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BARGAINING IN THE SHADOW OF RATE-SETTING COURTS

DANIEL A. CRANE*

Judges will tell you that they are comparatively poor rate regulators. The specialized, technical competence and supervisory capacity that public utilities commissions enjoy are usually absent from judicial chambers. Nonetheless, when granting antitrust remedies—particularly remedies for monopolistic abuse of intellectual property—courts sometimes purport to act as rate regulators for the licensing or sale of the defendant's assets.

At the outset, we should distinguish between two forms of judicial rate setting. In one form, a court (or the FTC in its adjudicative capacity) grants a compulsory license and sets a specific rate as part of a final judgment or an order. The established rate merges with the final judgment, just like a damages award, requiring no further action from the court. Examples here include the FTC's recent decisions in Rambus and N-Data, where the Commission's order either set an actual rate or a

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* Professor, University of Michigan Law School; Bill Blumenthal, Doug Melamed, and the other participants at the ABA Section of Antitrust Law Conference on Remedies for Dominant Firm Misconduct at the University of Virginia School of Law provided many helpful comments on an earlier draft.

1 See, e.g., Arsberry v. Illinois, 244 F.3d 558, 562 (7th Cir. 2001) (referring to rate setting as "a task [courts] are inherently unsuited to perform competently"); In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig., 906 F.2d 432, 445 (9th Cir. 1990) ("The federal courts generally are unsuited to act as rate-setting commissions."); Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 265, 294 (2d Cir. 1979) (rejecting "judicial oversight of pricing policies [that] would place the courts in a role akin to that of a public regulatory commission").


maximum rate for patent licenses. The Supreme Court has suggested that such compulsory licensing and judicial rate setting may be a preferred remedy in cases of monopolistic abuse of patents.

Another form of antitrust remedy involves merely potential judicial rate setting. Here, the relevant judgment requires the defendant to license on reasonable (or reasonable and nondiscriminatory—RAND) terms and reserves jurisdiction for any potential licensee who is unhappy with the rate offered by the defendant to petition the court to set a rate. Significantly, however, such "jurisdiction retention" judgments do not necessarily involve a court in ever setting a rate. Instead, the mere threat of rate setting frames future licensing negotiations. The licensor comes to the bargaining table bereft of the power to impose monopolistic royalty rates, given that the licensee can always appeal to a court to set a monopoly-free rate.

This essay is largely concerned with the latter form of judicial rate setting—the jurisdiction retention mode—about which it makes three general points. First, judges' lack of expertise to set rates should not be thought a major detraction from this sort of remedy. Courts rarely exercise their rate-setting powers even when they retain them. The interesting question is not whether courts are any good at setting rates—they are not, but that may not matter—but what happens to the bargain of the licensor and the licensee when the shadow of a rate-setting court lies upon them. The short answer is that the shadow of a rate-setting court, as distinguished from the more amorphous shadow of a damages-assessing antitrust court, makes equality the dominant norm in the licensing of intellectual property. However egalitarian the general impulse of liberal society, it is not clear that equality is such a desirable norm when it comes to the licensing of intellectual property. Even so, in cases where the defendant has acquired monopoly power unlawfully, it is useful to have it bargaining with licensees under the shadow of an undefined cap on what it can demand as royalties.

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4 Sometimes, a court has ordered licensing on reasonable terms and retained jurisdiction to set a rate, but the government and defendants have then agreed on a rate schedule that has become incorporated into a post-judgment consent decree. See, e.g., Maul Bros., Inc. v. Emhart Corp., 356 F.2d 628 (6th Cir. 1966).

5 Besser Mfg. Co. v. United States, 343 U.S. 444, 449 (1952) ("Compulsory licensing and sale of patented devices are recognized remedies. They would seem particularly appropriate where, as here, a penchant for abuses of patent rights is demonstrated.").

Second, whatever disinclinations we may otherwise have to allow judges to impose a rate-setting regime as an antitrust remedy, the tentative trend of intellectual property law is toward an increased judicial rate-setting function. Copyright has long embraced a number of compulsory licensing regimes. In light of the Supreme Court’s decision in eBay v. MercExchange, patent, too, may be heading away from a right-to-exclude property regime toward a right-to-collect-royalties liability regime. The objections to courts as intellectual property rate setters may diminish if intellectual property continues to be de-propertized and courts grow more active in setting prospective royalty rates in intellectual property infringement cases. Will familiarity breed contempt or acceptance? This remains to be seen, but it is clear that the fate of rate-setting provisions in consent decrees is tied to the fate of liability regimes in intellectual property more generally.

Third, when in doubt about the wisdom of imposing an antitrust remedy, consider how businesses vote with their feet when given a relatively unfettered choice. Intellectual property owners are increasingly choosing to precommit to RAND licensing and judicial rate setting in order to avoid antitrust liability for various exercises of intellectual property rights, such as participation in standard-setting organizations (SSOs) or patent pools. In other words, intellectual property rights holders are choosing to blend liability and remedy by stipulating that a court can set the rate for their intellectual property, so long as the hammer of antitrust liability for damages or injunction is kept from striking. At a minimum, this shows that a judicial rate-setting function is not uniformly hostile to the interests of intellectual property owners—at least given the alternatives. More expansively, it suggests that the line between liability and remedy need not be so bright.

I. JUDICIAL RATE SETTING IN PRACTICE (OR NOT)

Antitrust decrees that require the defendants to license their intellectual property on reasonable terms and retain jurisdiction in the court to determine what is reasonable are said to create “rate-setting courts,” as if the decree actually brought into existence a new form of court with regulatory jurisdiction over the defendant’s licensing practices. In fact, the decree creates no new institution, but merely commits the court to en-

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8 To be sure, privately ordered intellectual property regimes like SSOs require RAND commitments for reasons other than avoiding antitrust liability. However, antitrust avoidance is one of the perceived benefits. See Justin Hurwitz, The Value of Patents in Industry Standards: Avoiding License Arbitrage with Voluntary Rules, 36 AIPLA Q.J. 1, 4 (2008) (noting that the “root of the [RAND commitment] problem lies in antitrust law”).
force its judgment through further specification in the future. Two questions are presented: (1) how often do such rate-setting courts actually set rates; and (2) what effect does the rate-setting court have on the parties who bargain in its shadow?

A. A RELATIVELY LITTLE-PRACTICED ART

The archetypical model of the rate-setting court is the U.S. District Court for the Southern District of New York in its capacity as the guardian of the ASCAP and BMI consent decrees. Since 1941, ASCAP, a music performance rights clearinghouse, has been operating under a consent decree (modified in 1950 and 2000) that requires ASCAP to license certain musical performance rights to all comers, and retains jurisdiction in the district court to set a rate in the event that the parties are unable to agree on one. Over the decades the ASCAP consent decree has been in place, the district court has had to set a rate on a number of occasions, including 1970 (CBS); 1987 (Buffalo Broadcasting); 1989 (Showtime/The Movie Channel); 1994 (Capital Cities, et al.); 1995 (Fox); 1997 (Salem Media/New England Continental Media); 1999 (National Cable Television Association—Interim rate); 2004 (Muzak and DMX); 2008 (AOL). This count does not include cases where a party asked the court to set a rate but the court declined.

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19 See, e.g., United States v. Am. Soc’y of Composers, Authors & Publishers, 331 F.2d 117 (2d Cir. 1964) (holding that ASCAP was not required to issue the kinds of licenses requested).
The BMI "rate-setting court" has been less active, but only because the BMI consent decree did not provide for rate setting until it was amended in 1994. The first rate-setting decision under the 1994 amendment—in which the district court set a rate for a licensee's performance of music via cable and satellite—occurred in 2001. The docket sheet reflects one or two other occasions when a party filed to commence a rate-setting proceeding but withdrew its request after agreeing on a rate with BMI. In a separate action, not filed under the principal BMI docket, the Southern District of New York also set a rate in 2007.

Although the ASCAP rate-setting court has been relatively active in recent years and the BMI court has had two rate-setting proceedings in its first fourteen years, it would be a mistake to generalize about the effects of rate-setting provisions from the amount of activity under the performance rights organizations (PROs) consent decrees. ASCAP and BMI engage in thousands of licensing transactions on behalf of hundreds of thousands of composers, songwriters, lyricists, and music publishers, and only a small fraction of these end up in rate-setting proceedings. Further, the PROs' licensing business is comprehensively regulated by the consent decrees.

By contrast, the run-of-the-mill antitrust decree with a reasonable royalty licensing provision—typically for patents—has typically involved little more than a nominal role for the "rate-setting court." Table 1 in the Appendix summarizes fifty-two decree provisions with reasonable licensing provisions for patents or copyrights and retention of jurisdiction for the district court to set a rate in the event the parties cannot agree. Not

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23 See http://www.ascap.com/about/ (reporting that ASCAP represents more than 330,000 U.S. composers, songwriters, lyricists, and music publishers); http://www.bmi.com/about/?link=navbar (reporting that BMI represents 375,000 songwriters, composers, and music publishers).
24 Table 1 includes only decrees that contained a specific retention-of-jurisdiction provision allowing interested third parties to seek a rate determination. It excludes many other antitrust decrees that include other forms of reasonable royalty provisions. For example, the 2001 Microsoft consent decree requires Microsoft to license (on reasonable and nondiscriminatory terms) to ISVs, IHVs, IAPs, ICPs, and OEMs any intellectual property rights owned or licensable by Microsoft that are required to exercise any of the options or alternatives expressly provided to those entities under the Final Judgment. The decree, however, does not allow the specified third parties to directly enforce the decree through a rate-setting procedure. New York v. Microsoft Corp., 224 F. Supp. 2d 76 (D.D.C. 2002), aff'd sub nom. Massachusetts v. Microsoft Corp., 375 F.3d 1199 (D.C. Cir. 2004).
surprisingly, the results show that most rate-setting courts have to exercise their rate-setting function very rarely, if ever. The fifty-two cases in which I identified a retention-of-jurisdiction provision mostly dated from the 1940s, 1950s, or 1960s, suggesting that rate-setting provisions for intellectual property have fallen out of favor more recently. In only three of them—ASCAP, BMI, and American Optical—could I identify any evidence that a court was ever called upon to set a rate for intellectual property.

Unless we count the PRO outliers where rate-setting decisions seem to be made every few years, it seems that judicial rate setting by consent decree is extremely rare. One possible interpretation is that rate setting is rare simply because the Justice Department and the courts were wrong to think that there was any need for antitrust intervention in the first place. If we take the underlying antitrust claims seriously, however, there is a different hypothesis: actual rate setting is rare because the shadow of the rate-setting court frames the bargain sufficiently to eliminate the defendant's ability to charge an unfettered monopoly price.

B. How Does the Bargain Differ?

Even if actual rate setting is rare, this does not mean that rate-setting courts are irrelevant to the process of negotiation between intellectual property rights holders and potential licensees. Juries are also extremely rare in civil antitrust cases—about one percent of all civil antitrust cases end up before them—but the institution of the jury casts a long shadow over the entire structure of civil antitrust litigation, from the motion to dismiss stage forward.

So how does the shadow of the rate-setting court affect the bargain? In order to answer this question intelligently, one has to ask "compared to what?" The right point of comparison is bargaining in the shadow of liability for antitrust damages, because a consent decree with a rate-setting provision for intellectual property significantly diminishes the likelihood that a court will find the defendant liable for antitrust damages in the future. For example, when the Supreme Court effectively blessed ASCAP and BMI's blanket licensing practices in light of their respective consent decrees, it stated that "it cannot be ignored that the Federal

26 In each case I tried to double-check the existence of any rate-setting decisions by examining both the docket sheet and searching for reported decisions. As noted in the Appendix, docket sheet information was unavailable for thirty of the cases.
27 I make this point more completely in Daniel A. Crane, Technocracy and Antitrust, 86 Tex. L. Rev. 1159, 1184–88 (2008).
Executive and Judiciary have carefully scrutinized ASCAP and the challenged conduct, have imposed restrictions on various of ASCAP's practices, and, by the terms of the decree, stand ready to provide further consideration, supervision, and perhaps invalidation of asserted anticompetitive practices.\[^{28}\] In a but-for world of a simple "cease and desist" injunction, post-decree bargaining would occur in the shadow of damages liability (with the decree itself serving as the licensee's whip hand to establish liability in the event that the licensor exacted excessive royalties) rather than that of the rate-setting court.

How the negotiating parties perceive the likely outcome of a rate-setting proceeding will affect the shape of their bargain. So how would a rate-setting court establishing the reasonable royalty to be charged for intellectual property approach its task? Traditional rate regulation, of the kind held constitutional by the Supreme Court,\[^{29}\] requires an evaluation of a firm's cost and the setting of a sufficient rate for the regulated entity to enjoy a reasonable return on its capital investment. It is not surprising to find courts confessing their own incompetence to engage in this sort of rate regulation. Courts are not institutionally equipped to study a firm's cost structure in detail and figure out the difference between confiscatory, reasonable, and excessive rates.

Rate setting for intellectual property must follow a different set of principles than the traditional cost-based approach. Obviously, marginal cost pricing of intellectual property is not an option, since marginal costs tend to be close to nothing.\[^{30}\] Nor is it reasonable to approach rate regulation of intellectual property by trying to locate a firm's sunk capital costs. Simply allowing a firm to recover the sum of its sunk capital costs and its marginal costs of production for any particular invention would not be remunerative, since for every invention that succeeds there tend to be many others that fail.\[^{31}\] In order to be completely remunerative, a cost-based intellectual property rate regulation regime would

\[^{28}\] Broad. Music, Inc. v. CBS., 441 U.S. 1, 13 (1979). Although the Supreme Court only decided whether the ASCAP and BMI blanket licensing systems, as modified by the consent decree, fell under the per se rule of illegality for price fixing, later decisions have upheld blanket licensing under the rule of reason. See Buffalo Broad. Co. v. Am. Soc'y of Composers, Authors & Publishers, 744 F.2d 917 (2d Cir. 1984).

\[^{29}\] See, e.g., Munn v. Illinois, 94 U.S. 115 (1877) (permitting rate regulation of grain elevators and other industries affected with the public interest); Smyth v. Ames, 169 U.S. 466 (1898) (requiring rate regulators to allow regulated enterprise a reasonable return on its capital investment).


\[^{31}\] For example, it is well known that only a small fraction of new drugs invented by pharmaceutical companies ever reach the market. See Michael A. Carrier, Two Puzzles Resolved: Of the Schumpeter-Arrow Stalemate and Pharmaceutical Innovation Markets, 93 Iowa L.
have to take account of the risk-adjusted investment in the relevant invention. For example, if the research and development cost leading to the production of a drug was $100, the ex ante likelihood that this R&D program would produce a commercially viable drug was 50 percent, and the marginal cost of producing the drug was $20, then the appropriate cost-based rate would be $220 (not counting the allowance for a reasonable “profit”).\(^3\) Neither courts nor administrative agencies are likely up to the task of engaging in this sort of ex ante risk assessment in order to determine the appropriate rate.

Courts involved in prospective rate setting of intellectual property have limited tools at their disposal. The widely used Georgia-Pacific factors,\(^3\) which guide decisions about the appropriate royalty rate in patent infringement cases, provide only limited guidance for judges who are setting a royalty as a remedy for an antitrust violation. The goal of the antitrust remedy exercise is to strip away the incremental monopoly power obtained by the antitrust violation, but many of the most important Georgia-Pacific factors assume the patentee’s current market position as the appropriate baseline. For example, factor one focuses on the royalties currently being received by the patentee; factor eight focuses on the established profitability of the product made under the patent; factor eleven focuses on the profitability of the infringer’s use of the invention; and factor fifteen asks what amount the patentee and the infringer would have agreed upon at the time the infringement began (i.e., a time before the determination of antitrust liability) if both had been reasonably and voluntarily trying to reach an agreement.\(^3\) The Georgia-Pacific factors are more useful in solving hold-out problems than they are in locating the monopoly-free royalty rate.\(^5\)

In fact, the few available examples from antitrust rate courts suggest that comparability to external benchmarks is the chief guiding princi-

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\(^3\) I am assuming that the marginal costs are only incurred after it is known that the drug will be commercially successful (i.e., it has received FDA approval and has been shown effective in clinical trials) and therefore there is no need to adjust the marginal costs of production for risk.


\(^3\) Id.

\(^5\) To be more precise, in a remedial rate-setting proceeding, the correct rate is not necessarily a monopoly-free rate—since the defendant may have had monopoly power even before its violation—but a rate not reflecting any incremental monopoly power derived from the violation.
ple. A good example of this is the first (and, thus far, only) rate-setting proceeding under the BMI consent decree. When Music Choice, a cable and Internet music channel provider, sought a rate from BMI, the rate setting bounced up and down between the district court and the court of appeals on the issue of how the rate set for Music Choice should compare to the contractually agreed rate between BMI and DMX—Music Choice’s competitor.

Benchmarking may be the best that rate-setting courts can do, but it is highly imperfect as a remedial mechanism. First, as with the use of the more expansive Georgia-Pacific factors, benchmarking suffers from the fact that the rest of the market—including the benchmark contracts—may already be the products of the defendant’s monopoly power. It does not improve things much in terms of antitrust values to say that applicant X gets the same rate as firm Y got a year ago if the rate that firm Y got was itself inflated by the defendant’s elimination of competition.

Second, it is not clear that equality is a very useful norm for setting prices for intellectual property. Price discrimination is perhaps the best way that intellectual property rights owners have to recover the high fixed costs of creating information. Indeed, intellectual property is often priced discriminatorily even in markets where it has economic substitutes. Elsewhere, I have argued that the “nondiscriminatory” prong of RAND commitments should be read as a commitment not to price discriminate in such a way as to increase downstream market power, but that it should not be read as a general equal-royalty commitment, lest RAND commitments frustrate efficient price discrimination schemes. But if comparability is all that courts have to go on in setting

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36 See United States v. Broad. Music, Inc., 426 F.3d 91, 94 (2d Cir. 2005) (“A rate court’s determination of the fair market value of the music is often facilitated by the use of benchmarks—agreements reached after arm’s length negotiation between other similar parties in the industry.”).

37 The history of the rate-setting proceeding is recounted in id. at 92–93.

38 See Am. Soc’y of Composers, Authors & Publishers v. Showtime/The Movie Channel, Inc., 912 F.2d 563, 577 (2d Cir. 1990) (trial court opinion) (noting that “since there is no competitive market in music rights, the parties and the Court lack any economic data that may be readily translated into a measure of competitive pricing for the rights in question”).


royalty rates, then it is not hard to imagine that price discrimination will be thwarted.

In principle, the correct matrix for rate setting as an antitrust remedy is to place the burden on the licensor to justify its proposed royalty rate using a model that assumes, counterfactually, the presence or threat of competition in the market. Rates should be justified as those that would prevail in a market reflecting the status quo absent the challenged conduct.\footnote{Again, the defendant would be allowed to assume that amount of market power that it had before the alleged misconduct. For example, if prior to relevant conduct the defendant held a valuable patent that would allow it to charge $1 above a competitive level and after the relevant conduct it was able to charge $2 above the competitive level, the rate-setting court should allow it to charge $1, since the point of rate setting is to restore competitive pricing, not to penalize.} If the licensor seeks to engage in price discrimination, it should present a model showing that the particular pricing strategy adopted would be viable in a world where licensees could turn to substitute licensors in the event they were dissatisfied with the rates offered.

The conceptually correct model, like most others, is easier to articulate in theory than to apply in practice. And it is not clear that, should courts become more involved in consent decree rate setting, they would gravitate toward this norm. So perhaps the most we can say descriptively about the bargain in the shadow is that it is influenced by the knowledge that there is an undefined cap on how much the defendant can charge. That alone may be a useful feature of consent decrees in cases of true monopoly power.

II. PROPERTY RULES, LIABILITY RULES, AND JUDICIAL GRAVITATION

Judicial rate setting for intellectual property is not a new phenomenon. A compulsory license to make and distribute phonorecords—the "mechanical" license—was enacted as early as 1909.\footnote{Copyright Act of 1909, Pub. L. No. 60-349, §§ 1(e), 25(e), 35 Stat. 1075, 1075-76, 1081-82 (1909).} However, there is a significant difference between copyright's statutory compulsory licensing system and that created on an ad hoc basis under antitrust consent decrees: the statutory system allowed for the creation of specialized rate-setting tribunals (initially the Copyright Royalty Tribunal\footnote{See, e.g., Recording Indus. Ass'n of Am. v. Copyright Royalty Tribunal, 662 F.2d 1 (D.C. Cir. 1981) (reviewing rate-setting decision of Copyright Royalty Tribunal).} and since 2005 the Copyright Royalty Board\footnote{See http://www.loc.gov/crb/laws/}.}
As noted at the outset, judges often claim that they are ill-equipped to engage in rate setting. Judges claim that they are much better at determining past damages or fines and enjoining future misconduct than they are at acting like regulators. Following Guido Calabresi and A. Douglas Melamed's landmark article, judges often claim a preference for property rules, which in the context of intellectual property translates into the grant of past damages and a future injunction against infringement, rather than liability rules, which require the court to appraise the value of the defendant's property and set its future price.

A preference for property rules over liability rules undermines the case for rate-setting provisions in consent decrees, since such provisions essentially remove the "right to exclude" stick from the defendant's bundle of intellectual property rights and replace it with a right to receive a reasonable royalty, as determined by a judge, when others use the defendant's intellectual property. Whether property rules or liability rules should govern intellectual property in general is beyond the scope of this article. For now, it is enough to say a few words about historical resistance to de-propertizing intellectual property in the context of consent decrees and how recent developments in intellectual property law may affect these attitudes in the long run.

A. THE CASE AGAINST JUDICIAL RATE SETTING

Perhaps the clearest expression of resistance to intellectual property rate-setting provisions in antitrust consent decrees on institutional competence grounds comes not from the institution that would actually be involved in setting the rate—the judiciary—but instead from the Antitrust Division in its 1947 brief in National Lead, the titanium pigments cartel case. At issue in National Lead was a provision in the 1945 Final Decree entered by Judge Simon Rifkind of the U.S. District Court for the Southern District of New York requiring the defendants, National Lead and du Pont, to license all of their covered patents to any applicant.


cant at a “uniform, reasonable royalty.”50 The court reserved jurisdiction “to pass upon the reasonableness of any royalty or charge herein directed to be reasonable,” thus establishing a conventional “rate-setting court.”51

On appeal, the government asked the Supreme Court to modify the decree by either permanently enjoining the defendants from enforcing their patents or else to do the equivalent by requiring the defendants to license their patents royalty-free.52 Part of the government’s motivation was certainly punitive—it did not want to see the guilty defendants enjoy any fruits from their patents, the value of which had been pumped up by the cartel behavior.53 As the Supreme Court pointed out, however, National Lead was “a civil, not criminal proceeding” and the “purpose of the decree, therefore, is effective and fair enforcement, not punishment.”54 That left the government to argue that rate setting of patents was simply not an appropriate task for courts.

The centerpiece of the government’s brief was a section entitled “Unworkability of Reasonable Royalty Licensing as Antitrust Relief.”55 That section was clearly calculated not simply to address the specific merits of Judge Rifkind’s decree, but to make a case against judicial rate setting in antitrust cases, writ large. It began:

The practical difficulty of providing for reasonable royalties in a background of patent abuse and antitrust violation renders such relief unworkable. These practical considerations, implicit in the rationale of the rule terminating the enforceability of abused patents, are: 1. That the evaluation of patents as part of antitrust relief against a background of abuse of patents, imposes on the courts an “onerous and absorbing administrative burden.” 2. That the fixing of a patent value in terms of a royalty which will at the same time instill competition into the industry and dissipate the effects of monopoly, requires judicial regulation of the future economics of the industry, and is hence incompatible with our system of free enterprise.56

51 Id.
52 Id. at 335.
53 The government specifically worried that “any offhand determination of reasonable royalty could easily reward the defendant patentee for (and burden competitors and the public with the cost of) economic advantages resulting from its high level of know-how rather than from advantages stemming directly and solely from the inventive features of the processes, machinery or products covered by his patents.” U.S. Brief in National Lead, supra note 49, at *69.
54 National Lead, 332 U.S. at 338.
56 Id. at *63-*64 (internal citations omitted).
The government then laid out a detailed case against judicial rate setting. Following its roadmap, the government first made the practical, institutional competence case. Determining the prospective value of a patent was simply too difficult for courts, even with the help of a special master, since it almost impossible to “apportion[ ] to the invention only its particular share of the total value of the product, process or apparatus of which it is a part.” Another difficulty, which distinguished prospective rate setting from retrospective damages determinations, was that “determining the value of unexploited patents and applications of patents for future use” could “only be decided on the basis of the most conjectural kind of expert testimony.” Readjustments over the years would be inevitable. Should courts assume such responsibilities it would “saddle[ ] the courts, the public, the injured parties, and prospective competitors with what may be years of litigation as a method of providing relief against antitrust violations.”

The government then moved on to its philosophical objection. Judicial regulation of prices was antithetical to a free market society. It would result in an “economic system determined by judicial regulation rather than by the play of competitive forces in a free market.” It would require courts to choose between competing economic philosophies and accounting principles—an inappropriate role for the judiciary.

In support of its contention that judicial rate regulation was inappropriate, the government relied on two price-fixing precedents—Trenton Potteries and Socony-Vacuum—that had rejected efforts by defendants to justify the prices set by a cartel as “reasonable.” The government “submitted . . . that the fixation of a reasonable royalty is no different [than] a determination of the court as to whether or not an agreed price is reasonable.” In other words, the very rule of per se illegality for cartels also encompassed an implicit prohibition on remedial judicial rate setting.

Here, history and context are important. The Antitrust Division of the 1940s was controlled by the Brandeisian wing of the New Deal coalition. They were believers in atomistic competition “in which basic decisions

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57 Id. at *65.
58 Id. at *66.
59 Id.
60 Id. at *70-*71.
61 Id. at *77.
62 Id.
were made in an impersonal market and the pursuit of self-interest produced the greatest social good." The intensity of the government’s response to the prospect of judicial rate setting can be understood as a reaction to the regime that existed between the two cases cited by the government—the experimentation with government-mediated industry cartelization and planning during the brief era of the National Industrial Recovery Act (1933–35). In the second half of the New Deal (roughly from 1936 to beginning of U.S. involvement in World War II), such regulation of prices and conditions of sale rather than of the process of competition was anathema.

The Supreme Court did not take the government’s bait and involve itself in the ideological struggle between the competing New Deal ideologies (as it had earlier in *Socony-Vacuum*). It noted that in the last two years alone, the government had entered into six consent decrees with reasonable royalty provisions and that the 1946 amendments to the patent act specifically allowed for a “reasonable royalty” test for damages calculations in patent infringement suits. The decree stood.

Predictably, the government’s doomsday predictions did not come true. There are no reported decisions of any rate-setting activity under the 1945 decree—no evidence of distraction of the court’s mission, expenditure of its resources, or unseemly judicial interference in the give and take of the market. Presumably, as in most other cases where an antitrust decree requires licensing of intellectual property on reasonable terms with a reservation of jurisdiction, the parties bargained in the shadow of the rate-setting court rather than litigating in rate-setting proceedings. Still, the concerns expressed by the government are emblematic of a wider view that courts simply should not be in the rate-setting business for intellectual property because they cannot do it well and because markets, not courts, should determine rates.

B. The Gravitation Toward Liability Rules

The objection to judicial rate-setting provisions in antitrust consent decrees would be strongest if courts otherwise treated intellectual property rights as true property rights—i.e., they allowed for an unfettered

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68 *Id.* at 118–19.

69 332 U.S. at 350 n.9.

70 *Id.* at 349 n.8.
right to exclude others from the invention. In that case, the ordinary remedy for infringement of intellectual property rights would be damages for past infringement and an injunction against prospective infringement. Judicial rate setting under consent decrees would be an anomaly.

Before the Supreme Court's *eBay* decision, property rights protection of patents was the norm and the consent decree, rate-setting treatment was the aberration. The Federal Circuit, which generally controls the law of patents, followed a "general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances." In *eBay*, however, a fractured Supreme Court rejected this presumptive treatment of patents as property and held that, instead, the ordinary permanent injunction rule—irreparable harm, no adequate remedy at law, balance of hardships, and public interest—applied.

In light of *eBay*, injunctions no longer issue as a matter of right in infringement cases. If a court decides not to issue the injunction, the alternative is to allow the infringer to use the patents but to pay for them. And, of course, that entails the court deciding how much the infringer should pay for the patents—i.e., engaging in prospective judicial rate setting.

It remains to be seen just how wide the impact of *eBay* will be. Although the Court was unanimous in rejecting the Federal Circuit's "absent exceptional circumstances" standard, two concurring opinions struck widely different notes about the value of injunctions for patent infringement. Justice Roberts, joined by Justices Scalia and Ginsburg, believed that, even under the generic four-part permanent injunction test, the historical practice in patent cases—of granting the injunction—should usually prevail. Justice Kennedy, joined by Justices Stevens, Souter, and Breyer, believed that changed economic and technological circumstances—in particular, the rise of "patent trolls"—should make courts more skeptical about granting patent injunctions. The deep case for either property rules or liability rules remains to be made on the Court.

In the meantime, the lower courts are taking a more nuanced approach toward patent infringement injunctions than they previously

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73 Id. at 394–95 (Roberts, J., concurring).
74 Id. at 395–97 (Kennedy, J., concurring).
did. Two years after the *eBay* decision, a commentator summarized the early returns as follows:

1. The district courts continue to grant permanent injunctions in most cases; 
2. Typically, permanent injunctions continue to issue when the patent owner and the infringer are direct marketplace competitors; 
3. Typically, permanent injunctions are denied if the patent owner is a non-practicing entity; and, 
4. Other factors such as willful infringement, venue, the existence of a complex invention incorporating a patented feature, the willingness of the patent owner to license the invention and the likelihood of future infringement are not overly predictive with regard to whether patent infringement will result in issuance or denial of a permanent injunction.  

In other words, we are not seeing a complete shift away from property rules, but the number of ordinary patent infringement cases in which courts engage in prospective rate setting is growing. Patent courts, like antitrust courts, are increasingly rate-setting courts.

Assuming this trend continues, what will be the *eBay* decision's relevance for rate setting under consent decrees? One possibility is that judicial rate setting will be “normalized”—that it will come to be accepted as an ordinary function with respect to patents, whether in infringement cases or antitrust proceedings. In this “familiarity breeds respect” scenario, antitrust consent decrees involving patents will merely extend existing judicial involvement in determining reasonable royalties for prospective use. The only added wrinkle in the antitrust case—and it is a large wrinkle—is that the rate-setting court will have to determine the fair value of the patent in the but-for world where market power arising from an antitrust violation is absent.

The counter-scenario is that “familiarity breeds contempt.” Assume that the post-*eBay* world of judicial rate setting in a large number of infringement cases comes to be viewed as a failure. Judges are seen as routinely under-valuing intellectual property rights, leading to a diminution of inventive incentives. Infringers exploit the system by free riding on the creations of others and disappearing when it is time to pay up. Congress responds with an infringement remedy statute creating a strong statutory presumption in favor of injunction. In such a world, the Justice Department’s admonitions in *National Lead* will resonate anew. In a general movement back toward property rules for patents, we can expect to see that antitrust remedies for patent abuse will look more like

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76 See supra Part I.B.
those advocated in the government's *National Lead* brief: the defendant is stripped of its rights to enforce its patents or must license them for a zero royalty. Or the court simply leaves the defendant's patents alone, relying on the threat of future damages actions by aggrieved licensees to discipline the patentee's behavior.

Which one of these scenarios will come true? At this point, it is too early to say. For now, the most that we can say confidently is that the future of antitrust rate courts is tied to the future of intellectual property remedies more generally.

III. ERASING THE LIABILITY-REMEDY LINE

Thus far, we have assumed that judicial rate setting is a remedy that attaches after a liability determination. Conversations about remedy occur only once there has been a determination that the defendant violated the relevant legal norm. The articles in this symposium generally are about what happens after a court has found a defendant guilty of an antitrust violation. But the parties most immediately affected by antitrust judgments—the plaintiff and the defendant—usually prefer to blur the line between liability and remedy. We call this settlement. In rough terms, out of one hundred private antitrust cases, seventy-five are involuntarily dismissed before a verdict, twenty-three are settled, and only two are tried.\(^7\) Hence, private litigants vote for settlement over liability determination by a roughly 12-1 margin in those cases that would otherwise proceed to binary adjudication.

The settlement rate tells us that blurring the line between liability and remedy is usually a Pareto-optimal solution in treble damages cases. Indeed, those few cases that escape the jaws of pretrial motion practice and settlement to parade before a judge or jury are usually explained as ones in which strong informational asymmetries, transactions costs, or strategic considerations prevented an otherwise more efficient bargained solution. In this final section, I briefly discuss the context of line blurring in cases of antitrust and intellectual property and its potential implications for the future of judicial rate setting.

A. RAND PRECOMMITMENTS

In the IP-antitrust context, the movement to blur the liability-remedy line is underway. In recent years, some patentees participating in patent

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pools adjacent to SSOs have begun to precommit to licensing their patents to all comers on a reasonable and nondiscriminatory basis. The purpose of such precommitments is two-fold. First, other members of the SSO may insist on such a RAND pre-commitment in order to prevent hold-up once the patentee’s technology is incorporated into the standard. Second, the patentees themselves often voluntarily accept having their intellectual property rate-regulated in exchange for presumptive freedom from antitrust liability. It is as if they are settling an antitrust claim that has not yet been brought by agreeing not to price like a monopolist.

Additionally, RAND commitments are typically part of a package of “fixes” designed to answer prospectively the potential antitrust attacks that the pools are engaging in collusion or tying. In addition to the RAND commitment, the pool typically commits to include only patents essential to practicing the standard, which definitionally (although not necessarily practically) excludes the possibility that the pool will contain substitutes. Some “neutral” method is devised to ascertain what patents are essential and thus belong in the pool. The license granted the pool is nonexclusive—each patentee can continue to license all of its patents on whatever terms it chooses outside the pool. An example of such a package of fixes is the precommitments of the 6C and 3C DVD patent pools, both of which received positive business review letters from the Department of Justice in the late 1990s.

Such voluntary rate-setting provisions typically differ in one important regard from judicial rate setting under consent decrees: the patentees grant the rate-setting power to a neutral person, such as an arbitrator, rather than to a judge. For example, the current 6C license agreement calls for any dispute between licensors and licensees as to the determination of RAND terms and conditions to be “determined by an expert jointly appointed and paid by Licensee and Licensor or the other member of the Group.” Separately, the agreement contains a clause calling

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79 See generally Crane, supra note 41.
for arbitration of claims between licensors and licensees to occur under the auspices of the American Arbitration Association under the International Arbitration Rules of the International Centre for Dispute Resolution. This apparently creates a two-stage dispute resolution process with an initial informal mediation by an industry expert and then the possibility of escalation to formal arbitration.

There is, of course, a natural question as to whether arbitrators selected by the patentees will be sufficiently independent to protect consumers' interests in reasonably set royalty rates. But assuming that such questions can be resolved satisfactorily, the RAND precommitments offer an intriguing glimpse into the preferences of intellectual property owners constantly operating on the borders of antitrust liability. They are glad to trade the ostensible foundation of property rights—the right to exclude—for relief from the threat of antitrust regulation.

B. BEYOND LIABILITY, TOWARD LIABILITY?

Judicial rate setting implicates “liability rules” in two different ways. On the one hand, with the historical failure of no-fault monopolization proposals, courts only administer antitrust remedies once they have determined that the defendant is liable under the antitrust laws. This is a vestige of the historical choice to adopt a “crime-tort” model for antitrust conduct cases, which requires the identification of an affirmative bad act, rather than conceiving of antitrust as a form of corporate regulation. On the other hand, when courts do engage in rate setting (or threaten to do so), they are treating the intellectual property right as a liability right—the right to collect a reasonable royalty from others who use the invention.

The voluntary choice of some intellectual property holders to trade one kind of liability for the other—diminishing the prospect of antitrust liability in exchange for having their intellectual property treated as a liability right rather than a property right—is suggestive of how courts, the enforcement agencies, and even Congress should think about the uses and abuses of intellectual property. Despite the risks of undercom-
pensation when courts engage in rate setting for intellectual property, intellectual property rights holders do not invariably prefer property rules to liability rules. The value of the "right to exclude" stick is relative to what other sticks are allowed to be in the bundle. Intellectual property rights holders are often quite willing to trade the-right-to-exclude stick for other sticks, such as the right to bundle intellectual property rights in licenses, to establish technological standards with competitors, and to pool patents with rivals. Judicial rate regulation (or its shadow) is sometimes not so much a burden as a welcome relief from other, greater burdens.

IV. CONCLUSION

I will reveal my skepticism about the need for much antitrust enforcement against dominant firm behavior when I say that in an economy characterized by efficient capital markets, high rates of innovation, technological change, and labor mobility, and perpetual demographic change, long-lasting private monopoly power (apart from that conferred by the government itself) is rare. Nonetheless, where antitrust intervention is appropriate, my skepticism about judicial rate setting for intellectual property is less than my skepticism about the Section 2 enterprise more broadly. Actual judicial rate setting is relatively rare, and its mere threat may have a salutary effect on the bargain in the court's shadow. Disciplining dominant firms' intellectual property licensing behavior through the threat of judicial rate setting is a relatively non-interventionist yet effective remedy.


87 I develop this point more fully in Intellectual Liability, supra note 48.
APPENDIX

RATE-SETTING PROVISIONS IN DEPARTMENT OF JUSTICE DECREES

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<th>Defendant</th>
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<td>Bendix Aviation</td>
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<tr>
<td>Diamond Match</td>
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<td>1948</td>
<td>0*</td>
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<td>American Optical(^88)</td>
<td>1948</td>
<td>1 (1950)</td>
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<td>1949</td>
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<td>General Electric</td>
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<td>Standard Register</td>
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<td>Technicolor Inc.</td>
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<td>3M</td>
<td>1950</td>
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<td>Continental Can</td>
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<td>Permutit Co.</td>
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<td>0</td>
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<td>Kodak(^90)</td>
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<td>IBM</td>
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<td>National Screen Service</td>
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<td>Joseph A. Krasnov</td>
<td>1957</td>
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<td>Robert Shaw-Fulton Controls</td>
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<td>B.F. Goodrich</td>
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<td>Miller Industries</td>
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* Indicates that docket sheet information was unavailable for these cases.

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