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HAS THE SUPREME COURT RESURRECTED PRICE RESTRICTIONS IN PATENT LICENSES? THE IMPLICATIONS OF *LEEGIN*

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I. INTRODUCTION

Price restrictions in patent licenses dwell in antitrust limbo. They have never been declared *per se* unlawful, yet their use has virtually died out because of antitrust risk. That risk stems from a web of unfriendly Supreme Court decisions more than half a century ago. The situation may be changing, however, due to a recent Court holding that, surprisingly, did not involve a patent license.

In June 2007 the Supreme Court overturned the *per se* rule against vertical agreements that fix minimum resale prices in the sale of goods. The decision, *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, expressly overruled the Court's 1911 decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, which had declared vertical minimum price-fixing illegal.[1] Although *Dr. Miles* involved the sale of unpatented products, its implications for patent licensing were profound.[2] With *Dr. Miles*' foundation overruled and its rationale discredited, courts now have to reexamine the continued authority of the series of hostile patent licensing cases. The result may be greater leeway for price-restricting licenses in certain situations.

Part II of this Article will examine the evolution of the law governing price restriction clauses in patent licensing agreements, emphasizing key cases. Part III discusses the *Leegin* decision and its implications on past and future patent licensing agreements. Part IV hypothesizes about what the future of price restrictions in patent licenses might look like, and applies the Court's new *Leegin* rationale to historical precedents.

II. THE EVOLUTION OF ANTITRUST LAW GOVERNING PRICE RESTRICTIONS IN PATENT LICENSES

Through a series of Supreme Court decisions stretching over the first half of the twentieth century, the antitrust treatment of price restrictions in licenses has shifted from broad acceptance to acceptance in theory, but not in practice.

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[1] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 907 (2007), *overruling* Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911). The Court had, ten years earlier, overturned the *per se* rule against maximum resale price agreements. State Oil Co. v. Khan, 522 U.S. 3, 22 (1997). *Leegin* accomplished the same result with respect to minimum resale price agreements. *See* 551 U.S. at 906-07.

[2] *See* 220 U.S. at 402.

Dr. Miles played a seminal role in that shift; and tracing the development of that body of case law is essential to understanding how the overruling of *Dr. Miles* will affect patent licensing.

A. *The* National Harrow *Case*

In *E. Bement & Sons v. National Harrow Co.*, the Supreme Court considered a patent license for the right to manufacture and sell spring tooth harrows.[3] Six manufacturers of spring tooth harrows incorporated the National Harrow Company of New York in 1890 in order to settle an outstanding patent litigation to which they were all parties.[4] E. Bement & Sons later bought into the company by trading patents in return for stock in National Harrow and a license to manufacture spring tooth harrows under National Harrow's patents.[5] When Bement eventually breached the license agreement, National Harrow sued.[6] Bement asserted, as a defense, that the agreement violated the Sherman Act in several respects, one of which was a clause prohibiting Bement from selling harrows at prices below a minimum amount set in the license.[7]

The Supreme Court upheld the minimum price provision by a simple exercise in logic. Since a patent owner "can, of course, charge such price as he may choose" for the patented article, it followed that he could license someone else to manufacture "upon the condition that the [licensee] shall charge a certain amount for such article."[8] The effect, as the Court conceived it, would be no different than if the patent owner itself were selling the entire patented output at a monopoly price.[9] By this reasoning, price restrictions in patent licenses to manufacture and sell the patented invention would be, in effect, *per se* lawful, regardless of the number of licensees or their competitive relationship with the patent owner.

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[3] 186 U.S. 70, 71 (1902). A spring tooth harrow is an agricultural device used to level soil, uproot weeds, and break up clods of earth. *See* Britannica Online Encyclopedia, Harrow, http://www.britannica.com/EBchecked/topic/256050/harrow (last visited May 5, 2010).

[4] *Nat'l Harrow*, 186 U.S. at 76-77.

[5] *Id.* at 71-72.

[6] *Id.* at 75.

[7] *Id.* at 75-76.

[8] *Id.* at 93.

[9] *Id.* at 91.

B. *The* Dr. Miles *Case*

Nine years after *National Harrow*, the Supreme Court declared an altogether different rule regarding vertical price restrictions involving unpatented products in the *Dr. Miles* case. At issue were agreements in which Dr. Miles Medical Company required its wholesalers to adhere to minimum resale prices in the sale of Dr. Miles' pharmaceutical products.[10] Dr. Miles argued that its agreements were analogous to those in *National Harrow* and should therefore be upheld.[11] The Court disagreed, essentially limiting the result in *National Harrow* to cases involving patent licenses.[12] Since Dr. Miles' agreements lay "outside the policies of the patent law," the Court reasoned that they were governed by traditional restraint of trade principles embedded in both the common law and the Sherman Act.[13] Applying these principles, the price restraint was illegal *per se* because, although vertical, the Court concluded that its competitive effect was no different than if Dr. Miles' wholesalers had formed a horizontal cartel.[14] The Court failed to recognize any distinction between horizontal and vertical price restrictions in Dr. Miles' arrangements.[15]

C. *The* Patent Exhaustion *Cases*

With *National Harrow* limited to situations within "the policies of the patent law," the limits of patent protection assumed critical importance.[16] One long-recognized limit on patent rights is the exhaustion principle, which provides that the authorized, unconditional sale of a patented product extinguishes all of the patent holder's rights to that item.[17] The Supreme Court applied this limitation in a series of patent cases on the heels of *Dr. Miles* to deny the protection of the patent laws to licenses containing resale price provisions involving patented goods.

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[10] Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373, 394 (1911).

[11] *Id.* at 401.

[12] *Id.* at 402.

[13] *Id.*

[14] *See id.* at 408.

[15] *See id.*

[16] *See id.* at 402.

[17] Quanta Computer, Inc. v. LG Elecs., Inc., 128 S. Ct. 2109, 2115, 86 U.S.P.Q.2d (BNA) 1673, 1677 (2008); Adams v. Burke, 84 U.S. 453, 456-57 (1873).

The first such case, *Bauer & Cie. v. O'Donnell*, provides an example.[18] Bauer owned a patent on albumenoid, which it manufactured and furnished to its sole U.S. sales agent, Hehmeyer, under a license agreement.[19] The agreement prohibited Hehmeyer and downstream purchasers from reselling packages of the product for less than $1 each.[20] Downstream purchasers were advised of the price restriction by a notice on the package that threatened them with a lawsuit if they sold the package below the specified price.[21] O'Donnell was a retailer who resold Bauer's product for less than $1, after having purchased it for $1 from Hehmeyer.[22] Bauer sued O'Donnell for patent infringement.[23]

The Supreme Court held that, because the sale from Hehmeyer to O'Donnell was at full value, "[t]he right to vend conferred by the patent law has been exercised," and the patented article was placed "beyond the limits of the monopoly secured by the patent act."[24] In response to the objection that a sale subject to a condition which is later breached should not exhaust the patent, the Court held that minimum price conditions are "against public policy and void."[25] The first sale had therefore exhausted any patent rights, and the patent owner had no infringement claim against subsequent purchasers.[26] A handful of Supreme Court cases over the next several years reached similar results based on similar analysis.[27] Although not decided under antitrust laws, these cases

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18 *See generally* 229 U.S. 1 (1913).

19 *Id.* at 8.

20 *Id.*

21 *Id.* at 8-9.

22 *Id.* at 9.

23 *See id.* ("The question propounded is: 'Did the acts of the appellee . . . constitute infringement of appellants' patent?'").

24 *Id.* at 17. The Court relied heavily on the reasoning of *Bobbs-Merrill Co. v. Straus*, a copyright case holding that the first sale of a copyrighted work exhausted the owner's copyright. *See* 210 U.S. 339, 350 (1908).

25 *Bauer & Cie.*, 229 U.S. at 12.

26 *See id.* at 17.

27 *See, e.g.*, Boston Store v. Am. Gramophone Co., 246 U.S. 8, 24-25 (1918) (holding sale to dealer exhausted patent right and precluded infringement action against dealer for selling below prescribed resale prices); Straus v. Victor Talking Mach. Co., 243 U.S. 490, 501 (1917) (holding nominal "use" license was in reality a sale for full value thereby exhausting patent rights and precluding infringement suit).

defined the scope of patent protection for the coming antitrust-based attack on price restrictions.

D. *The* General Electric *Case*

Fifteen years after *Dr. Miles*, the Supreme Court was forced to decide how that case affected patent licenses in the antitrust context. General Electric (GE) had licensed Westinghouse to make, use, and sell tungsten light bulbs under GE's patents.[28] GE also made and sold bulbs covered by the same patents it was licensing to Westinghouse.[29] Westinghouse was required to sell the licensed light bulbs it manufactured at prices fixed by GE.[30] Here, the Court reached an opposite conclusion from *Dr. Miles* and upheld the price-fixing provision as "normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly."[31]

The Court distinguished the post-sale patent cases by invoking the reverse of the exhaustion principle.[32] In those cases, the patent owner was also the manufacturer, and its sale of the patented product was the "first sale" which exhausted the patent right.[33] In *General Electric*, however, the licensee (Westinghouse) was the manufacturer and was therefore making the first sale.[34] GE was entitled to fix Westinghouse's price for the patented article's first sale because the profit on *that* sale was the basis for GE's pecuniary reward.[35] Indeed, according to Chief Justice Taft, speaking for the Court, "price fixing is usually the essence of that which secures proper reward to the patentee."[36] The Court declared that the price fixing provision was reasonable because it protected the profits on GE's own sales of the patented bulbs, which would otherwise have

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[28] United States v. Gen. Elec. Co., 272 U.S. 476, 478-79 (1926).

[29] *Id.* at 478.

[30] *Id.* at 479.

[31] *Id.* at 490.

[32] *See id.* at 488.

[33] *Id.* at 487-88.

[34] *See id.* at 489-90.

[35] *See id.* at 490.

[36] *Id.* at 493.

been undermined by price competition from Westinghouse.[37] This analysis brought the GE license squarely within the *National Harrow* decision, which had also involved a manufacturing license.[38]

E. General Electric *Neutered*

The *General Electric* decision has led a troubled life. The Supreme Court has distinguished it in numerous decisions that continued to apply the *per se* rule to price-fixing provisions in patent licenses.[39] These cases exposed the limitations of the *National Harrow* and *General Electric* analysis, and on two occasions, *General Electric* barely escaped overruling.[40]

1. The *Ethyl* Case

The first case involving price-restrictive patent licenses to reach the Supreme Court after *General Electric* was *Ethyl Gasoline Corp. v. United States*.[41] In *Ethyl*, the Court struck down a program by the manufacturer of a patented tetraethyl fuel additive to license over a hundred gasoline refiners and over

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[37] *Id.* at 490 ("When the patentee licenses another to make and vend, and retains the right to continue to make and vend on his own account, the price at which his licensee will sell will necessarily affect the price at which he can sell his own patented goods. It would seem entirely reasonable that he should say to the licensee, 'Yes, you may make and sell articles under my patent, but not so as to destroy the profit that I wish to obtain by making them and selling them myself.'").

[38] A second facet of the case involved minimum price restrictions in agency agreements, which GE had with more than 21,000 retailers and distributors. *Id.* at 483. The Court upheld these arrangements, holding that *Dr. Miles* did not apply to price restrictions in agreements with genuine sales agents. *Id.* at 483-87.

[39] *See generally* United States v. Univis Lens Co., 316 U.S. 241, 53 U.S.P.Q. (BNA) 404 (1942); United States v. Masonite Corp., 316 U.S. 265, 53 U.S.P.Q. (BNA) 396 (1942); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 44 U.S.P.Q. (BNA) 614 (1940).

[40] *See* United States v. Line Material Co., 333 U.S. 287, 300-04, 76 U.S.P.Q. (BNA) 399, 405-07 (1948). In *United States v. Huck Manufacturing Co.*, the Court had another chance to overrule *General Electric*, but refused to do so in issuing a per curiam opinion for a five-to-four Court. 382 U.S. 197, 147 U.S.P.Q. (BNA) 404 (1965) (per curiam), *aff'g* 227 F. Supp. 791, 140 U.S.P.Q. (BNA) 544 (E.D. Mich. 1964).

[41] *See generally* 309 U.S. 436, 44 U.S.P.Q. (BNA) 614 (1940).

11,000 of their jobber customers.[42] Ethyl manufactured the patented additive and sold it to oil refiners.[43] The refiners were licensed to make gasoline containing the additive, but to sell it only to jobbers licensed by Ethyl.[44] In condemning the licensing arrangement in its entirety, the Court focused on the way that Ethyl administered its jobber-licensing program.[45] Ethyl refused to license discounters, and conditioned licenses to others on informal assurances to maintain retail gasoline prices.[46] *General Electric* did not protect such activity, the Court held, because Ethyl had exhausted its patent monopoly with the initial sale of the additive to the refiner at full value.[47]

Concentrating on price maintenance at the jobber level allowed the Court to sidestep the more interesting issue arising from Ethyl's license agreements with its refiners. The licenses required the refiners to maintain a specific differential between the prices of their regular and premium gasoline, both of which used Ethyl's additive in different ratios.[48] The Supreme Court characterized this provision as a "restraint[] on the sales price of refiners," but did not address its status under *General Electric*.[49] In the end, *Ethyl* added little to the pre-existing law of licenses with price restrictions, except to carry the exhaustion principle of the earlier patent cases into the antitrust realm.

2. The *Univis Lens* and *Masonite* Cases

The exhaustion doctrine played a pivotal role in two antitrust cases decided shortly after *Ethyl*. Both cases raised questions about what constitutes a

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[42] *Id.* at 449-50, 461, 44 U.S.P.Q. (BNA) at 617-18, 622.

[43] *Id.* at 445-46, 44 U.S.P.Q. (BNA) at 616.

[44] *Id.* at 447, 44 U.S.P.Q. (BNA) at 617.

[45] *See id.* at 457, 44 U.S.P.Q. (BNA) at 621.

[46] The jobber licenses did not contain express price maintenance provisions, but the Court found sufficient evidence of extra-contractual efforts to control jobber pricing to infer a combination to increase prices, rather than a mere unilateral refusal to sell to price-cutters. *Id.* at 453-54, 44 U.S.P.Q. (BNA) at 619-20. The latter, however, would have been permitted under *United States v. Colgate & Co.* *See* 250 U.S. 300, 307 (1919) (stating that the right to choose whom one does business with does not itself implicate the Sherman Act).

[47] *Ethyl*, 309 U.S. at 457, 44 U.S.P.Q. (BNA) at 621.

[48] *Id.* at 447-48, 44 U.S.P.Q. (BNA) at 617.

[49] *See id.* at 450, 44 U.S.P.Q. (BNA) at 618.

patent-exhausting "first sale." *United States v. Univis Lens Co.* involved patents for making multifocal eyeglass lenses.[50] Univis manufactured lens blanks, which it then sold for a lump sum to certain licensees who would grind the blanks into finished lenses.[51] The license agreement required the licensee who ground the lenses to resell them at prices fixed by Univis.[52] Absent patent protection for the ground lens, the arrangement would have been *per se* illegal under *Dr. Miles* as straightforward resale price maintenance.[53] But the ground lens was also patented.[54] The issue was, therefore, which sale exhausted the patent—the sale of the unfinished blank to the grinder, or the sale of the finished blank to the grinder's customer?[55]

The Supreme Court held that the sale to the grinder exhausted the patent, without deciding whether the relevant patent is "fully practiced until the finishing licensee has ground and polished the blank so that it will serve its purpose as a lens."[56] Noting that the lens blanks had no other use except to practice the patent, the Court found that the transaction with the finishing retailer was in the nature of a sale of the lens blank with an implied license to grind it, rather than a normal manufacturing license.[57] This characterization was reinforced by the fact that the sole reward the patent owner received was from the initial sale of the unpatented lens blanks; it extracted no royalty from the grinder who sold the finished lenses.[58] The transfer to the finishing retailer was thus held to be a complete transfer of ownership that exhausted the patent right.

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[50] 316 U.S. 241, 243, 53 U.S.P.Q. (BNA) 404, 405 (1942).

[51] *Id.* at 243-44, 53 U.S.P.Q. (BNA) at 405.

[52] *Id.* at 244, 53 U.S.P.Q. (BNA) at 405.

[53] *See id.* at 252, 53 U.S.P.Q. (BNA) at 409 (noting that price maintenance is, without more, an unreasonable restraint on trade).

[54] *Id.* at 243, 53 U.S.P.Q. (BNA) at 405.

[55] *See id.*

[56] *Id.* at 248-49, 53 U.S.P.Q. (BNA) at 407.

[57] *Id.* 249-50, 53 U.S.P.Q. (BNA) at 407-08.

[58] *See id.* The Supreme Court recently reaffirmed the exhaustion rule of *Univis Lens* in a case not involving price restrictions. *See* Quanta Computer, Inc. v. LG Elecs., Inc., 128 S. Ct. 2109, 2122, 86 U.S.P.Q.2d (BNA) 1673, 1682 (2008) ("The authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control post-sale use of the article.").

The same day as the *Univis Lens* decision, the Court decided *United States v. Masonite Corp.*[59] Masonite licensed other manufacturers and sellers of building materials to sell its patented wood-chip hardboard at prices dictated by Masonite.[60] The government alleged that these agreements constituted a price fixing combination in violation of the antitrust laws.[61] Writing for the Court, Justice Douglas first held that *General Electric* and *National Harrow* applied only to manufacturing licenses, whereas Masonite's licensees were not manufacturing the patented board but merely selling it.[62] This holding did not dispose of the exhaustion question, however, because the arrangement between Masonite and its licensees was not a straight purchase-resale; rather, the licensees were to sell the patented hardboard as *del credere* agents.[63] Masonite argued that the "first sale" exhausting the patent was the licensee/agent's sale to the customer, not Masonite's shipment on consignment to the agent.[64] The district court upheld the arrangements as valid agency agreements on the authority of *General Electric*.[65] The Supreme Court reversed with hardly a mention of *General Electric*, holding instead that "the patentee exhausts his limited privilege when he disposes of the product to the *del credere* agent."[66]

The Court could easily have stopped there. Having found that the "agency" agreements were in economic reality sales that exhausted the patent right,[67] *per se* illegality would have followed automatically under *Dr. Miles*. Yet,

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59 *See* 316 U.S. 265, 53 U.S.P.Q. (BNA) 396 (1942).

60 *Id.* at 272-73, 53 U.S.P.Q. (BNA) at 399-400.

61 *Id.* at 274, 53 U.S.P.Q. (BNA) at 400.

62 *Id.* at 277, 53 U.S.P.Q. (BNA) at 401.

63 *Id.* at 274, 53 U.S.P.Q. (BNA) at 400. A *del credere* agent guarantees the credit risk incident to sales by the principal for which it is acting. BLACK'S LAW DICTIONARY 73 (9th ed. 2009) (under definition of "agent").

64 *Id.* at 271, 53 U.S.P.Q. (BNA) at 399.

65 *Id.* at 276, 53 U.S.P.Q. (BNA) at 401.

66 *Id.* at 279, 53 U.S.P.Q. (BNA) at 402.

67 *Id.* Except for Masonite's retaining title to the board until sold and taking a commission rather than a mark-up for its compensation, virtually all of the other indicia of a sale were present. *See id.* at 271-72, 53 U.S.P.Q. (BNA) at 399. Masonite's agent was required to pay all costs of shipment, taxes and insurance, assume credit risk, and pay Masonite a substantial part of the list price shortly after receipt of the goods. *Id.*; *see also* Simpson v. Union Oil Co.,

Justice Douglas focused on the effect of the arrangement on existing competition between Masonite and its licensees in the sale of non-infringing insulation board and the development of a competing, non-infringing hardboard.[68] According to Justice Douglas, the promise of higher prices and a lack of price competition created an incentive to abandon such competition.[69] It did not matter that the district court found no such abandonment.[70] Merely putting a "brake" on this competition was enough to render the pricing provisions illegal *per se*.[71] This cartel rationale carved out a new basis for striking down restrictive price clauses that could be applied where exhaustion could not be established.

3. The *Gypsum* and *Line Material* Cases

The Supreme Court further developed the cartel analysis in the next brace of decisions addressing price restrictions in patent licenses. The Supreme Court held in *United States v. United States Gypsum Co.*—a case that did not implicate the exhaustion principle—that *General Electric* did not protect a horizontal price-fixing conspiracy among United States Gypsum (USG) and its licensees.[72] The scheme involved manufacturing licenses that required licensees to charge identical prices and terms for licensed and unpatented products.[73] The Court's holding described the arrangement in classic cartel terms:

> [*General Electric*] gives no support for a patentee, acting in concert with all members of an industry, to issue substantially identical licenses to all members of the industry under the terms of which the industry is completely regimented, the production of competitive unpatented products suppressed, a class of

377 U.S. 13, 24 (1964) (holding nominal consignment arrangement to be a sale in violation of *per se* rule against resale price maintenance).

68 *Masonite*, 316 U.S. at 280-82, 53 U.S.P.Q. (BNA) at 403.

69 *Id.* at 281, 53 U.S.P.Q. (BNA) at 403.

70 *Id.* at 280-81, 53 U.S.P.Q. (BNA) at 403.

71 *Id.* at 281-82, 53 U.S.P.Q. (BNA) at 403.

72 *See* United States v. U.S. Gypsum Co., 333 U.S. 364, 400, 76 U.S.P.Q. (BNA) 430, 445 (1948).

73 *Id.* The definitive evidence of a horizontal price-fixing cartel is described in greater detail below. *See infra* notes 163-68 and accompanying text.

> distributors squeezed out, and prices on unpatented products stabilized.[74]

In a companion case, *United States v. Line Material Co.*, the Court struck down a licensing program involving two patent owners and ten licensees who were competitors in the manufacture of dropout fuses.[75] The evidence showed enough communication among the competing licensees, and mutual awareness of identical price-fixing provisions in their licenses, to establish a horizontal price-fixing conspiracy analogous to the one condemned in *Gypsum*.[76]

The program was implemented by a separate cross-license between the owners of two blocking patents which the Court also condemned, reasoning that *General Electric* did not apply where two separately owned patents are combined in a single license to third parties.[77] This was true, the Court held, even though the patents were blocking and the licenses were limited to "a small number of patentees."[78] Significantly, the Court came within one vote of overruling *General Electric* entirely, which the government strongly advocated.[79]

4. The *New Wrinkle* Case

The last Supreme Court case to address price restrictions in patent licenses was *United States v. New Wrinkle, Inc.*[80] The industry-wide scheme in that case bore all of the hallmarks of the kind of cartel that previously had been struck down in *Gypsum*, involving licenses requiring more than two hundred licensees to adhere to a schedule of minimum prices, with assurances that other licensees would do the same.[81] The only difference from *Gypsum* was that the patent

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[74] *Gypsum*, 333 U.S. at 400, 76 U.S.P.Q. (BNA) at 445.

[75] *See* 333 U.S. 287, 315, 76 U.S.P.Q. (BNA) 399, 411 (1948).

[76] *Id.* at 295-97, 76 U.S.P.Q. (BNA) at 403-04.

[77] *Id.* at 311, 76 U.S.P.Q. (BNA) at 409.

[78] *Id.* at 312-13, 76 U.S.P.Q. (BNA) at 410.

[79] *See id.* at 300-04, 76 U.S.P.Q. (BNA) at 405-07. In *United States v. Huck Manufacturing Co.*, the Court had another chance to overrule *General Electric*, but refused to do so in issuing a per curiam opinion for an equally divided Court. 382 U.S. 197, 147 U.S.P.Q. (BNA) 404 (1965) (per curiam), *aff'g* 227 F. Supp. 791, 140 U.S.P.Q. (BNA) 544 (E.D. Mich. 1964).

[80] *See* 342 U.S. 371, 374, 92 U.S.P.Q. (BNA) 158, 159 (1952).

[81] *Id.* at 374-75, 92 U.S.P.Q. (BNA) at 159.

owner was a mere licensing entity that did not compete with its licensees in the manufacture or sale of the patented products.[82] The Court held that this fact made no difference and essentially condemned the arrangement under the Sherman Act as a cartel.[83]

F. *What Is Left of* General Electric *Today?*

The cumulative effect of the cases following *General Electric* created the legal landscape leading up to the *Leegin* decision. First, any minimum price restrictions outside the protection of the patent, whether horizontal or vertical, were *per se* illegal.[84] Courts would not entertain justifications that price restraints promoted more distribution of the patented product,[85] higher product quality, or better public health and safety.[86]

Second, where price restrictions were involved, the scope of patent protection would be narrowly construed.[87] The definition of a "sale" sufficient to invoke the exhaustion principle, for example, would be applied to sales of an article that contributorily infringed the patent,[88] and to consignment arrangements with *del credere* agents.[89] Cross-licensing arrangements involving blocking patents had their price restrictions condemned as well.[90] Lower court decisions held that *General Electric* did not apply to situations involving more

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82 *Id.* at 379, 92 U.S.P.Q. (BNA) at 161.

83 *Id.* at 379-80, 92 U.S.P.Q. (BNA) at 160-61.

84 *See generally* United States v. Masonite Corp., 316 U.S. 265, 276, 53 U.S.P.Q. (BNA) 396, 401 (1942); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 459-60, 44 U.S.P.Q. (BNA) 614, 622 (1940).

85 *See Masonite*, 316 U.S. at 276, 53 U.S.P.Q. (BNA) at 401.

86 *See Ethyl*, 309 U.S. at 459-60, 44 U.S.P.Q. (BNA) at 622 (1940).

87 *See Masonite*, 316 U.S. at 274, 53 U.S.P.Q. (BNA) at 400; United States v. Univis Lens Co., 316 U.S. 241, 249, 53 U.S.P.Q. (BNA) 404, 407 (1942).

88 *See Univis Lens*, 316 U.S. at 249, 53 U.S.P.Q. (BNA) at 407.

89 *See Masonite*, 316 U.S. at 274, 53 U.S.P.Q. (BNA) at 400.

90 *See* United States v. Line Material Co., 333 U.S. 287, 291, 76 U.S.P.Q. (BNA) 399, 401-02 (1948).

than one licensee,[91] price restrictions on unpatented products made with a patented process,[92] or unpatented products made by a patented machine.[93]

Third, the protections of *General Electric* did not necessarily apply to industry-wide licensing arrangements containing price restrictions, even if the exhaustion principle did not apply and the restraints themselves did not exceed the scope of the patents.[94]

In sum, although the law theoretically allowed some opening for price restrictions in patent licenses, in practice that opening proved dauntingly narrow. Industry-wide licenses with price restrictions ran an almost certain risk of condemnation as courts had limited *General Electric*'s protection for less pervasive licensing arrangements to manufacturing licenses only.[95] The hostility of government enforcers, and many commentators, toward the *General Electric* decision gave patent holders little comfort that the decision would be applied in future cases. The effect of this uncertainty was predictable. Practitioners, for the most part, advised clients simply to avoid price restrictions in patent licenses altogether.[96]

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91 *See* Newburgh Moire Co. v. Superior Moire Co., 237 F.2d 283, 293-94, 111 U.S.P.Q. (BNA) 126, 133 (3d Cir. 1956).

92 *See* Barber-Colman Co. v. Nat'l Tool Co., 136 F.2d 339, 341-42, 58 U.S.P.Q. (BNA) 2, 3-4 (6th Cir. 1943).

93 *See* Cummer-Graham Co. v. Straight Side Basket Corp., 142 F.2d 646, 647, 61 U.S.P.Q. (BNA) 395, 397 (5th Cir. 1944); Am. Equip. Co. v. Tuthill Bldg. Material Co., 69 F.2d 406, 409, 21 U.S.P.Q. (BNA) 198, 200-01 (7th Cir. 1934).

94 *See* United States v. New Wrinkle, Inc., 342 U.S. 371, 378-80, 92 U.S.P.Q. (BNA) 158, 160-61 (1952); United States v. U.S. Gypsum Co., 333 U.S. 364, 400, 76 U.S.P.Q. (BNA) 430, 445 (1948); *Masonite*, 316 U.S. at 276-82, 53 U.S.P.Q. (BNA) at 401-03.

95 *See* 2 WILLIAM C. HOLMES, INTELLECTUAL PROPERTY AND ANTITRUST LAW § 16:1 (2009).

96 The following advice is typical: "Price limitations plainly raise serious antitrust questions, notwithstanding the fact that *General Electric* has not been overruled. Such restrictions should be avoided if possible." 1 DRAFTING LICENSE AGREEMENTS § 4.03[D][5] (Michael A. Epstein & Frank L. Politano eds., 4th ed. 2010); *see also* WARD S. BOWMAN, JR., PATENT AND ANTITRUST LAW: A LEGAL AND ECONOMIC APPRAISAL 121 (1973) ("[F]ixing the price at which a licensee may sell a patented product has been narrowed almost to extinction."); 2 HOLMES, *supra* note 95, § 16.1 ("[C]onsiderable

III. WHAT HATH *LEEGIN* WROUGHT?

When *Leegin* overruled *Dr. Miles*, it potentially undermined the foundation for many of the decisions condemning price-fixing clauses in patent licenses. Recall that the first Supreme Court decision to denounce price restrictions in a patent license, *Bauer*, relied on *Dr. Miles* as having "settled" the question of their *per se* illegality two years earlier.[97] Nearly all of the subsequent Supreme Court cases distinguishing *General Electric* and condemning price restrictions in patent licenses rely expressly on *Dr. Miles* or on the line of patent cases emanating from *Dr. Miles*.[98] The question for patent owners today is how much of that house, built on *Dr. Miles*, remains standing. The place to start answering this question is the Court's rationale for overruling *Dr. Miles*.

A. *The Rationale for Overruling* Dr. Miles

Justice Kennedy cited several shortcomings of *Dr. Miles* to justify its demise.[99] First, the decision relied on the "formalistic" and "irrelevant" common law rule against restraints on alienation, "rather than 'demonstrable economic effect'" of the practice "'in the American economy today.'"[100]

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uncertainty existed as to whether and when a patentee might safely impose price restrictions on its licensees without violating the antitrust rules of per se illegality for price fixing (vertical as well as horizontal) . . . ."). *But see* LucasArts Entm't Co. v. Humongous Entm't Co., 870 F. Supp. 285, 289 (N.D. Cal. 1993) (upholding price restriction in a copyrighted software license for video game development tool on authority of *General Electric*).

[97] Bauer & Cie. v. O'Donnell, 229 U.S. 1, 11-12 (1913).

[98] *See, e.g.*, United States v. Line Material Co., 333 U.S. 287, 307 n.21, 76 U.S.P.Q. (BNA) 399, 408 n.21 (1948); *Masonit*e, 316 U.S. at 277-80, 53 U.S.P.Q. (BNA) at 401-03; United States v. Univis Lens Co., 316 U.S. 241, 250, 53 U.S.P.Q. (BNA) 404, 408 (1942); United States v. Ethyl Gasoline Corp., 309 U.S. 436, 456-57, 44 U.S.P.Q. (BNA) 614, 620 (1940); Boston Store v. Am. Gramophone Co., 246 U.S. 8, 21-24 (1918); Straus v. Victor Talking Mach. Co., 243 U.S. 490, 498 (1917).

[99] *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 887-89 (2007).

[100] *Id.* at 887-88 (quoting Cont'l T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 53 n.21, 58-59 (1977)).

Second, *Dr. Miles* had erred in placing vertical price restrictions on the same footing as horizontal cartels to allocate customers and raise prices.[101] As Justice Kennedy noted, there are "appreciated differences in economic effect between vertical and horizontal agreements"—differences which *Dr. Miles* ignored, but which have guided the Court's more recent antitrust decisions.[102]

Third, and most important, Justice Kennedy found the economics literature "replete with procompetitive justifications for a manufacturer's use of resale price maintenance."[103] The Court had long reserved *per se* treatment for practices that "'always or almost always tend to restrict competition and decrease output.'"[104] Economic literature demonstrated that vertical price restrictions did not fall into that category.[105]

Finally, the Court wanted to eliminate what it viewed as an anomaly between the way it had been treating vertical price and non-price restraints.[106] The Court saw "little economic justification" for applying the *per se* rule to vertical price restraints and the rule of reason to vertical non-price restraints, particularly when the latter could reduce intra-brand competition more than the former "by eliminating both price and service competition."[107] This anomaly was not just intellectually unsatisfying; it occasionally forced manufacturers "to engage in second-best alternatives" and required consumers "to shoulder the increased expense of the inferior practices."[108]

B. Leegin's *Guideposts for the Rule of Reason Era*

The *Leegin* opinion went on to provide some broad guidance on the criteria for evaluating vertical minimum price restrictions under the rule of

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[101] *Id.* at 888-89.

[102] *Id.* (citing Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 726, 734 (1988)); *see also GTE Sylvania*, 433 U.S. at 51-52 & n.19.

[103] *Leegin*, 551 U.S. at 889.

[104] *Id.* at 886 (quoting *Bus. Elecs.*, 485 U.S. at 723); *see also* Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co., 472 U.S. 284, 289 (1985).

[105] *See Leegin*, 551 U.S. at 889-90.

[106] *See id.* at 889-91.

[107] *Id.* at 904.

[108] *Id.* at 902.

reason. On the positive side, the Court identified several procompetitive justifications:

- encouraging retailers to invest in providing additional services for consumers by offering the retailer a "guaranteed" margin;
- giving consumers more options, allowing them to "choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between";
- facilitating market entry for new firms and brands; and
- minimizing the risk of "free-riding"—situations in which discounting retailers "capture some of the increased demand" generated by other retailers who invest in more services, thereby reducing the incentives to make those investments.[109]

The Court also identified some of the anticompetitive effects that would not pass muster under the new rule of reason.[110] They included situations in which resale price maintenance might facilitate horizontal price coordination at the manufacturing level, facilitate the organization of downstream dealer cartels, enable dominant manufacturers to induce dealers not to sell competitors' products, or reduce the incentive of dominant retailers or groups of retailers to improve efficiency.[111] These guideposts should prove useful in assessing how courts will treat price restrictions in patent licenses.

IV. POTENTIAL IMPLICATIONS OF *LEEGIN* FOR PRICE RESTRAINTS IN INTELLECTUAL PROPERTY LICENSES

Leegin dealt only with resale price agreements between manufacturers and their dealers or distributors.[112] There was no discussion of how the principles applied in that setting might also apply to agreements between intellectual property owners and their licensees. Still, given the obvious parallels between the two situations, the body of antitrust case law dealing with price restraints in licenses is bound to be reassessed. Some of that jurisprudence will undoubtedly remain intact, but some is clearly outdated. The remainder of this Article suggests how that authority might be realigned.

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[109] *Id.* at 890-92.

[110] *See id.* at 892-94.

[111] *Id.*

[112] *See id.* at 882-85.

A. *Patent Exhaustion Will No Longer Be Pivotal*

The Supreme Court's analysis of the price restriction in Univis' patent licenses stopped at patent exhaustion.[113] Once the Court determined that the sale of the unfinished lens blanks to the finishing retailer exhausted the patent right, the *per se* rule of *Dr. Miles* and its progeny controlled, and the price clause in the retailer's license was automatically condemned under the Sherman Act.[114]

The logic of *Leegin* contradicts that approach. The considerations that persuaded the Court to abandon the *per se* rule for minimum price restrictions on unpatented goods apply at least as strongly to patent licenses. Briefly summarized, most of the licensing transactions in which minimum price restrictions could be used will be vertical, not horizontal.[115] Also, the restrictions could have procompetitive virtues in many settings, and subjecting them to *per se* treatment would create an anomaly between price restraints and non-price restraints, such as territorial and field-of-use restrictions, which are judged under the rule of reason.[116] Finally, *Leegin* continued a thirty-year trend of paring back the *per se* rule and further entrenching the rule of reason as "the accepted standard for testing whether a practice restrains trade in violation of § 1."[117]

There is every reason to believe that, cartels aside, future courts will analyze minimum price restrictions in patent licenses under rule of reason standards similar to those applied to resale price maintenance involving unpatented goods. It will no longer be sufficient for a court, as the Supreme Court did in *Univis Lens*, to end the analysis of a price restriction merely by finding that the patent right has been exhausted.[118] The court will have to go on

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[113] *See* United States v. Univis Lens Co., 316 U.S. 241, 249-52, 53 U.S.P.Q. (BNA) 404, 407-09 (1942).

[114] *Id.*; *see also* United States v. Masonite Corp., 316 U.S. 265, 279-80, 53 U.S.P.Q. (BNA) 396, 402 (1942).

[115] *See* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY § 3.3 (1995), *available at* http://www.justice.gov/atr/public/guidelines/0558.pdf [hereinafter 1995 LICENSING GUIDELINES] ("A licensing arrangement has a vertical component when it affects activities that are in a complementary relationship, as is typically the case in a licensing arrangement.").

[116] *See Leegin*, 551 U.S. at 890-92.

[117] *Id.* at 885.

[118] *See Univis Lens*, 316 U.S. at 253-54, 53 U.S.P.Q. (BNA) at 409.

to analyze the actual impact of the provision on competition. Interestingly, had the *Univis Lens* Court been forced to do that analysis, the outcome would doubtless have been different because, at the time, Univis and its licensees accounted for less than six percent of the market of bifocal lenses.[119]

The same standard should pertain to claims of patent misuse. In *Mallinckrodt, Inc. v. Medipart, Inc.*, the United States Court of Appeals for the Federal Circuit declared that misuse claims based on patent license restrictions operating within the patent scope should be judged under the rule of reason, except for practices declared "*per se* anticompetitive by the Supreme Court."[120] Applying this principle, the Supreme Court's declaration that resale price restrictions are no longer *per se* anticompetitive should also place price restrictions in license agreements securely in the rule of reason category.

B. *The Business Justification for Price Restrictions Will Become Critically Important*

The business justification for a competitive restraint is a critically important feature of most rule of reason inquiries.[121] Unfortunately, there is no sample of patent licensing cases to consult for guidance on the kinds of justifications that might support price restrictions in patent licenses; these cases declined fifty years ago in the hostile aftermath of *General Electric*. What guidance remains comes from *General Electric* itself, and extrapolation from *Leegin*'s rationale.

1. Inducing Licensee Investment to Enhance the Value of the Licensed Patent

One obvious procompetitive justification for a price restriction in a patent license bears analogy to a similar rationale for resale price maintenance. *Leegin* confirmed the legitimacy of vertical price restraints that "encourage[]

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[119] *See* United States v. Univis Lens Co., 41 F. Supp. 258, 267, 51 U.S.P.Q. (BNA) 113, 121 (S.D.N.Y. 1941), *rev'd*, 316 U.S. 241, 53 U.S.P.Q. (BNA) 404 (1942).

[120] 976 F.2d 700, 706, 708-09, 24 U.S.P.Q.2d (BNA) 1173, 1178-80 (Fed. Cir. 1992) (quoting Windsurfing Int'l, Inc. v. AMF, Inc., 782 F.2d 995, 1001-02, 228 U.S.P.Q. (BNA) 562, 567 (Fed. Cir. 1986)).

[121] *See, e.g.*, United States v. Visa U.S.A., Inc., 344 F.3d 229, 238 (2d Cir. 2003) ("Once [the plaintiff's] initial burden [of showing probable anticompetitive effect] is met, the burden of production shifts to the defendants, who must provide a procompetitive justification for the challenged restraint.").

retailers to invest in tangible or intangible services or promotional efforts that aid the manufacturer's position as against rival manufacturers."[122] In like fashion, the federal enforcement agencies recognize that restrictive provisions in intellectual property licenses "can be used to give a licensee an incentive to invest in the commercialization and distribution of products embodying the licensed intellectual property and to develop additional applications for the licensed property."[123] These investments may, for example, take the form of unpatentable product improvements that increase the marketability of the patented product.

Historically, the mechanism of choice to induce this kind of licensee investment has been to prevent competition entirely among licensees, or between the licensee and the patent owner, either through an exclusive field-of-use restriction or territorial or customer allocation.[124] But in many cases this mechanism may be sub-optimal. It may be better for a patent owner, and for consumers, to have more than one licensee operating in a particular product space and competing on the basis of services and product improvements rather than price. A license which channels that competition away from price and into non-price dimensions may therefore be a more effective way of providing these consumer benefits.[125] At the same time, minimum price provisions can reinforce valid vertical territorial or customer allocation provisions by eliminating any price incentive for the customer to purchase from other licensees.[126] At the other

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[122] *Leegin*, 551 U.S. at 890.

[123] 1995 LICENSING GUIDELINES, *supra* note 115, § 2.3; *see also* JOHN W. SCHLICHER, PATENT LAW, LEGAL AND ECONOMIC PRINCIPLES § 11:9 (2d ed. 2009).

[124] 35 U.S.C. § 261 (2006) (exclusive territorial restrictions permitted); Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 181, 37 U.S.P.Q. (BNA) 357, 359, *aff'd on reh'g*, 305 U.S. 124, 127, 39 U.S.P.Q. (BNA) 329, 330 (1938) (field-of-use restriction); *In re* Yarn Processing Patent Validity Litig., 541 F.2d 1127, 1135, 192 U.S.P.Q. (BNA) 241, 247-48 (5th Cir. 1976) (customer restrictions); Brownell v. Ketcham Wire & Mfg. Co., 211 F.2d 121, 128, 100 U.S.P.Q. (BNA) 338, 342 (9th Cir. 1954) (territorial restrictions).

[125] *Cf. Leegin*, 551 U.S. at 904 ("[V]ertical nonprice restraints may prove less efficient for inducing desired services, and they reduce intrabrand competition more than vertical price restraints by eliminating both price and service competition.").

[126] *See* BOWMAN, *supra* note 96, at 133-34.

extreme, a licensor can also use maximum price restrictions to ensure that its product will be positioned as a "low-priced" alternative in the marketplace.[127]

2. Facilitating Creation of New Products

A more specific way in which a licensee can enhance the value of patented technology is by creating new products. *Leegin* recognized both the importance of new products to a dynamic economy,[128] and the role that price restraints can play in "facilitating market entry for new firms and brands" by inducing "'the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.'"[129] Patent licenses also command antitrust recognition as a procompetitive means for creating new products and competitors.[130] As with licensee investments for other purposes, price restrictions can deliver sufficient margins to promote investment in new products and product improvements where licensees might otherwise be concerned about free-rider encroachments from competing licensees.[131]

3. Protecting the Manufacturer's Own Sales

The *General Electric* decision offered another rationale for price restrictions in a license: protecting the profit margins on the patentee's own sales.[132] Commentators have questioned the economic logic of this rationale as not being in the patentee's best interest, particularly where the licensee operates more efficiently than the patent owner.[133] The argument arises from the following question: why would it not have been in GE's best interest to increase

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127 *See* State Oil Co. v. Khan, 522 U.S. 3, 15-16 (1997).

128 *Leegin*, 551 U.S. at 891 ("New products and new brands are essential to a dynamic economy, and if markets can be penetrated by using resale price maintenance there is a procompetitive effect.").

129 *Id.* (quoting Cont'l T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 55 (1977)).

130 *See* 1995 LICENSING GUIDELINES, *supra* note 115, § 2.3 (stating that "[l]icensing, cross-licensing, or otherwise transferring intellectual property" can benefit consumers through "the introduction of new products").

131 *See id.*

132 *See* United States v. Gen. Elec. Co., 272 U.S. 476, 490 (1926).

133 *See* BOWMAN, *supra* note 96, at 128-29 (citing F. W. Taussig, *Price Maintenance*, 6 AM. ECON. REV. 170, 171 (Supp. 1916)); William F. Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267, 331-35 (1966).

the royalty rate, leaving Westinghouse free to sell at a lower price, sell more light bulbs (even at the expense of GE's own sales), and thereby increase GE's overall return on the patent?[134]

There are a number of possible responses to this question that support price restrictions. Determining a royalty rate that allows GE to capture the full value of its patent rights becomes a much more difficult, uncertain, and inefficient exercise when price competition is introduced into the equation. With a simple price restriction, once GE determines a profit-maximizing market price for bulbs, and Westinghouse agrees to follow it, the only variable GE must focus on to determine whether it is getting fair value for its patent is the royalty rate.[135] But, if Westinghouse can charge lower prices to generate additional volume, then GE must take into account several other variables to determine a royalty rate that will capture that same value for its patent rights.[136] These variables might include the following: (1) the market price that will prevail under competitive conditions; (2) the additional output that will come from lower prices; (3) how much total volume GE will lose to Westinghouse; and (4) how that loss of volume will affect GE's own cost structure and ultimately GE's profits. A further complication will be GE's decision whether to follow Westinghouse and drop its price or to keep its price up and focus on more inelastic segments of the market.[137] Finding the right royalty rate to reflect the value of GE's patent becomes a more daunting task given these additional variables.

More importantly, this criticism should not be relevant unless there is proof of actual anticompetitive purpose or underlying effect. Absent such evidence, a patent owner should be free, for whatever reason, to accept less than the full reward for its patent. To be sure, a transaction that in hindsight seems to be less than profit-maximizing might suggest an anticompetitive arrangement, but it could just as easily suggest imperfect knowledge or insufficient prescience at the time of contracting.

4. Promoting Health and Safety

Health and safety considerations have fared poorly as justifications for price restrictions. As a general principle, competitive restrictions cannot be

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[134] *See* BOWMAN, *supra* note 96, at 128-29; Baxter, *supra* note 133, at 331-35.

[135] *See* Baxter, *supra* note 133, at 280.

[136] *See id.* at 314-15.

[137] *See id.* at 326-27 (discussing elasticity in the market for patent licenses).

justified by arguing that price competition itself (and the resulting drive to cut costs as margins erode) will lead to unsafe products or services.[138] The Supreme Court expressly rejected that argument as "nothing less than a frontal assault on the basic policy of the Sherman Act."[139]

The *Ethyl* case illustrates the problem of finding a sufficient health or safety rationale for price restrictions that do not amount to a "frontal assault" on the Sherman Act.[140] In that case, the Supreme Court rejected Ethyl's argument that its industry-wide price maintenance program was necessary to protect the public health from the adverse effects of its tetraethyl compound.[141] The Court found the health threat nonexistent, as the record contained "no authentic instance of injury resulting from the handling of lead-treated gasoline . . . attributable to its lead content."[142] Even if such a risk existed, the Court continued, it could be dealt with less restrictively through existing provisions in the contracts between the refiner licensees and the jobbers, which required the jobbers to comply with certain safety procedures.[143] Although the Supreme Court did not reject health and safety justifications in all situations, *Ethyl* demonstrates why it will still be a challenge to persuade a court that health and safety concerns must be addressed indirectly through price restrictions.[144]

C. *Price Restrictions Will Be Heavily Scrutinized for Less Restrictive Alternatives*

The Court's treatment of less restrictive alternatives in *Ethyl* raises an important issue for price restrictions. Courts often weigh the availability of less restrictive alternatives in judging the reasonableness of a competitive restraint.[145]

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138 Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 695 (1978) (discussing restriction on competitive bidding for professional engineering services).

139 *Id.*

140 *See* Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 459-60, 44 U.S.P.Q. (BNA) 614, 622 (1940).

141 *Id.*

142 *Id.* at 460, 44 U.S.P.Q. (BNA) at 622.

143 *Id.*

144 *Id.* at 460-61, 44 U.S.P.Q. (BNA) at 622.

145 *See, e.g.*, United States v. Visa U.S.A., Inc., 344 F.3d 229, 238 (2d Cir. 2003); United States v. Brown Univ., 5 F.3d 658, 679 (3d Cir. 1993); Bhan v. NME

In doing so, they have generally recognized that too strict a standard would subject the parties to imaginative second-guessing by creative lawyers, judges, and juries.[146] Courts have, therefore, given the parties to an agreement a certain amount of leeway before condemning a competitive restraint as excessive in light of the asserted justification.[147] Additionally, the approach of government agencies, as expressed in its 1995 IP Licensing Guidelines, is consistent with the courts' treatment of less restrictive alternatives: agencies "will not engage in a search for a theoretically least restrictive alternative that is not realistic in the practical prospective business situation faced by the parties."[148]

This standard may be relaxed, but it is not unbounded. It is hard to see, for example, how it would have saved the restrictions condemned in *Ethyl*, where health and safety risks could have been dealt with more efficiently with contractual obligations than by price restraints.[149] The question today is, under this relaxed standard, how much of a burden will agencies and courts impose on patent holders to explain why a price restraint is a more efficient way to achieve the intended procompetitive result?

Realistically, that burden may initially be higher for price restraints than for non-price restraints.[150] Of the various forms of competitive restraint, courts have been most sensitive to those relating to price.[151] It may, therefore, take a

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Hosps., Inc., 929 F.2d 1404, 1413 (9th Cir. 1991); 11 HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION § 1913a (2d ed. 2005).

146 11 HOVENKAMP, *supra* note 145, § 1913b ("A skilled lawyer would have little difficulty imagining possible less restrictive alternatives to most joint arrangements. Proffered less restrictive alternatives should either be based on actual experience in analogous situations elsewhere or else be fairly obvious." (footnote omitted)); *see also* Am. Motor Inns v. Holiday Inns, Inc., 521 F.2d 1230, 1249-50 (3d Cir. 1975).

147 *See, e.g.*, 11 HOVENKAMP, *supra* note 145, § 1913b.

148 1995 LICENSING GUIDELINES, *supra* note 115, § 4.2.

149 *See Ethyl*, 309 U.S. at 460, 44 U.S.P.Q. (BNA) at 622.

150 *See, e.g.*, *id.*

151 *See* United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n.59 (1940) (referring to price, Justice Douglas used the famous metaphor, "central nervous system of the economy"); *see also* United States v. Line Material Co., 333 U.S. 287, 309, 76 U.S.P.Q. (BNA) 399, 409 (1948) ("Perhaps no single fact

period of adjustment before courts overcome their conditioned antipathy to price restraints. The Supreme Court itself recognized in *Leegin* that it would take some time for courts dealing with vertical price issues under the new rule of reason to "establish the litigation structure to ensure the rule operates to eliminate anticompetitive restraints from the market and to provide more guidance to businesses."[152] Practitioners may do well to adopt a cautious approach while this process unfolds in the licensing area.

D. *Price Restrictions That Foster Cartels Will Continue to Be Per Se Unlawful*

History shows that competitors are able to form cartels around patent licenses containing price restrictions.[153] Such arrangements are likely to fare no better after *Leegin* than before. The *Leegin* opinion reemphasized in bold terms the Court's continuing concern about the role that price restrictions can play in facilitating cartel behavior:

> A horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful. . . . To the extent a vertical agreement setting minimum resale prices is entered upon to facilitate either type of cartel, it, too, would need to be held unlawful under the rule of reason. This type of agreement may also be useful evidence for a plaintiff attempting to prove the existence of a horizontal cartel.[154]

To say that patent-based cartels should be *per se* illegal does not, however, answer the harder question of how to distinguish a cartel from a legitimate licensing program. The owner of a patent that confers market power earns its reward by restricting output to a point where prices exceed marginal cost.[155] A cartel achieves returns the same way.[156] At the same time, many patent

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manifests the power and will to monopolize more than price control of the article monopolized.").

[152] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 898 (2007).

[153] *See, e.g.*, United States v. U.S. Gypsum Co., 333 U.S. 364, 368-69, 76 U.S.P.Q. (BNA) 430, 432 (1948); *Line Material*, 333 U.S. at 309, 76 U.S.P.Q. (BNA) at 409.

[154] *Leegin*, 551 U.S. at 893 (citation omitted).

[155] *See* George L. Priest, *Cartels and Patent License Arrangements*, 20 J.L. & ECON. 309, 318 (1977).

owners can only realize the full value of their patents by issuing multiple licenses, rather than exploiting the patent entirely on their own.[157] Where the patent owner seeks to obtain its reward in this fashion, distinguishing between socially beneficial patent exploitation and cartel behavior becomes difficult.[158]

One way commentators have approached this distinction is by determining whether the licensing arrangement allows the patent owner, or its licensees, to extract monopoly rents that clearly exceed the value of the patent.[159] The *Ethyl* and *Gypsum* cases are instructive. In *Ethyl*, the patented product was tetraethyl lead additive, which the patent owner sold to 123 refiners throughout the United States.[160] The amount received on each sale, at least presumptively, represented the full value of the patent owner's monopoly on the additive, as the patent owner received no other consideration under the arrangement.[161] But Ethyl's licensing program allowed wholesalers to fix the price of the gasoline, of which the additive formed a minuscule part.[162] Thus, whatever monopoly rents flowed from the license of the patent not only greatly exceeded the value of the patented invention, but also flowed to the licensees rather than solely to the patent owner.

Gypsum provides a similar example. USG owned basic patents on "closed-edge" gypsum board, which represented an improvement over the "open-edge" board manufactured by its competitors.[163] USG sought to license these patents to all of its competitors in the industry under terms that included agreements to follow prices set by USG.[164] The "closed-edge" patents, however,

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156 *See id.* at 326.

157 *See id.* at 326-27.

158 *See id.* at 309.

159 BOWMAN, *supra* note 96, at 124; Baxter, *supra* note 133, at 335; Helmut F. Furth, *Price-Restrictive Patent Licenses under the Sherman Act*, 71 HARV. L. REV. 815, 838 (1957); Louis Kaplow, *The Patent-Antitrust Intersection: A Reappraisal*, 97 HARV. L. REV. 1815, 1859-60 (1984).

160 Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 449-50, 44 U.S.P.Q. (BNA) 614, 617-18 (1940).

161 *See id.* at 447 n.1, 44 U.S.P.Q. (BNA) at 617 n.1.

162 *Id.* (1/4200 for regular gasoline and 1/1700 for premium).

163 United States v. U.S. Gypsum Co., 333 U.S. 364, 369-71, 76 U.S.P.Q. (BNA) 430, 432 (1948).

164 *Id.* at 372-73, 76 U.S.P.Q. (BNA) at 434.

expired before the licenses were ultimately signed.[165] Not to be deterred, the parties seized upon other USG patent applications for a "bubble-and-starch" process as their licensing vehicle, without regard to the value of those patents.[166] Following the industry-wide licensing arrangements, gypsum board prices rose fifty percent.[167] It is highly unlikely that this increase in prices could have been attributed to the "bubble-and-starch" process patents that at least one licensee believed were worth little, if anything.[168] Thus, as in *Ethyl*, the effect of the licensing agreement was to generate profits for the licensees that far exceeded the value of the licensed patents.

Ethyl and *Gypsum* were relatively easy cases by today's standards and do not provide much guidance for dealing with less obvious situations. In general, the Supreme Court decisions addressing this area have been broadly criticized for their failure to provide a principled analysis of the subject.[169] Consequently,

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165 *Id.* at 380, 76 U.S.P.Q. (BNA) at 437.

166 *Id.* In order to cover the period before those applications ripened into issued patents, one of the licensees assigned an additional process patent to USG, which was then incorporated into the price-fixing licenses as well. *Id.*

167 Furth, *supra* note 159, at 840-41 (noting that the price of closed-end gypsum board rose from $14 to $22.50 within seven weeks after industry-wide licenses were signed).

168 *Gypsum*, 333 U.S. at 378, 76 U.S.P.Q. (BNA) at 436. The licenses were thereafter administered as a blatant cartel, with USG fielding and responding to complaints about discounting licensees and continually issuing price bulletins to prohibit various forms of cheating on the minimum prices. *Id.* at 382-84, 76 U.S.P.Q. (BNA) at 438.

169 *See* 2 HERBERT HOVENKAMP, MARK D. JANIS & MARK A. LEMLEY, IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 31.3d (Supp. 2009) [hereinafter IP AND ANTITRUST] (stating that court decisions on license price restrictions are "often short on analysis, and are characterized by naked assertions about what is embodied in the patent grant and what is an unwarranted 'extension'"); Furth, *supra* note 159, at 841 ("[T]he Court has been less inclined toward errors of judgment than toward inadequate explanations for its decisions."); Kaplow, *supra* note 159, at 1867 ("[I]t is not clear whether courts could adequately distinguish situations in which price restrictions were being used for resale price maintenance from those in which price restrictions merely masked the monopoly loss due to cartelization."); Priest, *supra* note 155, at 376 (criticizing the Supreme Court's *per se* approach because "[t]he costs of the rule seem likely to outweigh the benefits").

there is no easy structural test to identify when a licensing arrangement results in monopoly rents that exceed the value of the patent. It is impractical to rely on pure econometrics for these determinations, particularly with judges and juries as the ultimate decision-makers.[170]

Although no single factor can be dispositive, there are some key signals that courts and enforcers are likely to rely on to distinguish a cartel from a legal patent license.[171] First, and most important, is the scope of the licensing program. Nearly all of the licensing programs condemned as cartels by the Supreme Court involved a licensee population that encompassed most, if not all, of the major competitors in the relevant industry.[172]

A second critical factor in cartel analysis is whether the driving force behind the arrangement is the patent owner or its licensees. In many cases, it was the licensees, not the patent owner, who were providing the impetus for the price restraints.[173] The source of the pressure often became evident when

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[170] *See* 1 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 112(c)(2)-(3) (3d ed. 2006) (noting "gaps in theory and problems with empirical verification" in economic science and the limitations of enforcement officials and courts in "know[ing] the facts and judg[ing] them with assurance"); Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 11 (1984) (stating that it is "fantastic to suppose" that judges and juries, even with the help of economists and unlimited computer budgets, can "conduct a full inquiry into the economic costs and benefits of a particular business practice").

[171] A more comprehensive analysis can be found in Priest, *supra* note 155, at 326-27.

[172] *See* United States v. New Wrinkle, Inc., 342 U.S. 371, 374, 92 U.S.P.Q. (BNA) 158, 159 (1952) (more than two hundred, or substantially all, manufacturers of wrinkle finishes in United States); *Gypsum*, 333 U.S. at 380-81, 76 U.S.P.Q. (BNA) at 437 (all manufacturers of gypsum board in United States); United States v. Line Material, Co., 333 U.S. 287, 289 n.2, 290 , 76 U.S.P.Q. (BNA) 399, 400 n.2, 401 (1948) (twelve companies accounting for all dropout fuse cutouts manufactured in United States); United States v. Ethyl Gasoline Corp., 309 U.S. 436, 449, 44 U.S.P.Q. (BNA) 614, 617 (1940) (123 refiners accounting for 88% of gasoline sold in United States). The situation with Masonite is less clear: there were only nine licensees, "and all needed the Masonite patented hardboard to complete their respective selling lines." United States v. Masonite Corp., 40 F. Supp. 852, 855 (S.D.N.Y. 1941), *rev'd*, 316 U.S. 265, 53 U.S.P.Q. (BNA) 396 (1942).

[173] *See* cases cited *supra* note 172.

licensees refused to sign individual licenses without assurances that most of their competitors had also committed to sign licenses with identical price terms.[174]

A related indicator is how the patent's rewards are allocated between the licensor and the licensee. In *Ethyl*, for example, the reward to the patent owner consisted entirely of the sale price of the gasoline additive and was dwarfed by the evident reward to the licensees from fixing the price of gasoline that contained the additive.[175] At a practical level, the absence of a reasonable royalty obligation may suggest a reward structure more indicative of a cartel than an arm's length licensing arrangement.[176]

In examining these factors, it becomes readily apparent that implementing a broad licensing program with price restrictions that avoids condemnation as a cartel will remain a challenging endeavor. One reason for this difficulty stems from real-world practicalities. It is difficult to structure such a program, if it involves competing licensees, without at least the appearance of, if not the fact of, licensee collusion. As the District Court pointed out in *Gypsum*, basic business sense suggests that competing licensees would be unwilling to take a license restricting their ability to lower prices if other competing licensees were not similarly restricted.[177] One would, therefore, expect a broad licensing program involving competitors to result in identical or similar price terms

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[174] *See New Wrinkle*, 342 U.S. at 374-75, 379, 92 U.S.P.Q. (BNA) at 159, 161 (price-restrictive provisions conditioned on agreement of twelve licensees who were leading producers of wrinkle finishes, together with advance assurances of their agreement); *Gypsum*, 333 U.S. at 375, 380-81, 76 U.S.P.Q. (BNA) at 435, 437 (licensee meetings in which assurances were given that all would sign similar licenses); *Masonite*, 316 U.S. at 269-70, 53 U.S.P.Q. (BNA) at 398-99 (agreements placed into escrow until all licensees had agreed); *cf. Ethyl*, 309 U.S. at 458-59, 44 U.S.P.Q. (BNA) at 621 (price restrictions primarily benefit jobber-licensees, not the patent owner).

[175] *See supra* note 162. *But see New Wrinkle* and *Masonite*, in which the licensed patents apparently covered the ultimate product to be sold. *See New Wrinkle*, 342 U.S. at 373-74, 92 U.S.P.Q. (BNA) at 159; *Masonite*, 316 U.S. at 277-78, 53 U.S.P.Q. (BNA) at 401-02.

[176] Priest, *supra* note 155, at 327.

[177] *Gypsum*, 333 U.S. at 390 n.8, 76 U.S.P.Q. (BNA) at 441 n.8; *see also* Furth, *supra* note 159, at 826 ("Few producers will agree to accept licenses that bind them to a higher minimum price or a higher royalty rate than other members of their industry, and no licensee can afford to adhere to terms less favorable than those subsequently obtained by a competitor.").

achieved by assuring licensees that other licensees were "on board," or through some form of a "most favored licensee" provision.[178] The parties are then left with the ingredients of a cartel and a daunting challenge to defend it,[179] particularly if courts follow the suggestion in *Gypsum* that the mere existence of "most-favored" provisions is enough to establish concerted action among licensees.[180] Despite *Leegin*, a resurgence of these types of broad licensing arrangements with price restrictions is, therefore, unlikely.

E. *The Analysis in* Line Material *and* Masonite *Should Be Refined*

If price restrictions again become a feature of patent license agreements, two Supreme Court decisions will face some analytical pressure. *Masonite* and *Line Material* each display flaws, or at least ambiguities, that courts should mend in future cases.

1. Reappraisal of *Masonite*

As described earlier, *Masonite* could have been decided on any one of several rationales, including horizontal price fixing.[181] Each licensee knew that the other licensees were agreeing to substantially identical terms; and an escrow agreement provided that the license agreements would not become effective

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[178] *See generally* Furth, *supra* note 159, at 826; *Gypsum*, 333 U.S. at 390 n.8, 76 U.S.P.Q. (BNA) at 441 n.8.

[179] *See, e.g.*, Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 347, 357 (1982) (holding agreement on maximum fees to be charged by competing physicians in a health plan illegal *per se*). *But see* Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 23, 201 U.S.P.Q. (BNA) 497, 507 (1979) (holding agreement on blanket license fee charged by an association of copyright owners not illegal *per se*).

[180] When the *Gypsum* case arrived back at the Supreme Court following remand, the Court reconfirmed the horizontal conspiracy finding, but, despite extensive evidence of horizontal communication in the record, chose to rely exclusively on the language of the licenses themselves. United States v. U.S. Gypsum Co., 340 U.S. 76, 87, 87 U.S.P.Q. (BNA) 276, 279 (1950). Specifically the Court relied on the "favored licensee clause"—a clause which simply provided that the licensor (USG) could not "grant any right under any such license, upon terms more favorable than those granted hereunder to this Licensee." *Id.*

[181] *See* United States v. Masonite Corp., 316 U.S. 265, 275, 53 U.S.P.Q. (BNA) 396, 401 (1942).

until all licensees had signed on.[182] These facts enabled the Court to conclude that the licensees had in fact reached a horizontal agreement to fix prices.[183] On this basis alone, the agreements could have been condemned as unlawful *per se*, notwithstanding the patented status of the relevant products.[184]

Vertical price fixing could have provided a second rationale for the result. The Court found that, despite the "agency" label, the transaction between Masonite and its distributors had fully exhausted Masonite's patent rights.[185] With the patent umbrella removed, the price restriction landed squarely within the *per se* prohibition of *Dr. Miles* and *Univis Lens*.

But Justice Douglas, writing for a unanimous Court, did not adopt either of these grounds for decision. As stated earlier, he went on to craft a more expansive *per se* prohibition based on the fact that several of the licensees had been actively trying to invent around Masonite's patents.[186] From this he judged that a price restriction would necessarily reduce the impetus for the licensees to continue to market or search for non-infringing products to compete with Masonite's patented hardboard.[187] Presuming further that since it was "difficult, if not impossible" to measure the strength of this "subtle and incalculable" disincentive, Justice Douglas concluded that the Court should not attempt the exercise but instead condemn the provisions as "illegal *per se*."[188]

There are serious difficulties with this approach. The Court's presumption that the licensees would inevitably stop competing runs directly counter to the district court's factual findings that, notwithstanding the price restraint, the licensees were continuing their search for non-infringing hardboard

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182 *See id.* at 269-70, 53 U.S.P.Q. (BNA) at 398-99.

183 *See id.* at 282, 53 U.S.P.Q. (BNA) at 403.

184 *See* Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 41-49 (1912) (holding horizontal combination of manufacturer-licensees and patent owner to fix prices of patented products violated the Sherman Act). At least one commentator has questioned whether the Masonite arrangement should have been condemned under any rationale. *See* Priest, *supra* note 155, at 350-55.

185 *Masonite*, 316 U.S. at 279, 53 U.S.P.Q. (BNA) at 402.

186 *See id.* at 280-82, 53 U.S.P.Q. (BNA) at 403; *supra* text accompanying notes 67-71.

187 *Masonite*, 316 U.S. at 281, 53 U.S.P.Q. (BNA) at 403.

188 *Id.* at 281-82, 53 U.S.P.Q. (BNA) at 403.

and distributing products, "which were in many respects competitive with hardboard."[189] The Supreme Court's *per se* holding thus precluded any inquiry into whether in fact (as opposed to just an assumption that) the price restraint actually reduced the licensees' incentive to develop or sell non-infringing, competitive products. It is conceivable, particularly if the license came with a royalty obligation, that a licensee would do better keeping all of the margin on its own non-infringing product than on an infringing product on which it would have to pay a royalty to its competitor.

The Court's *per se* approach also foreclosed any consideration of Masonite's justification that the purpose of its licensing program was "to increase the distribution of hardboard, without increase of price to the consumer, or even to promote competition between dealers, or the fact that from other points of view the arrangements might be deemed to have desirable consequences."[190] This was a perverse result because arrangements that increase the market penetration of a new product, or increase output generally, find favor under the antitrust laws.[191]

Finally, resting *per se* treatment on a mere incentive to compete less vigorously proves too much. Whether a license to a potential competitor reduces that licensee's incentive to invest in competing products is not the relevant question. Exclusive field-of-use and territorial restrictions may reduce that incentive even more.[192] Yet in a vertical context, these arrangements are treated under the rule of reason.[193] The question, which the Court finesses, is at what point does this reduced incentive become so powerful that it substantially impairs competition or restricts output? There is no *a priori* reason to think that a

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189 *Id.* at 280-81, 53 U.S.P.Q. (BNA) at 403.

190 *See id.* at 276, 53 U.S.P.Q. (BNA) at 401. Masonite argued that its licensing program was necessary to provide a national distribution of its products, which Masonite did not have the resources to accomplish itself, and that the pricing restriction was necessary to prevent free riding on necessary engineering services provided by distributors. United States v. Masonite Corp., 40 F. Supp. 852, 855 (S.D.N.Y. 1941), *rev'd*, 316 U.S. 265, 53 U.S.P.Q. (BNA) 396 (1942).

191 *See supra* Part IV.B.2.

192 *See* Gen. Talking Pictures Corp. v. W. Elec. Co., 304 U.S. 175, 181, 37 U.S.P.Q. (BNA) 357, 359, *aff'd on reh'g*, 305 U.S. 124, 127, 39 U.S.P.Q. (BNA) 329, 330 (1938).

193 *See* IP AND ANTITRUST, *supra* note 169, § 30.2.

licensee's competitive incentives would be dulled so much more by price restraints in a non-exclusive license as to warrant *per se* treatment than would exclusive field-of-use or territorial restrictions that eliminate all competition among licensees.

Given its setting, the *Masonite* result is most defensible today as a horizontal price-fixing agreement among Masonite's licensees. It is less defensible under the Court's expansive, incentive-based *per se* rationale, particularly if applied to price restrictions in licenses with one or few licensees.

2. Reappraisal of *Line Material*

Line Material involved two very different, but related, licensing arrangements, both of which the Supreme Court struck down.[194] The more suspect analysis involved a cross-license between the owners of two patents for dropout fuse cutouts that, the Court assumed, blocked each other.[195] To eliminate the gridlock, the two patent owners, Southern and Line Material, entered into a cross-licensing agreement that gave Line Material the sole right to sublicense the patents to other manufacturers and also required Southern to adhere to Line's unilaterally determined prices, so long as other licensees agreed to do so.[196] The way the majority opinion dealt with this agreement was intellectually unsatisfying, and it prompted a lengthy dissent signed by three Justices.[197]

The majority opinion reaffirmed the viability of *General Electric* as a precedent permitting price fixing in a single license, but went on to hold such arrangements *per se* unlawful when engaged in by "separate owners of separate patents."[198] The Court held that this principle applies "[e]ven when, as here, the

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[194] *See* United States v. Line Material Co., 333 U.S. 287, 360-61, 76 U.S.P.Q. (BNA) 399, 428 (1948) (Burton, J., dissenting).

[195] *Id.* at 291, 295, 297, 76 U.S.P.Q. (BNA) at 403-04. To be commercially feasible, the technology covered by Southern's dominant patent had to be combined with the technology covered by Line Materials' subservient patent. *Id.* at 293-95, 76 U.S.P.Q. (BNA) at 402-03. Thus, neither patent owner could create a commercial product without a license from the other. *Id.* at 291, 76 U.S.P.Q. (BNA) at 401-02.

[196] *Id.* at 293-95, 76 U.S.P.Q. (BNA) at 402-03.

[197] *See id.* at 321-63, 76 U.S.P.Q. (BNA) at 413-29 (Burton, J., dissenting).

[198] *Id.* at 311, 76 U.S.P.Q. (BNA) at 409.

devices are not commercially competitive because the subservient patent cannot be practiced without consent of the dominant,"[199] i.e. when the patents blocked each other. The principle also held true, the Court stated, whether the arrangement involved only one or numerous licensees.[200] Finally, it remained true even if, as the dissent pointed out, the agreement had the effect of promoting competition "by making available several sources where the patented devices could be obtained, thus increasing competition in such devices, particularly with respect to design, quality and service."[201] As one commentator succinctly put it, "[a] more arbitrary and unprincipled per se rule would be difficult to construct."[202]

The Court's failure to distinguish between complementary (or blocking) patents and competing patents would find little support today. In addition to academic criticism, it has been rejected as a matter of Federal antitrust enforcement policy.[203] The government's 1995 IP Licensing Guidelines distinguish cross-licenses involving only blocking patents—where the relationship is classified as vertical and the treatment is more lenient—from those involving competing patents, which are horizontal and treated more harshly.[204] Although not using the vertical-horizontal terminology, subsequent court decisions have recognized a similar distinction between agreements involving complementary (blocking) patents and competing patents.[205] The

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199 *Id.*

200 *Id.* (dealing with situations involving two or more patentees, and an agreement between the patent owner "and another or other patentees").

201 *Id.* at 322 n.2, 76 U.S.P.Q. (BNA) at 414 n.2. (Burton, J., dissenting).

202 BOWMAN, *supra* note 96, at 195.

203 *See* 1995 LICENSING GUIDELINES, *supra* note 115, § 5.5 & Examples 9-10.

204 *Id.*; *see also* U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 76-78 (2007) ("[Patent] pools consisting only of complementary patents are least likely to prove anticompetitive.").

205 Carpet Seaming Tape Licensing Corp. v. Best Seam Inc., 616 F.2d 1133, 1138, 1142-43, 206 U.S.P.Q. (BNA) 213, 217, 221 (9th Cir. 1980) (holding accumulation of blocking patents not *per se* illegal; effect indistinguishable from a vertical merger); Int'l Mfg. Co. v. Landon, Inc., 336 F.2d 723, 729-31, 142 U.S.P.Q. (BNA) 421, 426-27 (9th Cir. 1964) (holding mandatory package licensing of blocking patents not unlawful tying).

following influential commentary summarizes the current consensus on this point:

> Maintaining the distinctions between horizontal and vertical agreements is critical if anticompetitive effects are to be analyzed properly. The great majority of purely vertical price and nonprice agreements are socially beneficial, procompetitive, and survive scrutiny whenever the rule of reason is applied.[206]

Most importantly, the Supreme Court in *Leegin* declared its willingness to repudiate former precedents that do not reflect its current appreciation of the "differences in economic effect between vertical and horizontal agreements."[207] It is fair to assume from these developments that if a cross-license similar to the one in *Line Material*, but stripped of the additional inculpatory sublicensing scheme, were to come before the Supreme Court today, it would probably not be subjected to the same *per se* rule.

However, pinning an antitrust defense on blocking patents is still not without risk. Whether a court will actually find that patents are blocking cannot always be determined easily or reliably when the license is being negotiated.[208] A blocking relationship will ultimately depend on patent validity, claim interpretation, and a commercial assessment of non-infringing alternatives—issues that are often unsettled at the time of the license. As a result, some antitrust commentators are beginning to question the extent to which the exclusionary value of a patent can merely be assumed for antitrust purposes.[209]

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[206] IP AND ANTITRUST, *supra* note 169, § 30.2.

[207] Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 888 (2007).

[208] *See generally* Susan A. Creighton & Scott A. Scher, *Resolving Patent Disputes Through Merger: A Comparison of Three Potential Approaches*, 75 ANTITRUST L.J. 657, 661-63 (2009) ("The effect of patent claims on competition in a particular market . . . generally cannot be reduced to a simple binary proposition, but rather can range across a spectrum of possibilities that defy simple resolution.").

[209] *See id.*; IP AND ANTITRUST, *supra* note 169, § 34.2c; Mark D. Janis, *Patent Pools*, *in* 3 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 2085, 2095-98 (2008). On commercial realities, *see* United States v. Line Material Co., 333 U.S. 287, 290-91 & nn.4-5 (1948), 76 U.S.P.Q. (BNA) 399, 401 & nn.4-5, where Southern's dominant patent was blocked by Line's

The possibility of being trapped by a later determination of patent invalidity (or narrower claim construction) can create a significant risk for parties considering price restrictions in their licenses. The Federal Trade Commission's (FTC) proceeding against Summit Technology and VISX highlights some of that risk.[210] Summit and VISX were the only two sellers of FDA-approved laser equipment used to perform a type of corrective eye surgery known as photorefractive keratectomy (PRK).[211] Each held patents on its own equipment, which they pooled in a joint venture.[212] The joint venture agreement provided that each party could continue to sell its equipment, but would have to pay a per-procedure fee to the venture, thus providing a price floor for procedures charged to doctors.[213] The FTC challenged the arrangement as an "unfair method[] of competition" under Section 5 of the FTC Act,[214] and obtained a consent order dissolving the agreement.[215]

A critical plank in the FTC's theory was its allegation that Summit and VISX were competitors in the PRK market,[216] which was an allegation that necessarily assumed that neither company held patents that would block the other. Yet there was evidence that, at the time the joint venture was formed, Summit was "concerned" about a number of VISX patents, that VISX itself had widely asserted that its patents could block others from practicing PRK technology, and that at least one independent analysis had concluded that VISX's patents could block any infringing technologies.[217]

As it turned out, at least one of VISX's patents would have blocked Summit's entry into the PRK market.[218] The FTC contended that this patent had

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subservient patent as a result of commercial realities (lower manufacturing cost), not the patent claims themselves.

210 *See In re* Summit Tech., Inc., 127 F.T.C. 208, 209 (1999).

211 *Id.* at 208-09.

212 *Id.* at 209-10.

213 *Id.*

214 15 U.S.C. § 45 (2006).

215 *Summit*, 127 F.T.C. at 213-14, 221.

216 *Id.* at 209.

217 *See In re* VISX, Inc., No. 9286, at 92-93 (F.T.C. May 27, 1999), *available at* http://www.ftc.gov/os/1999/o6/visxid.pdf; *Summit*, 127 F.T.C. at 209.

218 *See Summit*, 127 F.T.C. at 214.

been obtained by fraud and/or inequitable conduct.[219] But while that issue was still in administrative litigation, the patent was re-issued with claims similar to the original, which the FTC staff conceded were sufficiently broad to cover all commercial versions of laser correction surgery being performed.[220] With the FTC staff taking the position that relief should not "go beyond what is needed to recreate the situation that would have existed if there had been no violation,"[221] the Commission dismissed the complaint.[222]

If it had been clear during the FTC's investigation that VISX's patents could, in fact, have blocked Summit from competing, then the arrangement would not have been between actual or potential competitors, and the license provisions might have been subjected to a more lenient standard. The agreement on a per-procedure royalty, for example, might have been defended on the basis of *General Electric* to protect VISX's margins on its own sales.[223] But, by the time the patent was re-issued, the parties had already chosen to settle that aspect of the case.[224]

It remains to be seen how courts will reconcile the need for predictability in licensing transactions with the introduction of uncertainty into the exclusionary power of patent rights. Numerous approaches have been put forward, including using a subjective determination of the parties' own view of that issue at the time of licensing, an objective determination based on the facts available at that time, a rebuttable or conclusive presumption, and a "sham"

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219 *Id.*

220 Complaint Counsel's Memorandum in Support of Motion to Dismiss the Complaint and in Response to VISX's Motion to Reopen the Record to Receive New Evidence at 3-4, *In re* VISX, Inc., No. 9286 (F.T.C. Feb. 7, 2001).

221 *Id.* at 7.

222 *In re* VISX, Inc., No. 9286 (F.T.C. Feb. 7, 2001), *available at* http://www.ftc.gov/os/2001/02/summitvisxorder.htm.

223 Such an argument would still have been subject to the objection, which the Commission raised, that there were less restrictive means of "unblocking" VISX's patent position, such as a cross-license that did not dictate prices. Analysis of Proposed Consent Order to Aid Public Comment, http://www.ftc.gov/os/1998/08/d09286ana.htm. The availability of less restrictive alternatives is discussed *supra* Part IV.C.

224 *Summit*, 127 F.T.C. at 217.

standard.[225] What is clear is that this issue threatens to introduce an additional element of uncertainty into the risk assessment of any licensing agreement between actual or potential competitors.

F. *The* General Electric *Decision May Be Rehabilitated, but with a Makeover*

Viewed literally, *Leegin* should not have any effect on *General Electric*. Both decisions upheld price restrictions.[226] But, as suggested earlier, *General Electric* has for decades been a virtual dead letter—deemed an unreliable precedent by courts, government enforcers, and practitioners alike. This result flowed largely from subsequent cases undermining *General Electric* based on the authority of *Dr. Miles* and its progeny. The *practical* effect of *Leegin*'s overruling of *Dr. Miles* may therefore be to resurrect *General Electric* as a viable precedent. But how will it be interpreted?

One reading of *General Electric* is that price restrictions in a manufacturing license are lawful simply because the licensee is exercising a right within the scope of the patent.[227] There is some basis for this reading, particularly in the Court's statement that "price fixing is usually the essence of that which secures proper reward to the patentee" and its reliance on *National Harrow* as controlling precedent.[228] Read that way, the decision is open to criticism. Subsequent decisions and commentaries have demonstrated that there are scenarios in which such a rule of *per se* legality for price restrictions in manufacturing licenses can provide patent owners and their licensees with

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[225] Some of these approaches are described in Creighton & Scher, *supra* note 208, at 666-68, 678, 684.

[226] *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 887-89 (2007); United States v. Gen. Elec. Co., 272 U.S. 476, 493 (1926).

[227] *See Gen. Elec.*, 272 U.S. at 493.

[228] *Id.* ("'The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article.'" (quoting E. Bement & Sons v. Nat'l Harrow Co., 186 U.S. 70, 93 (1902))).

rewards that exceed the value of their patents.[229] Modern courts are therefore unlikely to adopt such an expansive reading of *General Electric*.

There is an alternative reading of *General Electric* that points toward a different analysis. Chief Justice Taft's opinion states that a patent owner may grant a license "upon any condition the performance of which is reasonably *within the reward which the patentee by the grant of the patent is entitled to secure*."[230] Later on in the opinion, he states that the patent owner's license may limit the method of sale and the price, "provided the conditions of sale are *normally and reasonably adapted to secure pecuniary reward* for the patentee's monopoly."[231] A court wanting to "modernize" *General Electric* could read this language to prescribe a traditional rule of reason inquiry.

V. CONCLUSION

Despite the overruling of *Dr. Miles*, *Leegin's* impact in the licensing field may be rather modest. The *Leegin* precedent should open up room for price-restrictive clauses in licenses with licensees who are not actual or potential competitors of the licensor or, in the case of multiple licensees, of each other. Although this scenario was theoretically possible in manufacturing licenses under *General Electric*, later decisions and government enforcement pronouncements virtually eliminated the precedential value of that decision. That possibility will likely be revived as *General Electric* is partially rehabilitated.

Leegin should also eliminate the previous distinction between price restrictions in manufacturing licenses, where there was no patent exhaustion and the rule of reason applied, and other licenses, in which the patent rights had been exhausted and the *per se* rule applied. This could permit, even in exhaustion cases, price restrictions where the licensees account for a modest share of the relevant economic market. A case like *Univis Lens*, where Univis' share of the relevant market was only five to six percent would undoubtedly be decided differently under such an analysis.

Beyond these settings, however, price restrictions in licenses are likely to continue to encounter significant antitrust risks. Licensing programs that include

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229 IP AND ANTITRUST, *supra* note 169, § 31.6 (containing an excellent critique of the *General Electric* decision and its implications, including calling its rule "indefensible" for creating absolute immunity to *GE*-type price restraints).

230 *Gen. Elec.*, 272 U.S. at 489 (emphasis added).

231 *Id.* at 490 (emphasis added).

competitors accounting for a significant share of market output will have to be very carefully structured if they are to avoid condemnation under the cartel cases. Narrower licensing programs involving competitors are advised to have a strong justification for any price restrictions and a demonstrable absence of competitive harm. Finally, one can expect the law to evolve slowly as licenses with price restrictions trickle first into the marketplace and then into the courtroom.