

PATENT MISUSE IN PATENT POOL LICENSING: FROM *NATIONAL HARROW* TO “THE NINE NO-NOS” TO NOT LIKELY

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ABSTRACT

Courts and the Justice Department’s Antitrust Division have become increasingly tolerant of patent licensing practices that were previously viewed with suspicion. This trend has put pressure on the doctrine of patent misuse, which arose in the 1940s as a doctrine distinct from, but closely related to, standard antitrust analysis. The U.S. Court of Appeals for the Federal Circuit recently overturned an International Trade Commission order that held unenforceable, on the grounds of patent misuse, six patents licensed as a package by U.S. Philips Corporation. The Federal Circuit’s decision raises the question of just how much remains of the doctrine of patent misuse.

INTRODUCTION

¶1 In *U.S. Philips Corp. v. International Trade Commission*,² the U.S. Court of Appeals for the Federal Circuit revisited the issue of patent misuse in the context of patent pool licensing.³ Based on a complaint filed by U.S. Philips Corporation (Philips), the United States International Trade Commission (Commission) had investigated nineteen companies, all of which were ultimately accused of illegally importing compact discs (CDs) that infringed six of Philips’ patents.⁴ An administrative law judge found that the six patents were indeed infringed, but that the patents were

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² 424 F.3d 1179 (Fed. Cir. 2005).

³ *See id.* at 1182. The term *patent pool* refers to a variety of arrangements whereby multiple patents are licensed as a package (or “portfolio”). Often, several companies consolidate their technologically related patents into an independent entity for licensing to others. *See* Roger B. Andewelt, *Analysis of Patent Pools Under the Antitrust Laws*, 53 ANTITRUST L.J. 611, 611-14 (1984); Steven C. Carlson, Note, *Patent Pools and the Antitrust Dilemma*, 16 YALE J. ON REG. 359, 367-72 (1999).

⁴ *Philips*, 424 F.3d at 1182-83.

unenforceable “by reason of patent misuse.”⁵ On review, the Commission upheld the administrative judge’s ruling, confirming that Philips’ licensing program “constitute[d] patent misuse *per se* as a tying arrangement between (1) licenses to patents that are essential to manufacture [CDs] . . . and (2) licenses to other patents that are not essential to that activity.”⁶ Perhaps anticipating that the Federal Circuit might disagree with its *per se* holding, the Commission also analyzed the issue under the rule of reason standard and held that the Philips program likewise constituted patent misuse under the rule of reason.⁷

¶2 On appeal, the Federal Circuit reversed both holdings, ruling that neither *per se* patent misuse nor patent misuse under the rule of reason was demonstrated.⁸ But in doing so, the court’s opinion raises serious questions about the continued viability of the doctrine of patent misuse. Are there *any* patent licensing practices today, other than the most egregious instances of product tying, that will constitute *per se* patent misuse? Does the court’s opinion signal that the long-observed practice of excluding so-called non-essential patents from patent pools is unnecessary, and thus undermine a key premise of the Justice Department’s approach to patent licensing practices?

¶3 Part I of this iBrief details the early treatment of patent licensing schemes and then traces the history of the doctrine of patent misuse, beginning shortly after the passage of the Sherman Antitrust Act⁹ in 1890 and continuing through the Federal Circuit’s treatment of the doctrine in the 1980s. Part II addresses whether inclusion of a non-essential patent in a package license, offered on a take-it-or-leave-it basis, constitutes patent misuse, beginning with a description of the Justice Department’s recent views towards patent pools and continuing with a summary of the *Philips* decision. Following a brief criticism of the Federal Circuit’s economic analysis in *Philips*, this iBrief concludes that at a minimum, the Federal Circuit’s opinion suggests that the concept of *per se* patent misuse is

⁵ *Id.* at 1183.

⁶ *Id.* (quoting Int’l Trade Comm’n, Commission Opinion, In re Certain Recordable Compact Discs & Rewritable Compact Discs, Inv. No. 337-TA-474, at 4 (served Apr. 8, 2004) (public version)).

⁷ *Id.* at 1184. The Commission and the Federal Circuit each used the terms “patent misuse *per se*” and “patent misuse under the rule of reason.” *Id.* The latter usage especially reflects the decline of the doctrine of patent misuse as a doctrine distinct from general antitrust analysis. As shown below, the doctrine of patent misuse was originally employed to render patents unenforceable without any showing of actual anticompetitive effect, thus patent misuse was necessarily “*per se*.” See *infra* notes 56-59, and accompanying text.

⁸ *Philips*, 424 F.3d at 1197-98.

⁹ Sherman Act, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. § 1 (2000)).

essentially obsolete. Viewed more expansively, the opinion may suggest that carefully excluding non-essential patents from patent pool licenses is no longer necessary.

I. THE HISTORY OF PATENT MISUSE

A. Patent Licensing Before the Patent Misuse Doctrine: From the Sherman Act to Standard Oil

¶4 For the first twenty years after passage of the Sherman Act, antitrust law appeared to have little applicability to patent licensing.¹⁰ Indeed, as the Supreme Court stated in *Bement v. National Harrow Co.*:

[T]he general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws is monopoly, and the rule is, with few exceptions, that 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 sell 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.¹¹

Encouraged by *National Harrow*, at least one appellate court declared that patented items fell completely outside the scope of the Sherman Act, since, in its view, “patented articles, unless or until they are released by the owner of the patent from the dominion of his monopoly, are not articles of trade or commerce among the several states.”¹² Acknowledging the “evils to be remedied by the Sherman [Act],”¹³ the court nevertheless upheld the validity of a licensing scheme that fixed minimum prices and assigned maximum sales quotas to each of the eighteen licensees.¹⁴

¹⁰ See Carlson, *supra* note 3, at 373.

¹¹ *Bement v. Nat'l Harrow Co.*, 186 U.S. 70, 91 (1902). The National Harrow Company was formed by six companies holding various patents for “float-spring tooth harrows,” *id.* at 77, and held the rights to eighty-five patents, *id.* at 70. This was apparently the first Supreme Court challenge to a patent pool on the grounds of an antitrust violation. The license agreement included a number of provisions that clearly would violate the “Nine No-Nos,” see *infra* note 48 and accompanying text, including provisions explicitly fixing the selling prices for the licensed products and prohibiting the sale of similar products not covered by the licensed patents, *Nat'l Harrow*, 186 U.S. at 72-74.

¹² *Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co.*, 154 F. 358, 362 (7th Cir. 1907).

¹³ *Id.*

¹⁴ *Id.* at 359.

¶5 This virtual immunity from antitrust scrutiny ended abruptly in 1912.¹⁵ In *Standard Sanitary Manufacturing Co. v. United States*,¹⁶ the Supreme Court explicitly rejected any notion that patent licenses were immune from the Sherman Act.¹⁷ Then, two decades later, the Supreme Court decided *Standard Oil Co. v. United States*,¹⁸ “the seminal case involving patent pooling,”¹⁹ and introduced the basic contours of the economic analysis that is still applied today in antitrust cases involving patent pools.

¶6 The *Standard Oil* Court faced a complaint brought by the United States government alleging that a complicated array of seventy-nine contracts entered into by four patent holders and forty-six licensees violated the Sherman Act by creating “an illegal combination to create a monopoly and to restrain interstate commerce by controlling that part of the supply of gasoline which is produced by the process of cracking.”²⁰ The Court first re-affirmed the applicability of the Sherman Act to patent licenses, declaring, “Any agreement between competitors may be illegal if part of a

¹⁵ Carlson, *supra* note 3, at 374.

¹⁶ 226 U.S. 20 (1912).

¹⁷ *See id.* at 48-49 (“The added element of the patent in the case at bar cannot confer immunity from [condemnation under the Sherman Act]. . . .”); *see also* Carlson, *supra* note 3, at 374 (summarizing *Standard Sanitary Mfg.*). To no avail, counsel for the defendant vehemently warned the Supreme Court against extending the Sherman Act’s coverage to patent licenses:

Translated literally . . . the Sherman Act is a blight upon enterprise. The venom of anarchy could not elaborate a more enervating, paralyzing proscription. All business would be under the ban of the law; with the result that it would be left to the caprice or favor of the Attorney-General to give immunity to favorites or punish enemies. If the Sherman Act means this, then we make bold to say that it is the righteous duty of every lawyer to circumvent the Sherman Act if it can be accomplished.

Standard Sanitary Mfg., 226 U.S. at 21.

¹⁸ 283 U.S. 163 (1931).

¹⁹ Andewelt, *supra* note 3, at 633.

²⁰ *Standard Oil*, 283 U.S. at 165. “Cracking,” the heating of oil under pressure, is a secondary process for producing gasoline, applied to the oil left over from the primary distillation process. Andewelt, *supra* note 3, at 633. According to the Court, the contracts covered fifty five percent of all cracked gasoline production; cracked gasoline in turn accounted for twenty six percent of all gasoline production. *Id.* at 634. However, whether it was possible for *any* cracked gasoline to be produced at that time without use of the patented processes has been questioned. *Id.* at 635 (citing W. BOWMAN, PATENT AND ANTITRUST LAW 205-13 (1973)).

larger plan to control interstate markets.”²¹ However, the Court then rejected the government’s argument that proof of monopolistic intent was demonstrated by the fact that the license agreements provided for a division of royalties between the four patent holders. The Court said that patent pooling arrangements might not only be beneficial, but essential, “if technical advancement is not to be blocked by threatened litigation.”²²

¶7 In dismissing the government’s complaint, the *Standard Oil* Court emphasized the potential positive effects of a patent pool. If the patents were available “on reasonable terms to all manufacturers,” the Court reasoned, “such interchange may promote rather than restrain competition.”²³ Nevertheless, “reasonable terms” did not necessarily mean reasonable rates. Brushing aside the government’s claim that the licensing terms were “onerous,” and therefore distorted the gasoline market, the Court held that, absent proof that “the industry is dominated, or interstate commerce directly restrained,” the patent holders were entitled to their fees, as one of the “privileges incident to ownership of patents.”²⁴ Here, the Court decided, market dominance was not proven, nor, were the fees proven to be excessive.²⁵

B. A More Skeptical Approach: Standard Oil to the Nine No-Nos

¶8 *Standard Oil* appeared to establish a moderate approach towards antitrust analysis of patent pools. Patent licensing agreements were not

²¹ *Standard Oil*, 283 U.S. at 169 (emphasis added).

²² *Id.* at 171.

²³ *Id.* See also Andewelt, *supra* note 3, at 634 (“The Court also stressed the benefits that could derive from the pool . . .”). Cf. United States Department of Justice & Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property at 4-6 (1995), available at <http://www.usdoj.gov/atr/public/guidelines/0558.pdf> [hereinafter 1995 Guidelines] (describing the procompetitive benefits of intellectual property licensing).

²⁴ *Standard Oil*, 283 U.S. at 172.

²⁵ *Id.* at 172-73. Roger B. Andewelt, while Chief of the Intellectual Property Section of the Justice Department’s Antitrust Division, roundly criticized the Supreme Court’s market analysis in *Standard Oil*, noting that the Court incorrectly identified the relevant market and incorrectly assumed that a lack of market distortion could be determined by simply looking at the market share covered by the patent pool. Andewelt, *supra* note 3, at 634-35. However, as will be shown below, the *Standard Oil* Court’s recognition of the potential benefits flowing from patent pools emerges as a key premise underlying the Justice Department’s recent approach to patent pools.

immune from antitrust scrutiny, yet neither were they especially suspect.²⁶ Under the *Standard Oil* approach a court might refrain from questioning the reasonableness of royalty rates, since a royalty is but a reasonable perquisite of the patent grant; however, a patent pooling arrangement that excluded interested manufacturers would likely be viewed skeptically.²⁷

¶9 Over the four decades following *Standard Oil*, the Supreme Court applied antitrust analysis to a variety of patent licensing arrangements.²⁸ For example, in *Hartford-Empire Co. v. United States*,²⁹ the Court forced the members of a cartel controlling over 600 patents, covering virtually the entire field of glass-blowing technology,³⁰ to license the patents to all comers at a reasonable royalty rate.³¹ In doing so, however, the Court reversed the lower court's order that the patents be licensed to all comers royalty-free,³² expressing concern that such an order would effect a forfeiture of the patents: "[T]he courts, in enjoining violations of the Sherman Act arising from the use of patent licenses, agreements, and leases, have abstained from action which amounted to a forfeiture of the patents."³³

¶10 The *Hartford-Empire* Court distinguished the lower court's imposition of a royalty-free compulsory license from the concept of *unenforceability*.³⁴ The latter reflects "the doctrine that, so long as the patent owner is using his patent in violation of the antitrust laws, he cannot

²⁶ Cf. 1995 Guidelines, *supra* note 23, at 3 ("Intellectual property is thus neither particularly free from scrutiny under the antitrust laws, nor particularly suspect under them.").

²⁷ See Andewelt, *supra* note 3, at 638.

²⁸ See, e.g., *Hartford-Empire Co. v. United States*, 323 U.S. 386 (1945) (glass-blowing cartel controlling 600 patents); *United States v. Nat'l Lead Co.*, 332 U.S. 319 (1947) (patent pool covering the manufacture of titanium pigments); *United States v. Line Material Co.*, 333 U.S. 287 (1948) (collection of patents covering electrical circuit breakers); *United States v. Singer Mfg. Co.*, 374 U.S. 174 (1963) (cross-license agreements covering sewing-machine technology).

²⁹ 323 U.S. 386 (1945).

³⁰ Carlson, *supra* note 3, at 374-75. Carlson quotes Justice Hugo Black: "The history of this country has perhaps never witnessed a more completely successful economic tyranny over any field of industry than that accomplished by these appellants." *Id.* at 374 (quoting *Hartford-Empire*, 323 U.S. at 436-37 (Black, J., dissenting in part)).

³¹ See *Hartford-Empire*, 323 U.S. at 417-35 (modifying the district court's order, preserving pre-existing license agreements, as modified by the Court, and imposing restrictions on further licensing); Andewelt, *supra* note 3, at 636.

³² *United States v. Hartford-Empire Co.*, 46 F. Supp. 541, 620-21 (N.D. Ohio 1942), *modified*, 323 U.S. 386 (1945). See also Andewelt, *supra* note 3, at 636.

³³ *Hartford-Empire*, 323 U.S. at 415.

³⁴ See *id.* at 414-19 (reversing the lower court's imposition of a compulsory license, which it equated to a forfeiture, and ordering an injunction against pending infringement suits).

restrain infringement of it by others.”³⁵ On the other hand, the royalty-free compulsory license, which the Court equated with forfeiture, is inconsistent with a conceptualization of a patent as property: an appropriate remedy for antitrust violations is the “rearrangement of ownership, not [] its destruction.”³⁶ Thus, a prospective remedy for antitrust violations might include the imposition of mandatory non-discriminatory licensing, at reasonable rates, while a potential defense for infringement of a patent used in an abusive manner would include unenforceability.³⁷

¶11 The doctrine of patent misuse—unenforceability of a patent as a penalty for its improper use—was firmly established in *Morton Salt Co. v. G. S. Suppiger Co.*³⁸ (*Morton Salt* is also the source of the term “misuse of the patent.”³⁹). *Morton Salt*, the owner of a patent for a machine used for depositing salt tablets into canned food, sued a competitor for infringement.⁴⁰ As a condition for licensing its patent, *Morton Salt* required licensees to use its unpatented salt tablets.⁴¹ The Supreme Court found this condition to be an attempt “to secure an exclusive right or limited monopoly

³⁵ *Id.* at 415.

³⁶ *Id.* at 416.

³⁷ This distinction between patent licensing practices as potential antitrust violations and patent misuse as a defense against patent infringement allegations is illustrated by *Independent Ink, Inc. v. Illinois Tool Works, Inc.*, 396 F.3d 1342 (Fed. Cir. 2005), *cert. granted*, 125 S.Ct. 2937 (2005). In *Independent Ink*, the patent owner was accused of violating the Sherman Act by requiring licensees of its patented printer technology to also purchase the necessary ink exclusively from the patent owner, i.e. “tying.” *Id.* at 1345. The primary issue on appeal was whether the mere possession of a patent creates a presumption of market power with respect to a tying product, or whether that market power must be affirmatively shown. *Id.* The Federal Circuit noted that patent tying is “an issue which may arise both in the context of affirmative claims (as here) and in the context of a patent misuse defense.” *Id.* at 1346. That these contexts are different, and are governed by different law, is demonstrated by the court’s footnote: “We note that tying as a defense in patent cases is governed by statute.” *Id.* at 1346 n.3 (citing 35 U.S.C. § 271(d)(5) (2000)). In fact, had the defendant patent owner’s tying practices been raised as a defense to patent infringement, the answer to the market power question would be clear: Section 271(d)(5) of the patent code specifically requires that such market power be affirmatively demonstrated when tying is raised as an infringement defense. 35 U.S.C. § 271(d)(5). In contrast, in *Independent Ink*, the Federal Circuit found that in the context of a Sherman Act section 1 claim, market power arising from patent ownership need not be demonstrated, but could be presumed. *Indep. Ink*, 396 F.3d at 1344.

³⁸ 314 U.S. 488 (1942).

³⁹ Robert J. Hoerner, *The Decline (and Fall?) of the Patent Misuse Doctrine in the Federal Circuit*, 69 ANTITRUST L.J. 669, 670 (2001).

⁴⁰ *Morton Salt*, 314 U.S. at 489.

⁴¹ *Id.* at 491.

not granted by the Patent Office and which it is contrary to public policy to grant.”⁴² The Court thus held that Morton Salt’s patent was unenforceable until Morton Salt corrected its improper licensing practices.⁴³

¶12 The *Morton Salt* Court declared that there was no need to engage in lengthy analysis of the relevant markets, anticompetitive impacts, and so on:

The patentee, like . . . other holders of an exclusive privilege granted in the furtherance of a public policy, may not claim protection of his grant by the courts where it is being used to subvert that policy.

It is unnecessary to decide whether respondent has violated the Clayton Act, for we conclude that in any event the maintenance of the present suit to restrain petitioner’s manufacture or sale of the alleged infringing machines is contrary to public policy⁴⁴

In other words, where the patent holder is attempting to extend the reach of the patent monopoly, proof of anticompetitive effect is not required in order to render a patent unenforceable.⁴⁵

¶13 Courts in the 1960s and 1970s hewed to this per se rule of patent misuse, routinely refusing to enforce patents where extension of the monopoly-type abuse was demonstrated, *without* requiring evidence of anticompetitive effect.⁴⁶ Against this backdrop, the Department of Justice

⁴² *Id.* at 492.

⁴³ *See id.* at 493 (“Equity may rightly withhold its assistance from such a use of the patent by declining to entertain a suit for infringement, and should do so at least until it is made to appear that the improper practice has been abandoned and that the consequences of the misuse of the patent have been dissipated.”).

⁴⁴ *Id.* at 494. *See also* Hoerner, *supra* note 39, at 670 (“There was no consideration of the proper description of the relevant market, Morton Salt’s share of it, the amount of salt tablets engrossed, or the effect of the restriction”). The Court thus reversed the Court of Appeals for the Seventh Circuit, which had criticized the district court’s failure to perform an analysis of the “monopolistic extent of [Morton Salt’s] contract.” *G.S. Suppiger v. Morton Salt Co.*, 117 F.2d 968, 972 (7th Cir. 1941), *rev’d*, 314 U.S. 488 (1942).

⁴⁵ Hoerner, *supra* note 39, at 671. Hoerner describes “two species” of patent misuse: “use of a patent to violate the antitrust law and so-called extension of the monopoly-type misuse.” He cites *Hartford-Empire* as exemplifying the first type and *Morton Salt* as the progenitor of the second. *Id.* at 669-70.

⁴⁶ *See* Hoerner, *supra* note 39, at 671-72 (citing as examples *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969); *Berlenbach v. Anderson & Thompson Ski Co.*, 329 F.2d 782 (9th Cir. 1964); *Key Pharms., Inc. v. Lowey*, 373 F. Supp. 1190 (S.D.N.Y. 1974); *Jack Winter, Inc. v. Koratron Co.*, 375 F. Supp. 1 (N.D. Cal. 1974); *Dubuit v. Harwell Enters., Inc.*, 336 F. Supp. 1184 (W.D.N.C. 1971); *Sonobond Corp. v. Uthe Tech., Inc.*, 314 F. Supp. 878 (N.D. Cal. 1970); and *Columbus Auto. Corp. v. Oldberg Mfg. Co.*, 264 F. Supp. 779 (D. Colo. 1967)).

demonstrated a general hostility toward patent licensing, ultimately promulgating a list of licensing practices, known as the “Nine No-Nos,” that it presumed to be per se violations of the antitrust laws.⁴⁷ Representing the Justice Department’s enforcement policy rather than statutory or judge-made law, the Nine No-Nos were:

1. Requiring a licensee to purchase unpatented materials from the licensor (tying).
2. Requiring a licensee to assign to the licensor patents issued to the licensee after the licensing arrangement is executed.
3. Restricting a purchaser of a patented product in the resale of that product.
4. Restricting a licensee's freedom to deal in products or services outside the scope of the patent.
5. Agreeing with a licensee that the licensor will not, without the licensee's consent, grant further licenses to any other person.
6. Requiring that the licensee accept a “package” license.
7. Requiring royalties not reasonably related to the licensee’s sales of products covered by the patent.
8. Restricting the licensee’s sales of (unpatented) goods made with the licensed patented process.
9. Requiring a licensee to adhere to specified or minimum prices in the sale of the licensed products.⁴⁸

The articulation of the Nine No-Nos represented the peak of skepticism towards patent licensing; patent holders were on notice that defiance of these rules was at their peril.

⁴⁷ Carlson, *supra* note 3, at 375; Andewelt, *supra* note 3, at 620. Andewelt asserts that the Justice Department “never made any significant headway in the courts with its novel approach to the patent/antitrust interface.” Andewelt, *supra* note 3, at 620.

⁴⁸ Carlson, *supra* note 3, at 375 n.130 (citing Bruce B. Wilson, Remarks to Michigan State Bar Antitrust Law Section and Patent, Trademark and Copyright Law Section (Sept. 21, 1972), *reprinted in* 7 Trade Reg. Rep. (CCH) ¶ 50,146, at 50,146); Jere M. Webb & Lawrence A. Locke, *Intellectual Property Misuse: Developments in the Misuse Doctrine*, 4 HARV. J. L. & TECH. 257, 260-61 n.23 (1991).

C. The Recent Approach: The Demise of Per Se Patent Misuse

¶14 Although an articulation of Justice Department antitrust policy rather than a restatement of the law of patent licensing, the Nine No-Nos nevertheless appeared to be consistent with the doctrine of patent misuse announced in *Morton Salt*. Each rule (except perhaps the last) proscribes behavior that arguably constitutes an attempt to “extend” the patent monopoly. Thus a violation of any of these rules, in addition to constituting antitrust violations, would presumably also qualify as patent misuse per se, thus rendering the subject patents unenforceable. However, this official suspicion of patent licensing was quickly subsumed by criticism, some from within the Justice Department itself, which by the early 1980s was beginning to repudiate the Nine No-Nos approach.⁴⁹

¶15 Then, in 1986, the Court of Appeals for the Federal Circuit addressed patent misuse in *Windsurfing International, Inc. v. AMF, Inc.*⁵⁰ Windsurfing International (WSI) sought to enforce its patent, directed to a sailboard, against several alleged infringers, including AMF, Inc.⁵¹ In defense, AMF claimed that WSI had misused its patent, basing its claim on a provision included in patent license agreements between WSI and eleven licensees.⁵² This provision required that each licensee acknowledge the validity of WSI’s registered trademarks and refrain from using them.⁵³

¶16 Then-Chief Judge Markey briefly summarized the doctrine of patent misuse, and quickly reached his conclusion:

The doctrine of patent misuse is an affirmative defense to a suit for patent infringement, and requires that the alleged infringer show that the patentee has impermissibly broadened the “physical or temporal scope” of the patent grant *with anticompetitive effect*. . . .

To sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market. [This] provision . . . cannot possibly restrain competition unlawfully⁵⁴

⁴⁹ See Andewelt, *supra* note 3, at 620; Webb & Locke, *supra* note 48, at 262-64.

⁵⁰ 782 F.2d 995 (Fed. Cir. 1986).

⁵¹ *Id.* at 997.

⁵² *Id.* at 1001.

⁵³ *Id.* The trademarks included the terms *WINDSURFER*, *WINDSURFING*, and *WIND SURF*. The district court had found all of these terms to be generic. *Id.*

⁵⁴ *Id.* at 1001-02 (internal citations omitted; emphasis added).

In a footnote, Chief Judge Markey acknowledged changing views towards the patent misuse doctrine: “Recent economic analysis questions the rationale behind holding *any* licensing practice per se anticompetitive.”⁵⁵ This footnote perhaps explains why the *Windsurfing* definition of patent misuse differs significantly from the rule announced in *Morton Salt*.

¶17 A key difference between the rule articulated in *Windsurfing* and the rule followed by earlier courts stems from three words strategically inserted into the *Windsurfing* rule: *with anticompetitive effect*.⁵⁶ This requirement, that anticompetitive effect must be demonstrated, even in cases alleging “extension of the monopoly-type” patent misuse, was contrary to the approach followed by the courts in the two decades following *Morton Salt*.⁵⁷ For example, the Court of Appeals for the Ninth Circuit had stated: “[W]e find no merit in appellant’s contentions that the proof of substantial lessening of competition is a prerequisite to finding patent misuse.”⁵⁸ The District of Colorado similarly stated: “A showing of an actual monopoly or a tendency to create such in a line of commerce is not necessary.”⁵⁹

¶18 In any event, skepticism towards patent licensing provisions was quickly replaced by skepticism towards the doctrine of patent misuse. The Federal Circuit continued to apply its formulation of the doctrine to cases involving accusations of impermissible tying⁶⁰ and patent exhaustion.⁶¹

⁵⁵ *Id.* at 1001 n.9 (emphasis added). Chief Judge Markey is presumably referring to the Chicago School of economic/legal analysis. Cited in Markey’s footnote as critics of per se patent misuse are Judge Posner, of the Court of Appeals for the Seventh Circuit, and Roger B. Andewelt, Chief, Intellectual Property Section, Antitrust Division, Department of Justice. *Id.*

⁵⁶ Robert J. Hoerner points out that these three words are followed by a citation to *Blonder-Tongue Laboratories, Inc. v. Univ. of Ill. Found.*, 402 U.S. 313 (1971). Hoerner, *supra* note 39, at 672-73. However, as Hoerner notes, these words do not actually appear in the *Blonder-Tongue* opinion, which instead referred only to “the series of decisions in which the Court has condemned attempts to broaden the physical or temporal scope of the patent monopoly.” *Blonder-Tongue*, 402 U.S. at 343. Hoerner thus argues that *Windsurfing* represents a very significant departure from *Morton Salt*. See Hoerner, *supra* note 39, at 672-74.

⁵⁷ See Hoerner, *supra* note 39, at 671-72; *supra* note 46 and accompanying text. The examples following are provided by Hoerner, *supra* note 39, at 671-72.

⁵⁸ *Berlenbach v. Anderson & Thompson Ski Co.*, 329 F.2d 782, 784 (9th Cir. 1964).

⁵⁹ *Columbus Auto. Corp. v. Oldberg Mfg. Co.*, 264 F. Supp. 779, 783 (D. Colo. 1967), *aff’d*, 387 F.2d 643 (10th Cir. 1968).

⁶⁰ See Hoerner, *supra* note 39, at 679-80 (summarizing *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860 (Fed. Cir. 1997)). *But see id.* at 673-74 (describing *Senza-Gel Corp. v. Seiffhart*, 803 F.2d 661 (Fed. Cir. 1986), in

Congress weighed in, enacting the 1998 Patent Misuse Reform Act, which requires accused infringers who are asserting the defense of patent misuse under certain circumstances to demonstrate that the patent holder possesses market power in the relevant market.⁶² Finally, in 1995, the Justice Department, in cooperation with the Federal Trade Commission, released an updated version of federal antitrust enforcement policies with respect to patent licensing, the Antitrust Guidelines for the Licensing of Intellectual Property (“1995 Guidelines”).⁶³ The 1995 Guidelines extolled the pro-competitive benefits of patent licensing and prescribed a cautious approach to antitrust scrutiny of patent license agreements, especially compared to the Nine No-Nos.⁶⁴ These developments, signaling a clear decline of fortunes for the doctrine of patent misuse, set the stage for the Federal Circuit’s holding in *Philips*.

II. MANDATORY “PACKAGE” LICENSING – PATENT MISUSE?

¶19 Any discussion of the pro-competitive benefits of patent pooling includes the justification that pooling promotes the clearing of “blocking” patents.⁶⁵ The 1995 Guidelines explain that one patent “‘blocks’ another when the second cannot be practiced without the first.”⁶⁶ Since anyone that wishes to practice the combined invention requires access to both patents, pooling is an efficient way to promote exploitation of the invention.⁶⁷

¶20 But what if a group of patents is not mutually blocking? Can a licensor require that a licensee purchase a license to a patent he does not necessarily need? Until recently, such a requirement (a clear violation of the Nine No-Nos) was thought to be risky.

which the Federal Circuit did not require a finding of anticompetitive effect in a tying context).

⁶¹ *Id.* at 675-79 (summarizing *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), and *B. Braun Med. Inc. v. Abbott Labs.*, 124 F.3d 1419 (Fed. Cir. 1997)).

⁶² Pub. L. No. 100-173, 102 Stat. 4976 (1988) (codified at 35 U.S.C. §271(d)(4)-(5)). As amended, §271(d) requires a showing of market power in cases alleging patent misuse based on a “refus[al] to license . . . or condition[ing of] the license of any rights to the patent . . . on the acquisition of a license to rights in another patent or purchase of a separate product” 35 U.S.C. §271(d)(4)-(5) (2000).

⁶³ 1995 Guidelines, *supra* note 23.

⁶⁴ See Carlson, *supra* note 3, at 376-78.

⁶⁵ See Carlson, *supra* note 3, at 379; 1995 Guidelines, *supra* note 23, at 4-5; Andewelt, *supra* note 3, at 616.

⁶⁶ 1995 Guidelines, *supra* note 23, at 5.

⁶⁷ *Id.*

A. The 1995 Guidelines and the MPEG-2 Business Letter

¶21 In the 1995 Guidelines, the Justice Department (along with the FTC) outlined its approach to analysis of patent pool arrangements.⁶⁸ The 1995 Guidelines emphasize the positive aspects of patent pools, noting that they “may provide pro-competitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation.”⁶⁹ Only a few pooling practices are identified as potentially problematic: collective price or output restraints (unless they contribute to market efficiency); excluding competitors from access to the pooled patents (but only when the pool members collectively possess market power and the excluded member is therefore unable to compete); and restrictions that negatively impact research and development.⁷⁰ On the other hand, some practices that might “otherwise [be] prohibited, such as joint setting of royalty rates and package licensing,” are permissible when the involved patents are blocking.⁷¹

¶22 Absent from the 1995 Guidelines is any mention of the Nine No-Nos as such. Instead, the guidelines advocate that most licensing agreements should be analyzed under the rule of reason, requiring an examination of the anticompetitive effects of the agreement.⁷² Nonetheless, a few practices are acknowledged as “unlawful per se, without an elaborate inquiry into the restraint’s likely competitive effect,” including “naked price-fixing, output restraints, and market division among horizontal competitors, as well as certain group boycotts and resale price maintenance.”⁷³

¶23 Seeking to avoid potential problems, several pools have requested “business review letters” from the Antitrust Division of the Department of Justice.⁷⁴ A leading example is the letter provided to MPEG LA, L.L.C (the

⁶⁸ *Id.* at 27-30.

⁶⁹ *Id.* at 28.

⁷⁰ *Id.* at 28-29; Carlson, *supra* note 3, at 377-78.

⁷¹ Carlson, *supra* note 3, at 378; 1995 Guidelines, *supra* note 23, at 29-30 ex.10.

⁷² See 1995 Guidelines, *supra* note 23, at 16.

⁷³ *Id.*

⁷⁴ Examples are MPEG LA, *see* Letter from Joel Klein, Acting Assistant Attorney General, to Gerrard R. Beeney, Esq., of Sullivan & Cromwell (June 26, 1997), available at <http://www.usdoj.gov/atr/public/busreview/1170.pdf> [hereinafter MPEG Business Review Letter]; Toshiba Corporation and other owners of DVD-related patents, *see* Letter from Joel Klein, Assistant Attorney General, to Carey R. Ramos, Esq., of Paul, Weiss, Rifkind, Wharton & Garrison (June 10, 1999), available at <http://www.usdoj.gov/atr/public/busreview/2485.pdf>; and 3G Patent Platform Partnership, *see* Letter from Charles James, Assistant Attorney General, to Ky P. Ewing, Esq., of Vinson & Elkins L.L.P. (Nov. 12, 2002), available at

“MPEG Business Review Letter”), a company created to pool the rights to patents essential to a number of standards related to video and audio compression, including the MPEG-2 and MPEG-4 protocols.⁷⁵

¶24 Several of the Nine No-Nos are explicitly addressed in the MPEG Business Review Letter. For example, the letter notes that the MPEG LA agreement “imposes no obligation on the licensee to use only the licensed patents and leaves the licensee free independently to develop ‘competitive video products’”⁷⁶ In addition, although the MPEG LA agreement, constitutes a “package” license, this packaging is not mandatory, as “each Portfolio patent is also available for licensing independently from” its owner.⁷⁷ Finally, the letter notes approvingly that the proposed agreement conditions “licensee royalty liability on actual use of the Portfolio patents.”⁷⁸

¶25 The MPEG Business Review Letter stresses in particular the “essentiality” of the patents in the portfolio: “The limitation of the Portfolio to technically essential patents . . . reduces the risk that the Portfolio will be used to eliminate rivalry between potentially competing technologies.”⁷⁹ This emphasis demonstrates continued concern about a patent pool’s potentially anticompetitive effects, but reflects an understanding that no harm is done so long as “the prospective licensee is being compelled to accept no more than he would, in any event, have to obtain in order to make worthwhile a license under any of the patents.”⁸⁰ Here, *essential* carries a similar meaning to *blocking*; thus, the MPEG Business Review Letter’s emphasis on essentiality mirrors the 1995 Guidelines recognition that a patent pool is most likely to provide pro-competitive benefits if it includes only blocking patents.⁸¹

B. Philips and Mandatory Package Licensing

¶26 In *U.S. Philips Corp. v. International Trade Commission*, the Federal Circuit was faced squarely with the question whether a mandatory

<http://www.usdoj.gov/atr/public/busreview/200455.pdf>. The Justice Department’s business review procedure is codified at 28 C.F.R. § 50.6.

⁷⁵ See MPEG Business Review Letter, *supra* note 74, at 1. See also MPEG LA, MPEG-4 Visual, <http://www.mpegla.com/m4v/> (last visited Nov. 12, 2005); MPEG LA, MPEG-2, <http://www.mpegla.com/m2/> (last visited Nov. 12, 2005).

⁷⁶ MPEG Business Review Letter, *supra* note 74, at 7 (quoting the Patent Portfolio License submitted by MPEG LA).

⁷⁷ *Id.*

⁷⁸ *Id.* at 16.

⁷⁹ *Id.*

⁸⁰ See Carlson, *supra* note 3, at 389 (quoting *Int’l Mfg. Co. v. Landon*, 336 F.2d 723 (9th Cir. 1964)).

⁸¹ See 1995 Guidelines, *supra* note 23, at 5.

package license that included at least one non-essential patent constituted patent misuse.⁸² In an earlier proceeding, the Commission had declared six patents owned by Philips unenforceable on the grounds that Philips' licensing program constituted per se patent misuse, as well as misuse under the rule of reason.⁸³

1. The Philips patent pool was not per se patent misuse.

¶27 The Federal Circuit thoroughly dismantled the Commission's opinion in reversing the holding of unenforceability and remanding the case for further proceedings. First, the court rejected the Commission's conclusion that mandatory package licensing constitutes per se misuse. Accepting that Philips required licensees to accept the licenses as a package,⁸⁴ the court disagreed with the Commission that "finding patent misuse based on a tying arrangement between patents . . . is a reasonable application of Supreme Court precedent."⁸⁵ Instead, the court explained, the cases cited by the Commission were "more akin" to tying between a patent and a *product*, not tying between two patents.⁸⁶

¶28 In any event, the court pointed out, the Philips licensing arrangement did not force a licensee to actually *use* the non-essential patents.⁸⁷ In addition, there was no evidence that any portion of the royalty charged by Philips was directly attributable to the non-essential patents.⁸⁸ In the courts view, then, the Philips licensing scheme was easily distinguishable from product tying, known to be per se patent misuse,

⁸² U.S. Philips Corp. v. Int'l Trade Comm'n, 424 F.3d 1179, 1182-83 (Fed. Cir. 2005).

⁸³ *Id.* at 1184; Int'l Trade Comm'n, Commission Opinion, *In re Certain Recordable Compact Discs & Rewritable Compact Discs*, Inv. No. 337-TA-474, at 63 (served Apr. 8, 2004) (public version) [hereinafter Commission Opinion].

⁸⁴ *Philips*, 424 F.3d at 1182.

⁸⁵ *Id.* at 1187 (quoting Commission Opinion, *supra* note 83, at 13).

⁸⁶ *Id.* at 1188. The Commission had relied on two cases in which the Supreme Court had "condemned the practice of 'block-booking' movies," i.e. requiring theater owners to accept (and display) movies that they did not want in order to get access to those they did. *Id.* at 1187. In one of these cases, *United States v. Paramount Pictures, Inc.*, the Supreme Court struck down the block-booking practice by analogizing the practice to earlier cases involving license agreements conditioning a patent license on the purchase of unpatented products. 334 U.S. 131 (1948). The Commission read that condemnation broadly, asserting that "the Supreme Court has held the practice of mandatory package licensing of intellectual property illegal *per se*." Commission Opinion, *supra* note 83, at 13.

⁸⁷ *Philips*, 424 F.3d at 1188.

⁸⁸ *Id.* at 1189.

“because of the fundamental difference between an obligation to purchase a product and the extension of a nonexclusive license to practice a patent.”⁸⁹

¶29 The court pointed out that nothing prevented Philips from licensing only its essential patents as a package—at the same royalty rate that it was currently charging—and offering the non-essential patents for free.⁹⁰ Indeed, the Commission’s rule, the court asserted,

[W]ould have the perverse effect of potentially putting a party owning both an essential patent and a nonessential but related patent in a worse position than a party owning only the essential patent. The party owning only the essential patent would be free to charge any licensing fee up to the maximum that a manufacturer would be willing to pay to practice the patented technology, while a party owning both the essential patent and a nonessential patent would be barred from extracting that maximum licensing fee for its essential patent and assuring the manufacturer that it would not be subject to suit on the nonessential patent.⁹¹

On its face, this reasoning would seem to obviate any requirement that future patent licensors segregate nonessential patents from a pooling arrangement. In a single stroke, the Federal Circuit has discarded a major premise underlying the 1995 Guidelines.⁹²

2. *The Philips patent pool was not patent misuse under the rule of reason.*

¶30 Turning its attention to analysis of the Philips licenses under the rule of reason, the Federal Circuit concluded that the Commission’s approach “was predicated on legal errors and factual findings that were not supported by substantial evidence.”⁹³ “Most importantly,” the court said, “[the Commission’s] conclusion was largely predicated on the anticompetitive effect on competitors offering alternatives to the four so-called nonessential patents in the Philips patent packages.”⁹⁴ Even had such an effect actually been proven—the court concluded that it had not—the Commission should have proceeded to balance that effect against the “efficiencies that package licensing may produce,” especially in light of the transaction costs associated with multiple individuated licenses.⁹⁵

⁸⁹ *Id.*

⁹⁰ *Id.* at 1190-91.

⁹¹ *Id.* at 1192 n.5.

⁹² See *supra* text accompanying note 67.

⁹³ *Philips*, 424 F.3d at 1198.

⁹⁴ *Id.*

⁹⁵ *Id.*

¶31 The court acknowledged that the Commission had found that an alternative technology to two of the non-essential patents existed.⁹⁶ However, the court concluded that the evidence failed to demonstrate that this technology “was an alternative that Philips’s licensees wished to use in place of the technology covered by the [non-essential] patents.”⁹⁷ Accordingly, since no *actual* anticompetitive effect was demonstrated, there could be no patent misuse under the rule of reason.

C. A (Brief) Critique of the Federal Circuit’s Economic Analysis

¶32 The Federal Circuit claims that the Commission’s decision (condemning the inclusion of a non-essential patent in a mandatory package license) would effectively place a person with both essential and nonessential patents in a worse financial position than a person with only essential patents.⁹⁸ If true, this would be damning criticism. But is the court correct?

¶33 The court’s reasoning seems to be based on the premise that only a certain amount of funds are available from a potential licensee for purchasing patent licenses. Since the licensor has a blocking patent, he should be able to extract all of those funds from the licensee.⁹⁹ The court reads the Commission’s opinion as implying a requirement that a patent owner owning an essential patent as well as a related non-essential patent must price the non-essential patent separately.¹⁰⁰ Since the licensee only has a fixed amount to spend, the court suggests that the first patentee, owning only the essential patent, is able to demand the licensee’s entire budget, while the second patentee, forced to offer two separately-priced licenses, might end up with less than the entire budget, if the licensee chooses to decline the offer of the non-essential patent.

¶34 The court is correct. In the second situation, the patentee might indeed receive less from the licensee. However, the court fails to realize that it is comparing two different market situations. If the so-called non-essential patent has any value at all, then it is competing in a separate (albeit closely related) technology market. If the licensee is participating in both markets (i.e. he has a need for both technologies) then he must necessarily

⁹⁶ *Id.* at 1195.

⁹⁷ *Id.*

⁹⁸ *See supra* note 91 and accompanying text.

⁹⁹ *See Philips*, 424 F.3d at 1192 n.5 (“The party owning only the essential patent would be free to charge any licensing fee up to the maximum that a manufacturer would be willing to pay to practice the patented technology . . .”).

¹⁰⁰ *See id.* (“[A] party owning both the essential patent and a nonessential patent would be barred from extracting that maximum licensing fee for its essential patent and assuring the manufacturer that it would not be subject to suit on the nonessential patent.”).

allocate his budget between the two. The Commission's rule, that a patent owner must not tie these two markets together by means of a single, mandatory package license, does not make the patent owner worse off. Rather, the particular market situation, where the licensee has a fixed budget to allocate between two distinct purchases, makes the patent owner (potentially) worse off.

¶35 As an illustration, assume that licensee A desires access to patent X. The technology enabled by patent X has a maximum value of one dollar to the licensee; either the technology adds one dollar's worth of commercial value to the end user, or the technology shaves one dollar from A's manufacturing costs. P is the owner of patent X; with perfect information about A's needs and excellent negotiation skills, P might win the entire dollar from A in return for a license.

¶36 Next, assume that licensee B also needs access to patent X. However, in order to make any use at all of the technology enabled by patent X, B must also have access to *either* patent Y or patent Z. In addition, assume that licensee B values either of these combinations (X with Y or X with Z) at one dollar. Finally, P, the owner of technology X, also owns technology Y. However, a third party, Q, owns technology Z.

¶37 The preceding describes two scenarios like those mentioned by the court in *Philips*. In the first scenario, P can potentially capture licensee A's entire budget. In the second scenario, P can only capture that entire budget if he packages X and Y together. Since the licensee must have either X with Y or X with Z, and is only offered X with Y, licensee B's choice is clear. On the other hand, if P is forced to offer X and Y separately, then Q can compete with P. In some cases, licensee B might select Z over Y; then the amount P collects for technology X depends on how much of B's budget was spent on technology Z.¹⁰¹

¶38 Patent owner P is clearly in a worse position in the second scenario described above, if the law requires him to license his technology separately. However, this is not a perverse consequence of an arbitrary rule.

¹⁰¹ Of course, P could choose to dedicate technology Y to the public domain. See *Philips*, 424 F.3d at 1192 (suggesting that a patentee in this situation could surrender the nonessential patent or announce a policy of nonenforcement). Doing so might very well foreclose the possibility that patent Z's owner is unable to collect any licensing revenues. However, this would only be rational if patent Y offered no technical or commercial advantage at all over patent Z; otherwise P should be able to claim at least part of the value Y offers relative to Z. For example, if patent Y allows a cost savings of \$0.10 in the manufacturing, while Z only contributes \$0.05, P should be able to claim at least a portion of the \$0.05 value created by his patent. One might argue that it makes no sense for the law to be overly concerned with protecting inferior technology.

Rather, this is a consequence of a completely different market scenario. Indeed, this illustration demonstrates precisely the issue of concern: if patent owner P is allowed to bundle his patents together, he is able to use his blocking position with technology X to completely foreclose competition between technologies Y and Z.¹⁰² This would appear to be the epitome of extension of the monopoly-type patent misuse.¹⁰³

CONCLUSION

¶39 Regardless of whether the Federal Circuit's economic analysis stands up to scrutiny, a few things are apparent in the wake of *Philips*. First, per se patent misuse appears destined to be only of historical interest.¹⁰⁴ Unless a patent licensing practice is directly analogous to the few practices explicitly deemed illegal by the Supreme Court, lower courts following *Philips* are unlikely to find per se patent misuse merely because a licensing practice can be construed to "extend" the patent monopoly. Rather, accused infringers raising the defense of patent misuse must demonstrate *actual* anticompetitive effects stemming from the patentee's licensing practices.

¶40 Second, and perhaps more significantly for today's practitioner, *Philips* suggests that patent pool administrators need not be as concerned as they were in the past about excluding non-essential patents from package licensing arrangements, despite the decades-long assumption that patent pools could *only* be justified by their beneficial clearing of blocking patents. While *Philips* should not be read to broadly approve of the intentional inclusion of non-essential patents in portfolios offered only as a package, the case is nonetheless likely to be widely cited as a defense, at least for an accidental or incidental inclusion of such patents.¹⁰⁵ Unless a challenger can show not only that alternatives to the non-essential patent exist, but that

¹⁰² Cf. Commission Opinion, *supra* note 83, at 61 (describing administrative law judge's conclusion that inclusion of a non-essential patent in the Philips patent portfolio "unreasonably foreclosed competition").

¹⁰³ See *supra* note 45.

¹⁰⁴ Cf. Hoerner, *supra* note 39, at 683 (suggesting, pre-*Philips*, that "the Federal Circuit appears to have abolished extension of the monopoly-type misuse altogether").

¹⁰⁵ Accidental or incidental inclusion of a non-essential patent in a patent pool might be quite likely, despite the best efforts of an administrator to admit only essential patents. This may be especially true when the technology is rapidly evolving. See *Philips*, 424 F.3d at 1198 ("[C]hanges in the technology . . . could render some patents that were indisputably essential at the time of licensing arguably nonessential at some later point in the life of the license.").

licensees were *actually* deterred from using those alternatives, such an inclusion is unlikely to provide a basis for patent misuse.¹⁰⁶

¶41 For today's accused infringer, asserting patent misuse as a defense is likely to result in a harrowing experience.

¹⁰⁶ *See id.* (“There was no evidence before the Commission that any manufacturer had actually refused to consider alternatives to the technology covered by those patents.”).