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THE MISAPPLICATION OF ANTITRUST THEORY TO PATENT LICENSE CONDITIONS*

THEODORE L. BOWES†

INTRODUCTION

OVER THE past few years, there has been wide debate over patent license law, the law regarding the conditions patent owners can legally impose on licensees or the permissible scope of license grants. The controversy came to a head in 1970 when Senator Scott of Pennsylvania introduced amendments¹ to a then-pending bill intended to revise the patent laws.² According to the Senator, the amendments were intended to stabilize and codify license law. The amendments were rejected in the subcommittee and the bill was not enacted.

The history which led to the proposals for codification is a long one of gradual, case-by-case loss of rights for patent owners. Prior to the second decade of the twentieth century, conditions and restrictions of many kinds were commonly included in patent licenses, and the courts consistently held them valid. The Supreme Court's decision in *Henry v. A. B. Dick Co.*³ so held, but it raised a warning to future licensors and licensees that rights so broadly permitted might be in jeopardy. The minority in this 5-3 decision would have invalidated the tie-in which served as the basis for the suit, and ultimately the minority view of *A. B. Dick* prevailed in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*,⁴ another tie-in situation.⁵ The reversal

*The views expressed are those of the author and are not necessarily those of any organization or firm with which he is associated.

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¹ S. 2576 amend. 578, 91st Cong., 2d Sess. (1970).

² Title 35 of the United States Code. The last revision was enacted in 1952.

³ 224 U.S. 1 (1912). The Supreme Court, *per* Lurton, J., stated:

The books abound in cases upholding the right of a patentee owner of a machine to license another to use it, subject to any qualification in respect of time, place, manner or purpose of use which the licensee agrees to accept. 224 U.S. at 18.

⁴ 243 U.S. 502 (1917).

⁵ A tie-in situation arises when the owner of a product, such as a mimeograph machine (the tying product), sells that product only on the condition that the buyer purchases from him the paper or ink (tied products) necessary to operate the machine. For a further explanation and discussion of this concept, see E. KITNER, AN ANTITRUST PRIMER 47, 55 (1973).

was perhaps foretold in *Bauer & Cie v. O'Donnell*,⁶ where the Supreme Court held that price restrictions were outside the scope of the patent.

In the sixty years following the *Motion Picture* case, a wide variety of practices has been denied to patent owners. These include a number of tie-in situations,⁷ charging of different royalty rates according to source of material,⁸ or geographic location,⁹ licensee estoppel,¹⁰ free cross licenses,¹¹ grant backs,¹² mutual agreements among distributors,¹³ resale price provisions,¹⁴ price restrictions in cross licensees,¹⁵ industry networks to stabilize prices,¹⁶ compulsory package licensing,¹⁷ settlement of interferences with cross-licenses,¹⁸ foreign patent pools,¹⁹ post expiration royalties,²⁰ and royalty on an entire machine where the patent covered something less.²¹ Other invasions of patent owners' established rights include *in rem* invalidity²² and federal preemption.²³

⁶ 229 U.S. 1 (1913). The Court, in a 5-4 decision, found illegal resale price maintenance in a patent case involving a license condition. This was the first case to place a restriction on a patent owner's right to condition permission to infringe.

⁷ *Mercoird Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944) (sale of unpatented switches not contributory infringement); *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942) (use of unpatented salt); *IBM v. United States*, 298 U.S. 131 (1936) (purchase of IBM tabulating cards); *Carbice Corp. v. American Patents Dev. Corp.*, 283 U.S. 27 (1931) (purchase of unpatented dry ice); *Lincoln Electric Co. v. Linde Air Products Co.*, 171 F.2d 223 (6th Cir. 1948) (license only purchase of articles that use method); *American Lecithin Co. v. Warfield Co.*, 23 F. Supp. 326 (N.D. Ill. 1938), *aff'd*, 105 F.2d 207 (7th Cir. 1939) (implied licenses).

⁸ *Barber Asphalt Corp. v. LaFera Grecco Contracting Co.*, 116 F.2d 211 (3rd Cir. 1940) (different royalty according to source of material).

⁹ *LaPeyre v. FTC*, 366 F.2d 117 (5th Cir. 1966) (different royalties in different geographic areas).

¹⁰ *Lear v. Adkins*, 395 U.S. 653 (1969).

¹¹ *United States v. Automobile Mfrs. Ass'n*, 307 F. Supp. 617 (C.D. Cal. 1969).

¹² *United States v. Associated Patents, Inc.*, 134 F. Supp. 74 (E.D. Mich. 1955) (grant back in connection with a patent pool).

¹³ *United States v. Masonite Corp.*, 316 U.S. 265 (1942).

¹⁴ *United States v. Univis Lens Co.*, 316 U.S. 241 (1942).

¹⁵ *United States v. Line Material Co.*, 333 U.S. 287 (1948).

¹⁶ *United States v. United States Gypsum Co.*, 333 U.S. 364 (1948).

¹⁷ *American Securit Co. v. Shatterproof Glass Corp.*, 268 F.2d 769 (3rd Cir. 1959).

¹⁸ *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963).

¹⁹ *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 239 F. Supp. 51 (N.D. Ill. 1965).

²⁰ *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

²¹ *Kearney & Trecker Corp. v. Giddings & Lewis, Inc.*, 452 F.2d 579 (7th Cir. 1971).

²² *University of Ill. Foundation v. Blonder-Tongue Laboratories, Inc.*, 465 F.2d 380 (7th Cir. 1972).

²³ *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964); *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225 (1964); *Budis v. Kewanee Oil Co.*, 376 U.S. 829 (1964); *Stiffel Co. v. Hewlett-Packard Co.*, 416 U.S. 302 (1974); *Stiffel Co. v. Light Bulb Patent Co.*, 416 U.S. 302 (1974); *Stiffel Co. v. Light Bulb Patent Co.*, 416 U.S. 302 (1974).

It may be useful to roll back the pages of the casebooks to see whether the courts have treated the patent right fairly or reasonably. This is a period of history when it may be more important than ever to maximize every incentive to improve technology — especially in high public interest areas such as ecology and energy. Reward under the patent right is of crucial importance in maximizing incentives to invent and invest.

HISTORICAL DEVELOPMENT

This study begins with the *Button Fastener* case.²⁴ Although it has been overruled,²⁵ the decision is based on sound, unrefuted reasoning. In *Button Fastener*, the plaintiff sold machines used to fasten buttons to shoes on condition that they be used only with unpatented staples obtained from the plaintiff. The defendant argued that the condition operated to create a monopoly in unpatented staples and was, therefore, contrary to public policy, or so unconscionable that the plaintiff was not entitled to relief. The Court noted that there are limitations upon a patentee's power to contract. These include restraints imposed by the police power and uses by those charged with maintenance of public duties, such as telephone companies subject to regulation by law. This principle was held inapplicable to the facts of the case. The Court's reasoning reflects careful analysis:

If the patentee chooses to reserve to himself the exclusive use of his device, and the invention be of a wide character, and so radical as to enable him to make and sell an unpatentable product cheaper than any other competitor, a practical monopoly of the market for that article will result; and yet no one could say that a monopoly thus secured was illegitimate, or obnoxious to public policy. . . . Now, if the patentees, by retaining to themselves the exclusive use of their invention, are able, legitimately and lawfully, to acquire a monopoly of the manufacture of shoes, and destroy the shoe market for those who before had shared it, why may they not, by a system of restricted licenses, permit others to use their devices on condition that only some minor part of the shoe, — the pegs, the tips, the thread, or the buttons, or the button fasteners, — shall be bought from them? If these concessions were such as to enable others to compete, though their use of the mechanism was restricted by the terms of the license, who could justly complain, if the inventors, content with a monopoly of the market for the article named in their license, surrendered the opportunity for a monopoly of the manufacture of the complete shoe? . . . The monopoly in the unpatented staple results as an incident from the monopoly in the use of

²⁴ *Heaton-Peninsular Button Fastener Co. v. Eureka Specialty Co.*, 77 F. 288 (6th Cir. 1896) [hereinafter cited as *Button Fastener*].

²⁵ *Motion Picture Patent Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917) [hereinafter cited as *Motion Picture*].

complainant's invention, and is therefore a legitimate result of the patentee's control over the use of his invention by others. Depending, as such a monopoly would, upon the merits of the invention to which it is a mere incident, it is neither obnoxious to public policy, nor an illegal restraint of trade.²⁶

The Court's position can be summarized as follows:

- (1) An exclusive market position, built up by exercising the exclusivity of the patent right by manufacture and sale by the patentee for his own account, is legitimate, even if his success destroys his competitors;
- (2) If a sole position can then legally be developed, a patentee should be allowed to permit others to use the invention with tie-in conditions;
- (3) A tie-in provides a form of competition in the patented product; there is no improper end-product monopoly, nor are providers of unpatented components improperly or illegally excluded;
- (4) Licensing on terms such that the profit results from sales of the tied product is permissible and the tie-in acts as a counter by which the royalty is proportioned to use; and,
- (5) Any superior market position enjoyed by plaintiff is reached by reason of the competitive superiority of the patented machine.

While this case was tried as an infringement case five years after passage of the Sherman Act in 1890,²⁷ that Act was not mentioned. Yet the opinion discusses monopolies resulting from patents. It seems a fair inference that this Circuit Court believed that there was a clear line between positions developing out of patents and those where patents are not involved. This seems to echo Senator Sherman himself who said that "a limited monopoly secured by a patent right is an admitted exception, for this is the only way an inventor can be paid for his invention."²⁸

A few years later, another case was brought to recover damages for the breach of a patent license, to restrain future breach, and to compel specific performance. This was *Bement v. National Harrow Co.*,²⁹ decided early in 1902. The license was based on eighty-five patents relating to float spring tooth harrows, frames, and attachments. Each licensee agreed:

- (1) To pay a royalty for each harrow or frame sold except for those exported, and to pay a much greater sum as damages for unlicensed sales;

²⁶ *Button Fastener*, 77 F. at 295-96.

²⁷ Sherman Act §§1-7, ch. 647, §§1-7, 26 Stat. 209 (1890), as amended 15 U.S.C. §§1-7 (1955).

²⁸ 21 CONG. REC. 2457 (1890) (Remarks of Senator Sherman).

²⁹ 186 U.S. 70 (1902) [hereinafter cited as *Bement*].

- (2) Not to ship on commission, allow rebates, or sell below the prices fixed by the licensee or on more favorable terms than established under the license contracts;
- (3) Not to engage in manufacture or sale of products not licensed except to other licensees;
- (4) Not to contest validity; and,
- (5) Not to re-design the licensed products or make or sell different styles.

The plaintiff-patentee reserved the right to decrease the selling price of products, to establish terms more favorable to purchasers, to reduce stated royalties, and not to license others. Schedules identified the kinds of harrows licensed and contained a statement of prices including permitted discounts.

The defendant brought the case within the Sherman Act by charging that the various contracts were in violation of that Act. The Court made it abundantly clear that it was not ignoring the Sherman Act. The opinion notes that the only federal question raised is the validity of the various contracts "with regard to the act of Congress on the subject of trusts."³⁰ The *Bement* Court quoted Chief Justice Marshall and established the importance of the patent right for the Court. The quotation is important enough to be quoted fully:

... It cannot be doubted that the settled purpose of the United States has ever been, and continues to be, to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent. It is the reward stipulated for the advantages derived by the public for the exertions of the individual, and is intended as a stimulus to those exertions. The laws which are passed to give effect to this purpose ought, we think, to be construed in the spirit in which they have been made; and to execute the contract fairly on the part of the United States, where the full benefit has been actually received: if this can be done without transcending the intention of the statute, or countenancing acts which are fraudulent or may prove mischievous. The public yields nothing which it has not agreed to yield; it receives all which it has contracted to receive. The full benefit of the discovery, after its enjoyment by the discoverer for fourteen years, is preserved; and for his exclusive enjoyment of it during that time the public faith is pledged.³¹

After quoting extensively from the *Button Fastener* case, Justice Peckham reiterated that with few exceptions, the very object of the patent law is monopoly:

³⁰ *Id.* at 83.
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³¹ *Id.* at 89-90, citing *Grant v. Raymond*, 31 U.S. (6 Pet.) 94, 97 (1832).

... Any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sale of the article, will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does not render them illegal.³²

A very important and significant statement of the *Bement* Court was that the Sherman Act "clearly does not refer to that kind of a restraint of interstate commerce which may arise from *reasonable* and legal conditions imposed upon the assignee or licensee of a patent by the owner thereof, restricting the terms upon which the article may be used and the price to be demanded therefor. Such a construction of the Act, we have no doubt, was never contemplated by its framer."³³ (emphasis added.) This is a clear establishment of a special rule of reason in patent cases.

Finally, the opinion states that "On looking through these licenses we have been unable to find any conditions contained therein rendering the agreement void because of a violation of that [Sherman] Act."³⁴ It is worth noting that there was no dissent to this decision although three justices did not hear the argument and took no part in the decision.

The *Bement* opinion makes it clear that the Court, with full appreciation of the existence of the Sherman Act, concluded that:

- (1) Monopolies are the very object of the patent laws. Therefore, patents, as monopolies, are permissible monopolies not offensive under the Sherman Act;
- (2) Conditions which maintain the monopoly provided by a patent are not illegal;
- (3) A condition fixing prices in a patent license is not illegal; and,
- (4) A patent rule of reason is applicable to license and assignment situations.

The next significant happening in the development of license law was the decision of the Supreme Court in *Henry v. A. B. Dick*,³⁵ which held that it was not illegal to tie the sale of mimeograph machines to the supply of ink, stencils, and other supplies. The patentee sold the rotary mimeographing machines, covered by the patent, at cost and made his profit from the sale of the unpatented supplies. Justice Lurton asked, "Where, then, is the line

³² *Id.* at 91.

³³ *Id.* at 92.

³⁴ *Id.* at 93.

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³⁵ 224 U.S. 1 (1912) [hereinafter cited as *A. B. Dick*].

between a lawful and an unlawful qualification upon the use?"³⁶ He answered that the question is one of statutory construction and the governing statute creates a "true monopoly, one having its origin in the ultimate authority, the Constitution."³⁷ He also queried whether the statute should be narrowly scrutinized, which is "proper when a statutory right is asserted to uphold a claim which is lacking in those moral elements which appeal to the normal man. Or shall we approach it as a monopoly granted to subserve a broad public policy, by which large ends are to be attained, and, therefore, to be construed so as to give effect to a wise and beneficial purpose?"³⁸ The Court never answered specifically this question, but the balance of the opinion can only be construed as supporting a broad construction. For example, the Court said that "Congress alone has the power to determine what restraints shall be imposed. *As the law now stands it contains none . . .*"³⁹ (emphasis added.) The defendant in this case, and the minority, as will be more fully developed later, urged that earlier cases should be overruled. The Court answered that "A line of decisions which has come to be something like a rule of property . . . should at least not be overruled except upon reasons so clear as to make any other construction of the patent law inadmissible."⁴⁰

Whereas the *Bement* case was decided on a 6-0 alignment of the Court, a 4-3 majority decided *A. B. Dick*. Due to the swing in philosophy between 1902 and 1912, and because the minority foretold the future of tie-ins, the minority opinion and the reasoning exemplified justify careful study. The strong dissent was written by Chief Justice White and he was joined by Justices Hughes and Lamar.

One position of Justice White was that the attempted restriction dealt with an unpatented material to be used with a mimeographing machine, as distinguished from a restriction of the use of the machine or the duration of its use. Under White's approach, it would seem that only elements of the patented invention can be subject to any restriction; otherwise, the licensor can extend the patent to an infinite variety of unpatented supplies. This may be too fine a distinction. If it is a proper limitation to restrict the use to which the machine might be applied, or the duration of the use, it would seem reasonable to hold that the normal use of the machine was for ink-printing. The minority may have missed the point that almost every patent — and surely every machine patent — involves unpatented components, so

³⁶ *Id.* at 26.

³⁷ *Id.* at 27.

³⁸ *Id.*

³⁹ *Id.* at 35.

⁴⁰ *Id.* at 36.

that licensing any such patent results, in some degree, in collecting royalty for the sale or use of something unpatented. In an inventive sense, the ink was part of the concept. The whole idea was to develop a machine which would make multiple copies from a stencil with the use of ink. That the ink was not an element of a claim in the patent does not detract from its necessary presence in the use of the machine.

To return to Justice White's argument, he noted that the tied material — ink — was not covered by the patent in suit. He wrote, "This curious anomaly then results, that that which was not embraced by the patent, which could not have been embraced therein . . . is now by the effect of a contract held to be embraced by the patent . . . that a patentee . . . has power by contract to extend the patent so as to cause it to embrace things which it does not include . . ."⁴¹ The challenge to this position is that the patentee in no way claimed his patent covered supplies necessary to the use of the patented machine. What he did establish was that a fair price for sharing his exclusivity was the purchase of supplies from his designees, including the patentee.

A few paragraphs later, Justice White returned to his argument and carried it forward, writing, ". . . the ruling now made in effect is that the patentee has the power, by contract, to extend his patent rights so as to bring within the claims of his patent things which are not embraced therein, thus virtually legislating by causing the patent laws to cover subjects to which without the exercise of the right of contract they could not reach, the result being . . . to multiply monopolies at the will of an interested party . . ."⁴² (emphasis added.) The added element is the assertion that tie-ins extend monopolies, an argument that has prevailed and spread ever since. The snowball effect appears somewhat amazing in that no effort was made to show how monopoly extension took or could take place. Earlier opinions explained how this does *not* occur.

Rebuttal of Justice White's argument can be made on several grounds:

- (1) No old market is foreclosed. The pre-existing market for ink is changed in no way;
- (2) On the contrary, the license creates a new market which did not previously exist. It expands the market for the tied product;
- (3) The most likely reason for the establishment and growth of this new market is the competitive superiority of the patented inventions. There is domination in this micro-area only to the extent desired by the public which uses the invention;
- (4) The restriction expanded - not contracted - the output of the tied

⁴¹ *Id.* at 51 (White, J. dissenting).
<http://ideaexchange.uakron.edu/akronlawreview/vol10/iss1/2>

⁴² *Id.* at 53.

material, if as in this case, alternative ink and paper uses are not displaced;

(5) Not all dominations are illegal. This was carefully explained by Justice Lurton in *A. B. Dick Co.*,⁴³ and,

(6) Tie-ins can be metering devices serving to maximize profits of the patented invention, more often than not leading to expansion rather than contraction of sales, thus serving the interests of both customers and patentees.

The majority in *A. B. Dick* faced up to the extension of monopoly argument, which was the core of the minority opinion. They again used the *Button Fastener* argument that the patentee *created* the market. If the patentee had kept it to himself, no ink would have been sold by others. Hence, the license restriction took nothing from others and did not, in any way, restrict suppliers from serving their legitimate markets.

One difference between the positions of Justice Lurton and Justice White is that the former justified his conclusion but the latter assumed his. Justice White did not explain how monopolies are extended, and no succeeding opinion or commentary has remedied that deficiency. In addition, no one following Justice White's rationale has explained why profit maximization, economic efficiency, or success by reason of competitive superiority are not sufficient defenses under the antitrust laws. Nor has it been explained why tie-ins are not as reasonable as other permissible limitations upon use.

THE INTERFACE BETWEEN PATENT AND ANTITRUST LAWS

One of the great issues today revolves around the interface between the patent and the antitrust laws. The Department of Justice clearly takes the position that there is no patent rule of reason,⁴⁴ and if there is any rule of reason applicable to patent cases, it is not rationally related to whether the patentee gets his full reward or whether an unwarranted additional "monopoly" is created. This view seems to have been foreshadowed by Justice White. His dissent in *A. B. Dick*⁴⁵ includes reference to a resale price maintenance case, *Dr. Miles Medical Co. v. Park & Sons, Co.*,⁴⁶ decided in 1911. According to Justice White, the majority treated the *Miles* case "as inapplicable" because "... this case is one governed by the patent laws, and therefore not within the rule of public policy which the *Miles*

⁴³ Justice Lurton wrote the majority opinion in *A. B. Dick*.

⁴⁴ Address by Bruce B. Wilson, American Patent Law Association, January 21, 1975; Address by Richard H. Stern, Association of Corporate Patent Counsel, May 14, 1973.

⁴⁵ 224 U.S. at 49.

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⁴⁶ 220 U.S. 373 (1911).

Case applied . . ."⁴⁷ Thus, the minority assumed that the Sherman Act superseded the patent law and ignored any expressed rule of reason as in *Bement*, the subsequently enacted Clayton Act⁴⁸ notwithstanding.

The minority opinion went on to set up a number of fanciful situations. The majority felt these illustrations failed of their purpose because the public was free to take or refuse the patented articles. If the terms imposed were too onerous, there would be no market. The public would lose nothing it had before and when the patent expired, the public would be free to use the underlying patent in any way it chose. The larger right of suppression, the majority felt, embraces the lesser of permitting use upon terms of the licensor's (or assignor's) choosing.⁴⁹

Justice White next returned to his monopoly-extending thesis by asserting that the majority, by permitting suit under the patent laws because of plaintiff's suit for infringement, brings ". . . numerous articles of common use within the monopoly of a patent when otherwise they would not have been embraced therein, thereby tending to subject the whole of society to a widespread and irksome monopolistic control."⁵⁰ Now we find the minority of a Court, which throughout history has often drawn fine distinctions, unable to appreciate the broad difference between the scope of a patent or the nature of the patented invention, and a condition on which permission to infringe was granted. The root of the minority's misunderstanding may be revealed in the next statement of the dissent. It should be noted that one of the main issues was whether, when a patent license is involved and the suit charges infringement, the suit must be on the contract (in which case the general law controls) or whether suit can be based on the patent (in which case the patent law applies). The Court in *A. B. Dick* ruled that the plaintiff may elect to sue for breach of contract or for infringement. This, to the dissent, conflicts with many earlier cases which ". . . directly refute the existence of a supposed right of extension by contract of the patent laws, and are therefore, as I understand them, in conflict with the ruling now made."⁵¹

In the interest of brevity, the cases cited by Justice White in support of

⁴⁷ *A. B. Dick*, 224 U.S. at 54 (White, J., dissenting).

⁴⁸ Clayton Act §§1-26, ch. 323, §§1-26, 38 Stat. 730 (1914), as amended 15 U.S.C. §§12-27 (1973) [hereinafter cited as Clayton Act].

⁴⁹ This "part-whole" dilemma, identified long ago by Professor Thomas Reed Powell, works in a discriminatory fashion against those who must license as against those who may license themselves exploit the patented invention. See Powell, *The Nature of a Patent Right*, 17 COLUM. L. REV. 663 (1917).

⁵⁰ *A. B. Dick*, 224 U.S. at 56 (White, J. dissenting).

his position will not be discussed individually. They may be generally summarized as suits for recovery of royalties not paid, failure to perform other contract obligations, or determination of whether an act of Congress extending the life of a patent also extended a license to use the patent. The Court, in an attempt to simplify, failed to distinguish between situations where there was a breach of a contract provision and where there was an unlicensed act. The legality of a license condition and a breach of a legal condition are different questions. To be an infringement, there must be an unlicensed act. To be a contract breach, there must be breach of a license provision.

The remainder of Justice White's dissent returned to the scope of a patentee's "monopoly." He complained that ". . . since the decision in the *Button Fastener* Case, the attempt to increase the scope of the monopoly granted by a patent has become common by resorting to the device of license restrictions manifested in various forms, all of which tend to increase monopoly and to burden the public to the exercise of their common rights."⁵² Finally, the following quotation appears to be the well from which anti-trust supremacy — specifically whether patent licenses are primarily tested by the patent laws, i.e., whether there is a special patent rule of reason with respect to the antitrust laws — has sprung. It is of importance because Justice White's views prevailed in the landmark *Motion Picture* case:

The contract, therefore, can only be maintained upon the assumption that the patent law and the issue of a patent is the generating source of an authority to contract to procure rights under the patent law not otherwise within that law, and which could not be enjoyed under the general law of the land.⁵³

Motion Picture presents another tie-in situation. Plaintiff's license for the manufacture and sale of motion picture projectors provided that sales by license should be on condition that the projectors run only film containing the inventions of a specified patent. The condition was expressed on a plate attached to the projector. There were also minimum price provisions. The Court, with Justices Holmes, McKenna, and Van Devanter dissenting, held the tie-in illegal. Justice Clark, writing for the majority, stated that *Henry v. A. B. Dick Co.* "must be regarded as overruled."⁵⁴ The rationale of the majority was based on the views of Justice White (now Chief Justice), so thoroughly stated in his dissent in *A. B. Dick*.

The first point of particular interest was that the opinion set up two

⁵² *Id.* at 70.

⁵³ *Id.* at 71.

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⁵⁴ *Motion Picture*, 243 U.S. at 518.

questions for decision. Both were directed to whether *mere notice* could be effective to limit use of the apparatus. The decision and opinion were much broader than those issues. The Court, for all practical purposes, considered only the legality of tie-ins irrespective of how the condition was brought home to users.

Since there was some reference to the notice, it may be useful to trace the majority's "reasoning". It began with the patent statutes and observed that the statutes made no mention of any such notice and decided that whatever validity an attached notice has, it must be derived from the general law - not the patent law. In the next paragraph, the Court stated that "the extent to which the use of the patented machine may validly be restricted to specific supplies or otherwise by special contract between the owner of a patent and the purchaser or licensee is a question outside the patent law, and with it we are not here concerned."⁵⁵ This conclusion was not supported or explained; nor was the opinion of the majority in *A. B. Dick* refuted (the minority in *A. B. Dick* became the majority in *Motion Picture*).

The *Motion Picture* Court next set forth three "long established" rules helpful in interpreting the statute:

- (1) The scope of every patent is limited to the invention claimed;
- (2) The patentee receives only the right to restrain others from making, using or selling the patented invention; and,
- (3) The primary purpose of the patent laws is to promote progress of the useful arts and not the "creation of private fortunes for the owners of patents."⁵⁶

These generalizations are accepted by every knowledgeable patent lawyer. In fact, these rules were so well established that there was no real need for the Court to recite them - except as crutches to support the majority's conclusion.

This allegation follows because Justice Clark went on to emphasize that the statute and the three rules "restrict the patent granted on a machine . . . to the mechanism described . . . as necessary to produce the described results. *It is not concerned with and has nothing to do with the materials with which or on which the machine operates . . . The . . . materials with which the machine is operated are no part of the patented . . . results.*"⁵⁷ (emphasis added.) The Court missed, or ignored, the reasoning exhibited in the earlier cases. The statute and the rules mentioned go only to what exclusion the

⁵⁵ *Id.* at 509.

⁵⁶ *Id.* at 510-11.

⁵⁷ *Id.* at 512.

patentee can effect and what he can prevent others from doing. He can prevent others only from doing what is claimed in the patent. This is not the same thing as licensing others on condition that certain other things be done or not done.

A license may be looked upon as a specifically permitted or excused infringement. The condition is nothing more than limited permission. It does not in any way equate the subject matter of the condition to the claims of the patent. Permission based on royalty payments, never challenged in principle for legality, is little different in effect from permission based on the purchase of materials or parts. Both provide income to the licensor and both aim at maximization of profits. Again, the Court stated that the restrictions of the law "... have nothing to do with the materials used in the operation of the machine . . ." ⁵⁸ This is another piece of the same cloth. The allegation is sound only when the problem involves enforcement of the patent against an infringer.

The Court again drags into the picture the argument that notice restrictions have nothing to do with the invention which is patented but relate wholly to the materials to be used with it. ⁵⁹ In answer, it is impossible to divorce a patented combination from unpatented components or supplies to be used with them. A method claim necessarily operates entirely on unpatented materials with unpatented machines (i.e., materials and machine components are not part of the claim). Since the invention cannot be practiced without the use of unpatented materials or machines, the invention obviously has very much to do with the patented inventions. Therefore, any restriction, whether by notice or by contract, has a real connection with the claimed invention; one cannot be used without the other. The patent claims do not relate specifically to the materials used, but relate to the condition for use of the invention. Finally, the tie-in of this case was not a restriction on the use of materials but a condition on the use of an invention.

Early in the opinion, the Court referred to the protection accorded by the patent laws to the inventor's "monopoly". There are many who seriously quarrel with that appellation as applied to patents. It is not the intention of this article to quibble over semantics. The problem involves a legal right to exclude, and the earlier cases discussed above show clearly that the vertical arrangement such as resale price requirements and tie-ins can well be held reasonable under either patent or antitrust law. A rule of reason is clearly applicable. ⁶⁰

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ See W. BOMAN, PATENT AND ANTITRUST LAW (1973).

The Court in *Motion Picture* lacked appreciation of the nature of the patent right and the partial yielding of the exclusivity which is an important part of that right. The Court, after stating that "the exclusive use of just what his inventive genius has discovered . . . is all that the statute provides . . .",⁶¹ predicted that if ". . . his discovery is an important one, his reward under such a construction of the law will be large, as experience has abundantly proved, and if it be unimportant, he should not be permitted by legal devices to impose an unjust charge upon the public in return for the use of it."⁶² But no rational explanation of an "unjust" charge is exposed. A limited license is merely a means of maximizing the reward as recognized by the Court. A tying requirement can, in no way, impose any charge upon the public if the invention is unimportant. There will be nothing to sell if the public finds the invention unimportant. The same is true of other vertically imposed provisions.

The Court next asserted that "for more than a century this plain meaning of the statute was accepted . . . and that it afforded ample incentive to exertion . . ."⁶³ This seems to be in flat contradiction to *Button Fastener* and *A. B. Dick* as well as other precedent available at that time, and the majority neither refers to this line of decisions nor explains them away. The Court went on to stress how patent profits may arise without explaining the reason for proscribing some and permitting others:

The time came in which the full possibilities seem first to have been appreciated of . . . gathering great profits in small payments, which are not realized or resented, from many, rather than smaller or even equal profits in larger payments . . . and it came to be thought that . . . a patent gave to the patentee or assigns the right to restrict the use of it to materials or supplies not described in the patent, and not by its terms made a part of the thing patented.⁶⁴

The materiality of this argument is not apparent. It should make no difference whatever whether income to licensors comes from a few large payments or in bits and pieces. It makes no difference to a buyer or a lessee; surely the total will be prorated across the entire production in both cases. The "competitive superiority test," as a measure of patent reward, is thus not met; it is evaded.

The Court next recognizes the *Button Fastener* case and its endorsement of tie-ins and quotes the opinion in that case to the effect that the defendant

⁶¹ *Motion Picture*, 243 U.S. at 513.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 513-14.

called upon the court "to mark another boundary line around the patentee's monopoly which will *debar him from engrossing the market for an article not the subject of a patent*; which it declined to do."⁶⁵ The Court noted that *Button Fastener* proceeded on the theory that since the patentee possessed exclusivity, ". . . he must logically and necessarily be permitted to impose any conditions . . . upon any use which he may allow of it."⁶⁶ Monopoly extension was here recognized as the central issue.

The Court believed that there was a defect in thinking which sprang from substituting "inference and argument for the language of the statute"⁶⁷ and from a failure to distinguish the right which may be created by private contract. This argument fails to recognize, as was carefully explained in the earlier cases, that an unlicensed use (i.e., use outside the conditions of the license) is an infringement, and therefore, within the scope of the remedy covered by a suit for infringement. No explanation was offered as to how the "inference and argument" of the earlier cases was incorrect. The Court next "explained" that a patentee is restricted to use of the invention as claimed and "not as it may be expanded by limitations as to materials and supplies necessary to the operation of it . . ."⁶⁸ Neither then nor later has there been any explanation of how tying (or other use limitation) expands. The patentee — it deserves repeating — is merely asking a price equivalent for the right to use the patented invention.

At this stage, the *Motion Picture* Court returned to the notice attached to the machines sold and held that "it is not competent for the owner of a patent by notice attached to its machine to, in effect, extend the scope of its patent monopoly by restricting the use of it to materials necessary in its operation but which are no part of the patented invention . . ."⁶⁹ The rule of this case, then, is that such restrictions may not be imposed by *notice*. Later cases relying on *Motion Picture* ignored the actual decision and applied it to facts not involving notice.

The Court in *A. B. Dick* had referred to the Circuit Court's statement that the patentee sold at cost, or less, and depended upon the profit realized from the sale of unpatented supplies. In *Motion Picture*, Justice Clark found this to be reprehensible. He said that "This fact, if it be a fact, instead of commending, is the clearest possible condemnation of the practice adopted, for it proves . . . the owner intends to and does derive its profit not from the

⁶⁵ *Id.* at 514.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 515.

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⁶⁹ *Id.* at 516.

invention . . . but from the unpatented supplies . . . which are wholly without the scope of the patent . . ."⁷⁰ Again, the wrong answer is made to a proper question. The sale of unpatented supplies can be justified as a measure of the use to which the machine is put. Again, there was no answer to the question: how can there be sale of a certain volume of unpatented supplies but for the patented machine? The profit, whether resulting from the machine or the supplies or both, accrues from the worth of the patented invention.

Motion Picture is important for another reason. Between *A. B. Dick* and *Motion Picture*, the Clayton Act was enacted into law. By its terms it became unlawful:

To lease or make a sale or contract for sale of goods . . . machinery, supplies or other commodities whether patented . . . on the condition . . . that the lessee or purchaser thereof shall not use . . . the goods . . . machinery, supplies or other commodities of a competitor or competitors of the lessor or seller where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.⁷¹

The Court acknowledged that fact by stating that it was confirmed in its conclusion by the passage of the Clayton Act. Interestingly enough, the majority of the Court did not base its decision on that act, since it was not applicable when *Motion Picture* was brought — a conclusion in which the minority concurred. The Court summarized its decision by stating that a restriction such as that involved is invalid because:

- (1) The film was not part of the patented invention;
- (2) There was an attempt to continue a patent monopoly after a patent had expired; and,
- (3) To enforce the condition "would be to create a monopoly in the manufacture and use of moving picture films, wholly outside of the patent in suit and of the patent law as we have interpreted it."⁷²

Justice Holmes wrote a short but strong dissent, in which he was joined by Justices Van Devanter and McKenna. After supposing that a patentee has no less property interest in his invention than any other owner, and that he may, for whatever motive, keep his invention wholly out of use, Holmes "cannot understand why he (the patentee) cannot keep it out of use unless the licensee, or, for the matter of that, the buyer, will use some

⁷⁰ *Id.* at 517.

⁷¹ Clayton Act, 15 U.S.C. §14 (1973).

<http://idealexchange.uakron.edu/akronlawreview/vol10/iss1/2>

⁷² *Motion Picture*, 243 U.S. at 518.

unpatented thing in connection with it. *Generally speaking, the measure of a condition is the consequence of a breach, and if that consequence is one that the owner may impose unconditionally, he may impose it conditionally upon a certain event.*⁷³ (emphasis added.)

The dissent recognized that there may be predominant public interest which may dictate otherwise, but in this case, there was no such predominant public interest. The dissenter's position reiterated the majority position:

The supposed contravention of public interest sometimes is stated as an attempt to extend the patent law to unpatented articles, which of course it is not, and more accurately as a possible domination to be established by such means. But the domination is one only to the extent of the desire for the teapot or film feeder, and if the owner prefers to keep the pot or the feeder unless you will buy his tea or films, I cannot see, in allowing him the right to do so anything more than an ordinary incident of ownership . . .

Not only do I believe that the rule that I advocate is right under the *Paper Bag* case,⁷⁴ but I think that it has become a rule of property that law and justice require to be retained.⁷⁵

It deserves repeated emphasis that the majority in *A. B. Dick* analyzed and explained what Holmes' dissent in *Motion Picture* supported.

The majority opinion in *Motion Picture*, no less than the dissent in *A. B. Dick*, did not face up to their opponent's argument. Rather, they assumed that tie-ins create monopoly beyond any justifiable patent exclusivity. This early error has been refuted — but never corrected.

CONCLUSION

Patent tie-ins have become virtually per se illegal on the assumption that they serve no purpose other than monopoly extension in inappropriate areas, as if it were possible to refute the logic of Justice Lurton in *A. B. Dick* by reiteration of "bootstrap" reasoning.

Professor Bowman has said, "One may begin to suspect that antitrust is less a science than elaborate mythology, that it has operated for years on hearsay and legends rather than on reality."⁷⁶ That opinion seems to find ample support in the apparent overriding of the value of the patent right by

⁷³ *Id.* at 519 (Holmes, J., dissenting).

⁷⁴ *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908).

⁷⁵ *Motion Picture*, 243 U.S. at 520 (Holmes, J., dissenting).

⁷⁶ BOWMAN, *supra* note 60, at 49.

antitrust principles without suitable justification.⁷⁷ Ever since *Bauer v. O'Donnell*⁷⁸ and *Motion Picture*, the misconception has ballooned that many useful patent contract provisions such as tie-ins create monopolies broader than the patent. This is so despite the fact that no proponent of that theory — lawyer or economist — has been able to show either that such a result has occurred or could be expected to occur.

This is a time when the public needs, perhaps more than ever before, advancement of technology and innovation. This is a time when one of the most useful incentives to invention and innovation, the patent right, should be strengthened and not further eroded. This is a time when turning back the clock would be progression and not retrogression.

⁷⁷ There is considerable literature supporting the application of antitrust principles to license situations. See, e.g., Oppenheim, *The Patent-Antitrust Spectrum of Patent and Know-How License Limitations: Accommodation? Conflict? or Antitrust Supremacy?* 15 IDEA, Spring 1971 at 1. The Oppenheim article provides strong support for a patent rule of reason at the patent-antitrust interface. The author states:

First, preserve to the patentee the full reward to which the exclusive rights of the patent group entitle him within the scope of the claims of his patented invention. Second, apply the antitrust laws only when there is proof of, plus antitrust elements arising from restraints beyond the exclusivity bounds of the grant.

See also *Hearings Before the Subcomm. on Patents, Trademarks, and Copyrights of the Senate Comm. on the Judiciary*, 92d Cong., pt. 2 at 505-06 (1971). For differing antitrust approaches to patent licenses, see Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267 (1966) (providing a far-reaching economic study of licensing provisions); Kidwell, *Patent Right Interchange and Antitrust Policy: Defining the Interface*, 43 COLO. L. REV. 369 (1972).