



## Canada-United States Law Journal

Volume 12 | Issue

Article 16

January 1987

# The Interface between Intellectual Property Law and Competition Law in the North American Context

Tom Arnold

Craig M. Lundell

Michael B. Schroeder

Tim Cook

Follow this and additional works at: <https://scholarlycommons.law.case.edu/cuslj>

 Part of the [Transnational Law Commons](#)

### Recommended Citation

Tom Arnold, Craig M. Lundell, Michael B. Schroeder, and Tim Cook, *The Interface between Intellectual Property Law and Competition Law in the North American Context*, 12 Can.-U.S. L.J. 121 (1987)

Available at: <https://scholarlycommons.law.case.edu/cuslj/vol12/iss/16>

This Article is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Canada-United States Law Journal by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

## The Interface Between Intellectual Property Law and Competition Law in the North American Context

by Tom Arnold, Craig M. Lundell, Michael B. Schroeder, Tim Cook\*

### I. INTRODUCTION TO STATUTES

**T**he title to this paper implies that there exists some common boundary between intellectual property law and competition law. While Webster's defines the verb form of the word interface as "to interact or coordinate harmoniously,"<sup>1</sup> the interaction between these two bodies of jurisprudence has not always been harmonious.

The United States Constitution grants to Congress the power to "promote the progress of science and useful arts, by securing for limited times to . . . inventors the exclusive right to their . . . discoveries."<sup>2</sup> Congress implemented this power in 1790, and thereby established the U.S. patent system.

A patent is a grant to an inventor for a seventeen-year period<sup>3</sup> of the property<sup>4</sup> right to exclude others from making, using, or selling the invention.<sup>5</sup> It is this property right, an exclusivity also dubbed monopoly, which has been the basis of the apparent conflict with the U.S. antitrust laws, adopted a century after the first patent statute.

The Sherman Act and later the Clayton Act were responses to perceived abuses of the system of free enterprise. Section 1 of the Sherman Act, 15 U.S.C. § 1, provides in part that: "Every contract . . . in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."

Section 2 of the Sherman Act, 15 U.S.C. § 2, provides in part: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ."

The Clayton Act of 1914 was, in effect, a supplement and an amend-

---

\* Tom Arnold is a member of the firm Arnold, White & Durkee, Houston, Texas. Messrs. Lundell, Schroeder, and Cook are associates of that firm.

<sup>1</sup> WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 631 (1983).

<sup>2</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>3</sup> Shorter terms for ornamental design patents.

<sup>4</sup> 35 U.S.C. § 261 (1986), "Subject to the provisions of this title, patents shall have the attributes of personal property."

<sup>5</sup> 35 U.S.C. § 154 (1986), "Every patent shall . . . grant to the patentee . . . the right to exclude others from making, using, or selling the invention throughout the United States . . . ."

ment to the Sherman Act. Section 3 of the Clayton Act, 15 U.S.C. § 14, provides:

[I]t shall be unlawful . . . to lease or make a sale or contract for sale of goods . . . whether patented or unpatented . . . or fix a price charged therefor . . . on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor . . . of the lessor or seller, where the effect . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Section 7 of the Clayton Act, 15 U.S.C. § 18, provides: “[N]o corporation engaged in commerce shall acquire . . . the whole or any part of the assets of another corporation . . . where in any line of commerce . . . the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.”

Finally, section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1), recites in totally broad generalities that: “Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.”

Thus, an inventor has the right to exclude others from making, using or selling his invention but a person may not monopolize any part of the commerce among the several states. Therein lies the perceived conflict.

It is beyond the scope of this paper to compare all aspects of Canadian and U.S. law on the subject but a few particularly pertinent comparisons will be provided. For example, section 4 of the Sherman Act, 15 U.S.C. § 1, provides that: “The several district courts of the United States are invested with jurisdiction to prevent and restrain violations of this act;” and the Federal Rules of Civil Procedure provide at 28 U.S.C. § 1338(a) that: “The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents . . . .” However, the construction of a licensing agreement is solely a matter of state law.<sup>6</sup> In practice, disputes involving license agreements for technology transfer are much more likely to raise a federal question in the United States than in Canada and such disputes are normally under the jurisdiction of the Canadian provincial courts rather than the Federal Court.<sup>7</sup> As a result, Canadian patent licensing disputes will generally be resolved under the common law of contracts,<sup>8</sup> whereas resolution of a U.S. patent licensing dispute will more likely involve analysis under the antitrust laws, as construed by the Federal Courts.

<sup>6</sup> See *Lear, Inc. v. Adkins*, 395 U.S. 653, 661-62 (1969).

<sup>7</sup> See Primak, *Technology Licensing in Canada*, 3 LAW AND BUSINESS OF LICENSING 384.781 (1980) and Meredith, *Licensing Operations in Canada*, 3 LAW AND BUSINESS OF LICENSING 384.121, 384.123 (1980) (“The constitutional division of powers in Canada places enforcement of contracts generally in the provincial courts, and so patent license agreements are ordinarily litigated in the provincial courts.”)

<sup>8</sup> See Henderson, *Licensing in Canada*, 3 LAW AND BUSINESS OF LICENSING 83 (1980).

### A. Misuse

Our courts have added to statutory antitrust law an appendage we call "misuse": He who uses his patent, trademark, trade secret or know-how, in violation of the antitrust law, or otherwise unreasonably to restrain trade outside the scope of the particular grant or protected franchise, is guilty of misuse.

He who misuses his patent, as in licenses violative of the antitrust laws, is said, in the idiom of the law, to have "unclean hands." With unclean hands, he cannot come into a court of equity to enforce his patent even against a more heinous wrongdoer who suffered no injury by the misuse. Hence, a misused patent is unenforceable even if otherwise valid. This is so even though the infringer did not suffer from the misuse which may have occurred in a license to some other party.

Thus, we have a mix of antitrust and misuse law. An antitrust violation is the basis for a legal suit by way of offensive action for which a remedy for injury and damages suffered is sought. A parallel patent misuse violation is a defense which an infringer can urge when sued for infringement irrespective of the infringer's injury or damage by the misuse.

Most patent misuses do not rise to the level of an antitrust violation that would serve as the basis for an offensive antitrust cause of action.<sup>9</sup> But, at least since 1982, the U.S. Justice Department has taken the position that the courts should find a licensing practice to be a misuse only if the practice to be condemned amounts to an antitrust violation.<sup>10</sup>

### B. Rule of Reason

You will recall that the proscriptions of the statute which were quoted above condemn all monopolies and monopolists, and all acquisitions which "may . . . tend to create a monopoly."<sup>11</sup>

The statutes made no accommodation for reasonable restraints, and no accommodation for patents or many other business dealings. An example is duly franchised utilities in metropolitan areas in which monopoly is the standard and accepted practice of the day. The statutes were in the nature of emotional overstatements and overcorrections of perceived abuses.

Following the enactment of the proscriptions in the antitrust laws, the courts frequently found those proscriptions to be born of generic overstatement and therefore excessive. The courts and the Department of Justice soon began a process of refinement of the law by which only unreasonable restraints were prohibited while reasonable ones were

<sup>9</sup> Duplan Corp. v. Deering Milliken, Inc., 444 F. Supp. 648 (D. S.C. 1977), *aff'd in part, rev'd in part*, 594 F.2d 979 (4th Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980).

<sup>10</sup> See Remarks of Charles F. Rule before The World Trade Association and The Cincinnati Patent Law Association, "The Antitrust Implications of International Licensing: After the Nine No-Nos," 33 PAT. TRADEMARK & COPYRIGHT J. (BNA) No. 804, 18, 19 (November 6, 1986).

<sup>11</sup> Clayton Act § 3, 15 U.S.C. § 14 (1982).

not.<sup>12</sup> Unfortunately, the determination of reason has left much uncertainty as to what acts are, and are not, judicially reasonable and under what circumstances.

The Department of Justice participates in new lawmaking both by way of issuing position papers and policy statements for the Congress and the Administration<sup>13</sup> and also by being selective in the cases that it prosecutes and the cases in which it appears *amicus curiae* to advocate its perception of the public interest.

The rule of reason of U.S. antitrust law, as developed by the courts, seems to have a will of its own. The courts have tried, and tried again, to find some certainty and definiteness with occasional successes (called *per se* rules) of which we shall speak in a moment. But these efforts of the rule to acquire definiteness seem mostly to have been frustrated.

As recited by Richard McLaren, Assistant Attorney General in charge of the Antitrust Division, in a speech in London, July 1971,

The Rule of Reason . . . embraces three principal elements. First, the restriction or limitation must be ancillary to the lawful main purpose of a contract. Second, the scope and duration of the limitation must not be substantially greater than necessary to achieve that purpose. Third, the limitation must be otherwise reasonable in the circumstances.

The first two elements seem to inch up upon something definite, and then the third element seems to retreat. We find that different lawyers and courts have different views of what is "reasonable in the circumstances."

While an expression of the rule in a clear and universally applicable form has defied the best legal minds of our nation, the tools of analysis of the situations have not. The principal tools of analysis may be expressed as five basic elements: a primary lawful purpose; restraints which are ancillary to lawful purpose; purpose and effect of the restraint in question; leverage; and relevant market.

Lets start with relevant market. What is it that a monopolist monopolizes? If he monopolizes, he must monopolize something. That something is the relevant market. Then, is the market digital watches, self-winding spring watches, all watches, or timepieces including grandfather clocks? If there is a complete cross-elasticity of market as between watches, the relevant market will be watches. But for some antitrust purposes, the relevant market sought to be monopolized might be merely digital watches, or might be all watches, as distinguished from clocks and other timepieces.

Next a word about the primary lawful purpose, ancillary, and purpose and effect elements. The primary lawful purpose of a license may be

<sup>12</sup> *Standard Oil v. United States*, 221 U.S. 1 (1911); *United States v. Addyston Pipe & Steel*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899).

<sup>13</sup> See, e.g., Department of Justice Guidelines — Vertical Distribution Restraints, [1985 Transfer Binder] TRADE REG. REP. (CCH) ¶ 50,473 at 56,200 (April 15, 1985).

to transfer technology and afford its use for the benefit of those who need it in applications or places not served by its owner. If the purpose and effect of the royalty and other license terms is to seek profits from licensed use of the technology, they are reasonably ancillary to the primary lawful purpose and are lawful; but if the purpose or effect of some given royalty pattern or restraint written into the license is to obtain profits from elimination of competition, or to obtain profits from unpatented products not covered by the patents or outside the licensed know-how package, they are not reasonably ancillary and may be unlawful.

Finally, if the leverage of one's strength in one market area or item has been used to extract a restraint in a different market area so that a buyer is not free to choose, the restraint is likely to be held unlawful.

These, then, are the analytical looking glasses or tools of analysis which are used to measure the rule of reason. In any given situation, to fail to use every one of these looking glasses is to risk a fatal flaw in your analysis.

### *C. Royalties*

Both the courts and lawyers tend to write opinions as though there were something intrinsically lawful or unlawful in some given license provision. But this is false logic and misleading. We can see this by applying the tool of analysis to graduated royalties.

Suppose that a private inventor has made a very worthwhile invention, useful in a market which is completely occupied by three companies which have substantially equal market shares. In order to induce them to promote his invention in the market, he puts into a license which he offers to all three companies, a royalty provision calling for a 20% royalty on the first million dollars worth of annual sales, a 10% royalty on the second million dollars worth of annual sales, and a 1% royalty on all sales over the second million dollars worth of annual sales.'

His purpose is to induce the licensees to bring the invention promptly to public enjoyment—nothing could be more noble or benign than that. The effect in this instance is consistent with the purpose. The result is to bring to the licensor a larger and more prompt return on his invention. The mere return of money to the patent owner is reasonably ancillary. So, in our first example we find that graduated royalties appear to be inherently lawful. We might even say they are *per se* lawful.

But suppose the patent owner occupies 50% of the total market, a competitor who is charged with infringement occupies 30% of the total market, and the remaining 20% of the market is divided about equally among fifteen price-cutting competitors. While sitting around the corporate conference room discussing possible formulae for settlement of a pending infringement suit against the 30% company, the president of the patent-owning company says that the 30% defendant in the infringement suit is "a responsible company," which we all know translates into being

“not a price cutter.” The president opines that the rest of those companies are always upsetting the market with their special discounts and other price-cutting maneuvers. Then he proceeds to say, if we offer all comers a 20% royalty on the first million, 10% on the second million, and 1% thereafter on annual sales, the 30% defendant will be paying an average royalty of about 2%, which it will likely agree to in settlement of the lawsuit. None of the rest of those fly-by-night operators could afford either to defend the lawsuit or pay their near 20% royalty rate—we will drive the price cutters out of business.

When depositions are taken the first question will be, “Who thought up the graduated royalty formula?” The next question will be “What was the purpose?” We see instantly, under the purpose and effect analysis, that in this different industrial marketplace context, the same graduated royalty that we thought to be per se lawful in the first instance is clearly and affirmatively unlawful in the second instance.

The point is that there is nothing intrinsically lawful or unlawful in graduated royalties, discriminatory royalties, tying of one product to another, or many other activities that courts find to be antitrust violations and misuses. Rather, they take on legality or illegality depending upon their purpose and effect—in the context of the particular market structure and circumstances.

The grandfather case for the rule of reason, as applied to patent licenses, is *United States v. General Electric*<sup>14</sup>, which recites:

The patentee may make and grant a license to another to make and use the patented articles but withhold his right to sell them . . . . If the patentee goes further and licenses the selling of the articles, may he limit the selling by limiting the method of sale and the price? We think he may do so *provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly*.<sup>15</sup> (emphasis added)

Since 1926, limitations on the application of that rule have dominated the evolving law.

#### D. *Per se Violations*

Reference has been made to an occasional success of the antitrust law in finding definiteness. These successes take the form of rules as applied to specific fact patterns in which the courts find illegality without consideration of reason—a so-called per se illegality. The Supreme Court held in *Northern Pacific Railway v. United States*.<sup>16</sup>

However, there are certain agreements or practices which because of their [presumed] pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and

<sup>14</sup> *United States v. General Electric*, 272 U.S. 476 (1926).

<sup>15</sup> *Id.* at 490.

<sup>16</sup> *Northern Pacific Railway v. U.S.*, 356 U.S. 1 (1958).

therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. This principle of *per se* unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable—an inquiry so often fruitless when undertaken. Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are price fixing, *United States v. Socony-Vacuum Oil*, 310 U.S. 150 (1940); division of market, *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899); group boycotts, *Fashion Originators' Guild v. Federal Trade Commission*, 312 U.S. 457 (1941); and tying arrangements, *International Salt v. United States*, 332 U.S. 392 (1947).<sup>17</sup>

Note that the *per se* rule finds a wrong in the absence of evidence of a socially bad purpose or effect. The very reason for having the *per se* rule is to cut off the evidence—to eliminate the burdens of marshalling the evidence, presenting the evidence and analyzing the evidence.

In *United States v. Arnold, Schwinn & Co.*<sup>18</sup>, the Supreme Court found vertical territorial restrictions to be *per se* illegal. Before the ink was dry on the *Arnold, Schwinn per se* rule, a trial court in California perceived that more justice can be done with evidence than without it. The court elected to hear evidence on the reasonableness of vertical territorial restrictions. The case went up to the United States Supreme Court,<sup>19</sup> and said that under the *per se* rule that the Supreme Court had announced in *Arnold, Schwinn*, the Court should never have had before it any evidence on which to base a reversal of its *per se* rule. In *Continental T.V.*, the Supreme Court reversed its *Arnold, Schwinn per se* rule. The Court urged an analysis of the purpose and effects of the restraint under the rule of reason.

It is worth noting that, while fearsomely rigid, even the *per se* rules are *not always per se* in every context. An example is *National Collegiate Athletic Ass'n v. Board of Regents of the University of Oklahoma*.<sup>20</sup> Horizontal price fixing and output limitation, restraints which would ordinarily be held illegal *per se*, were at issue. The Supreme Court held that it would be inappropriate to apply a *per se* rule in cases which involve industries in which horizontal restraints on competition are essential if products are to be available at all. Though using the Rule of Reason analysis, the Court found an anticompetitive effect in the broadcasting plan which was proposed by the N.C.A.A., a common result in cases

---

<sup>17</sup> *Id.* at 5.

<sup>18</sup> *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

<sup>19</sup> *Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977).

<sup>20</sup> *N.C.A.A. v. Univ. of Oklahoma*, 468 U.S. 85 (1984).



which involve horizontally imposed restraints.<sup>21</sup> Another example—and there are many—is *Broadcast Music, Inc. v. CBS*.<sup>22</sup> Two classical per se illegalities were indicated, price fixing and conditional package licensing, but the Court adopted a *purpose and effect* analysis of the activity in the context of the particular market so as to reach the conclusion that the Rule of Reason standard had to be applied, and no impropriety was then found.

At least one court has voiced its reluctance to apply the per se rule to conduct which falls anywhere outside the strictly proscribed classifications of judicially-defined anticompetitive conduct.

Although Hennessey characterizes the alleged concerted restraint of trade as a per se violation of Section 1, attachment of the per se label is inadequate in itself to sustain a Section 1 violation without a showing of injury to competition. In *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101 (7th Cir. 1984), this court adopted a stringent test to determine whether a violation is illegal per se. We held that the per se label must be applied with caution and we will expand that class of violations 'only after the courts have had considerable experience with the type of conduct challenged and application of the Rule of Reason has inevitably resulted in a finding of anticompetitive effects.'<sup>23</sup>

As we proceed further, it will become apparent that the per se label is in fact only a tough Rule of Reason with which courts play verbal games.

Recently proposed changes to the antitrust laws, about which more will be said later, if enacted, would mandate a Rule of Reason analysis of technology licenses. Premises and general conclusions stated, let's consider briefly a few of the many areas where antitrust/misuse is at least a wash over the patent owner's historic rights in patent exploitation.

## II. SPECIFIC PATENT ANTITRUST AREAS CONSIDERED

### A. Acquisition of Technology and Patent Rights

#### 1. Internally Generated Superior Technology and Patents Therefrom Which Result

To date, acquisition of a patent and accumulation of patents through internal research have presented no antitrust problem.<sup>24</sup> However, the District Court in *SCM v. Xerox*<sup>25</sup> suggested in dictum that an antitrust violation arguably may exist when a company with monopoly

<sup>21</sup> See also *Car Carriers v. Ford Motor*, 745 F.2d 1101 (7th Cir. 1984), *cert. denied*, 470 U.S. 1054 (1985); *Regents of University of California v. ABC*, 747 F.2d 511 (9th Cir. 1984); *Rothery Storage & Van v. Atlas Van Lines*, 597 F. Supp. 217 (D.D.C. 1984).

<sup>22</sup> *Broadcast Music, Inc. v. CBS*, 441 U.S. 1 (1979).

<sup>23</sup> *Hennessey Industries v. FMC Corp.*, 779 F.2d 402, 403-04 (7th Cir. 1985).

<sup>24</sup> *Automatic Radio Manufacturing v. Hazeltine Research*, 339 U.S. 827 (1950).

<sup>25</sup> *SCM v. Xerox*, 463 F. Supp. 983 (D. Conn. 1978), *remanded*, 599 F.2d 32 (2d Cir.), *on remand*, 474 F. Supp. 589 (D. Conn. 1979), *aff'd*, 645 F.2d 1195 (2d Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

power attempts to obtain new patents on its own inventions *primarily for the purpose of blocking the development and marketing of competitive products* rather than primarily to protect its own products from being imitated or blocked by others. There seems to be no statutory justification for such a rule in the United States.<sup>26</sup>

Note here the tool of analysis, which is the purpose or effect of acquiring the new patents. Think a moment on the likely available proofs of that purpose or effect. Normally, proof of a purpose to acquire patents primarily for blocking will not be obtainable; in truth, however, by the nature of real world technology and market development economics, the primary purpose is commonly going to be the lawful purpose.

But in almost every antitrust case some “smoking gun” letter has been found in somebody’s file that ends up being the key to an argument of possibly wrongful intent. We can easily perceive some intra company memorandum to the effect of, “We don’t yet know whether the market will evolve from our present approach X or approach Y, so let’s get all the patents we can on approach Y to block out all competition and thereby preserve our options.”

There is no experienced patent lawyer in the country who has not received, authored, or otherwise observed such a letter without the thought of its being improper or unlawful. But, given the construction that such letters can sometimes undergo in court, particularly against a big company in at least a pseudomonopoly position, and given that these cases are decided as much by attitudinal instincts and biases of judges as by logical following of evidence and burden of proof law, this type of recitation by any company with a near-monopoly position or power must be viewed as a serious issue under our system of jurisprudence.

*United States v. Grinnell Corp.*<sup>27</sup> is repeatedly cited for the tenet that, a dominant firm which acquires or maintains its dominant position as a consequence of growth or development resulting from a superior product, business acumen, or historic accident will not, for those factors, be in violation of section 2 of the Sherman Act.<sup>28</sup> While some writers suggest that this premise allows dominant firms too much latitude to maintain their position, the courts have not yet retreated from that position. The Supreme Court has overruled a long line of cases and has held that the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single entity.<sup>29</sup> Several cases have affirmed the proposition that section 2 of the Sherman Act was not intended to prevent dominant firms from participating in aggressive competition or innovation.<sup>30</sup>

---

<sup>26</sup> But see Klitzke, *Patents and Section 7 of the Clayton Act: The Significance of Patents in Corporate Acquisitions*, 12 LOY. U. CHI. L.J. 401 (1981).

<sup>27</sup> U.S. v. Grinnell Corp., 384 U.S. 563 (1966).

<sup>28</sup> *Id.* at 570-71.

<sup>29</sup> *Copperweld Corp. v. Independence Tube*, 467 U.S. 752 (1984).

<sup>30</sup> *SCM v. Xerox*, 645 F.2d 1195 (2d Cir. 1981); *Berkey Photo v. Eastman Kodak*, 603 F.2d

For purposes of the decision in *California Computer v. IBM*, the court assumed that IBM had monopoly power in the relevant market. The plaintiff asserted three section 2 violations, the most relevant to this discussion being that IBM had made design changes on certain of its central processing units, disc drives and controllers which were for no technological advantage, but done solely for the purpose of frustrating competition in plug-to-plug compatible peripheral equipment. The court concluded that even a monopolist had the right to redesign its products to make them more attractive to buyers, whether this end was accomplished by reason of lower manufacturing costs and prices or by improved performance. The court stated that IBM was under no duty to help the plaintiff or other peripheral equipment manufacturers to survive or expand. It was also noted that when an opportunity existed to increase or protect market share profitability by offering equivalent or superior performance at a lower price, even a virtual monopolist might do so.<sup>31</sup>

Nor should the integrated nature of a large business which has monopoly power in one or more markets, in and of itself, stand as a barrier to that firm's taking advantage of its technological innovation. *Berkey v. Kodak*<sup>32</sup> involved the following five distinct markets: amateur conventional still cameras, conventional photographic film, color print paper, photofinishing services and photofinishing equipment, with Kodak having a monopolistic or dominant position in the first three of those markets.

A primary objection by Berkey was Kodak's simultaneous introduction of a new camera and film format, which were designed to work only with each other and which were introduced without predisclosure to other camera manufacturers. The court ruled that Kodak's ability to introduce this new format without predisclosure was solely a benefit of integration and not, on the record established, the misuse of its power in the film market to gain a competitive advantage in the camera market. It was the position of the court that so long as we allow a firm to compete in several fields, we must expect that it will seek the competitive advantages of its broad-based activities, such as more efficient production, greater ability to develop complementary products, reduced transaction costs and so forth. These activities, according to the court, are not considered to be uses of monopoly power.<sup>33</sup>

While the courts may be seeking to avoid uncertainties which would have a chilling effect on innovation, a line of demarcation between those

---

263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); and *California Computer Products v. IBM Corp.*, 613 F.2d 727 (9th Cir. 1979).

<sup>31</sup> *California Computer Products v. IBM*, 613 F.2d 727 (9th Cir. 1979).

<sup>32</sup> *Berkey Photo v. Eastman Kodak*, 603 F.2d 263, 302-03 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980).

<sup>33</sup> *Id.* at 276. *See also* *Foremost Pro Color Inc. v. Eastman Kodak*, 703 F.2d 534 (9th Cir. 1983).

activities which are merely “the benefits of integration” and those which are directed at “smothering competition” remains unclear.

As yet, there does not appear to be any direct limitation on a firm’s right to innovate and capitalize on that innovation regardless of the firm’s position in the relevant market prior to the technological development. John H. Schenefield, while Chief of the Antitrust Division of the Department of Justice, stated in an October 17, 1978, Department of Justice memorandum on the Domestic Policy Review of Industrial Innovation that “a firm has the green light to advance its position by the employment of innovation whose purpose is not simply to create entry barriers.”

But consider the appeal of this scenario: A company advances parallel technology paths, elects to market one while using patents covering the other development as protection against competition from that parallel quarter. Surely the company has offered on the market what it perceived at the time to be the best of the two alternatives, so the public is unlikely to be injured; and unilateral refusal to license others is generally accepted in this country as a lawful right.

But to enforce patents on the parallel approach without licensing them (i.e., to block others from development of the competitive technology) somehow simply feels anticompetitive to some personality types who can be found in the bar and on the bench, notwithstanding the statutory unrestricted patent right to exclude others. Indeed, in a number of countries, including Canada, a compulsory license may be granted if a patented invention is withheld from the public. This “non working” (and other violations of the Patent Act) of the patented invention is termed in Canada, a patent “abuse.”<sup>34</sup> One day a case may come along in the U.S. in the context of other factors (like a high percent of the relevant market already controlled and/or evidence of mischief of some kind) when the dictum “may” of *SCM v. Xerox* (mentioned earlier) is expressed as a section 2 liability if the unused parallel technology patents are enforced to block, rather than license, the competition.

## 2. Acquisition of Patent Rights by Purchase or Merger

There is nothing intrinsic to the purchase or sale of patents that renders the transaction lawful or unlawful. Given the analytical tools in the rule of reason discussion above, the industry context of the purchase or sale decides the issues.<sup>35</sup>

In *Kobe, Inc. v. Dempsey Pump*,<sup>36</sup> the court awarded treble damages under the Sherman and Clayton Acts to an accused infringer. The plain-

---

<sup>34</sup> Patent Act, R.S.C., ch. P-4 § 67 (1970).

<sup>35</sup> See *United States v. United States Gypsum*, 333 U.S. 364, 430 (1948); 35 U.S.C. § 261 (1986?).

<sup>36</sup> *Kobe, Inc. v. Dempsey Pump*, 97 F. Supp. 342 (N.D. Okla. 1951), *aff’d on other grounds*, 198 F.2d 416 (10th Cir.), *cert. denied*, 334 U.S. 837 (1952).

tiff had acquired ownership or received licenses under more than 90 patents, most of which related to hydraulically actuated pumps for installation in oil wells; i.e., the plaintiff had cornered the market on one class of pumps. The patent rights had been acquired from a number of parties and were deemed to give the plaintiff a complete monopoly of all hydraulically actuated oil well pumps. It was a monopoly of a relevant market, a broad relevant market, which was not protected by any single patent.

The court found that the patents were acquired pursuant to a plan and purpose to monopolize commerce in such hydraulic pumps, and granted treble damages. In doing so, the court also noted that many of the patents were not used commercially.<sup>37</sup>

Compare the situation in *Chisholm-Ryder Co. v. Mecca Bros.*<sup>38</sup> Chisholm-Ryder had acquired the rights to several patents in the area of harvesting grapes by machine. The court found that the progressive acquisition of patents occurred during development of a practical harvesting machine and followed *SCM v. Xerox*, holding that no Sherman sections 1 or 2 or Clayton section 7 violations had occurred.

The risk of a Clayton section 7 violation in some circumstances has been suggested.<sup>39</sup> In *Dairy Foods*, the court stated:

Section 7 prohibits acquisition of assets . . . where “. . . such acquisition may . . . substantially . . . lessen competition . . .” Patents are assets and where two large business concerns own patents which may be similar in scope and decide not to compete but to put both into a common corporation or pool of which each owns 50% of the stock, such may tend to lessen competition.<sup>40</sup>

Contrast *Dole Valve v. Perfection Bar Equipment*,<sup>41</sup> where the court held that a patent may be an asset under section 7 of the Clayton Act, but a suit for infringement of a patent acquired by an acquisition which is unlawful under section 7 is not necessarily an injury by reason of that acquisition; rather, injury stems from misuse of the patent.

In particular, if one of the two largest companies in a given market acquires a substantial package of technology from the first, second, or third largest company in the market, and between them they control over 60% of the relevant market, you may derive from some cases such as *Honeywell, Inc. v. Sperry-Rand Corp.* the strong suggestion that for anti-trust safety you should not only offer the subject technology to others on reasonable license terms, but you should advertise the availability of the license to competitors and potential competitors as well. Without such

<sup>37</sup> *Id.* at 348.

<sup>38</sup> *Chisholm-Ryder Co. v. Mecca Bros.*, 217 U.S.P.Q. 1322 (W.D.N.Y. 1983).

<sup>39</sup> *E.g.*, *Honeywell, Inc. v. Sperry-Rand Corp.*, 180 U.S.P.Q. 673 (D. Minn. 1973); *Dairy Foods v. Farmers Co-op Creamery*, 298 F. Supp. 774 (D. Minn. 1969).

<sup>40</sup> *Dairy Foods*, 298 F. Supp. at 774.

<sup>41</sup> *Dole Value v. Perfection Bar Equipment*, 311 F. Supp. 459, 462-63 (N.D. Ill. 1970).

an offer, the acquisition runs a risk of being held to be anticompetitive with respect to small competitors who are suffering technological impediments to market entry or development.

The acquisition of patent rights often involves a technological merger; that is, an agreement or cross-licensing arrangement covering patents, proprietary information and unpatented design and manufacturing technology. This kind of arrangement was one focal point in *Honeywell Inc. v. Sperry-Rand Corp.*<sup>42</sup> Plaintiff Honeywell claimed that a technological merger between Sperry-Rand and IBM violated sections 1 and 2 of the Sherman Act and section 7 of the Clayton Act, and resulted in damage to Honeywell. The Sperry-Rand/IBM technological merger grew out of the settlement of several interference proceedings between applications for patents by Sperry-Rand and IBM.

The Minnesota District Court found that the merger injured competition in the electronic data processing (EDP) industry in two ways. First, the industry was injured by a conspiracy to perpetuate the dominance of the EDP market by the two companies who were party to the merger (95% of the EDP market at the time of the merger). Second, the court held that EDP market was injured by the merger because the merger tended to protect the market share of each conspirator. While the agreement purported to be a nonexclusive cross-licensing agreement, the court found it to be *de facto* exclusive in view of the secrecy and confidentiality with which the parties cloaked the agreement, especially when coupled with the absence of any licenses to other competitors in the EDP market.

The court found the cross-license and exchange of technical information agreement to be an unreasonable restraint of trade and an attempt by IBM and Sperry-Rand to strengthen or solidify their monopoly in the EDP industry. The court held, however, that Honeywell had failed to prove that Sperry-Rand's participation in the technological merger violated section 2 of the Sherman Act. While Honeywell's standing to sue under section 7 (the anti-merger section) of the Clayton Act was barred by the statute of limitations, it seems clear that this claim would have been sustained had the cause of action been raised in a timely fashion. In view of the market positions held by IBM and Sperry-Rand in the EDP market, the court concluded that each of the parties to the agreement had a duty to the remaining members of the industry to make a full disclosure of the agreement and affirmatively to seek out parties such as Honeywell and offer them access to technological information equal to that offered in the technological merger.

One district court case and dicta in other cases are not necessarily controlling law. But let us not be oblivious to the handwriting on the wall, like *Honeywell*.

Existing market power and intent were key factors in the decision in

---

<sup>42</sup> *Honeywell*, 180 U.S.P.Q. at 673.

*McDonald v. Johnson & Johnson*.<sup>43</sup> Johnson & Johnson (J&J) had acquired a corporation which was engaged in the manufacture of an electric nerve stimulator for controlling pain. After the acquisition, J&J suppressed the manufacture of the stimulator invention (at least arguably because it was not uniformly effective). Combined with the finding of fact that J&J wanted to protect its own over-the-counter pain drug product and its dominant market position in the drug, the J&J reason for the suppression was disregarded and J&J was found guilty of violations of both Sections 1 and 2 of the Sherman Act.

A further note with regard to a potential section 7 Clayton Act violation on the purchase of a patent or patents arose in *SCM v. Xerox Corp.*<sup>44</sup> The relevant product market and submarket did not exist until eight years after the acquisition by Xerox of still uncommercialized patents, and Xerox then possessed no market power whatsoever even in the inchoate market and submarket until some four years after the acquisition.

The appellate court held that the probable economic effects are to be viewed at the time of acquisition and that if the relevant product market did not exist at the time of acquisition, section 7 cannot be violated as a matter of law.<sup>45</sup> Moreover, when the acquisition of patents does not violate section 7, subsequent conduct which is permissible under the patent laws cannot trigger any liability under the antitrust laws because to hold otherwise would violate the policies that underlie the patent law system.<sup>46</sup>

But what if Xerox possessed power in the inchoate market and submarket at the time of the acquisition? The court indicated in dictum that a section 2 Sherman Act violation will occur when the dominant competitor in a market acquires a patent which covers a substantial share of the same market that, when added to his existing share, will afford him monopoly power.<sup>47</sup>

In 1982, the Department of Justice and the Federal Trade Commission issued new Merger Guidelines to "improve the predictability of the [Justice] Department's merger enforcement policy."<sup>48</sup> No special provisions relating to technological mergers were included. The unifying theme of these Guidelines is that mergers—technological or otherwise—should not be permitted to create or enhance "market power" or to facilitate its exercise.

<sup>43</sup> *McDonald v. Johnson & Johnson*, 537 F. Supp. 1282 (D. Minn. 1982), *aff'd in part and vacated in part*, 722 F.2d 1370 (8th Cir. 1983).

<sup>44</sup> *SCM v. Xerox*, 463 F. Supp. 983 (D. Conn. 1978), *remanded*, 599 F.2d 32 (2d Cir.), *on remand*, 474 F. Supp. 589 (D. Conn. 1979), *aff'd*, 645 F.2d 1195 (2d Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

<sup>45</sup> *SCM v. Xerox*, 645 F.2d at 1211.

<sup>46</sup> *Id.* at 1212.

<sup>47</sup> *Id.* at 1205.

<sup>48</sup> Merger Guidelines of Department of Justice — 1982, Trade Reg. Rep. (CCH) ¶ 4500 (1982).

### 3. Grant-backs

Historically, the acquisition of almost any form of patent license or title by grant-back from a patent licensee to his licensor was viewed as legal.<sup>49</sup> But it is always dangerous to follow precedents of this type, including the industry context of the transaction, without going through the rule of reason analysis. Acquisition of exclusive licenses or patent title by grant-backs from the licensee or by exclusive cross-license is now in antitrust hot water at least up to the ankles. The Department of Justice (in the 1970s) announced its intent to challenge grant-backs of exclusive rights and when the result is an expansion or extension of the original licensor's patent licensing power.

Apparently, a Canadian licensor is not under the same kind of restrictions in that a licensor may require the licensee to grant back to him fully and completely, all improvements which relate to the licensed technology and may also require that royalties be paid on such improvements.<sup>50</sup>

In the United States, limited-term, nonexclusive grant-backs, at least if without the right to sublicense and if the rights granted back cannot be practiced without practicing the original licensor's patented invention, are on solid dry ground.<sup>51</sup> But long-term and exclusive grant-backs merit close study before putting them into any new license to be drafted.

### 4. Patent Pools, Cross-Licensing

Patent pools and cross-licenses are generally not per se violations of section 1 of the Sherman Act.<sup>52</sup> The antitrust inquiry is generally directed to the purpose and the effect of the particular arrangement, as always, in context of the particular industrial structure. For example, one court has held that a finding that competitors' patents were blocking arrangements supported an inference that the existence of a pooling arrangement was for a legitimate, rather than an anticompetitive, purpose.<sup>53</sup>

Arrangements of this nature can have positive effects in extending technology to new products and geographic markets and increasing the return available on the pooled technology, thereby increasing the incentive to innovate. The countervailing aspects include the possibility that the arrangement, in some contexts, may dampen the incentive for individual firms to engage in competitive technical research and development. Consider, for example, an industry-wide, cross-license pool of

<sup>49</sup> *Transparent-Wrap Machine v. Stokes & Smith Co.*, 329 U.S. 637 (1947). *But see* *Chandler v. Stern Dental Laboratory*, 335 F. Supp. 580 (S.D. Tex. 1971).

<sup>50</sup> *Primak*, *supra* note 7, at 384.784.

<sup>51</sup> *Santa Fe-Pomeroy, Inc. v. P & Z Co.*, 569 F.2d 1084 (9th Cir. 1978).

<sup>52</sup> *See* *Standard Oil v. United States*, 283 U.S. 163 (1931).

<sup>53</sup> *Carpet Seaming Tape Licensing v. Best Seam*, 694 F.2d 570 (9th Cir. 1982), *cert. denied*, 464 U.S. 818 (1983).



patents on new inventions. If you are assured of access to all your competitors' new things at a reasonable royalty—reasonable in this context means you can pay it and still make a profit—why assume the high risks inherent in research and development (R&D)? The arrangement, in some contexts, operates as a form of security blanket, reducing investments in innovation by all members of the pool.

This concern led the government to challenge the pooling arrangements in the cases of *United States v. Automobile Manufacturers Ass'n*,<sup>54</sup> and *United States v. Aircraft Manufacturers Ass'n Inc.*<sup>55</sup> Both cases involved industry wide agreements to pool patents and technology; in the first case, a requirement that all members grant royalty-free licenses to other members and in the second case, licenses at a fairly low rate as set by an arbitration board. In one case it was also provided that no member would take licenses from outside parties unless similar rights and terms were available to all other members.

It was the government's position in both cases that the pace of innovation among members of the pools was reduced, as was the competition for patents developed by others. In both cases, the government obtained consent decrees which provided all of the relief that had been requested.

In a decision by the district court in Los Angeles, the government's request for an extension of the consent decree against the automobile manufacturers was denied. *United States v. Motor Vehicle Manufacturers Ass'n of the U.S.*<sup>56</sup> In reaching its conclusion, the court cited changing circumstances, specifically noting a shift in national concern toward energy efficiency.

In its report "Domestic Policy Review on Industrial Innovation," dated October 17, 1978, the Department of Justice set forth these guidelines for pooling arrangements: (1) industry wide pooling arrangements should be avoided; (2) the exchanges should relate only to interfering patents; (3) the arrangement should cover only present patents rather than future patents; and (4) the arrangement should be of limited duration.

It is clear that the broader the scope of the particular arrangement, the more likely it is that antitrust problems will arise. Roger B. Andewelt, Chief, Intellectual Property Section Antitrust Division, United States Department of Justice, made it clear in 1985 that the Department of Justice favors an evaluation of pooling arrangements using a rule of reason approach rather than a rigid per se condemnation.<sup>57</sup>

It is interesting to note that in May, 1985, the Justice Department

---

<sup>54</sup> *United States v. Auto. Manufacturers Ass'n*, 1969 Trade Cas. (CCH) ¶ 72,907 (S.D. Cal. 1969).

<sup>55</sup> *United States v. Aircraft Manufacturers Ass'n*, 1976-1 Trade Cas. (CCH) ¶ 60,810 (S.D.N.Y. 1975).

<sup>56</sup> *United States v. Motor Vehicle Manufacturers Ass'n*, 1979 Trade Cas. (CCH) ¶ 62,759 (S.D. Cal. 1979).

<sup>57</sup> Remarks of Roger B. Andewelt, Chief, Intellectual Property Section Antitrust Division,

petitioned the U.S. District Courts of the Southern District of New York and Delaware to modify or terminate three consent decrees that had been entered against the RCA Corporation. The original consent decrees ended litigation the Department had brought against RCA under sections 1 and 2 of the Sherman Act. The Department had alleged that certain patent pooling agreements, market division agreements, and restrictive patent licensing practices in restraint of trade. In explaining the Department's change of attitude with respect to these decrees, acting Assistant Attorney General Charles F. Rule noted that under certain circumstances the practices which are prohibited under the earlier decrees can promote, rather than harm, competition. The Department cited changing market conditions as the reason for its change of attitude and concluded that the decrees were no longer in the public interest.<sup>58</sup>

But consider this situation: eight major companies in a chemical processing industry, each with big R&D budgets and two continuously running pilot plants from which to learn new efficiencies; and 50 minors in the industry, each without finances to keep up in the R&D race, who pool a joint R&D effort of about the same size as most of the majors and exchange cross-licenses. Absent some conflicting, smoking-gun-letter, reason would seem to say, "lawful".

## 5. Technical Interchange Contract

The tremendous size and the high risk of the costs associated with R&D efforts are significant factors in the turn to technical interchange contracts like joint venture arrangements. Many projects are simply beyond the financial means of any one entity. Moreover, the long time lapse between the R&D investment and any return from the marketing of the resulting technology is increasing. The financial risks are reaching such proportions that many individual companies which may have money available, cannot, from a reasonable ROI (Return on Investment) business standpoint, invest in R&D activity. Another important consideration is that individual companies, which may have sufficient funds for R&D, often lack essentials, such as a particular expertise, or the appropriate pilot plant facilities. Finally, a joint effort may often be more efficient because needless and costly duplication of efforts may be avoided.

Joint ventures for R&D are not per se violations of section 1 of the Sherman Act. Not even a joint venture between a monopolist and another firm in a complementary market is considered a per se violation of section 1.<sup>59</sup> Joint ventures are reviewed by the Justice Department under

---

United States Department of Justice, before the National Institute On Industrial & Intellectual Property, Philadelphia, Pennsylvania, Oct. 11-12, 1984, 53 ANTITRUST L.J., Issue 3, p. 620 (1985).

<sup>58</sup> *Justice Dept. Seeks Termination of Decrees Relating to Patent Licensing*, 30 PAT., TRADE-MARK & COPYRIGHT J. (BNA) No. 735 (June 20, 1985).

<sup>59</sup> *See Berkey Photo v. Eastman Kodak*, 603 F.2d 263 (2d Cir. 1979).

the rule of reason analysis.<sup>60</sup>

President Reagan signed the National Cooperative Research Act of 1984. This act specifically clarifies the application of the rule of reason to joint R&D ventures. The Act also limits the amount of damages recoverable in antitrust actions to the actual, as opposed to treble, damages suffered if the joint venturers register their venture with the Justice Department within ninety days after entering into a written agreement to form the ventures. Therefore, the legality of a joint venture will generally be determined on the basis of the circumstances and purpose which lead to the particular arrangement and by the manner in which it is implemented.

For example, in the *Berkey* case, the court found that Kodak had actually obtained agreements from Sylvania and GE which delayed new flash cube technology from hitting the market until Kodak was ready to incorporate the new technology into its cameras. The court felt the jury could have found this to be a clear loss to consumers; a loss with no justification other than Kodak's convenience. The court, however, held that the agreement was not a per se violation of section 1. The court cited the following factors as relevant variables: the size of the joint ventures; their share of the respective markets; the contributions of each party to the venture and the benefits derived; the likelihood that in the absence of the joint effort, one or both parties would undertake a similar project, either alone or with a smaller firm in the other market; the nature of the ancillary restraints imposed and the reasonableness of their relationship to the purposes of the venture.<sup>61</sup>

Other factors to be considered, as set out in *United States v. Penn-Olin Chemical*, include: the number and power of the competitors in the relevant market; the background of their growth; the power of the joint venturers; the relationship of their lines of commerce; the competition in existence between them and the power of each in dealing with competitors of the other; the setting in which the joint venture was created; the reasons and necessities for its existence; the adaptability of its line of commerce to noncompetitive practices; the potential power of the joint venture in the relevant market; and an appraisal of what the competition in the relevant market would have been if one of the joint venturers had entered it alone instead of through the joint venture. Other factors to be considered include the size of the research project proposed in relation to prior independent R&D efforts by the participants and the ability or inability of each to undertake the project on its own. Finally, consideration must also be given to whether the joint venture is an "essential facility" that must be open to all on reasonable and nondiscriminatory terms.<sup>62</sup>

---

<sup>60</sup> K.P. Berkey, "Antitrust Enforcement: A Positive Force for Innovation," remarks made before the Institute of Electrical and Electronics Engineers, September 20, 1979.

<sup>61</sup> *Berkey*, 603 F.2d at 302.

<sup>62</sup> *United States v. Penn-Olin Chemical*, 378 U.S. 158, 177 (1964).

One of the dangers of various forms of joint venture R&D programs is the likelihood that parties who start such a program with strict and pure guidelines will soon forget to think about antitrust violations and then may inadvertently slip into an illegal pattern.

With respect to industry joint action, comments made in 1979 by then Deputy Assistant Attorney General Ky P. Ewing regarding U.S. industry's conversion to the metric system are of interest. It has been stated that industry conversion plans that make every effort to accommodate all members will not be attacked under section 1 of the Sherman Act, provided that the restraints inevitably flowing from them are reasonable. Caution must be exercised, however, to avoid anticompetitive exploitation of the conversion process and of coordinated anticompetitive conduct such as excessively broad information exchanges and the adoption of standardization proposals which are designed to facilitate price coordination.

### *B. Royalties Based on Unpatented Subject Matter*

Although payment of royalties by a consenting party for unpatented subject matter is not per se illegal, using the leverage of a patent to extort royalties on unpatented subject matter from an unwilling licensee is almost certainly a patent misuse. For example, in *Zenith Radio v. Hazeltine Research*,<sup>63</sup> Hazeltine offered to license Zenith on the condition that Zenith pay royalties, on all television sets manufactured regardless of whether the set employed any of Hazeltine's patented inventions. Zenith refused to license and was sued for patent infringement. The Supreme Court held that conditioning a license on payment of royalties as based on final sales of a product which might not incorporate the patented invention, is misuse.<sup>64</sup>

A royalty base which is broader than the patented subject matter is not objectionable if it serves the mutual convenience of both the licensee and the licensor and provided that the licensor does not condition the granting of the license on the broad base royalty while at the same time, refusing to license on any other terms.<sup>65</sup>

In considering whether such a royalty base is merely a convenience for the parties, one factor is whether the patented component is regularly marketed by itself. If it is not, and if there is no other egregious conduct, an agreement which bases royalties on sales of the finished product, rather than on the fair market value of the patented component has been held not to be patent misuse.<sup>66</sup>

To determine if the licensor placed a condition on a license, courts

---

<sup>63</sup> *Zenith Radio v. Hazeltine Research*, 395 U.S. 100 (1969).

<sup>64</sup> *Zenith Radio*, 395 U.S. at 135.

<sup>65</sup> *Zenith Radio*, 395 U.S. at 133.

<sup>66</sup> *Western Electric v. Stewart-Warner Corp.*, 631 F.2d 333 (4th Cir. 1980), *cert. denied*, 450 U.S. 971 (1981).

look to see whether the license condition was the result of good faith bargaining between the parties or was imposed on the licensee by the patent holder and whether the licensee raised objections that were overridden by the licensor.<sup>67</sup> If there is the placement of a condition or coercion by the licensor, or lack of arm's length bargaining between the parties, a royalty which is based on selling price of the whole rather than fair market value of the patented component may constitute misuse.<sup>68</sup> What can properly be included in a royalty base is limited only by the creativity of the parties, provided that the royalty base is chosen for their mutual convenience and no conditions are placed.

If it can be shown that the entire market value of the whole is attributable to the patented component, then royalties which are based on sale of the whole are proper.<sup>69</sup> Furthermore, it is not patent misuse for a multipatent licensing agreement to base royalties on the sale of all products which use any of the inventions covered by the licensed patents, so long as the arrangement is designed to serve the parties' mutual convenience.<sup>70</sup>

In summary, "the fact that royalties are paid on unpatented goods is not the test of misuse."<sup>71</sup> "[T]he test for patent misuse is the purpose and effect of the royalty provision."<sup>72</sup>

### C. Discriminatory Royalties

Historically, patent owners have felt that they could charge different royalties to different licensees. There are a number of reasons why this is often sound economic practice, and often it may encourage rather than restrict competition. For example, the first licensee may have assumed the expense and risk of getting Food and Drug Administration approval of foods produced by use of a patented, arsenic-base agricultural chemical. The second licensee may have assumed the burden of talking to every county agriculture agent in five states, and of teaching them to educate farmers as to the value and use of the new chemical, thereby developing the market. The third licensee may seek his license at a time when the market has already been proven and developed, and sterilized of risk. Are nonuniform royalties justified? Furthermore, the first licensee may have honored the patent without litigation, while the second

<sup>67</sup> *Glen Manufacturing v. Perfect Fit Industries*, 420 F.2d 319, 321 (2d Cir.), *cert. denied*, 397 U.S. 1042 (1970).

<sup>68</sup> *Warner-Jenkinson Co. v. Allied Chemical*, 477 F. Supp. 371 (S.D.N.Y. 1979), *aff'd*, 633 F.2d 208 (2d Cir. 1980).

<sup>69</sup> *See Paper Converting Machine v. FMC Corp.*, 432 F. Supp. 907 (E.D. Wis. 1977), *aff'd mem.*, 588 F.2d 832 (7th Cir. 1978).

<sup>70</sup> *Leesona Corp. v. Varta Batteries*, 522 F. Supp. 1304, 1341 (S.D.N.Y. 1981).

<sup>71</sup> *General Tire & Rubber v. Firestone Tire & Rubber*, 349 F. Supp. 333, 343 (N.D. Ohio 1972), *petition denied*, 431 F.2d 1199 (6th Cir. 1970), *cert. denied*, 401 U.S. 975 (1974).

<sup>72</sup> *Id.*

licensee may have forced the patent owner to expend \$1,000,000 on litigation before taking the license.

One licensee may be primarily interested in high-priced, low volume applications of an invention, while a second licensee may be primarily interested in a low-priced, high volume market. A first licensee may have sales power in markets which the patent owner cannot reach, while a second licensee may be strongest in the market of the patentee's own back yard. These and a number of other factors often bias the patent owner either to license at variant royalties or to grant no second license at all.

Congress has spoken in the Robinson-Patman Act<sup>73</sup> to the effect that commodity price discrimination as between competitors is unlawful. You will all agree that price discrimination in legal services is lawful. Why not also in patent licenses? A license to make, use, and sell is an intangible right, no more a commodity than legal services and, therefore, not within the ambit of Robinson-Patman.<sup>74</sup>

Note that any two licensees of the licensed product could not compete but for the patent owner's waiver of his right to preclude others from use of his invention. Nevertheless, we find holdings that discriminatory royalty rates among competing licensees, which result in injury to competition among the licensees, may be both patent misuse and an unfair method of competition in violation of section 5 of the Federal Trade Commission Act.<sup>75</sup> Certainly, if the nature of the royalty discrimination pattern can be shown to have been intended or to have the inherent effect of substantially restraining competition, we must view the discrimination critically even though we might view less critically other discriminations which are not afflicted in this way.

Happily, in one case on this particular point, *Bela Seating v. Poloron Products*,<sup>76</sup> the court took a significant swipe at *Allied Research Products v. Heatbath Corp.*,<sup>77</sup> and *Laitram Corp. v. King Crab*,<sup>78</sup> by sustaining the legality of discriminatory royalties, at least when valid reasons are shown. In *Honeywell, Inc. v. Sperry-Rand Corp.*, the court stated that a finding of patent misuse or a Sherman Act violation for discriminatory licensing requires a showing of the following:

- (a) the plaintiff took a license;
- (b) the royalty rate charged the plaintiff and that charged a competitor were unequal;

---

<sup>73</sup> 15 U.S.C. § 13(a) (1986).

<sup>74</sup> *Allen Archery v. Browning Manufacturing*, 1982-2 Trade Cas. (CCH) ¶ 64,736 (D. Utah 1982).

<sup>75</sup> *LaPeyre v. FTC*, 366 F.2d 117 (5th Cir. 1966).

<sup>76</sup> *Bela Seating v. Poloron Products*, 438 F.2d 733 (7th Cir. 1977), *cert. denied*, 403 U.S. 922 (1971).

<sup>77</sup> *Allied Research Products v. Heatbath Corp.*, 300 F. Supp. 656 (N.D. Ill. 1969).

<sup>78</sup> *Laitram Corp. v. King Crab*, 244 F. Supp. 9 (D. Alaska 1965), *modified*, 245 F. Supp. 1019 (D. Alaska 1965).

- (c) in all particulars relevant to equality of rates, plaintiff and its licensed competitor were similarly situated; and
- (d) the royalties were an important expense factor in the production costs and the discriminatory rate caused substantial impairment of competition in the relevant market.<sup>79</sup>

But why should the burden be upon a patent owner to show valid reasons for waiving part of his total right to preclude others for one consideration, and another part of his right to preclude others for another consideration? And by what measure do we determine the validity of the reason, when no waiver of his right to preclude others can be as anticompetitive as the total nonwaiver, the total nonlicense. We who practice law by foresight, instead of by judicial hindsight, find that discriminatory royalty rates are one of the many areas of per se uncertainty of the law.

#### D. *Graduated Royalties*

Recall the graduated royalty which was used as an example in the rule of reason discussion earlier in this paper. The context of the graduated royalty, not the fact of graduated royalty, determined its legality.

Patent royalty escalation is not, by itself, misuse.<sup>80</sup> Normally a patent holder may charge whatever it likes for a license.<sup>81</sup> Royalty rates which decreased when a stated minimum royalty had been paid were upheld in *Eversharp v. Fisher Pen*.<sup>82</sup> This decrease encouraged a "larger volume of manufacture and sales and, in turn, . . . encourage[d] competition."<sup>83</sup>

Ascending royalty rates have on occasion been used to force licensees to abide by territorial or quota limitations. Thus, it can be argued that a decision whether such a limitation violates the antitrust laws does not involve a clash between patent and antitrust law.<sup>84</sup>

A royalty rate for a package of patent licenses, with the rate per patent decreasing as the number of patents increases, may also escape the antitrust laws and the misuse doctrine. Furthermore, to refuse to grant a royalty reduction through grant-back licensing when a potential licensee seeks a license under one patent, but to allow a royalty reduction provided that the licensee takes a license under a package of patents, did not constitute patent misuse or violation of an antitrust consent decree in *Western Electric v. Stewart-Warner Corp.*<sup>85</sup> This holding is based on the fact that the prospective licensee was given a choice—take a license

<sup>79</sup> *Honeywell Inc. v. Sperry-Rand Corp.*, 180 U.S.P.Q. 673, 763 (D. Minn. 1973).

<sup>80</sup> See *In re Yarn Processing Patent Validity Litigation*, 541 F.2d 1127 (5th Cir. 1976), cert. denied, 433 U.S. 910 (1977).

<sup>81</sup> See *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

<sup>82</sup> *Eversharp v. Fisher Pen*, 204 F. Supp. 649 (N.D. Ill. 1961).

<sup>83</sup> *Eversharp*, 204 F. Supp. at 669.

<sup>84</sup> *Pfotzer v. Aqua Systems, Inc.*, 162 F.2d 779 (2d Cir. 1947).

<sup>85</sup> *Western Electric v. Stewart-Warner Corp.*, 631 F.2d 333 (4th Cir. 1980), cert. denied, 450 U.S. 971 (1981).

under one patent alone or on a combination of patents at a different royalty rate.<sup>86</sup>

In one case, *Laitram Corp. v. Depoe Bay Fish*,<sup>87</sup> the alleged infringer accused the patentee of misuse in charging a uniform license fee throughout the country. The fee for a license on the patentee's process for peeling cooked shrimp was based on pounds of unpeeled shrimp. Depoe contended that this uniform rate base discriminated against Northwest peelers because Northwest shrimp lose more of their weight in the cooking and peeling process than other shrimp. The court rejected this argument, pointing out that "if Laitram were to adjust its royalty rate to account for the generally lower yields of the Northwest, it could also be required to adjust its rate for higher quality shrimp which command a higher price in the marketplace. . . ."<sup>88</sup>

### E. Post-expiration Royalties

Post-expiration royalties do not seem to fit as neatly into the per se format as price fixing. Nevertheless, the Supreme Court called these provisions "unlawful per se" in *Brulotte v. Thys Co.*<sup>89</sup> and pointed out the analogy to leveraged tie-ins. Indeed, post-expiration royalties are in the rough nature of a leveraged tie-in because they are royalties on unpatented goods. They are often an exercise of leverage, and the more you study trends in antitrust law, the more leverage gravitates to front center front. Hence, it may seem appropriate to apply the rationale for tie-ins, and require a not insubstantial amount of commerce in the formerly patented product before these misuses will become violations of the Sherman Act.

There is yet another problem, however, in carrying tie-in law over to post-expiration royalties. Under *Brulotte*, these royalties are uncollectible and the licensees merely need to decline to pay them when the time comes. The patentee at that time has no more patent leverage to exert — the patent has expired.

What we really have is a situation in which the contract obligation to pay post-expiration royalties is a nullity. There will be great difficulty in proving direct damage. But beyond that, we have a situation of zero patent leverage with post-expiration royalties, since no one needs to fear an infringement suit once the patent expires. The foregoing leads us to conclude that a post-expiration royalty provision is a patent misuse only by error, and is not an antitrust violation in normal circumstances.

Of course, the more sympathetic point of view to patents is that the consideration of any contracted-for covenant or privilege can be a time payment, not paid contemporaneously with the running of the privilege.

<sup>86</sup> *Western Electric*, 631 F.2d. at 338-39.

<sup>87</sup> *Laitram Corp. v. Depoe Bayfish*, 549 F. Supp. 29 (D. Or. 1982).

<sup>88</sup> *Laitram Corp.*, 549 F. Supp. at 35.

<sup>89</sup> *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).



Under such a theory, the grant of license could relate to any period and payments could be in that or any subsequent period; it is a matter of free and proper contract negotiation whether there will be payments after the patent has expired, either in an absolute amount or an amount based upon production. In *Brulotte*, the Court characterized the post-expiration royalties as not being deferred payments for use of the patented machine during the pre-expiration period. Several cases have distinguished *Brulotte* on these grounds or on grounds that continuing R&D services were being rendered.

Canada has apparently taken the contract point of view on this question as well. That is, the term of an agreement and royalty payment may exceed the life of the patent on which the agreement is based, and, if the licensee has agreed to pay royalties even after expiration of the patent, he cannot avoid this obligation.<sup>90</sup>

*Aronson v. Quick Point Pencil*<sup>91</sup> merits consideration on this issue of royalties. The Court held that the federal patent law did not preempt state contract law so as to preclude enforcement of a contract for a "reduced royalty" on the sale of an "invention," for which a patent was sought but not issued, for as long as the contracting party continued to sell the "invention."

*Brulotte* was distinguished on the basis that the decision was premised on the use of a patent monopoly as leverage, in effect, to extend the life of that monopoly; while in the *Aronson* case, the parties clearly contemplated in their agreement that no patent might be issued, and structured their royalty arrangement on that possibility. The Court recognized that leverage might also be drawn from a pending application for a patent and suggested that abuse of this "leverage" might vitiate a license. However, the stipulated record of this case did not directly evidence the use of leverage and the Court decided the patent application was not proved to have played any part in the contract to pay the reduced royalty indefinitely. Enforcement of the contract was not found to be inconsistent with any of the purposes of the patent system (i.e., to encourage and reward invention, promote disclosure, and ensure that ideas in the public domain remain there for free use by the public).

The result in this case may be misleading, because it will commonly be possible to show that a leverage of the possible patent was used to extract the promise to pay royalties for indefinite terms, and the premise of the case may dissipate. But in *Stanfield v. Osborne Industries*,<sup>92</sup> the court used the precedent of *Aronson* to enforce a license agreement which

---

<sup>90</sup> See Primak, *supra* note 7, at 384.794, citing *Pigeon Hole Parking (Eastern Canada) v. Automatic Parking*, 6 C.A.2d 71 (Que. Sup. Ct. 1971).

<sup>91</sup> *Aronson v. Quick Point Pencil*, 440 U.S. 257 (1979).

<sup>92</sup> *Stanfield v. Osborne Industries*, 7 Kan. App.2d 416, 643 P.2d 1115, *modified*, 232 Kan. 197, 654 P.2d 917 (1982).

required payment of a royalty for as long as the licensee uses the invention, despite rejection of the required patent application.

Thus, *Brulotte* controls with regard to royalty payments which project beyond the expiration date of the underlying patents when the agreement is solely a patent license. *Aronson* appears to control with regard to royalty payments which are based solely upon trade secret or know-how agreements and without the use of leverage in the bargaining process. But when the agreement is a hybrid—granting exclusive rights both to trade secrets and know-how, and to claims of patents—the law is not so clear.

In *Pitney-Bowes v. Mestre*,<sup>93</sup> the trial court concluded in light of *Aronson* and *Kewanee Oil v. Bicron Corp.*,<sup>94</sup> that “given a hybrid trade secret and patent agreement providing clearly separate forms of protection, the trade secret protection might have a separate legal viability and might survive the expiration of the patent.” Furthermore, the issuance of a patent on a machine that is the subject of a trade secret agreement and that is mentioned in descriptive terms by reference to its patent application, though the issuance of that patent is not a condition of the agreement, does not transform the agreement solely into a patent license.<sup>95</sup> The court held, however, that the agreement must contain explicit language which differentiates between the trade secret protection and the patent protection which underlies the royalty obligation. The agreement must also contain language which allocates the royalties between the two forms of protection. Absent these provisions, the agreement on its face would be contrary to the decision in *Brulotte*.<sup>96</sup> On appeal, the *Pitney* court followed *Brulotte* and held the hybrid agreement to be unenforceable.

In *Boggild v. Kenner Products*, the court leaned toward the *Aronson* decision to uphold an agreement which required the licensee to pay royalties beyond the expiration of patents of the licensed device.<sup>97</sup> The key factor in the court’s decision was that no patent applications had even been filed when the agreement was executed. The Court of Appeals reversed, and held “that the *Brulotte* rule of per se invalidity precludes enforcement of license provisions which were developed in anticipation of patent protection and which require royalty payments for use, sale or manufacture of a patented item beyond the life of the patent.”<sup>98</sup>

<sup>93</sup> *Pitney-Bowes v. Mestre*, 517 F. Supp. 52 (S.D. Fla. 1981), *aff’d in part and dismissed in part*, 701 F.2d 1365 (11th Cir.), *cert. denied*, 464 U.S. 893 (1983).

<sup>94</sup> *Kewanee Oil v. Bicron Corp.*, 416 U.S. 470 (1974).

<sup>95</sup> *Pitney-Bowes v. Mestre*, 517 F. Supp. at 61-62.

<sup>96</sup> *Pitney-Bowes v. Mestre* 517 F. Supp. at 63.

<sup>97</sup> *Boggild v. Kenner Products*, 576 F. Supp. 533 (S.D. Ohio 1983), *rev’d*, 776 F.2d 1315 (6th Cir. 1985), *cert. denied*, — U.S. —, 106 S. Ct. 3284 (1986).

<sup>98</sup> *Boggild v. Kenner*, 776 F.2d at 1319.

### III. CURRENT THINKING AND LIKELY ENFORCEMENT POLICY OF THE ANTITRUST DIVISION WITH REGARD TO PATENT LICENSING PRACTICES

In the 1970s, officials of the Antitrust Division catalogued patent licensing practices which were viewed by the Department of Justice to be per se antitrust violations. The catalog, the infamous Nine No-No's, listed practices which were characterized as being "pretty clearly unlawful," and became the subject of talks intended "to dispel some of the alleged doubts and reported uncertainty concerning the law in this area."<sup>99</sup>

But in the 1980s, the patent licensing practices that were formerly declared "pretty clearly unlawful" have been recognized by the Department as being not so "clearly unlawful", and the Nine per se No-No's have been criticized as being over-inclusive, lacking economic rationality and being per se where the rule of reason should apply.<sup>100</sup>

In 1984, policy statements of the Justice Department toward patent licenses, the Chief of the Intellectual Property Section of the Antitrust Division, Roger Andewelt, and the Assistant Attorney General of the Antitrust Division, J. Paul McGrath, both repudiated the Nine No-No's and hostile court decisions as, in McGrath's words, "antiquated antitrust doctrines that unreasonably restrict [American firms'] ability to secure efficiencies through patent licensing." Mr. McGrath noted the decline of America's R&D investment compared to that of its competitors, Japan and West Germany, and the importance of technology licensing to give the R&D investor a fair chance to benefit from his investment. He pointed to two licensing practices, tie-ins and field-of-use restrictions, which often have procompetitive effects. Mr. McGrath reiterated the Department's position that the lawfulness of patent licenses should be based on a factual economic analysis; only when the overall effect of a license is anticompetitive should it be held unlawful.<sup>101</sup>

Unfortunately the courts have not yet revealed such a reversal of thought as has the Department of Justice. And indeed, case law estab-

---

<sup>99</sup> See Remarks of Bruce B. Wilson, Deputy Assistant Attorney General, Antitrust Division, before the Michigan State Bar Antitrust Law Section and the Patent, Trademark and Copyright Law Section, Detroit, Michigan, September 21, 1972, Trade Reg. Rep. (CCH) ¶ 50,146 (1972); Remarks of Ky P. Ewing, Jr., Deputy Assistant Attorney General, Antitrust Division, before the San Francisco Patent Law Association, Pebble Beach, California, May 5, 1979, Trade Reg. Rep. (CCH) ¶ 50,398 (1979).

<sup>100</sup> See Remarks of Abbott B. Lipsky, Jr., Deputy Assistant Attorney General, Antitrust Division, before the American Bar Association Antitrust Section, Washington, D.C., November 5, 1981, Trade Reg. Rep. (CCH) ¶ 50,434 (1981).

<sup>101</sup> See Remarks of Roger B. Andewelt, Chief, Intellectual Property Section, Antitrust Division, before the National Institute on Industrial & Intellectual Property, Philadelphia, Pennsylvania, October 11-12, 1984, 53 Antitrust Law Journal, Issue 3, p. 260 (1985); and remarks of J. Paul McGrath, Assistant Attorney General, Antitrust Division, before the Seminar Services International Conference on U.S. Patent Practice, Arlington, Virginia, April 5, 1984, 27 Pat. Trademark & Copyright J. (BNA) 624 (April 12, 1984).

lished prior to 1981 may make it hard to come by such a judicial correction within this decade even if judges of the Federal Circuit are all of the same mind as the Department—which is unlikely. So licensors and licensees are advised to be extremely cautious in avoiding any violations of the Nine No-No's, lest some court find a per se patent misuse in spite of the reversal of the view of the Department of Justice.

Two bills<sup>102</sup> were introduced in the 99th Congress to mandate the use of the rule of reason in analyzing technology transfer licenses. The Intellectual Property Antitrust Protection Act of 1987 (H.R. 557) was introduced on January 8, 1987. This bill would prohibit courts from declaring patent, trade secret and mask work licensing arrangements as per se violations of the antitrust laws. The bill would also eliminate the potential for treble damage liability under the antitrust laws for intellectual property licensing.<sup>103</sup>

On January 27, 1987, President Reagan submitted to Congress a message entitled "A Quest for Excellence." Included among the proposals under the heading "Better Protecting Intellectual Property" were the following: encourage patent owners to engage in newer and more novel ways to license their patent by limiting the "patent misuse doctrine;" amend the Clayton Antitrust Act to provide a more flexible standard of review for intellectual property licensing arrangements; restore the bargaining power of parties contracting to license technology by codifying and clarifying the Supreme Court holding in *Lear v. Adkins*.

These efforts by the Administration and the Congress indicate an increasing likelihood of meaningful change in the laws which govern the patent/antitrust interface.

#### IV. CONCLUSION

In 1970, the Chief of the Patent Group of the Antitrust Division of the Department of Justice said that, with respect to the interface of intellectual property and antitrust, there are "no rules of per se legality, there are not any completely safe harbors."<sup>104</sup> If there are no certainties in the law of antitrust as applied to licensing of intellectual property, and not *any* completely safe harbors, would it surprise anybody that licensing diminishes—to the detriment of competition? Or would it surprise anyone that investment in intellectual property thereafter diminishes; because when it is not licensed, the return on those investments also diminishes? Would it surprise anyone that progress of the useful arts and sciences stagnates to great public detriment?

The United States has changed sharply from a large manufactured goods exporter to a large net manufactured goods importer. This is due,

---

<sup>102</sup> H.R. 4585, 32 PTCJ 16; H.R. 4808, 32 PTCJ 82.

<sup>103</sup> *New Bill Would Apply Rule of Reason to Patent Licensing*, 33 Pat., Trademark & Copyright J. (BNA) No. 815,290 (January 29, 1987).

<sup>104</sup> Stern, *A Future Look at Patent Fraud and Antitrust Laws*, 52 J. PAT. OFF. SOC'Y 3 (1970).

owing in significant part, to the decline of the technical superiority of U.S. manufactured goods. This, along with many other economic factors, has led to the decline of United States technological leadership in the world.

Among the many philosophies which have earned a full share of the blame is the egalitarian sophistry of antitrust and misuse law of the 1940s to 1980, as applied to technology transfer contracts.

A few decisions since 1973, and the Department of Justice position since 1980, have both reflected a desirable change of trend, as well as an appreciation of the fact that neither "patent" nor "exploitation of a patent" is a four letter word.