to enjoy market prominence that can come back to haunt you five or 10 years later when the standard that the patents are essential to practice are suddenly viewed as being very important in the marketplace.

MR. FREITAS: In that case, of course, one of the important background facts is the success of the standards that were involved.

MODERATOR: Gil, I know you are also looking at another district court case, *Broadcom v. Qualcomm*. Tell us about that.

MR. OHANA: I'll do that pretty briefly, so we can get onto *Twombly*, which is a really interesting case. *Broadcom v. Qualcomm* involves another very successful standard, the third-generation platform for cellular communications. Qualcomm has patented some very fundamental technology in that area and as part of the standards process it agreed to license that technology on fair, reasonable and nondiscriminatory terms. It also competes in the market for chipsets embodying the technology that it has under patent. What it is accused of doing is failing to honor the RAND obligation by charging what Broadcom has described as "unreasonable rates" for its technology in order to prevent competition at the level of chipsets. The case poses or may pose a question of what exactly is a reasonable royalty under RAND, something that a lot of people disagree on, though there apparently is also an issue in the case about whether in fact there was an understanding within 3GPP as to what "reasonable" meant. Assuming that there was that understanding, then I guess the question is whether Qualcomm's license and terms comply with that understanding. But assuming there was no understanding, you get to the question of what "reasonable" means.

MR. SMITH: It strikes me that the kinds of cases that arise in the standard-setting context are ones in which we see the increased importance of a standard-setting organization actually establishing the rules at the outset, so as to avoid these downstream disputes, whether they get characterized as antitrust disputes or otherwise, about whether parties have played by the rules.

MR. OHANA: Chad mentioned before the increase of inequitable conduct defenses in patent infringement cases, and some defenses you are starting to see more and more of when the claims in the patent are included in a standard are along the lines of "you failed to comply with the rules of the standard-setting organization, you didn't disclose, the terms that you're asking for are unreasonable," et cetera. I know that's been a real growth industry among patent lawyers, and many of those claims also spill over onto the antitrust side.

MODERATOR: Julie, let's move to *Bell Atlantic v. Twombly.*

MS. WOOD: *Bell Atlantic v. Twombly* is a case that probably all of us are aware of, and a number of people have been watching closely, and in which the court recently granted cert. It involves the Rule 8 pleading standard in Section 1 cases. In *Twombly*, the plaintiffs have alleged that various telecommunications carriers conspired to prevent new entry into their respective territories. What's noteworthy is that the plaintiffs did not plead an unlawful agreement or any plus factors to support the inference of a conspiracy, but instead simply alleged parallel conduct on behalf of the defendants. The Southern District of New York dismissed the class action and held that nothing about the parallel conduct supported an inference of a conspiracy. The Second Circuit reversed and held that the plaintiff's allegations of parallel conduct were sufficient to satisfy the pleading standard under Rule 8. So everybody is watching to see what the Supreme Court has to say about the pleading standard under Rule 8. A number of commentators have indicated that the Second Circuit decision threatens to basically strip Rule 8 of any of its vigor.

MR. SMITH: It's an important case because, as everyone sitting around this table understands all too well, antitrust litigation, particularly in these days with electronic discovery, is extraordinarily burdensome and expensive. And it's important, I think, that the courts impose discipline on plaintiffs to ensure that there is a substantial basis for an allegation before they are able to invoke the heavy machinery of the judicial process in an antitrust litigation.

MS. WOOD: I think there has to be some meaningful opportunity to dismiss truly meritless cases, so the question is, what's the appropriate standard.

MR. CUMMING: This case in essence raises something that may not be on the surface but has been raised in other parallel conduct cases, particularly in the Third Circuit, where if you make the plus-factor requirement too low you have basically said these people are guilty because they ran a concentrated market where the product is essentially a commodity product and they have, for example, made announcements as to the prices that they will sell, which in some contexts can be a plus factor, but certainly not in this situation. And it seems to me first of all, if you bring a parallel conduct case and you can't even allege some plus factors, you deserve to be thrown out for being, if nothing worse, lacking in creativity. But if Rule 8 or Rule 12b(6) is going to be the kind of screen at that time I think it fairly should be and with all the amendments in favor of the pleader and everything else, if there is a concern about parallel conduct and the plus factors that allow you to go forward, they should be required so that the Court can evaluate them under what I'm going to call the Third Circuit test. It's in other cases as well, but it's kind of been refined better in several cases there.

MR. HUMMEL: The plaintiffs are bumping up against Rule 11, not just Rule 8, and that's a problem. And the fact of the matter is Steve's got it exactly right. Last time I checked, parallel conduct was legal. You had to prove a combination or conspiracy. You had to meet the Matsushita test, and you ought to be able to plead that. And if you can't, you ought to be out. Because, as Steve says, you are then bypassing a Rule 12 standard. You are invoking this incredible machinery of the judicial discovery process and the early disclosures under local rules, and you can't get to summary judgment that fast anymore. And so allowing a plaintiff or plaintiffs to proceed without even an allegation of conduct that would violate Section 1 strikes me as a no-brainer. But obviously those much wiser than I have disagreed.

MR. FREITAS: So maybe this really is not a Rule 8 or a Rule 12 issue, but a Rule 11 issue. If one can't achieve the minimum levels of creativity to which George referred and make an allegation of illegal conduct, well, they ought to be thrown out. But if there's a real basis, a real, good faith basis for believing that there is a combination, it shouldn't be too difficult to make an allegation. Looking at it from the other side, the idea that there should be a formalistic requirement of the allegation of certain kinds of plus factors would be wrong as well. But the basic idea that there must be an allegation of something that violates the law, who can quarrel with that? ■

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