Patent Pools, Patent Misuse and Antitrust Rule of Reason Analysis

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The Court of Appeals for the Federal Circuit (CAFC) recently decided a very important case at the intersection of patent and antitrust laws. It presented the question of whether it was "patent misuse" to tie together, for purposes of licensing, a group of the patents owned by different companies who were competitors.

The case involved pools or packages of patents covering alternative technologies, joint ventures, industry technical standards, antitrust "quick look" and "rule of reason" analysis, competitors acting in concert and anti-competitive conduct. In Princo Corporation v. Int'l Trade Commission, the CAFC decided 8-2 that the owners of the patents could require licensees to license a pool or package of patents rather than one patent out of the pool or package, and it was not patent misuse even if the competitors had agreed to suppress one of the alternative technologies.

Philips and Sony owned patents relating to recordable compact discs and rewritable compact discs (CD-R and CD-RW), specifically how to encode position information on the discs so a consumer's reader/writer could work properly. Sony's solution was set forth in its Lagadec patents and Philips's solution was set forth in its Raaymakers patents.

Because the Lagadec solution was prone to errors, the companies agreed to Raaymakers method as the technical standard and published the standard in a document called "Recordable CD Standard," informally known as the "Orange Book," to ensure that discs made by different manufacturers would be compatible.

Philips and Sony offered licenses to Philips' Raaymakers and Sony's Lagadec patents and those of several other patentholders that they regarded as being required to meet the Orange Book standard as a package of patents. Princo became one of the licensees. Philips and Sony did not offer to license individual patents, but only offered to license a package of the patents.

Subsequently, Princo stopped paying the royalty, which resulted in Philips filing a complaint with the International Trade Commission (ITC) to prevent importation by Princo of infringing CD-Rs and CD-RWs.

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An ITC administrative law judge (ALJ) found that Princo infringed six valid Philips patents but denied relief on the ground that the patents were unenforceable because of patent misuse due to tying, price-fixing, price discrimination and restraint of trade. The tying ground was because Philips forced manufacturers such as Princo to license extraneous patents in order to license the relevant ones. The ITC itself upheld the ALJ's finding of patent misuse on the tie-in ground but did not address the other grounds.

Philips appealed and, in a 2005 opinion, the CAFC rejected the ITC's holding of patent misuse due to improperly tying the nonessential Lagadec patents to essential Raaymakers ones because the licensees had the option of using any of the patents for a uniform fee, were not required to use any particular technology — including patents Princo claimed were nonessential — and there was an economic advantage of minimizing transaction costs and assuring against risk. The CAFC applied a "rule of reason" analysis for holding no misuse.

However, the CAFC remanded the case to the ITC because it had not addressed the other grounds of misuse found by the ALJ, namely price fixing, price discrimination and restraint of trade. The CAFC directed the ITC to determine whether Philips and Sony agreed not to license Lagadec in a way that would allow a competitor to use or license that technology to create a competing product, i.e., one not complying with Orange Book technical standards. On remand, the ITC held that Philips and Sony had not so agreed and found no misuse.

Princo appealed again to the CAFC, where a panel rejected some of Princo's tying-based misuse argument but remanded to the ITC again. The CAFC ordered the ITC to re-examine the record to determine whether Philips and Sony had agreed to prevent the development of alternatives technologies, since that would be a misuse under the theory of elimination of competition or price fixing, with no proper benefits and therefore an antitrust violation. The CAFC panel found that misuse depended on whether the Sony Langadec technology could have been viable.

Philips, Princo, the ITC, Sony as intervener and amicus curie all requested a rehearing en banc. A rehearing was granted, but it was confined to Philips' argument that "regardless of whether Philips and Sony agreed to suppress the technology embodied in the Lagadec patent, such an agreement would not constitute patent misuse and would not be a defense to Philips claim of infringement against Princo."

The en banc opinion discussed the history of the patent misuse doctrine, which originated with the famous 1917 Motion Picture Patents Co. v. Universal Film Mfg. Co. U.S. Supreme Court decision, which held it was patent misuse that rendered patents unenforceable during the misuse to require patented motion picture projectors to be used to project only films distributed by the patentee. It was an illegal tie-in to force the users of the projectors to project only certain films.

Other Supreme Court cases held it to be patent misuse for an owner of a patent on refrigerating transportation packages for transporting and storing dry ice require licensees to purchase their dry ice from the patent owner, and for an owner of a patent on a machine to add salt to canned foods to require purchasers of the machine to buy their salt tablets from patentee. Another Supreme Court decision held that patentees could not require licensees to pay royalties beyond the term of the patent. CAFC jurisprudence characterized the misuse doctrine as impermissibly broadening the physical or temporal scope of the patent with anticompetitive effect.

The court discussed the doctrine of patent exhaustion, wherein the sale of a patented device exhausts the patentee's right to control the purchaser's use of the device. But that doctrine does not apply to a conditional sale or license, and so field of use limitations on such a sale have been upheld, and price-fixing and tying have not.

In addressing the issue before the court, "regardless of whether Philips and Sony agreed to suppress the technology embodied in the Lagadec patent, such an agreement would [or would] not constitute patent misuse and would not be a defense to Philips claim of infringement against Princo," the CAFC held that it was not misuse, even if the patentee Philips had engaged in anticompetitive conduct because the misuse must be of the patent itself.

In 1988, the patent code was amended to limit the doctrine of patent misuse, setting forth five types of conduct which may not provide the basis for finding misuse or illegal extension of the patent.

According to 35 U.S.C. §271(d), "No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: ... (4) refused to license or use any rights to the patent; or (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned."

The majority and dissenting opinions disagreed as to the intent of Subsections (4) and (5). The majority determined the congressional intent to be to confine patent misuse with respect to certain licensing practices to conduct having anticompetitive effects, whereas the dissent argued that congress intended the patent misuse doctrine to extend to a refusal to license technologies by parties acting in concert, and that such acting in concert could be patent misuse.

The majority pointed out that the statute did not mention "acting in concert" and the dissent referred to the legislative history where covenants not to compete were previously held to be misuse. Reminiscent of a Talmudic debate, the majority found the legislative history to be referring to covenants not to compete "in patent licenses," not concerted refusals to license among horizontal competitors. Furthermore, as a coup de grace on that issue, the majority stated that Secion 271(d) was not even implicated directly because the conduct in question was not within any of the five categories.

The CAFC concluded that Philips was not imposing restrictive conditions on the use of the Raaymaker patents to enlarge the physical or temporal scope of those patents. The alleged misuse was a horizontal agreement between Philips and Sony not to license the Lagadec patents separately. The en banc court held that even if they did that, it would not have been a patent misuse so as to excuse Princo's infringement.

The court agreed with Philips that the Lagadec techonolgy was not a viable competitor to the Raaymaker technology.

As applied to joint ventures, the court stated that an agreement among joint venturers to pool their research efforts is analyzed under the Rule of Reason, as is an agreement not to compete against their own joint venture. The dissent advocated a "quick-look" Rule of Reason analysis on the ground that any agreement not to compete is inherently suspect and that competitive harm should be presumed.

The majority determined that quick-look analysis only applies when an arrangement is so plainly anticompetitive that courts can impose liability after only a cursory examination, which would be justified in the present case if the joint venture were a sham or if the alleged agreement was a naked restraint, not reasonably necessary to achieve the efficiency-enhancing benefits of the joint venture.

The court concluded that even if Philips and Sony had agreed not to license the Lagadec patent for non-Orange Book purposes, that would have had no bearing on the physical or temporal scope of the patents in suit, nor did have anticompetitive effects in the relevant market.

This case has been decided first by the ALJ, then by the first ITC panel, then by the first CAFC panel, then back for a second ITC opinion, back to the CAFC where a first panel decided to remand but a 10-member en banc court rendered a majority opinion with one dissent and one concurring opinion. In all, more than 20 judges have analyzed the issues with many disagreements.

It can hardly be said that the law is clear regarding patent pools packaging patents covering alternative technologies, research joint ventures, licensing agreements among competitors, and the antitrust consequences.