

# Analyzing IP License Restrictions Under the Antitrust Laws: A General Outline of Issues

by George G. Gordon

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**Analyzing IP License Restrictions Under The Antitrust Laws:  
A General Outline Of Issues**

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- I. Shifting Perspectives On Licensing.** Perspectives on the degree of antitrust scrutiny to which intellectual property licensing agreements should be subject have changed over time. Broadly speaking, the approach to licensing arrangements in the courts, and in particular by the Agencies, has evolved from one characterized by suspicion and rigid *per se*-type rules to a more flexible, supple analysis. This evolution is consistent with the shifting of attitudes toward intellectual property generally. Although the current approach may sacrifice some degree of certainty and make counseling more of a challenge, it increases the probability that antitrust judgments will be based not on pre-conceived notions regarding the nature of intellectual property but on the real-world facts and circumstances of the situation at hand. Such an approach recognizes that, in the words of Justice Holmes, “[c]ertainty is not the test of certainty. We have been cocksure of many things that were not so.”<sup>1</sup>
- A. The Nine No-Nos.** In the 1970s, the Department of Justice exhibited a somewhat rigid approach to licensing arrangements, identifying particular practices that it considered to be forbidden as the “Nine No-Nos” of intellectual property licensing.<sup>2</sup>
- B. A Single No-No?** Some have read the Federal Circuit’s decision in *In re Independent Servs. Orgs. Antitrust Litig.* (“*Xerox*”) as shrinking the list of licensing “no-nos” to one: illegal tying. *See* 203 F.3d 1322, 1327 (Fed. Cir. 2000).<sup>3</sup> At least one district court has cited *Xerox* for the proposition that because “a patent owner has the legal right to refuse to license his or her patent on any terms, the existence of a predicate condition to a license agreement cannot state an antitrust violation.” *Townshend v. Rockwell*

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<sup>1</sup> Holmes, “The Natural Law,” 32 *Harvard Law Review* 40 (1918), reprinted in *The Essential Holmes* at 181 (University of Chicago Press, 1992).

<sup>2</sup> *See* Bruce B. Wilson, Deputy Assistant Attorney Gen., Remarks before the Fourth New England Antitrust Conference, Patent and Know-How License Agreements: Field of Use, Territorial, Price and Quantity Restrictions (Nov. 6, 1970). The “Nine No-Nos” were: (1) tying the purchase of unpatented materials as a condition of the license, (2) requiring the licensee to assign back subsequent patents, (3) restricting the right of the purchaser of the product in the resale of the product, (4) restricting the licensee’s ability to deal in products outside the scope of the patent, (5) a licensor’s agreement not to grant further licenses, (6) mandatory package licenses, (7) royalty provisions not reasonably related to the licensee’s sales, (8) restrictions on a licensee’s use of a product made by a patented process, and (9) minimum resale price provisions for the licensed products.

<sup>3</sup> In broad language, the Federal Circuit proclaimed that:

In the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws.

*Id.* at 1327.

*Int'l Corp.*, 2000-1 Trade Cas. (CCH) ¶ 72,890 (N.D. Cal. 2000).<sup>4</sup> That is likely an overly-broad reading of *Xerox*. In contrast to *Townshend*, the court of appeals in *United States v. Microsoft Corp.*, 253 F.3d 34, 63 (D.C. Cir. 2001), also cited *Xerox* for the proposition that “[i]ntellectual property rights do not confer a privilege to violate the antitrust laws” in the course of rejecting Microsoft’s copyright-based defense of its OEM licensing restrictions.

- C. The Agencies’ Guidelines.** The Agencies have come a long way since the days of the Nine No-Nos. The Department of Justice’s and the Federal Trade Commission’s *Antitrust Guidelines for the Licensing of Intellectual Property* (the “*Guidelines*”)<sup>5</sup> recognize that “[l]icensing, cross-licensing, or otherwise transferring intellectual property ... can facilitate integration of the licensed property with complementary factors of production” and that such integration can “benefit[] consumers through the reduction of costs and the introduction of new products.” (*Guidelines*, §2.3.) The *Guidelines* also caution, however, that “[w]hile intellectual property licensing arrangements are typically welfare-enhancing and procompetitive, antitrust concerns may nonetheless arise” particularly “when a licensing arrangement harms competition among entities that would have been actual or likely potential competitors in a relevant market in the absence of the license (entities in a ‘horizontal relationship’).” (*Id.* at §3.1.)

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<sup>4</sup> Former FTC Chairman Pitofsky expressed concern that the Federal Circuit’s reasoning in *Xerox* could be applied to legitimize licensing practices that courts (including the Supreme Court) have previously condemned. See *Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property*, remarks at the American Antitrust Institute’s Conference: An Agenda for Antitrust in the 21<sup>st</sup> Century (June 15, 2000), available at <http://www.ftc.gov/speeches/pitofsky/000615speech.htm>. Specifically, he questioned whether, under *Xerox*, a patent holder would be allowed (1) to refuse to sell or license except on condition that the purchaser/licensee not deal with a potential competitor; (2) to agree with certain licensees to terminate a licensee because it was a price cutter; (3) to refuse to license a rival as the result of a patent pooling arrangement in which participants retain veto power over licensees; and (4) to refuse to license rivals under a patent necessary to meet an industry standard when the patent holder had failed to disclose the existence of the patent when asked by the standard setting body.

<sup>5</sup> See U.S. DEP’T OF JUSTICE & FEDERAL TRADE COMM’N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (April 6, 1995), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,132, and available at <http://www.usdoj.gov/atr/public/guidelines/ipguide.htm>.

- II. Potential Causes of Action And Remedies.** The consequences of entering into an unlawful licensing arrangement can be severe. They range from potential government investigations to civil treble damage liability to a finding that the relevant intellectual property is unenforceable under a misuse theory.
- A. Government Enforcement.** The Agencies can seek injunctive relief through civil actions (e.g., *United States v. Microsoft*).<sup>6</sup> The states may also seek injunctive relief in their capacity as *parens patriae* (e.g., *United States v. Microsoft*; *FTC v. Mylan Labs.*). The Federal Trade Commission has also sought disgorgement of unlawfully acquired profits under §13(b) of the Federal Trade Commission Act, although it has used this power sparingly in competition law cases. *See e.g., FTC v. Mylan Labs.*, 62 F.Supp. 2d 25 (D.D.C. 1999). The Department of Justice can also pursue criminal penalties, but such action is generally reserved for hardcore violations such as price fixing and market allocation agreements.
- B. Private Claims.** Unlawful licensing arrangements may provide the basis for private claims for treble damages under 15 U.S.C. §15 and/or injunctive relief under 15 U.S.C. §26.
- C. Patent And Copyright Misuse.** Certain types of unlawful licensing arrangements might be deemed misuse and render the patent or copyright unenforceable in an infringement action until the misuse is purged.<sup>7</sup> The Federal Circuit has effectively held that a licensing arrangement must either have been held to constitute *per se* misuse by the Supreme Court or violate the antitrust rule of reason to be considered *patent* misuse. *See e.g., Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992). The same is not necessarily true for purposes of *copyright* misuse, at least in those jurisdictions that have recognized the defense. *See e.g., Lasercomb Am. Inc. v. Reynolds*, 911 F.2d 970 (4<sup>th</sup> Cir. 1990).
- III. Threshold Concepts.** The ultimate conclusion with respect to the antitrust consequences of a particular licensing arrangement may turn, in large part, on certain threshold issues regarding the competitive relationship of the parties and the appropriate analytical test to be applied (e.g., *per se* analysis v. the rule of reason).
- A. Horizontal v. Vertical Relationships.** One often tricky threshold issue is determining whether parties to the licensing arrangement are in a horizontal relationship (i.e., competitors or potential competitors) or a

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<sup>6</sup> The *Guidelines* contain a “safety zone” for licensing restraints where the restraints are not facially anticompetitive and the parties account for no more than 20 percent of each relevant market significantly affected by the restraint. *Guidelines* at §4.3.

<sup>7</sup> For in-depth background regarding the defenses of patent and trademark misuse, *see* ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY MISUSE: LICENSING AND LITIGATION (4<sup>th</sup> ed. 1997).

vertical relationship (i.e., parties in a complementary relationship, often at different stages in the chain of production/distribution).

1. The nature of the parties' relationship will affect the possible competitive consequences of a licensing restriction. With few exceptions (such as certain resale price maintenance provisions), vertical arrangements will almost always be analyzed under the antitrust rule of reason. Although the same is true of many horizontal licensing arrangements, they are more likely than vertical arrangements to be subject to *per se* analysis. They may also be more likely to attract scrutiny, even under a rule of reason analysis.
2. The key question is what the competitive situation would have looked like in the absence of the licensing arrangement in question: "For analytical purposes, the Agencies ordinarily will treat a relationship between a licensor and its licensees, or between licensees, as horizontal when they would have been actual or potential competitors in a relevant market in the absence of the license." (*Guidelines*, §3.3.)
3. In practice, such an analysis can be difficult, particularly when the parties have chosen the license as an alternative to infringement litigation over the very question of whether or not the licensee could lawfully compete with the licensor. Key relevant questions include:
  - a. Did the licensee have the technical capability and/or resources necessary to enter the relevant market without the licensing arrangement?
  - b. Is there any evidence that the licensee had any intention of entering the relevant market absent the licensing arrangement in question?
  - c. Would the licensee have been precluded from entering the relevant market by the licensor's intellectual property?
4. The questions of who has the burden of proof on these issues and what that burden should be are unresolved. The potential competition doctrine might provide guidance on questions such as the first two raised above. The third question, however, raises the specter of having to perform a full-blown infringement analysis in order to assess the antitrust consequences, if any, of a licensing arrangement.

**B. The Test To Be Applied To A Licensing Restraint: Per Se v. Rule of Reason Analysis.**

1. The majority of licensing arrangements are likely to be analyzed under the antitrust rule of reason, which typically entails an inquiry into whether the license is likely to have anticompetitive effects and, if so, whether the restraint is reasonably necessary to achieve pro-competitive benefits that outweigh the anticompetitive effects.
2. In certain limited instances, the Agencies and the courts will apply a “*per se*” analysis to licensing arrangements – i.e., they will treat the licensing arrangement as *per se* unlawful without an inquiry into its competitive effects. *Per se* treatment is reserved for conduct that is so plainly anticompetitive that no inquiry into its effect is necessary (e.g., naked price-fixing, market allocation among horizontal competitors, certain types of tying arrangements and certain types of group boycotts).
3. The *Guidelines* state that “[t]o determine whether a particular restraint in a licensing arrangement is given *per se* or rule of reason treatment, the Agencies will assess whether the restraint in question can be expected to contribute to an efficiency-enhancing integration of economic activity.” (*Guidelines*, §3.4.) The *Guidelines* go on to state that “if there is no efficiency enhancing integration of economic activity and if the type of restraint is one that has been accorded *per se* treatment, the Agencies will challenge the restraint under the *per se* rule. Otherwise, the Agencies will apply a rule of reason analysis.” (*Id.*)

**IV. Specific Types Of License Restrictions.<sup>8</sup>**

- A. Tying Arrangements/Package Licensing.** A tying arrangement is “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 product from any other supplier.” *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 461 (1992). In the licensing context, tying may involve a requirement that a licensee purchase a product or service from the licensor as a condition of receiving a license, or a requirement that a licensee take a license on additional intellectual property as a condition of receiving the license it is seeking (this is often referred to as “package licensing”).

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<sup>8</sup> There is an extensive analysis of particular types of licensing provisions in the context of the misuse defense in ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY MISUSE: LICENSING AND LITIGATION (4<sup>th</sup> ed. 1997), chs. II-III.

1. In general, tying is *per se* unlawful where (1) it involves two separate products or services; (2) that are tied together (that is, the purchase of one is conditioned on the purchase of the other); (3) the supplier possesses market power in the market for the tying product; (4) the tie has an anticompetitive effect in the tied market; and (5) the tie affects a not insubstantial volume of commerce. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *but see Guidelines*, §5.3 (stating that tying arrangements can “result in significant efficiencies and procompetitive benefits” and that, “[i]n the exercise of their prosecutorial discretion, the Agencies will consider both the anticompetitive effects and the efficiencies attributable to a tie-in”).
  
2. Mandatory, coercive package licensing may also be *per se* unlawful. *See e.g., Zenith Radio Corp. v. Hazeltine Research Inc.*, 395 U.S. 100 (1969); *United States v. Loews Inc.*, 371 U.S. 38 (1962); *United States v. Paramount Pictures*, 334 U.S. 131 (1948); *MCA Television Ltd. v. Public Interest Corp.*, 171 F.3d 1265, 1277-79 (11<sup>th</sup> Cir. 1999); *American Security Co. v. Shatterproof Glass Corp.*, 268 F.2d 769, 777 (3d Cir. 1959). A package license may not be unlawful, however, if the parties voluntarily enter into such an arrangement as a matter of mutual convenience. *See e.g., Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827, 834 (1950).<sup>9</sup>
  
3. Congress has specifically provided that proof of market power “in view of the circumstances” is a necessary element of any patent misuse defense based on allegations of tying or package licensing. 35 U.S.C. 271(d)(5) (2001). Some courts have held that the requirements of § 271(d) apply to antitrust claims as well as misuse defenses. *See In re Indep. Servs. Orgs. Antitrust Litig.*, 203 F.3d 1322 (Fed. Cir. 2000); *In re Indep. Servs. Orgs. Antitrust Litig.*, 989 F. Supp. 1131 (D. Kan. 1997); *see also Orion Electric Co., Ltd. v. Funai Electric Co., Ltd.*, 2002 WL 377541 at \*6-7 (S.D.N.Y. 2002) (dismissing patent misuse defense and antitrust claims based on alleged mandatory package licensing because the plaintiffs failed to show adequate market power). Others have held that §271(d) applies only to misuse defenses. *See Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1214 n.7 (9<sup>th</sup> Cir. 1997); *Grid Sys. Corp. v. Texas Instruments, Inc.*, 771 F.Supp. 1033, 1044, n.2 (N.D. Cal. 1991). Market power in the tying product market is already an element of *per se* unlawful tying. If, however, §271(d)(5) applies to antitrust claims, proof of market power in the tying product market will also become an essential

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<sup>9</sup> Similarly, package patent licensing may not be unlawful where the patents in the package are blocking patents. *See e.g., International Mfg. Co. v. Landon, Inc.*, 336 F.2d 723, 729-30 (9<sup>th</sup> Cir. 1964).

element of a tying or package licensing claim even under the rule of reason.

4. The *Microsoft* case has recently focused attention on the issue of “technological tying” – in effect, using product design to combine two potentially separate products into one (e.g., in *Microsoft*, an operating system and an internet browser). Although the court of appeals in *Microsoft* stated that courts have been “very skeptical” about antitrust claims based on product design, it held that Microsoft’s exclusion of Internet Explorer from the Add/Remove Programs utility and its commingling of browser and operating system code constituted exclusionary conduct in violation of §2. *United States v. Microsoft*, 253 F.3d 34, 66-67 (D.C. Cir. 2001). In connection with the §1 tying claims based largely on the same conduct, however, the court held that *per se* analysis was inappropriate because the case “offer[ed] the first up-close look at the technological integration of added functionality into software that serves as a platform for third-party applications.” *Id.* at 84. The court of appeals made it clear that its holding was confined to the facts of the case (which involved platform software) and that it was not “finding the *per se* rule inapplicable to software markets generally.” *Id.* at 95.<sup>10</sup>

**B. “Tie-Outs” Or Covenants Not To Deal In Competing Technologies.**

The term “tie out” is often used to refer to arrangements in which a license prohibits a licensee from dealing in and/or developing competing, *non-infringing* technologies.<sup>11</sup> Such arrangements have been found to be intellectual property misuse and could form the basis for an antitrust claim as well. *See e.g., Practice Mgmt. Info. Corp. v. American Med. Ass’n*, 121 F.3d 516 (9<sup>th</sup> Cir. 1997); *Service & Training, Inc. v. Data Gen. Corp.*, 963 F.2d 680 (4<sup>th</sup> Cir. 1992); *Lasercomb Am. Inc. v. Reynolds*, 911 F.2d 970 (4<sup>th</sup> Cir. 1990); *Guidelines*, §5.4 (covering exclusive dealing arrangements).

1. The elements of a claim based on a licensing “tie-out” are not settled. At least two courts have held that the requirement of proving market power under 35 U.S.C. 271(d)(5) applies to patent-based tie-out cases. *See In re Recombinant DNA Tech. Patent &*

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<sup>10</sup> The court in *Microsoft* also considered Microsoft’s license restrictions prohibiting OEMs from removing any desktop icons, folders or start menu entries, altering the initial boot-up sequence or otherwise altering the appearance of the Windows desktop. With the exception of a restriction prohibiting automatically launched alternative interfaces, the court found that “all the OEM license restrictions at issue represent uses of Microsoft’s market power to protect its monopoly, unredeemed by any legitimate justification.” *Id.* at 355-360.

<sup>11</sup> Such arrangements are conceptually similar to exclusive dealing arrangements. Because some courts have treated “tie-outs” as a distinct category of licensing restriction, they are treated separately here as well.

*Contract Litig.*, 850 F. Supp. 769 (S.D. Ind. 1994); *Texas Instruments, Inc. v. Hyundai Elec. Indus. Co.*, 49 F. Supp. 2d 893 (E.D. Tex. 1999).

2. At least in the context of analyzing patent misuse defenses, some courts have also expressly required a showing of an anticompetitive effect from a tie-out. *See Keystone Retaining Wall Systems, Inc. v. Westrock, Inc.*, 792 F.Supp. 1552 (D.Or. 1991) (treating an agreement not to deal in competing goods as an exclusive dealing arrangement), *aff'd in part, rev'd in part*, 997 F. 2d 1444 (Fed. Cir. 1993); *Texas Instruments*, 49 F.Supp. 2d at 907-13. Similarly, the Agencies appear likely to treat most such arrangements as exclusive dealing requirements, subject to rule of reason analysis. *See Guidelines*, §5.4.
3. In the context of copyright misuse, however, it is not clear that proof of an anticompetitive effect is necessary. In *Lasercomb and Practice Management*, for example, the courts did not require any additional proof of anticompetitive effect before finding provisions restricting licensees' development and/or use of non-infringing, competing technologies to be copyright misuse.

**C. Royalty Provisions.** Licensors generally have a great deal of freedom in deciding what royalties to charge and how to structure their royalty arrangements. In very few cases, most of which have been subject to significant criticism and are of questionable precedential value, have royalty provisions provided the basis for an antitrust violation or a finding of misuse.

1. Excessive Royalties. Allegations of “excessive” royalties are unlikely, on their own, to support the finding of an antitrust violation or intellectual property misuse. *See Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964) (“A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly”); *LaSalle St. Press, Inc. v. McCormick & Henderson, Inc.*, 445 F.2d 84 (7<sup>th</sup> Cir. 1971); *In re Indep. Servs. Orgs. Antitrust Litig.*, 964 F. Supp. 1479 (D.Kan. 1997); *but see American Photocopy Equip. Co. v. Rovico Inc.*, 359 F.2d 745 (7<sup>th</sup> Cir. 1966) (expressing concern that an “exorbitant, oppressive royalty” might cause licensees to raise prices).
2. Post-Expiration Royalties. The Supreme Court has held that a provision that extends the payment of royalties for a patent beyond its expiration is unenforceable. *See Brulotte*, 379 U.S. at 33. This rule does not apply to package licenses in which the parties have agreed for their mutual benefit to a royalty that stays the same even as the individual patents expire (*See Automatic Radio Mfg. Co. v.*

*Hazeltine Research, Inc.*, 339 U.S. 827 (1950)) or agreements to defer royalties. Whether or not post-expiration royalties are misuse, rendering the intellectual property unenforceable, remains unsettled. See *Modrey v. American Gage & Mach. Co.*, 478 F.2d 470 (2d Cir. 1973) (post-expiration royalty clause not enforceable, but patent not rendered unenforceable); *Rocform Corp. v. Acitelli-Standard Concrete Wall, Inc.*, 367 F.2d 678, 681 (6<sup>th</sup> Cir. 1966) (post-expiration royalty clause rendered the patent unenforceable until it was purged); *Sanford Redmond, Inc. v. Mid-America Dairymen, Inc.*, 29 U.S.P.Q.2d 1222 (S.D.N.Y. 1992) (post-expiration royalty provision was misuse), *aff'd*, 993 F.2d 1534 (2<sup>nd</sup> Cir. 1993).<sup>12</sup>

3. Total Sales Royalties. A royalty based on total sales, regardless of whether the sales are of products incorporating infringing technologies, may be the basis for an antitrust violation or a finding of misuse if the licensor used its “leverage to coerce a promise to pay royalties” on products not covered by the relevant intellectual property. See *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 137 (1969); *Glen Mfg. Inc. v. Perfect Fit Indus., Inc.*, 420 F.2d 319 (2<sup>nd</sup> Cir. 1970); *Lightwave Techs., Inc. v. Corning Glass Works*, 19 U.S.P.Q.2d 1838, 1840 (S.D.N.Y. 1991). Such a total sales royalty, however, may be lawful if it is agreed upon for the convenience of the parties. See e.g., *Automatic Radio*, 339 U.S. at 834 (upholding total sales royalties provision); *Zenith*, 395 U.S. at 138; *Engel Indus., Inc. v. Lockformer Co.*, 96 F.3d 1398, 1408-09 (Fed. Cir. 1996) (rejecting claim of misuse premised on royalty provision that was based on sales of unpatented components where the licensee had a choice of whether or not to buy the components from the licensor); *Construction Tech., Inc. v. Cybermation, Inc.*, 1996 WL 44430 at \*4 (S.D.N.Y. 1996) (calculating royalties based on total sales is not misuse “if it is done for the convenience of the parties”). Part of the basis for the 1995 Consent Order involving Microsoft was its practice of requiring manufacturer-licensees to pay a per-processor royalty, regardless of whether a computer system actually used a Microsoft operating system. See *United States v. Microsoft Corp.*, 1995 WL 505998, 1995-2 Trade Cas. ¶ 71,096 (D.D.C. 1995).
4. Discriminatory Royalties. In a series of cases labeled the “Shrimp Peeler” cases, the courts found a discriminatory royalty scheme to

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<sup>12</sup> Similarly, agreements not to contest the validity of a patent have generally been held to be unenforceable but not to constitute an antitrust violation or misuse. See *Lear v. Adkins*, 395 U.S. 653 (1969); *Panther Pumps & Equip. Co. v. Hydrocraft, Inc.*, 468 F.2d 225, 232 (7<sup>th</sup> Cir. 1972); *Congoleum Indus. v. Armstrong Cork Co.*, 366 F. Supp. 220, 233 (E.D.Pa. 1973), *aff'd*, 510 F.2d 334 (3<sup>rd</sup> Cir. 1975); but see *Bendix Corp. v. Balax, Inc.*, 471 F.2d 149, 158 (7<sup>th</sup> Cir. 1972) (suggesting that a provision preventing contests to a patent’s validity after termination of the license might constitute misuse).

be patent misuse. See *LaPeyre v. FTC*, 366 F.2d 117 (5<sup>th</sup> Cir. 1966); *Peelers Co. v. Wendt*, 260 F. Supp. 193 (W.D. Wash. 1966); *Laitram Corp. v. King Crab, Inc.*, 245 F.Supp. 1019 (D.Alaska 1965). Those decisions, however, have been roundly criticized, and the Seventh Circuit has subsequently refused to find misuse or an antitrust violation based on licenses providing for differential royalties. See, e.g., *USM Corp. v. SPS Techs. Inc.*, 694 F.2d 505 (7<sup>th</sup> Cir. 1982); see also, *Akzo NV v. United States Int'l Trade Comm'n*, 808 F.2d 1471 (Fed. Cir. 1986). In a pair of pre-Shrimp Peeler decisions, the Third Circuit condemned differential royalty arrangements based on whether the licensees purchased unpatented goods from the licensor. See *National Foam Sys. v. Urquhart*, 202 F.2d 659, 663-64 (3d. Cir. 1953); *Barber Asphalt Corp. v. La Fera Grecco Contracting Co.*, 116 F.2d 211, 214-16 (3d. Cir. 1940).

- D. Restrictions On Fields Of Use, Customers And Territories.** License agreements often limit the fields of use in which a licensee may practice the patent, the customers with which they can deal or the territories in which they can sell. In most cases, such restrictions have been upheld as lawful.
1. License provisions that restrict the field of use, customers or territories to which a licensee may sell patented goods are not subject to *per se* analysis and have generally been upheld as valid. See *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 456 (1940) (limiting licenses to particular territories in the United States is not an antitrust violation); *General Talking Pictures Corp. v. Western Elec. Co.*, 305 U.S. 124 (1938) (field of use restrictions are not patent misuse); *In re Yarn Processing Patent Validity Litig.*, 541 F.2d 1127, 1135 (5<sup>th</sup> Cir. 1976) (a patent holder may restrict the customers to whom a licensee can sell a patented good); *Brownell v. Ketcham Wire & Mfg. Co.*, 211 F.2d 121 (9<sup>th</sup> Cir. 1954) (relying on 35 U.S.C. §261 to hold that exclusive territorial licenses are, without more, legal); *B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997) (upholding field of use restriction); *Carter v. Variflex, Inc.*, 101 F. Supp.2d 1261, 1264-66 (C.D. Cal. 2000) (cross-license agreement with a field of use restriction upheld under rule of reason analysis).
  2. Although some courts have condemned a restriction on the sale or use of an *unpatented* good manufactured using a patented process as misuse or exceeding the scope of the patent (*Robintech, Inc. v. Chemidus Wavin, Ltd.*, 628 F.2d 142 (D.C. Cir. 1980) (restriction was misuse); *Amgen, Inc. v. Chugai Pharm. Co.*, 808 F. Supp. 894, 904 (D.Mass. 1992) (restriction exceeded the scope of the patent), *aff'd sub. nom. Ortho Pharm. Comp. v. Genetics Inst.*, 52 F.3d

1026 (Fed. Cir. 1995)), such a restriction will also likely be analyzed under the antitrust rule of reason. *See United States v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1128 (D.C. Cir. 1981).

3. A license restriction that is viewed as a sham to cover a market allocation or price-fixing agreement will be *per se* unlawful. *See e.g. In re Cardizem CD Antitrust Litig.*, 105 F.Supp. 2d 682, 707 (E.D. Mich. 2000); *see also In re Terazosin Hydrochloride Antitrust Litig.*, 203 F.R.D. 551, 2001-2 Trade Cas. ¶ 73,469 (S.D.Fla. 2001); *Guidelines*, example 7.

#### **E. Restrictions On Price, Quantity Or Output.**

1. The Supreme Court has held that a patentee may set the price at which a licensee must sell a patented good where both parties manufactured the product and were direct horizontal competitors. *United States v. General Elec. Co.*, 272 U.S. 476, 480-90 (1926). This rule, however, has been criticized and significantly narrowed over time (although never overruled). *See e.g., United States v. New Wrinkle, Inc.*, 342 U.S. 371 (1952) (holding that *General Electric* does not apply to a case involving price-fixing in concert with others); *United States v. Line Material Co.*, 333 U.S. 287, 293-97 (1948) (holding that §1 of the Sherman Act was violated by a provision in a sublicense setting the sublicensee's price in a case involving cross-licensed patents); *United States v. Univis Lens*, 316 U.S. 241, 249-51 (1942) (*General Electric* does not apply after the first sale of a product by the licensor); *Newborough Moire Co. v. Superior Moire Co.*, 237 F.2d 283 (3d Cir. 1956) (*General Electric* does not apply to a case involving multiple licenses containing price-fixing provisions); *Cummer-Graham Co. v. Straight Side Basket Corp.*, 142 F.2d 646 (5<sup>th</sup> Cir. 1944) (*General Electric* does not apply to restrictions on the price of an unpatented good manufactured using a patented process); *but see LucasArts Entmt. v. Humongous Entmt. Co.*, 815 F. Supp. 332 (N.D. Cal. 1993) (relying on *General Electric* to reject a misuse challenge to a provision in a copyright license that limited price reductions for a computerized game incorporating the copyrighted feature).
2. Provisions setting minimum resale prices imposed after the first sale of a patented product will likely be found *per se* unlawful. *Univis Lens*, 316 U.S. at 249-51; *Guidelines*, §5.2 ("Consistent with the principles set forth in §3.4, the Agencies will enforce the *per se* rule against resale price maintenance in the intellectual property context"). Maximum resale price restrictions are judged under the antitrust rule of reason. *State Oil Co. v. Khan*, 522 U.S. 3 (1997).

3. Provisions limiting the quantity of a patented product that a licensee may make, use or sell have been upheld as valid and, without more, are unlikely to raise significant misuse or antitrust risks. *See e.g., Atari Games Corp. v. Nintendo of Am., Inc.*, 897 F.2d 1572, 1578 (Fed. Cir. 1990); *United States v. E.I. DuPont de Nemours & Co.*, 118 F.Supp. 41, 226 (D. Del. 1953), *aff'd*, 351 U.S. 377 (1956); *Q-Tips, Inc. v. Johnson & Johnson*, 109 F.Supp. 657 (D.N.J. 1951), *modified*, 207 F.2d 509 (3<sup>rd</sup> Cir. 1953).

**F. Exclusivity And Exclusive Dealing Arrangements.** In the licensing context, exclusivity can refer to limitations on the licensor's ability to license others to use the relevant intellectual property (i.e., an exclusive license) or limitations on the licensee's ability to deal in (i.e., sell, license, develop, distribute or use) competing technologies. *See Guidelines*, §4.1.2.

1. Courts have held that a grant of an exclusive license is within the scope of the patent grant. *See e.g., Genentech, Inc. v. Eli Lilly & Co.*, 998 F.2d 931, 949 (Fed. Cir. 1993). The Agencies have stated that "an exclusive license may raise antitrust concerns only if the licensees themselves, or the licensor and its licensees, are in a horizontal relationship." *Guidelines*, §4.1.2. Such an exclusive license will likely be analyzed by the Agencies under the principles used to analyze mergers and acquisitions as set forth in the *1992 Horizontal Merger Guidelines*.<sup>13</sup> The acquisition of an exclusive license may also qualify as an asset acquisition for purposes of Hart-Scott-Rodino notification. The Agencies will treat a nominally non-exclusive license as a *de facto* exclusive license if the facts justify such treatment. *See United States v. S.C. Johnson & Son, Inc.*, 1995-1 Trade Cas. (CCH) ¶ 70,884 (N.D.Ill. 1994) (the DOJ alleged that a nominally non-exclusive license was exclusive where the patentee had refused to license others and had itself refrained from using the technology); *Guidelines*, Example 11.
2. Limitations on a licensee's ability to deal in competing technologies will likely be analyzed under the rule of reason. *See Guidelines*, §5.4. Key factors in such an analysis will be (1) the duration of the exclusivity; (2) the rationale for the restriction; and (3) the degree of foreclosure caused by the restriction. As noted above, however, in the copyright context, courts have found limitations on a licensee's ability to develop and/or use competing technologies to be misuse without any further analysis of competitive effects. *See, e.g., Practice Mgmt. Info. Corp. v.*

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<sup>13</sup> U.S. DEP'T OF JUSTICE & FEDERAL TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104.

*American Med. Ass'n*, 121 F.3d 516 (9<sup>th</sup> Cir. 1997); *Lasercomb Am. Inc. v. Reynolds*, 911 F.2d 970 (4<sup>th</sup> Cir. 1990).

- G. Grantbacks.** A “grantback” provision typically requires the licensee to grant the licensor the right to intellectual property developed by the licensee. The antitrust concern with grantback provisions is based primarily on their potential to limit the licensee’s incentive to innovate.
1. Grantback provisions are analyzed under the rule of reason. *See Transparent-Wrap Mach. Corp. v. Stokes & Smith Co.*, 329 U.S. 637, 646-48 (1947); *Guidelines*, §5.6.
  2. The antitrust consequences of a grantback may differ based on a number of factors: (1) whether the grantback includes technology that goes beyond the originally licensed intellectual property; (2) whether the grantback is in the form of an assignment, exclusive license, non-exclusive license or an option; (3) whether the licensee retains any rights under the intellectual property subject to the grantback; (4) the duration of the licensee’s grantback obligation; (5) the parties’ market power; (6) whether the parties are competitors; (7) whether the grantback is royalty-free; (8) the effect of the grantback on the parties’ incentive to innovate; (9) whether the licensor can sublicense the intellectual property that is the subject of the grantback; and (10) whether the grantback promotes dissemination of improvements developed by the licensee, increases the licensor’s incentive to license or otherwise increases competition and output in the relevant market. *See Guidelines* §5.6; ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY MISUSE: LICENSING AND LITIGATION (4<sup>th</sup> ed. 1997), at 63; *see also Robintech, Inc. v. Chemidus Wavin, Ltd.*, 450 F. Supp. 817 (D.D.C. 1978), *aff’d*, 628 F.2d 142 (D.C. Cir. 1980); *Duplan Corp. v. Deering Milliken, Inc.*, 444 F. Supp. 648, 699-701 (D.S.C. 1977), *aff’d in part, rev’d in part*, 594 F.2d 979 (4<sup>th</sup> Cir. 1979).
- H. Cross-Licensing, Patent Pooling And Licensing Through Joint Ventures.**
1. Even where cross-licensing arrangements involve exclusivity, they are unlikely, without more, to violate the antitrust laws. *See Boston Scientific Corp. v. Schneider A.G.*, 983 F. Supp. 245 (D. Mass. 1997); *but see Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 113-114 (1969) (suggesting that exclusive patent pools might violate the Sherman Act). Indeed, the Agencies have recognized that cross-licensing arrangements and patent pooling “may provide procompetitive benefits by integrating complementary technologies, reducing transaction costs, clearing

blocking positions and avoiding costly infringement litigation.” *Guidelines*, §5.5; *see also Carter v. Variflex, Inc.*, 101 F. Supp.2d 1261, 1264-66 (C.D. Cal. 2000) (cross-license agreement with a field of use restriction upheld under rule of reason analysis).

2. The Agencies have also, however, identified a number of situations in which cross-licenses and patent pools might have unlawful anticompetitive effects: (1) where the arrangements include collective price or output restraints and do not contribute to an efficiency enhancing integration of economic activity; (2) where the patent pool is exclusive and (a) excluded firms cannot compete in the relevant goods or service market without access to the technology and (b) the pool participants collectively possess market power; and (3) where the pooling arrangement discourages or deters members from engaging in research and development (e.g. if the pooling arrangement includes mandatory grantback obligations, particularly at low royalty rates). *Id.* In *United States v. Krasnov*, 143 F.Supp. 184 (E.D.Pa. 1956), *aff’d per curiam*, 355 U.S. 5 (1957), the court condemned an exclusive patent pool in which the participants possessed monopoly power and agreed not to license others without mutual consent, to allocate customers, to fix prices and to jointly maintain infringement suits.
3. A review of three Business Review Letters related to the video portion of the MPEG-2 standard and the DVD-Rom and DVD-Video formats illustrates the factors that the DOJ considers important in analyzing patent pools designed to facilitate an industry standard. *See Letter from Joel I. Klein to Gerrard R. Beeney, Esq., June 26, 1997 “MPEG-2”, Letter from Joel I. Klein to Garrard R. Beeney, Esq., December 16, 1998 (DVD-Rom)” and Business Review Letter issued by Joel I. Klein, June 10, 1999 (DVD-Video).*<sup>14</sup> In approving the patent pools described in those letters, the DOJ was influenced by a variety factors, including that the pools were limited to complementary patents and to those patents that an independent expert determined were necessary to use the applicable standards; that the pools provided for non-discriminatory licensing; that pool licensees were free to use alternative technologies; and that the “grantback clauses” were limited to requiring pool participants to include essential patents in the pool. The Business Review Letters are highly fact-specific, but they are an invaluable resource for counsel seeking insight into the type of factors that might influence the competitive analysis of a patent pool.

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<sup>14</sup> All of these Business Review Letters are available at <http://www.usdoj.gov/atr/public/busreview>.

4. By contrast, the FTC recently challenged a patent pool in which horizontal competitors contributed patents on competing technologies, set the fees charged by sublicensees for use of the patented equipment, and allowed the two firms to have veto power over decisions to license the pool patents to others. *See In The Matter of Summit Tech.*, 63 Fed. Reg. 46452 (1998). The FTC noted that the parties could have remedied any real or perceived issue of blocking patents by entering into cross-licenses that did not contain price-fixing provisions.
5. In the *Napster* litigation, the court recently allowed discovery into Napster's allegations of antitrust violations and copyright misuse based on, *inter alia*, licensing restrictions imposed by MusicNet, a joint venture comprising three out of the five major record companies. *In re Napster, Inc. Copyright Litig.*, 2002 WL 482361 (N.D.Cal. 2002). The challenged restrictions include a provision that prevented Napster from entering into a license with any individual record company until March 1, 2002; a provision that allowed MusicNet to terminate the license if Napster did enter into any license with an individual record company, even after March 1, 2002; a pricing structure under which Napster will be charged higher fees if it does not use MusicNet as its exclusive licensor for content. According to the court, the licensing arrangement "effectively grants MusicNet control over which content Napster licenses." *Id.* at \*14. Napster has also asserted that the record companies have violated the antitrust laws through a variety of other conduct, including retail price squeezes, raising costs through licensing provisions, refusals to deal and exclusive dealing. *Id.* at \*16-17.

**v. A Few Words On The "First-Sale" Or "Exhaustion" Doctrine.** The right of a patent owner to place even lawful restrictions on the sale or use of a product was traditionally deemed to be exhausted after the product's first sale.<sup>15</sup> In *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), however, the Federal Circuit held that a single use only restriction could be enforced against a company that had acquired the product from the original purchaser and reconditioned the product so that it could be re-used. The Federal Circuit appeared to rely on the fact that the product had never been sold without a condition; that the product contained a label warning the "secondary" purchaser of the single use only restriction; and that the use restriction was motivated by what the court considered to be a legitimate business purpose. *See also PSC Inc. v. Symbol Techs. Inc.*, 26 F. Supp. 2d 505, 510-11 (W.D.N.Y. 1998) (finding a

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<sup>15</sup> The first sale doctrine in copyright law is codified at 17 U.S.C. §109(a) and prevents the copyright owner from controlling future transfers of a particular copy of a copyrighted work after he has transferred its material ownership to another. *See e.g., Video Pipeline, Inc. v. Buena Vista Home Entertainment, Inc.*, 2002 WL 484910 at \*6 (D.N.J. 2002).

royalty provision that required a downstream purchaser to pay a royalty based on the use of a component for which the original purchaser had already paid a royalty to be misuse because the first sale had exhausted the patent owner's rights in the patent).