JANUARY 2014

DEVOTED TO LEADERS IN THE INTELLECTUAL PROPERTY AND ENTERTAINMENT COMMUNITY

VOLUME 34 NUMBER 1

THE Licensing Journal

Edited by Gregory J. Battersby and Charles W. Grimes

Wolters Kluwer
Law & Business

A Modern Look at the Nine "No-Nos" of Patent Licensing under US Antitrust Law

Howard M. Ullman

Howard M. Ullman is of counsel at Orrick, Herrington & Sutcliffe, LLP, in San Francisco, CA, where he focuses on antitrust issues, particularly at the intersection of competition law and intellectual property law.

In the 1970s, Bruce Wilson, a former deputy assistant attorney general at the Department of Justice, developed a well-known list of nine patent licensing "no-nos." The somewhat formalistic US antitrust law of the 1970s viewed these licensing practices generally as unlawful, if not *per se* illegal. In this article, and in a follow-up article that will be published in the next edition of this newsletter, we will consider the nine "no-nos" from the perspective of U.S. antitrust law in 2013. Many "no-nos" are no longer automatically unlawful, but it is nevertheless important to understand the issues, because patent licensing practices can still draw fire under the Rule of Reason.

1. Tying the Purchase of Unpatented Materials as a Condition of a Patent License

Patent/product tying is no longer an automatic "no-no." It is subject to an analysis that takes into account market power, as well as, at least in some cases, procompetitive benefits and anticompetitive effects.

A "tying" or "tie-in" or "tied sale" arrangement has been defined as "an agreement by a party to sell one product…on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that [tied] product from any other supplier."[1] As the Department of Justice (DOJ) and Federal Trade Commission (FTC) Antitrust Guidelines for the Licensing of Intellectual Property state, "[c]onditioning the ability of a licensee to license one or more items of intellectual property on the licensee's purchase of another item of intellectual property or a good or a service has been held in some cases to constitute illegal tying." However, although tying arrangements may result in anticompetitive effects, such arrangements also can result in significant efficiencies and procompetitive benefits.

For many decades, the courts have considered tying arrangements involving patents, in particular, ties where a patented product is offered only on the condition that the buyer also purchase an unpatented product. Courts have been concerned that the tie could expand the patentee's rights or powers beyond the statutory patent monopoly grant into related products or adjacent markets and interfere with competition in those markets.

Ties are potentially problematic when the firm imposing the tie has market power in the tying product market, and can use that power to "force" the consumption of tied products. For a number of decades, patents were presumed to confer market power. This presumption meant that patent/unpatented product ties were particularly troublesome. However, on the patent/patent misuse side of the law, the patent laws were reformed in the 1980s, and under 35 U.S.C. § 271(d)(5), there is no patent misuse absent proof of market power in the relevant market for the patent or patented product. On the antitrust side of the law, a patent also no longer creates a presumption of market power—market power must be proven as in any other antitrust case.[2] Thus, ties imposed by licensors without market power are unlikely to pose significant concerns.

There remains the question of whether, if the patentee indeed has substantial market power, a tie is "*per se*" unlawful or whether it is evaluated under the Rule of Reason (which balances procompetitive benefits and anticompetitive effects). Often this is a somewhat academic question. Once courts start examining market power issues, they are necessarily inquiring into effects or potential effects issues, whether they say so or not.[3] Even those courts that still treat market power ties as *per se* unlawful sometimes accept business justifications for the ties.

2. Requiring the Licensee to Assign Back Subsequent Patents

Sometimes, patent owners require licensees to grant the patentee rights to any improvements to the licensed technology or to any subsequently-developed and related patents. These provisions, known as "grantbacks," can be either exclusive or nonexclusive.

As the DOJ/FTC antitrust and IP guidelines state:

> Grantbacks can have procompetitive effects, especially if they are nonexclusive. Such arrangements provide a means for the licensee and the licensor to share risks and reward the licensor for making possible further innovation based on or informed by the licensed technology, and both promote innovation in the first place and promote the subsequent licensing of the results of the innovation. Grantbacks may adversely affect competition, however, if they substantially reduce the licensee's incentives to engage in research and development and thereby limit rivalry in innovation markets.[4]

Grantbacks are not *per se* unlawful. For example, in *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*,[5] the Supreme Court applied a Rule of Reason analysis to a grantback provision in an exclusive license agreement.

Nonexclusive grantbacks, everything else being equal, are much less likely to raise competition concerns. In analyzing grantbacks, courts also look at a number of other factors, including: (1) whether the parties are competitors; (2) the parties' market power; (3) the effect of the grantbank on R&D incentives; (4) the grantback's duration; (5) whether the grantbank extends to inventions that would not infringe the licensed patent(s); and (6) whether the grantback permits sublicenses. Patentees' market power, long duration grantbacks, grantbacks that extend beyond the licensed patent(s), and grantbacks that prevent any sublicenses are, again, everything else being equal, potentially more anticompetitive than grantbacks lacking these features or provisions.

In sum, patent grantbacks can raise competitive concerns. In most cases, at least some back-of-the-envelope sort of analysis is warranted to make sure that a grantback does not violate any antitrust law. In some cases, a more in-depth analysis may be required.

3. Restricting the Right of the Purchaser of the Patented Product in the Resale of the Product

If you own a patent, and sell or license patented products, can you impose restrictions on the resale of the products, and if so, are there any limitations on the types of restrictions you can impose?

Early case law focused on the distinction between restrictions on licensees of the right to make and/or sell patented articles (permissible) and restrictions on end users who use articles in the ordinary pursuits of life (not permissible).[6] However, it is not clear that the manufacturer/end user distinction makes sense.

Under more recent case law, as a general matter, an unconditional sale of a patented device exhausts the patentee's right to control the purchaser's use of the device thereafter.[7] The theory behind this rule is that in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods.[8] This exhaustion doctrine, however, does not apply to an expressly conditional sale or license. In such a transaction, it is more reasonable to infer that the parties negotiated a price that reflects only the value of the "use" rights conferred by the patentee. As a result, express conditions accompanying the sale or license of a patented product generally are upheld.[9] These contractual conditions are subject to antitrust, patent, and other applicable law, as well as equitable considerations such as patent misuse.

In *Mallinckrodt, Inc. v. Medipart, Inc.*,[10] the Federal Circuit outlined the framework for evaluating whether an express condition on the post-sale use of a patented product constitutes patent misuse. In reversing a grant of summary judgment to Medipart, the Federal Circuit held that, except as to *per se* violations such as price-fixing or tying, restrictions on use are judged in terms of their relation to the patentee's right to exclude from all or part of the patent grant.[11] "The appropriate criterion is whether Mallinckrodt's restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason."[12] The court concluded that the district court erred in holding that the restriction on reuse was, as a matter of law, unenforceable under patent law. If the sale of the apparatus was validly conditioned "under the applicable law such as the law governing sales and licenses," and if the restriction on reuse was within the scope of the patent grant "or otherwise justified," then violation of the restriction may be remedied by

action for patent infringement.[13] Field of use restrictions are generally upheld.[14] A restriction on how and where a product can be resold can be thought of as a field of use restriction.

Some authorities believe that in *Quanta Computer, Inc. v. LG Electronics, Inc*.,[15] the Supreme Court overruled *Mallinckrodt sub silentio*.[16] In *Quanta Computer*, LG owned certain patents, and licensed the technology to Intel for use in microprocessors and chipsets, subject to a stipulation that no license was granted to any third-party chip purchasers using the Intel products in combination with non-Intel components. Quanta built computers that employed Intel chips with non-Intel components, and LG sued for patent infringement. The Supreme Court held that the first-sale doctrine barred the suit. LG argued that there was no authorized sale because the license agreement did not permit Intel to sell its products for use in combination with non-Intel products to practice the LG patents. In rejecting this argument, the Court noted that nothing in the license agreement actually restricted Intel's rights to sell products to purchasers who intended to combine them with non-Intel parts. "Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products."[17] In other words, the LG-Intel agreement did not impose conditions on the sale of patented products, but attempted to impose conditions on the use of those products after an authorized sale.

Even if *Quanta Computer* did effectively overrule *Mallinckrodt*, it did so on the basis of the first-sale doctrine. Nothing in *Quanta Computer* expressly suggests that *Mallinckrodt*'s field-of-use analysis of license restrictions, effective prior to or at the time of sale, is no longer valid. But given the complexities in this area, if you are considering any restrictions after the first sale or license of the product, you should consider the potential antitrust implications before implementing them.

4. Restricting the Licensee's Ability to Deal in Products Outside the Scope of the Patent

Patentees, of course, can offer either exclusive or nonexclusive licenses. In an exclusive license, the licensee receives the sole right to practice the patent in a field or fields. Under a non-exclusive license, the patentee retains the right to license others.

But there is another type of exclusivity: Exclusive dealing in connection with a patent license may exist where express terms or incentives created by the license prevent or restrain the licensee from licensing, selling, distributing, or using competing technologies. Under the approach of the DOJ and the FTC (collectively referred to as the Agencies), such exclusive dealing arrangements are evaluated under the Rule of Reason, meaning that in evaluating their legality, the Agencies will take into account the extent to which the arrangement: (1) promotes the exploitation and development of the licensor's technology, and (2) anti-competitively forecloses the exploitation and development of, or otherwise constrains competition among, competing technologies.

According to the Agencies, "[t]he likelihood that exclusive dealing may have anticompetitive effects is related, *inter alia*, to the degree of foreclosure in the relevant market, the duration of the exclusive dealing arrangement, and other characteristics of the input and output markets, such as concentration, difficulty of entry, and the responsiveness of supply and demand to changes in price in the relevant markets."

Note that some old cases talk about exclusivity requirements as *per se* patent misuse. However, this is not the approach of the Agencies, is generally inconsistent with modern economic theory, and is arguably at odds with the Patent Misuse Reform Act.

The bottom line: Exclusive dealing in connection with a patent license is probably no longer *per se* unlawful. But that does not make exclusive dealing *per se* lawful, either. If exclusive dealing potentially causes significant market foreclosure in a technology or innovation market, then it could be subject to challenge. In other words, the law on exclusive dealing in connection with patent licenses resembles the law on exclusive dealing more generally.

5. A Licensor's Agreement Not to Grant Further Licenses

Under an exclusive license, the licensor agrees not to license others, and may agree not to practice the patent itself. Generally speaking, an exclusive license—exclusive in the sense that no other licensee is granted rights—does not violate the antitrust laws.

However, an exclusive license

> may raise antitrust concerns … if the licensees themselves, or the licensor and its licensees, are in a horizontal relationship. Examples of arrangements involving exclusive licensing that may give rise to antitrust concerns

include crosslicensing by parties collectively possessing market power (*see* section 5.5), grantbacks (*see* section 5.6), and acquisitions of intellectual property rights (*see* section 5.7).[18]

In short, if the licensor and licensee are actual or potential competitors, and an exclusive license serves to create or enhance the exercise of market power, the license may raise concerns.

6. Mandatory Package Licenses

According to the federal enforcement agencies' antitrust/IP guidelines, package licensing—the licensing of multiple items of intellectual property in a single license or in a group of related licenses—may be a form of tying arrangement if the licensing of one product is conditioned on the acceptance of a license of another, separate product. Package licensing also can be efficiency enhancing under some circumstances and entirely lawful. All things being equal, exclusively offering patent licenses through a package carries more risk than offering them as a package but also offering them separately. Sometimes package licenses are issued by two or more separate companies. The practice of multiple defendants' pooling patents in a mandatory package license becomes even more problematic when the pooled patents contain technology necessary to practice a technological standard.

For example, in *Princo Corp. v. International Trade Commission*,[19] Philips and Sony independently created two different and technologically incompatible methods of solving the same problem presented by recording address space on a blank compact disc. Instead of choosing one solution to the problem and including the associated patents in the patent pool that Sony and Philips created, they put patents relating to both of the solutions in the pool but allowed licensees to use only one solution (the Philips solution), which became the industry standard. The possible or arguable consequence was to prevent Sony's alternative technology (protected by one Sony patent) from ever being tested (and possibly developed) in a commercial setting.

Following some complex procedural history, on rehearing, the Federal Circuit held that when a patentee offers a license to a patent, the patentee does not misuse the patent by inducing a third party not to license its separate, competitive technology. That is because any such agreement would not have the effect of increasing the physical or temporal scope of the patent in suit, and it therefore would not fall within the rationale of the patent misuse doctrine. However, the court did note, possibly in *dicta*, that such an agreement might be vulnerable to challenge under the antitrust laws.

In sum, package licenses, especially nonexclusive ones, usually are procompetitive, but they do not necessarily confer an antitrust immunity to enter into horizontal agreements to suppress competitive technologies.

7. Royalty Provisions Not Reasonably Related to the Licensee's Sales

Even monopolists are entitled to engage in business and earn a profit. Hence, as a general rule, patentees, even assuming they have a monopoly, can charge what they wish for their patents.

Often, a patentee will charge royalties based on the number of units of product sold, or that equal a percentage of licensee revenues. If the license is conditioned on royalties on products "which do not use the teaching of the patent," then it may be unlawful as a matter of patent law.[20]

But this rule is probably no longer *per se*. Under the Patent Misuse Reform Act of 1988,[21] a patentee can condition a patent license on the purchase of a separate product, unless, in view of the circumstances, the patent owner has market power. If a patentee has the greater power to condition purchase on a nonpatented product, it would seem to have the lesser power to charge royalties based on purchases of nonpatented products.

The Supreme Court in *Zenith* was addressing patent misuse doctrine. There is a separate inquiry as to whether "metered tying"—where a patentee charges a relatively low price for a patented product, and then ties the product to nonpatented products (usually parts or supplies)—should be viewed as an antitrust violation. Under current tying law, such a tie could indeed violate the antitrust laws.

However, a broad royalty base, one which includes nonpatented products, doesn't really amount to a tie; the element of forced purchases from the patentee seems to be lacking. Instead, the potential antitrust danger with a broad royalty base is that it could, at least in theory, curtail competition in the nonpatented product market, because if a licensee is already paying a royalty on nonpatented products, it may have a disincentive to purchase or use competing products.

In that connection, in the Microsoft case[22] the government challenged operating system license fees paid by original equipment manufacturers (OEMs) calculated according to the number of computers shipped, regardless of whether the computers were loaded with Microsoft's operating system (OS). In other words, Microsoft licensed the OEMs on a "per processor" basis. Because OEMs had to pay Microsoft for each computer shipped, they were arguably less likely to pay to install a competing OS on their computers. Microsoft agreed in a consent decree to charge the OEMs license fees only for computers actually loaded with the Microsoft OS. The precedential value of a consent decree is of course quite limited.

8. Restrictions on a Licensee's Use of a Product Made by a Patented Process

Here, we're concerned with what are vertical restraints; for example, requirements that a licensee sell only to certain customers, or in certain territories. Such restraints often are procompetitive.[23]

However, because of the first sale doctrine, patent rights are exhausted after the first true sale (not license) of a product. Thus, a territorial restriction on a customer of a licensed manufacturer would not be enforceable under the Patent Act. Nevertheless, it might be enforceable as an ordinary vertical restraint under traditional antitrust law.[24]

9. Minimum Resale Price Provisions for the Licensed Products

Today, generally speaking, restrictions on a licensee's resale prices are not *per se* illegal as a matter of federal law. Recent nonpatent cases have breathed new life into old doctrine in this area.

In the early 20th century, the Supreme Court held that an IP owner could condition an IP license on the licensee's agreement to sell licensed product at a specified price.[25] The exclusive right of a patentee, the court wrote, "is to acquire profit by the price at which the article is sold."[26] The court concluded that this right extended to ensuring that licensees do not undercut the licensor and destroy its margins.

General Electric diverged from the basic rule announced in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[27] and reconciling the decisions was not entirely easy. Arguably, *General Electric* may have been limited to the situation where a patent owner itself manufactures and sells the patented product and also licenses licensees to sell the product. Since *General Electric*, courts have further limited its application.[28]

The 1995 DOJ/FTC Antitrust Guidelines for Intellectual Property went further and suggested that the agencies will enforce the *per se* rule against resale price maintenance (RPM) in the intellectual property context. The agencies took the position that General Electric had been effectively overruled, and that fixing a licensee's resale price was *per se* illegal.

However, after *State Oil Co. v. Khan*,[29] and *Leegin Creative Leather Products Inc. v. PSKS Inc.*,[30] vertical agreements on price are no longer *per se* illegal under federal law. Although *Khan* and *Leegin* did not involve patents, there is little reason to think that the federal antitrust rule would be different for patented products. There is an important caveat: State law can and does differ. Some states continue to treat RPM (or at least minimum RPM) as *per se* illegal. Thus, some continued caution is necessary.

In sum, most of the licensing restrictions previously thought to be *per se* unlawful are now subject to the Rule of Reason. However, that does not necessarily mean that such restrictions automatically are lawful. Depending on the facts and circumstances, some inquiry into the nature of any restriction and its likely effects is warranted to ensure compliance with the antitrust laws.

1. Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451, 461 (1992).
2. *See* Illinois Tool Works v. Independent Ink, Inc., 547 U.S. 28 (2006).
3. *Compare* NCAA v. Bd of Regents, 468 U.S. 85 (1984) at 104 n.26 ("there is often no bright line separating *per se* from Rule of Reason analysis. *Per se* rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct. For example, while the Court has spoken of a '*per se*' rule against tying arrangements, it also has recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis.")
4. DOJ/FTC Antitrust Guidelines for the Licensing of Intellectual Property (Apr. 6, 1995) Section 5.6, available at *http://www.justice.gov/atr/public/guidelines/0558.htm#t56*.
5. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., 329 U.S. 637 (1947).
6. *See* Adams v. Burke, 84 U.S. 453 (1873).
7. *See* B. Braun Med., Inc. v. Abbott Labs, 124 F.3d 1419, 1426 (Fed. Cir. 1997).
8. *See id*. (*citing* cases).
9. *See id*.
10. Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 704 (Fed. Cir. 1992).
11. *See id*. at 706.
12. *Id*. at 708.
13. *See id.* at 709.
14. *B. Braun Med*., 124 F.3d at 1426.
15. Quanta Computer, Inc. v. LG Elec., Inc., 553 U.S. 617 (2008).

16. *See*, *e.g.*, Herbert Hovenkamp, "Innovation and the Domain of Competition Policy," 60 *Ala. L. Rev*. 103, 11 n.35 (2008); Static Control Components, Inc. v. Lexmark Int'l, Inc., 615 F. Supp. 2d 575, 585 (E.D. Ky. 2009).
17. *Id*. at 637.
18. DOJ/FTC Antitrust IP Guidelines § 4.1.2.
19. Princo Corp. v. Int'l Trade Commission, 563 F.3d 1301 (Fed. Cir. 2009)).
20. *See* Zenith Radio Corp. v. Hazeltine Research Inc., 395 U.S. 100, 135 (1969).
21. 35 U.S.C. § 271(d)(5),
22. United States v. Microsoft Corp., 56 F.3d 1448 (D.C. Cir. 1995).
23. *See* DOJ/FTC Antitrust IP Guidelines § 2.3 and Example 1. *See also* In re Yarn Processing Patent Validity Litig., 541 F.2d 1127, 1135 (5th Cir. 1976).
24. *See* Continental T.V. Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).
25. *See* United States v. Gen. Elec. Co., 272 U.S. 476 (1926).
26. *Id*. at 490.
27. Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
28. *See*, *e.g.*, United States v. Line Material Co., 333 U.S. 287, 312 (1948) (multiple patentees may not enter a cross licensing scheme that establishes the resale price of products to be manufactured under cross licenses); Newburgh Moire Co. v. Supreme Moire Co., 237 F.2d 283, 293-294 (3d Cir. 1956).
29. State Oil Co. v. Khan, 522 U.S. 3 (1997).
30. Leegin Creative Leather Prods. Inc. v. PSKS Inc., 551 U.S. 877 (2007).

Copyright © 2014 CCH Incorporated. All Rights Reserved.
Reprinted from *The Licensing Journal,* January 2014, Volume 34, Number 1, pages 1–6,
with permission from Aspen Publishers, Wolters Kluwer Law & Business, New York, NY,
1-800-638-8437, www.aspenpublishers.com

Wolters Kluwer
Law & Business