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Intellectual Property Misuse

SUMMARY CONTENTS

Intellectual property rights, particularly patents and copyrights, are powerful legal instruments that give their owners exclusive rights over potentially broad fields of technical and creative output. Not surprisingly, actors holding rights of such potency often seek to use them to their greatest commercial advantage. And, at times, these uses have overstepped the line of legitimate business competition and entered a realm that the law has deemed worthy of sanction.

The antitrust laws, discussed in Chapter 25, were created to curb abuses in the competitive landscape by limiting both collusive agreements among competitors and abusive practices by monopolists. Yet merely holding a patent or a copyright does not necessarily give its owner power to distort competition in a particular market.[1] After all, many modern technology devices are covered by thousands of patents held by hundreds of different firms, and it is unlikely that any one patent or group of patents confers the type of market power necessary to trigger the antitrust laws.[2] Yet the owners of intellectual property (IP) rights may still overstep the bounds of legitimate competition in ways that public policy seeks to contain. Redress for this conduct must therefore come from the IP laws themselves, rather than the antitrust laws. The IP-based doctrines that have arisen to address the anticompetitive or abusive use of IP rights are loosely classified as intellectual property "misuse."

In this chapter we will explore the origins of misuse doctrine and its evolution into several distinct doctrines that remain important today. Understanding these doctrines is of critical importance to the transactional licensing attorney because, as we will see, IP misuse almost always arises in the context of a licensing agreement that – with or without ill intent – oversteps the line.

[1] Though this principle was long believed to be true, the Supreme Court definitively confirmed it in *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 547 U.S. 28 (2006) (discussed in Section 25.6).

[2] An exception may exist with respect to patents that are essential to practice industry-wide standards. See Section 25.6, Note 4.

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24.1 THE ORIGINS OF THE MISUSE DOCTRINE

Though the doctrine has existed since at least 1917,[3] most discussions of IP misuse begin with the Supreme Court's famous decision in *Morton Salt v. Suppiger*, which gave a name to a species of abusive use of patents that was distinct from previously recognized offenses under the antitrust laws.

Morton Salt Co. v. G.S. Suppiger Co.

314 U.S. 488 (1942)

STONE, CHIEF JUSTICE

Respondent brought this suit in the district court for an injunction and an accounting for infringement of its Patent No. 2,060,645, of November 10, 1936, on a machine for depositing salt tablets, a device said to be useful in the canning industry for adding predetermined amounts of salt in tablet form to the contents of the cans.

Upon petitioner's motion … the trial court, without passing on the issues of validity and infringement, granted summary judgment dismissing the complaint. It took the ground that respondent was making use of the patent to restrain the sale of salt tablets in competition with its own sale of unpatented tablets, by requiring licensees to use with the patented machines only tablets sold by respondent. The Court of Appeals for the Seventh Circuit reversed because it thought that respondent's use of the patent was not shown to violate § 3 of the Clayton Act, as it did not appear that the use of its patent substantially lessened competition or tended to create a monopoly in salt tablets.[4] We granted certiorari because of the public importance of the question presented and of an alleged conflict of the decision below with [prior cases].

The Clayton Act authorizes those injured by violations tending to monopoly to maintain suit for treble damages and for an injunction in appropriate cases. But the present suit is for infringement of a patent. The question we must decide is not necessarily whether respondent has violated the Clayton Act, but whether a court of equity will lend its aid to protect the patent monopoly when respondent is using it as the effective means of restraining competition with its sale of an unpatented article.

Both respondent's wholly owned subsidiary and the petitioner manufacture and sell salt tablets used and useful in the canning trade. The tablets have a particular configuration rendering them capable of convenient use in respondent's patented machines. Petitioner makes and leases to canners unpatented salt deposition machines, charged to infringe respondent's patent. For reasons we indicate later, nothing turns on the fact that petitioner also competes with respondent in the sale of the tablets, and we may assume for purposes of this case that petitioner is doing no more than making and leasing the

[3] *Motion Picture Patents Co. v. Universal Film Manufacturing Corp.*, 243 U.S. 502 (1917).

[4] Chief Justice Stone's summary of the Seventh Circuit's decision, 117 F.2d 968 (7th Cir. 1941), is not entirely accurate. The Circuit did not find that "the use of [Suppiger's] patent" did not "substantially lessen[] competition or tend[] to create a monopoly in salt tablets." Rather, the Circuit reversed the district court's summary judgment in favor of Morton on the ground that the lower court entered judgment "without an inquiry into the facts." The Circuit reasoned that, given the lack of factual inquiry in the case below, it was "not able to determine the monopolistic extent of plaintiff's contract." Id. at 972.

alleged infringing machines. The principal business of respondent's subsidiary, from which its profits are derived, is the sale of salt tablets. In connection with this business, and as an adjunct to it, respondent leases its patented machines to commercial canners, some two hundred in all, under licenses to use the machines upon condition and with the agreement of the licensees that only the subsidiary's salt tablets be used with the leased machines.

It thus appears that respondent is making use of its patent monopoly to restrain competition in the marketing of unpatented articles, salt tablets, for use with the patented machines, and is aiding in the creation of a limited monopoly in the tablets not within that granted by the patent. A patent operates to create and grant to the patentee an exclusive right to make, use and vend the particular device described and claimed in the patent. But a patent affords no immunity for a monopoly not within the grant and the use of it to suppress competition in the sale of an unpatented article may deprive the patentee of the aid of a court of equity to restrain an alleged infringement by one who is a competitor. It is the established rule that a patentee who has granted a license on condition that the patented invention be used by the licensee only with unpatented materials furnished by the licensor, may not restrain as a contributory infringer one who sells to the licensee like materials for like use.

The grant to the inventor of the special privilege of a patent monopoly carries out a public policy adopted by the Constitution and laws of the United States, "to promote the Progress of Science and useful Arts, by securing for limited Times to … Inventors the exclusive Right" to their "new and useful" inventions. But the public policy which includes inventions within the granted monopoly excludes from it all that is not embraced in the invention. It equally forbids the use of the patent to secure an exclusive right or limited monopoly not granted by the Patent Office and which it is contrary to public policy to grant.

It is a principle of general application that courts, and especially courts of equity, may appropriately withhold their aid where the plaintiff is using the right asserted contrary to the public interest. Respondent argues that this doctrine is limited in its application to those cases where the patentee seeks to restrain contributory infringement by the sale to licensees of competing unpatented articles, while here respondent seeks to restrain petitioner from a direct infringement, the manufacture and sale of the salt tablet depositor. It is said that the equitable maxim that a party seeking the aid of a court of equity must come into court with clean hands applies only to the plaintiff's wrongful conduct in the particular act or transaction which raises the equity, enforcement of which is sought; that where, as here, the patentee seeks to restrain the manufacture or use of the patented device, his conduct in using the patent to restrict competition in the sale of salt tablets does not foreclose him from seeking relief limited to an injunction against the manufacture and sale of the infringing machine alone.

Undoubtedly equity does not demand that its suitors shall have led blameless lives; but additional considerations must be taken into account where maintenance of the suit concerns the public interest as well as the private interests of suitors. Where the patent is used as a means of restraining competition with the patentee's sale of an unpatented product, the successful prosecution of an infringement suit even against one who is not a competitor in such sale is a powerful aid to the maintenance of the attempted monopoly of the unpatented article, and is thus a contributing factor in thwarting the public policy underlying the grant of the patent. Maintenance and enlargement of the attempted monopoly of the unpatented article are dependent to some extent upon persuading the public of the validity of the patent, which the infringement suit is intended to establish. Equity may rightly withhold its assistance from such a use of the patent by declining to entertain a suit for infringement, and should do so at least until it is made to appear that the improper practice has been abandoned and that the consequences of the misuse of the patent have been dissipated.

The reasons for barring the prosecution of such a suit against one who is not a competitor with the patentee in the sale of the unpatented product are fundamentally the same as those which preclude an infringement suit against a licensee who has violated a condition of the license by using with the licensed machine a competing unpatented article, or against a vendee of a patented or copyrighted article for violation of a condition for the maintenance of resale prices. It is the adverse effect upon the public interest of a successful infringement suit in conjunction with the patentee's course of conduct which disqualifies him to maintain the suit, regardless of whether the particular defendant has suffered from the misuse of the patent. Similarly equity will deny relief for infringement of a trademark where the plaintiff is misrepresenting to the public the nature of his product either by the trademark itself or by his label. The patentee, like these other holders of an exclusive privilege granted in the furtherance of a public policy, may not claim protection of his grant by the courts where it is being used to subvert that policy.

It is unnecessary to decide whether respondent has violated the Clayton Act, for we conclude that in any event the maintenance of the present suit to restrain petitioner's manufacture or sale of the alleged infringing machines is contrary to public policy and that the district court rightly dismissed the complaint for want of equity.

REVERSED.

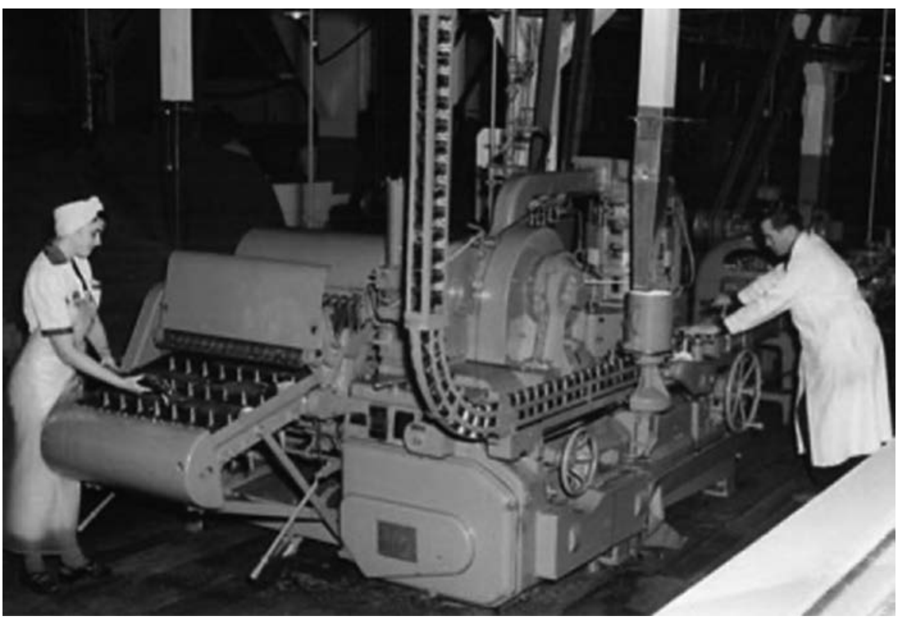

FIGURE 24.1 G.S. Suppiger Co. leased its patented salt-depositing machines to canneries with a contractual requirement that they purchase unpatented salt tablets exclusively from Suppiger. When Suppiger sued Morton Salt for selling an allegedly infringing salt-depositing machine, Morton accused Suppiger of misusing its machine patents to corner the market for salt tablets.

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Notes and Questions

1. *Public policy*. The Court in *Morton Salt* bases its decision largely on public policy grounds. Chief Justice Stone famously writes, "equity does not demand that its suitors shall have led blameless lives; but additional considerations must be taken into account where maintenance of the suit concerns the public interest as well as the private interests of suitors." What public policy is at stake in the case, and how is it advanced by the recognition of patent misuse as a defense to infringement?
2. *Antitrust or not*? The Court in *Morton Salt* states that Suppiger's contractual restriction "restrain[s] competition in the marketing of unpatented articles, salt tablets, for use with the patented machines, and is aiding in the creation of a limited monopoly in the tablets not within that granted by the patent." This sounds a lot like an antitrust claim, yet the Court later states that it is "unnecessary to decide whether respondent has violated the Clayton Act" (and the Seventh Circuit below found insufficient facts to prove such a violation). Why did the Supreme Court brush aside the antitrust laws to create the new doctrine of patent misuse in this case?[5]
3. *The crux of misuse*. The Court seems to identify the crux of Suppiger's misuse as "aiding in the creation of a limited monopoly in the tablets not within that granted by the patent." That is, Suppiger's offense was seeking to expand its patent monopoly (in the machines) beyond its granted scope (i.e., to the tablets). The expansion of a patent (or copyright) monopoly beyond what was granted by the government is thus the gravamen of misuse claims. What is so bad about such an expansion, so long as it is accomplished via mutual agreement of the affected parties?
4. *Injury?* Recall that the *Morton Salt* case was brought as an infringement action by Suppiger against Morton. Morton did not allege any particular harm from Suppiger's alleged misuse of the asserted patent. Morton presented no evidence that it lost potential sales of salt tablets to users of Suppiger's machines or even that Suppiger overcharged customers for its salt tablets. So, who was injured by Suppiger's misuse? And why should a provision in a licensing agreement between Suppiger and its customers have anything to do with whether or not Morton is liable for selling infringing machines?
5. *A drastic remedy*. The Court's remedy for Suppiger's patent misuse was drastic: Suppiger lost the ability to enforce its patent against Morton, even if Morton had been infringing. How can such a drastic remedy be justified?
6. *No cause of action*. In *Morton Salt*, Suppiger sued Morton for selling salt-depositing machines that allegedly infringed Suppiger's patent. Morton raised Suppiger's alleged misuse of its machine patents as an affirmative defense. Interestingly, unlike an antitrust claim, patent misuse is *only* an affirmative defense and gives rise to no independent cause of action. Should it be?
7. *Blameless lives?* In *Morton Salt*, Chief Justice Stone cryptically observes that "equity does not demand that its suitors shall have led blameless lives." He is perhaps referring to the fact, noted in the Seventh Circuit opinion below, that Morton "also leases its machine to the trade and provides in its lease that *the lessee shall use only salt tablets made by it*." 117 F.2d

[5] Judge Richard Posner considers these issues in *USM Corp. v. SPS Techs., Inc.*, 694 F.2d 505, 511 (7th Cir. 1982) ("Since the antitrust laws as currently interpreted reach every practice that could impair competition substantially, it is not easy to define a separate role for a doctrine also designed to prevent an anticompetitive practice – the abuse of a patent monopoly. One possibility is that the doctrine of patent misuse, unlike antitrust law, condemns any patent licensing practice that is even trivially anticompetitive, at least if it has no socially beneficial effects").

at 970 (emphasis added). Thus, Morton employed precisely the same exclusive purchasing provision as Suppiger. What do you make of this coincidence? Why did the Supreme Court pay it so little heed? Does it matter than Suppiger's salt-depositing machine was patented, but Morton's was not? How would you answer one commentator's question "[s]hould not Morton be estopped by its own conduct from asserting the misuse defense?"[6]

24.2 MISUSE BY SCOPE EXPANSION: TYING AND STATUTORY REFORM

As we will see in Section 25.5, the improper use of leverage in one market to support sales in another market is known as "tying," a practice that is condemned by the antitrust laws. In a sense, Suppiger's requirement that users of its patented machines buy its unpatented salt tablets can also be viewed as a type of illegal "tie." Liability for this form of tying misuse, however, is different than that under the antitrust laws. With tying misuse, there is no requirement that the tying party (Suppiger) have market power in the market for the tying product (salt-depositing machines) or that the claimant establish any injury from the alleged tie. It is simply enough that the misuse occur to trigger the drastic remedy of patent unenforceability.

Following *Morton Salt*, the courts considered a number of cases in which a patent holder sought to use its patents to exert control over unpatented articles. In *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944), the Supreme Court considered a patent held by Minneapolis-Honeywell covering a furnace thermostat control system. Each such system includes three thermostats that control the switching of the furnace stoker and the fan. While the combination of these components was covered by the patent, the individual thermostatic switches used in the system were not patented.

Minneapolis-Honeywell granted five manufacturers a royalty-bearing license under the patent to make thermostatic switches designed for use in the patented furnace system. The licensing agreement required each such manufacturer to include a notice with each switch, informing the customer that its purchase of the switch included a license for one installation of the patented furnace system. The only way for a customer to obtain a license to install and use the patented system, apparently, was to purchase a thermostatic switch from one of the licensed manufacturers.

Mercoid, a switch manufacturer, refused to take a license. When Mercoid then sold thermostatic switches that were compatible with the patented furnace system, Minneapolis-Honeywell sued Mercoid for contributory infringement – supplying a necessary part of the patented system, even if it did not itself infringe the full patent.[7] Mercoid raised the defense of patent misuse, arguing that Minneapolis-Honeywell, in its five licensing agreements with other switch manufacturers, was collecting royalties on the sale of unpatented switches. The Supreme Court, citing *Morton Salt*, ruled in favor of Mercoid, holding that

> The legality of any attempt to bring unpatented goods within the protection of the patent is measured by the anti-trust laws[8] not by the patent law … [T]he effort here made to control competition in this unpatented device plainly violates the anti-trust laws … It follows that [Mercoid] is entitled to be relieved against the consequences of those acts. It likewise

[6] L. Peter Farkas. *Can a Patent Still be Misused?* 59 Antitrust L.J. 677, 681 (1990).

[7] At this time, contributory patent infringement was recognized under the common law, but was not yet embodied in the Patent Act.

[8] Though the court references the "anti-trust laws," it does not refer to the Sherman Act, Clayton Act or other specific antitrust law. It can be assumed that the Court was referring to patent misuse, per its recent decision in *Morton Salt*.

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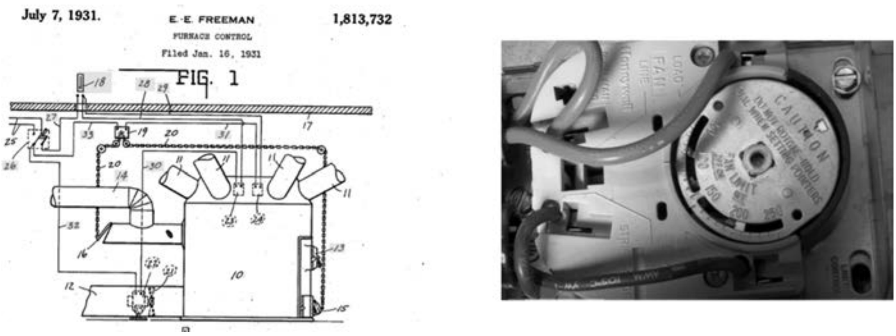

FIGURE 24.2 The 1931 Minneapolis-Honeywell furnace control system patent and a Honeywell furnace switch (unpatented).

> follows that [Minneapolis-Honeywell] may not obtain from a court of equity any decree which directly or indirectly helps it to subvert the public policy which underlies the grant of its patent.

The court did not seem to care that Mercoid's thermostatic switch was a critical element of the patented Minneapolis-Honeywell system. It explained that "However worthy it may be, however essential to the patent, an unpatented part of a combination patent is no more entitled to monopolistic protection than any other unpatented device." Thus, like Suppiger's attempt to control the supply of unpatented salt pellets, Minneapolis-Honeywell was barred by the misuse doctrine from using its patent to control the sale of unpatented thermostatic switches.

The *Mercoid* decision set off alarm bells throughout the industry. Effectively, it meant that a patent holder could not stop a supplier from selling a critical but unpatented component designed for use in a patented system, even if the *only use* for that component was in the patented system. In other words, a patent on a complex mechanical system was virtually worthless unless an infringer sold the entire system as a whole. The sale of components that were not separately patented could not be prevented.

The result of this public outcry was the inclusion of a new statutory prohibition on contributory infringement in the 1952 version of the Patent Act. This section, now codified as 35 U.S.C. § 271(c), provides that

> Whoever [sells] a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer.

Section 271(c) clarifies the law of contributory patent infringement, establishing that the seller of a component of a patented system can be held liable for contributory infringement, so long as the component is not a "staple article" (e.g., sale of a screw, nail or wire should not result in contributory infringement by the seller even if the component is used in a patented system).

But the 1952 Act went further. In addition to establishing the framework for contributory patent infringement, it clarified the law of patent *misuse*, now codified in Section 271(d):

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(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following:

(1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent;
(2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent;
(3) sought to enforce his patent rights against infringement or contributory infringement

This new provision exonerates patent holders from three actions for which Minneapolis-Honeywell was condemned in *Mercoid*: charging a royalty to someone who is not directly infringing a patent; licensing someone to sell a noninfringing product if it would contribute to someone else's infringement; and enforcing a patent against a contributory infringer.

Even with these modifications, the patent misuse doctrine had its detractors, some of them highly placed. For example, Senator Orrin Hatch (R-Ut), a long-time champion of strong IP rights, remarked:

> The patent misuse doctrine has come to provide a defense even to a person who knowingly infringes a valid patent and is not affected by the conduct held to be misuse. If there ever existed a reason for this harsh result, it is long gone.

Hatch's comments were not idle posturing. In 1988, the Senate passed a sweeping bill that all but eliminated the doctrine. Eventually, a less extreme version of the bill was enacted as the Patent Misuse Reform Act of 1988.[9] It adds two additional exclusions from patent misuse already present under § 271(d), providing that it shall not be misuse if a patent owner has:

(4) refused to license or use any rights to the patent; or
(5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has *market power* in the relevant market for the patent or patented product on which the license or sale is conditioned.

Clause 4 of the 1988 amendment codifies a venerable doctrine under patent law: A patent owner may choose whether and with whom to conduct business; it need not grant a license to any particular party, and is free to refuse to grant such a license.[10]

Clause 5, however, effects a more significant change. It effectively reconnects the misuse doctrine to antitrust law – a connection that was severed by the Supreme Court in *Morton Salt*. That is, it provides that tying-based patent misuse will not be found unless the patent holder has "market power in the relevant market for the patent or patented product" (i.e., the tying product). As such, tying misuse now requires a similar level of market leverage as the offense of tying under the antitrust laws (see Section 25.5).

[9] For a summary of this history, see Farkas, supra, note 6, at 681–84.

[10] See Kenneth J. Burchfiel, *Patent Misuse and Antitrust Reform: "Blessed be the Tie?"* 4 Harv. J.L. & Tech. 1, 6 (1991) ("It is clear that prior to the amendment there was no duty to license another to make, use or sell a patented invention, which are the basic exclusive rights granted by a United States patent. The right of the patentee to prevent others from practicing the invention has long been regarded as absolute, and Section 271(d)(4) was intended only to codify this established principle"). This clause may have been a reaction to statements by the US Department of Justice in its 1987 business review letter to the MPEG-2 pool, which promoted "nondiscriminatory" licensing to all competitors as a procompetitive feature of the pool (see discussion in Section 26.3, Note 3).

Notes and Questions

1. *Contributory and direct infringers*. In *Mercoid*, Minneapolis-Honeywell sued Mercoid for contributory patent infringement under the old common law regime. Even before the 1952 Act this was a risky move, as Mercoid was only selling an unpatented component of Minneapolis-Honeywell's patented furnace control system. In order to establish a claim for contributory infringement, the alleged contributory infringer must be contributing to a direct infringement by somebody else. In this case, the direct infringer would be anyone who installed a furnace control system covered by the patent. Why didn't Minneapolis-Honeywell simply sue these direct infringers? What was attractive about suing Mercoid?
2. *Legislative override*. It is not uncommon in IP law for Congress to enact laws specifically designed to overrule unpopular judicial decisions.[11] What commercial interests were most opposed to the patent misuse doctrine? How do you explain a concerted industrial lobbying effort in this regard, given that cases in which patent misuses arises often involve two large corporations (e.g., Morton Salt and Suppiger)?
3. *Codifying contributory infringement*. Why did Congress feel the need to codify the law of contributory patent infringement in 1952? Other than overriding the decision in *Mercoid*, what else did this statutory enactment have?
4. *Antitrust and misuse*. Prior to 1988, many commentators felt that patent misuse should be treated as a species of antitrust violation, and no more. Section 271(d)(5) achieved this goal, in part, for tying-type misuse. But patent misuse is still a separate legal doctrine, distinct from antitrust law. How does misuse differ from antitrust law, even after the 1988 amendments?
5. *Other forms of scope expansion*. In *Bayer AG v. Housey Pharmaceuticals, Inc.*, 169 F. Supp. 2d 328 (2001), Housey licensed four patents relating to screening methods for therapeutic compounds to more than thirty different companies. Housey offered two different payment options for this license: a lump-sum payment based on the licensee's R&D budget, or a running royalty based on the licensee's sale of therapeutic compounds discovered using the patented method. Bayer attempted to negotiate a license with Housey, but the parties could not come to terms and Bayer sought a declaratory judgment that Housey had committed patent misuse by charging royalties based on compounds not covered by its patent claims. The court, echoing the reasoning of the "package licensing" cases *Automatic Radio* and *Zenith* (discussed in Section 24.4), held that Housey had not committed misuse, as it did not condition the grant of its license on the payment of royalties on unpatented products, but rather offered this as an option.[12]

24.3 MISUSE BY TERM EXPANSION: POST-EXPIRATION ROYALTIES

24.3.1 *The Long Shadow of* Brulotte

As the Supreme Court established in *Morton Salt*, patent misuse constitutes the expansion of the patent monopoly beyond the scope granted by the Patent and Trademark Office (PTO). The tying-type misuse claims discussed above each involved the purported expansion of a patent's

[11] For another example in the context of IP licensing, see Section 21.3, discussing the enactment of § 265(n) of the Bankruptcy Code in response to the Court's decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*

[12] For an analysis of this case and the application of the patent misuse doctrine to "reach-through" royalty arrangements (discussed in more detail in Section 8.2.3.2, Note 3), see Alfred C. Server, Nader Mousavi & Jane M. Love, *Reach-Through Rights and the Patentability, Enforcement, and Licensing of Patents on Drug Discovery Tools*, 1 Hastings Sci. Tech. L.J. 21, 90–92 (2009).

reach to unpatented articles sold by the patent holder or its licensees (e.g., salt tablets, sensors). But a patent monopoly can be expanded in other ways.

In *Brulotte v. Thys Co.*, 379 U.S. 29 (1964),[13] Thys Co. held twelve patents covering the process of mechanized hop-picking and hop-picking machines. Walter Brulotte and Raymond Charvet were hop farmers in Yakima County, Washington. They each purchased portable Thys hop-picking machines that they acquired second-hand. When Thys approached the farmers with its patents, each agreed to take a license under which he would pay Thys minimum annual royalties of $500 for seventeen years from the date of the original purchase.[14] They also agreed during this period not to remove the machines from Yakima County. Brulotte's royalty obligation was scheduled to expire in 1958, Charvet's in 1960. Both farmers ceased to pay Thys royalties in 1952, and the last of the patents expired in 1957. When Thys sued to recover unpaid royalties, the farmers argued that Thys committed patent misuse by charging royalties and seeking to control the location of the machines after expiration of the patents.

Justice Douglas, writing for the Supreme Court, reasoned that

> a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*. If that device were available to patentees, the free market visualized for the post-expiration period would be subject to monopoly influences that have no proper place there … The exaction of royalties for use of a machine after the patent has expired is an assertion of monopoly power in the post-expiration period when, as we have seen, the patent has entered the public domain.

FIGURE 24.3 Prior to the introduction of mechanical hop-picking equipment, the harvesting of hops was a labor-intensive manual process, as illustrated by this photograph (left) of hop pickers in Yakima County, Washington.

[13] Many of the most relevant (and interesting) facts in this case can be found in the decision below of the Washington Supreme Court, 382 P.2d 271 (Wash. 1963).

[14] At this time, the duration of a patent was seventeen years from the date of issuance.

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Justice Harlan dissented from the Court's decision, arguing that the payment of royalties following expiration of the patents should be treated as an extension of payment terms, rather than an expansion of the patent monopoly:

> The essence of the majority opinion may lie in some notion that "patent leverage" being used by Thys to exact use payments extending beyond the patent term somehow allows Thys to extract more onerous payments from the farmers than would otherwise be obtainable. If this be the case, the Court must in some way distinguish long-term use payments from long-term installment payments of a flat-sum purchase price. For the danger which it seems to fear would appear to inhere equally in both, and as I read the Court's opinion, the latter type of arrangement is lawful despite the fact that failure to pay an installment under a conditional sales contract would permit the seller to recapture the machine, thus terminating – not merely restricting – the farmer's use of it.

Criticisms of this nature continued in the years following *Brulotte*. In *Scheiber v. Dolby Laboratories, Inc*., 293 F.3d 1014 (7th Cir. 2002), Judge Richard Posner reasoned that "charging royalties beyond the term of the patent does not lengthen the patentee's monopoly; it merely alters the timing of royalty payments." Nevertheless, he followed *Brulotte*, but only because he was compelled to, complaining that "we have no authority to overrule a Supreme Court decision no matter how dubious its reasoning strikes us, or even how out of touch with the Supreme Court's current thinking the decision seems."

Despite nearly continual criticism by commentators and lower courts, *Brulotte* has remained good law, and was most recently affirmed in no uncertain terms by the Supreme Court in the following case.

Kimble v. Marvel Entertainment, LLC

576 U.S. 446 (2015)

KAGAN, JUSTICE

In *Brulotte v. Thys Co*., 379 U.S. 29 (1964), this Court held that a patent holder cannot charge royalties for the use of his invention after its patent term has expired. The sole question presented here is whether we should overrule *Brulotte*. Adhering to principles of stare decisis, we decline to do so. Critics of the *Brulotte* rule must seek relief not from this Court but from Congress.

I

In 1990, petitioner Stephen Kimble obtained a patent on a toy that allows children (and young-at-heart adults) to role-play as "a spider person" by shooting webs—really, pressurized foam string—"from the palm of [the] hand." … Respondent Marvel Entertainment, LLC (Marvel) makes and markets products featuring Spider–Man, among other comic-book characters. Seeking to sell or license his patent, Kimble met with the president of Marvel's corporate predecessor to discuss his idea for web-slinging fun. Soon afterward, but without remunerating Kimble, that company began marketing the "Web Blaster"—a toy that, like Kimble's patented invention, enables would-be action heroes to mimic Spider–Man through the use of a polyester glove and a canister of foam.

Kimble sued Marvel in 1997 alleging, among other things, patent infringement. The parties ultimately settled that litigation. Their agreement provided that Marvel would

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FIGURE 24.4 *Kimble v. Marvel* involved a licensing agreement entered into to settle patent litigation over the popular "Web Blaster" toy.

purchase Kimble's patent in exchange for a lump sum (of about a half-million dollars) and a 3% royalty on Marvel's future sales of the Web Blaster and similar products. The parties set no end date for royalties, apparently contemplating that they would continue for as long as kids want to imitate Spider–Man (by doing whatever a spider can).

And then Marvel stumbled across *Brulotte*, the case at the heart of this dispute. In negotiating the settlement, neither side was aware of *Brulotte*. But Marvel must have been pleased to learn of it. *Brulotte* had read the patent laws to prevent a patentee from receiving royalties for sales made after his patent's expiration. So the decision's effect was to sunset the settlement's royalty clause. On making that discovery, Marvel sought a declaratory judgment in federal district court confirming that the company could cease paying royalties come 2010—the end of Kimble's patent term. The court approved that relief, holding that *Brulotte* made "the royalty provision … unenforceable after the expiration of the Kimble patent." The Court of Appeals for the Ninth Circuit affirmed, though making clear that it was none too happy about doing so. "[T]he *Brulotte* rule," the court complained, "is counterintuitive and its rationale is arguably unconvincing."

We granted certiorari, to decide whether, as some courts and commentators have suggested, we should overrule *Brulotte*. For reasons of stare decisis, we demur.

II

Patents endow their holders with certain superpowers, but only for a limited time. In crafting the patent laws, Congress struck a balance between fostering innovation and ensuring public access to discoveries. While a patent lasts, the patentee possesses exclusive rights to the patented article—rights he may sell or license for royalty payments if he so chooses. But a patent typically expires 20 years from the day the application for it was filed. And when the patent expires, the patentee's prerogatives expire too, and the right to make or use the article, free from all restriction, passes to the public.

In a related line of decisions, we have deemed unenforceable private contract provisions limiting free use of such inventions. In *Scott Paper Co. v. Marcalus Mfg. Co.*, 326 U.S.

249 (1945), for example, we determined that a manufacturer could not agree to refrain from challenging a patent's validity. Allowing even a single company to restrict its use of an expired or invalid patent, we explained, "would deprive … the consuming public of the advantage to be derived" from free exploitation of the discovery. And to permit such a result, whether or not authorized "by express contract," would impermissibly undermine the patent laws.

Brulotte was brewed in the same barrel. There, an inventor licensed his patented hop-picking machine to farmers in exchange for royalties from hop crops harvested both before and after his patents' expiration dates. The Court (by an 8–1 vote) held the agreement unenforceable—"unlawful per se"—to the extent it provided for the payment of royalties "accru[ing] after the last of the patents incorporated into the machines had expired."

The *Brulotte* rule, like others making contract provisions unenforceable, prevents some parties from entering into deals they desire. As compared to lump-sum fees, royalty plans both draw out payments over time and tie those payments, in each month or year covered, to a product's commercial success. And sometimes, for some parties, the longer the arrangement lasts, the better—not just up to but beyond a patent term's end. A more extended payment period, coupled (as it presumably would be) with a lower rate, may bring the price the patent holder seeks within the range of a cash-strapped licensee. (Anyone who has bought a product on installment can relate.). Or such an extended term may better allocate the risks and rewards associated with commercializing inventions—most notably, when years of development work stand between licensing a patent and bringing a product to market. As to either goal, *Brulotte* may pose an obstacle.

Yet parties can often find ways around *Brulotte*, enabling them to achieve those same ends. To start, Brulotte allows a licensee to defer payments for pre-expiration use of a patent into the post-expiration period; all the decision bars are royalties for using an invention after it has moved into the public domain. A licensee could agree, for example, to pay the licensor a sum equal to 10% of sales during the 20-year patent term, but to amortize that amount over 40 years. That arrangement would at least bring down early outlays, even if it would not do everything the parties might want to allocate risk over a long timeframe. And parties have still more options when a licensing agreement covers either multiple patents or additional non-patent rights. Under *Brulotte*, royalties may run until the latest-running patent covered in the parties' agreement expires. Too, post-expiration royalties are allowable so long as tied to a non-patent right—even when closely related to a patent. That means, for example, that a license involving both a patent and a trade secret can set a 5% royalty during the patent period (as compensation for the two combined) and a 4% royalty afterward (as payment for the trade secret alone). Finally and most broadly, Brulotte poses no bar to business arrangements other than royalties—all kinds of joint ventures, for example—that enable parties to share the risks and rewards of commercializing an invention.

Contending that such alternatives are not enough, Kimble asks us to abandon *Brulotte* in favor of "flexible, case-by-case analysis" of post-expiration royalty clauses "under the rule of reason." Used in antitrust law, the rule of reason requires courts to evaluate a practice's effect on competition by "taking into account a variety of factors, including specific information about the relevant business, its condition before and after the [practice] was imposed, and the [practice's] history, nature, and effect." Of primary importance in this context, Kimble posits, is whether a patent holder has power in the relevant market and so might be able to curtail competition. Resolving that issue, Kimble notes, entails "a full-fledged economic inquiry into the definition of the market, barriers to entry, and the like."

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III

Overruling precedent is never a small matter. Stare decisis—in English, the idea that today's Court should stand by yesterday's decisions—is "a foundation stone of the rule of law." Application of that doctrine, although "not an inexorable command," is the "preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." It also reduces incentives for challenging settled precedents, saving parties and courts the expense of endless relitigation.

Respecting stare decisis means sticking to some wrong decisions. The doctrine rests on the idea, as Justice Brandeis famously wrote, that it is usually "more important that the applicable rule of law be settled than that it be settled right." *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (dissenting opinion). To reverse course, we require as well what we have termed a "special justification"—over and above the belief "that the precedent was wrongly decided."

And Congress has spurned multiple opportunities to reverse *Brulotte*—openings as frequent and clear as this Court ever sees. *Brulotte* has governed licensing agreements for more than half a century. During that time, Congress has repeatedly amended the patent laws, including the specific provision on which Brulotte rested. *Brulotte* survived every such change. Indeed, Congress has rebuffed bills that would have replaced *Brulotte*'s per se rule with the same antitrust-style analysis Kimble now urges. Congress's continual reworking of the patent laws—but never of the *Brulotte* rule—further supports leaving the decision in place.

Nor yet are we done, for the subject matter of *Brulotte* adds to the case for adhering to precedent. *Brulotte* lies at the intersection of two areas of law: property (patents) and contracts (licensing agreements). And we have often recognized that in just those contexts—"cases involving property and contract rights"—considerations favoring stare decisis are "at their acme." That is because parties are especially likely to rely on such precedents when ordering their affairs. To be sure, Marvel and Kimble disagree about whether *Brulotte* has actually generated reliance. Marvel says yes: Some parties, it claims, do not specify an end date for royalties in their licensing agreements, instead relying on *Brulotte* as a default rule … Overturning *Brulotte* would thus upset expectations, most so when long-dormant licenses for long-expired patents spring back to life. Not true, says Kimble: Unfair surprise is unlikely, because no "meaningful number of [such] license agreements … actually exist." To be honest, we do not know (nor, we suspect, do Marvel and Kimble). But even uncertainty on this score cuts in Marvel's direction. So long as we see a reasonable possibility that parties have structured their business transactions in light of *Brulotte*, we have one more reason to let it stand.

As against this superpowered form of stare decisis, we would need a superspecial justification to warrant reversing *Brulotte*. But the kinds of reasons we have most often held sufficient in the past do not help Kimble here. If anything, they reinforce our unwillingness to do what he asks.

IV. B

Kimble also seeks support from the wellspring of all patent policy: the goal of promoting innovation. *Brulotte*, he contends, "discourages technological innovation and does significant damage to the American economy." Recall that would-be licensors and licensees may

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benefit from post-patent royalty arrangements because they allow for a longer payment period and a more precise allocation of risk. If the parties' ideal licensing agreement is barred, Kimble reasons, they may reach no agreement at all. And that possibility may discourage invention in the first instance. The bottom line, Kimble concludes, is that some "breakthrough technologies will never see the light of day."

Maybe. Or, then again, maybe not. While we recognize that post-patent royalties are sometimes not anticompetitive, we just cannot say whether barring them imposes any meaningful drag on innovation. As we have explained, *Brulotte* leaves open various ways—involving both licensing and other business arrangements—to accomplish payment deferral and risk-spreading alike. Those alternatives may not offer the parties the precise set of benefits and obligations they would prefer. But they might still suffice to bring patent holders and product developers together and ensure that inventions get to the public. Neither Kimble nor his amici have offered any empirical evidence connecting *Brulotte* to decreased innovation; they essentially ask us to take their word for the problem. And the United States, which acts as both a licensor and a licensee of patented inventions while also implementing patent policy, vigorously disputes that *Brulotte* has caused any "significant real-world economic harm." Truth be told, if forced to decide that issue, we would not know where or how to start.

V

What we can decide, we can undecide. But stare decisis teaches that we should exercise that authority sparingly. Finding many reasons for staying the stare decisis course and no "special justification" for departing from it, we decline Kimble's invitation to overrule *Brulotte*.

For the reasons stated, the judgment of the Court of Appeals is affirmed.

Notes and Questions

1. *Deferred payments*. *Brulotte* has been criticized – from Justice Harlan's original dissent to the dissenting justices in *Kimble* – for seeming to disregard the parties' reasonable desire to spread payments over time. But Justice Douglas understood the concept of installment payments, and rejected the argument that Thys was simply allowing the licensee farmers to make payments over time. "The royalty payments due for the post-expiration period are by their terms for use during that period, and are not deferred payments for use during the pre-expiration period." 379 U.S. at 31. "The sale or lease of unpatented machines on long-term payments based on a deferred purchase price or on use would present wholly different considerations." 379 U.S. at 32. What distinction does Justice Douglas draw regarding the nature of the post-expiration payments, and why is it so important?
2. *Nonroyalty obligations*. In *Brulotte*, Justice Douglas is careful to note that the obligations imposed on the farmers after expiration of the Thys patents included not only the payment of royalties, but also an agreement not to move the machines out of Yakima County. Yet this point is seldom raised in the critiques of *Brulotte*. What is its significance, and how does it support the Court's holding?
3. Per se *vs. rule of reason*. In *Kimble*, Kimble asks the Court to replace the *per se* rule of *Brulotte* with the more flexible "rule of reason" approach adopted in most antitrust cases

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today. We will discuss the differences between *per se* and rule of reason approaches in greater detail in Chapter 25. But for now, consider why Justice Kagan declined this invitation.

4. A *market power requirement?* In *Scheiber v. Dolby Laboratories, Inc.*, 293 F.3d 1014 (7th Cir. 2002), a licensor seeking to charge post-expiration royalties argued that under 35 U.S.C. § 271(d)(5) he could be found to have engaged in patent misuse only if he possessed "market power in the market for the conditioning product." Judge Posner responded, correctly, that § 271(d)(5) only applies by its terms to tying-type patent misuse. But should the statute be so limited? Should the market power requirement of § 271(d)(5) be extended to other forms of patent misuse, such as the type of term-extension misuse alleged in *Brulotte* and *Kimble*?
5. *Effects on innovation*. Kimble argued that retaining the *Brulotte* rule would discourage technological innovation. Why? Justice Kagan seems skeptical of his theory. How convincing do you find it?
6. *Patent vs. contract*. Justice Alito, who wrote a dissenting opinion in *Kimble*, returns to the well-worn debate over the nature of IP licenses: whether they are interests in property or contracts (see Chapter 3). As Justice Alito writes, "A licensing agreement that provides for the payment of royalties after a patent's term expires does not enlarge the patentee's monopoly or extend the term of the patent. It simply gives the licensor a contractual right." Why is this distinction important?
7. *Drafting around* Brulotte. Marvel argues that contracting parties depend on the rule in *Brulotte* when drafting their licensing agreements. "Some parties, it claims, do not specify an end date for royalties in their licensing agreements, instead relying on *Brulotte* as a default rule … Overturning *Brulotte* would thus upset expectations, most so when long-dormant licenses for long-expired patents spring back to life." How much credence do you give to this argument? Would it be a good practice to draft a licensing agreement with no end date in reliance on a case that prohibits the payment of royalties after the expiration of the licensed patents?
8. *The* Brulotte *windfall*. In *Kimble*, Justice Kagan writes that Marvel "stumbled" across *Brulotte*, implying that neither party was aware of the case when they drafted the settlement agreement including the perpetual royalty clause. Does this matter? What if Marvel, a large corporation represented by high-priced lawyers, did know about *Brulotte*, but simply allowed Kimble, a garage inventor, to enter into an invalid agreement. Would this change the outcome? Recall Chief Justice Stone's comment in *Morton Salt* that "equity does not demand that its suitors shall have led blameless lives." Does that sentiment apply here as well?
9. *Hybrid licensing*. In *Kimble*, Justice Kagan explains how parties can easily avoid the problems imposed by *Brulotte* through contractual drafting. We discussed one of these techniques in Section 8.2.2.4 – hybrid rates, in which the license covers both patents and unpatented know-how, and the combined royalty rate is lower in jurisdictions, and at times, that no patents are in force. What other drafting techniques does Justice Kagan imply might avoid the *Brulotte* rule?

24.3.2 *The Limits of* Brulotte: Aronson v. Quick Point *and Unpatented Articles*

Not long after the Supreme Court's decision in *Brulotte*, the Court considered another case – *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979) – that quietly established the outer limits of the *Brulotte* misuse doctrine. In 1955, Jane Aronson filed a patent application for a novel form of keyholder into which a photo or corporate logo could be inserted. While the patent application was pending, she negotiated a contract for the manufacture and sale of the keyholder with

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a St. Louis-based office supply manufacturer, Quick Point Pencil Co. The relevant facts are set forth by the district court:

> On June 26, 1956, [Aronson] entered into an agreement with [Quick Point] which gives [Quick Point] the exclusive license and right to make and sell key holders of the type shown in [Aronson's] patent application … which was filed with the United States Patent Office on October 25, 1955 … The agreement was amended on June 27, 1956. The agreement provides that [Quick Point] would pay [Aronson] royalties at the rate of 5 percent and if no patent was issued within five years of June 27, 1956 the royalties would be reduced to 2½ percent "as long as [Quick Point] continue[s] to sell the same."
>
> [Quick Point] commenced manufacturing key holders in July of 1956 and paid a five percent royalty on gross sales until June 26, 1961, when the royalty was reduced to two and one-half percent. On that date [Aronson] had not been granted a patent …
>
> On January 27, 1959, the parties executed a supplementary agreement, which provided for royalties on key holders sold in combination with rulers, watches and other items. This agreement did not otherwise alter any terms of the original agreements.
>
> [Quick Point] paid royalties … in excess of $200,000.00 from July 9, 1957 to September, 1975.[15]
>
> [O]n September 27, 1961, the Board of Patent Appeals held this was an unpatentable invention.[16]

In 1975, Quick Point sought a declaratory judgment that the royalty agreement was unenforceable. The Eighth Circuit agreed. Citing *Brulotte*, it reasoned that "if Aronson actually had obtained a patent, Quick Point would have escaped its royalty obligations either if the patent were held to be invalid or upon its expiration after 17 years. Accordingly, it concluded that a licensee should be relieved of royalty obligations when the licensor's efforts to obtain a contemplated patent prove unsuccessful."

The Supreme Court reversed. Chief Justice Burger explained:

> No decision of this Court relating to patents justifies relieving Quick Point of its contract obligations. We have held that a state may not forbid the copying of an idea in the public domain which does not meet the requirements for federal patent protection. Enforcement of Quick Point's agreement, however, does not prevent anyone from copying the keyholder. It merely requires Quick Point to pay the consideration which it promised in return for the use of a novel device which enabled it to preempt the market.

The Court's move here is an interesting one. Rather than characterizing the royalty payable to Aronson as an impermissible expansion of the nonexistent patent right that she never obtained, the Court treats the agreement as dealing entirely with nonpatent matters. As a result, the federal patent law doctrine of misuse is wholly inapplicable to her arrangement with Quick Point. As Chief Justice Burger further explains:

> On this record it is clear that the parties contracted with full awareness of both the pendency of a patent application and the possibility that a patent might not issue. The clause de-escalating the royalty by half in the event no patent issued within five years makes that crystal clear. Quick Point apparently placed a significant value on exploiting the basic novelty of the device, even if no patent issued; its success demonstrates that this judgment was well founded. Assuming, arguendo, that the initial letter and the commitment to pay a 5% royalty was subject to federal

[15] As detailed by the Supreme Court, Quick Point paid Aronson total royalties of $203,963.84 on sales of over $7 million.

[16] 425 F. Supp. 600 (E.D. Mo. 1976).

patent law, the provision relating to the 2 1/2% royalty was explicitly independent of federal law. The cases and principles relied on by the Court of Appeals and Quick Point [e.g., *Brulotte* – Ed.] do not bear on a contract that does not rely on a patent, particularly where, as here, the contracting parties agreed expressly as to alternative obligations if no patent should issue.

Commercial agreements traditionally are the domain of state law. State law is not displaced merely because the contract relates to intellectual property which may or may not be patentable; the states are free to regulate the use of such intellectual property in any manner not inconsistent with federal law. In this as in other fields, the question of whether federal law preempts state law "involves a consideration of whether that law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Kewanee Oil Co. v. Bicron Corp.*, 416 U. S. 470, 479 (1974). If it does not, state law governs.

In *Kewanee Oil Co.*, we reviewed the purposes of the federal patent system. First, patent law seeks to foster and reward invention; second, it promotes disclosure of inventions to stimulate further innovation and to permit the public to practice the invention once the patent expires; third, the stringent requirements for patent protection seek to assure that ideas in the public domain remain there for the free use of the public.

Enforcement of Quick Point's agreement with Aronson is not inconsistent with any of these aims. Permitting inventors to make enforceable agreements licensing the use of their inventions in return for royalties provides an additional incentive to invention. Similarly, encouraging Aronson to make arrangements for the manufacture of her keyholder furthers the federal policy of disclosure of inventions; these simple devices display the novel idea which they embody wherever they are seen.

Notes and Questions

1. *Royalties without patents*. In *Brulotte*, Thys Co. was found liable for patent misuse by charging royalties after its patents had expired – when the patented inventions were in the public domain. But in *Aronson*, the Court held that Aronson was entitled to charge Quick Point a royalty on her invention, even though it was never patented. How does the Supreme Court's decision in *Aronson* square with *Brulotte*?
2. *Fixing* Brulotte. Given the decision in *Aronson*, how might you advise Thys Co. today regarding contractual wording that would accomplish its business goals without constituting patent misuse?
3. *When patents come and go*. In *Aronson*, the Court holds that the contract between Aronson and Quick Point was governed by principles of state contract law, as no patent had ever issued. But what if a patent had issued? Presumably, federal law would govern the contract while the patent was in force. But what if the patent were found invalid by a court five years after its issuance? Would state contract law then become applicable, or is the rule "once federal, always federal"? Under this hypothetical, would Aronson be entitled to charge Quick Point a royalty at the reduced rate after the patent was invalidated? If so, why didn't that approach work for Thys in *Brulotte*?
4. *No-challenge clauses as patent misuse*? In a 2010 article, the authors speculate whether a licensor's use of a "no-challenge" clause in a patent licensing agreement (discussed in Section 22.4) should be interpreted as an act of patent misuse.[17] As noted in Section 22.4, no-challenge clauses in ordinary patent licensing agreements are generally unenforceable

[17] Alfred C. Server & Peter Singleton, *Licensee Patent Validity Challenges Following MedImmune: Implications for Patent Licensing*, 3 Hastings Sci. & Tech. L.J. 243, 412–16 (2010). See also id. at 419, discussing a claim of misuse in connection with a "termination-for-challenge" clause.

under the Supreme Court's precedent in *Lear v. Adkins*. But as discussed in this chapter, a finding of misuse has far greater ramifications for the patent holder, including the broad unenforceability of the patent against others. How might a no-challenge clause potentially fit within the rubric of patent misuse? Do you think that the existence of such a clause in a licensing agreement, whether or not enforced, should constitute misuse? What about other types of clauses discouraging licensees from challenging patents (see Section 22.4.3)?

24.4 MISUSE BY BUNDLING: PACKAGE LICENSING

A third form of potential patent misuse arose when the early patent aggregator and licensing entity Hazeltine Research began to license a large portfolio of patents to manufacturers in the electronics and broadcast industries beginning in the 1940s. Below are two leading cases involving Hazeltine's "package" licenses of large portfolios of patents.

Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.

339 U.S. 827 (1950)

MINTON, JUSTICE

This is a suit by respondent Hazeltine Research, Inc., as assignee of the licensor's interest in a nonexclusive patent license agreement covering a group of 570 patents and 200 applications, against petitioner Automatic Radio Manufacturing Company, Inc., the licensee, to recover royalties. The patents and applications are related to the manufacture of radio broadcasting apparatus. Respondent and its corporate affiliate and predecessor have for some twenty years been engaged in research, development, engineering design and testing and consulting services in the radio field. Respondent derives income from the licensing of its patents, its policy being to license any and all responsible manufacturers of radio apparatus at a royalty rate which for many years has been approximately one percent. Petitioner manufactures radio apparatus, particularly radio broadcasting receivers.

The license agreement in issue, which appears to be a standard Hazeltine license, was entered into by the parties in September 1942, for a term of ten years. By its terms petitioner acquired permission to use, in the manufacture of its "home" products, any or all of the patents which respondent held or to which it might acquire rights. Petitioner was not, however, obligated to use respondent's patents in the manufacture of its products. For this license, petitioner agreed to pay respondent's assignor royalties based upon a small percentage of petitioner's selling price of complete radio broadcasting receivers, and in any event a minimum of $ 10,000 per year.

This suit was brought to recover the minimum royalty due for the year ending August 31, 1946, for an accounting of other sums due, and for other relief. The District Court … sustained the motion of respondent for judgment. The validity of the license agreement was upheld against various charges of misuse of the patents, and judgment was entered for the recovery of royalties and an accounting, and for a permanent injunction restraining petitioner from failing to pay royalties, to keep records, and to render reports during the life of the agreement. The Court of Appeals affirmed, and we granted certiorari in order to consider important questions concerning patent misuse and estoppel to challenge the validity of licensed patents.

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The questions for determination are whether a misuse of patents has been shown, and whether petitioner may contest the validity of the licensed patents, in order to avoid its obligation to pay royalties under the agreement.

It is insisted that the license agreement cannot be enforced because it is a misuse of patents to require the licensee to pay royalties based on its sales, even though none of the patents are used. Petitioner directs our attention to the "Tie-in" cases. These cases have condemned schemes requiring the purchase of unpatented goods for use with patented apparatus or processes, prohibiting production or sale of competing goods, and conditioning the granting of a license under one patent upon the acceptance of another and different license. Petitioner apparently concedes that these cases do not, on their facts, control the instant situation. It is obvious that they do not. There is present here no requirement for the purchase of any goods. Hazeltine does not even manufacture or sell goods; it is engaged solely in research activities. Nor is there any prohibition as to the licensee's manufacture or sale of any type of apparatus. The fact that the license agreement covers only "home" apparatus does not mean that the licensee is prohibited from manufacturing or selling other apparatus. And finally, there is no conditioning of the license grant upon the acceptance of another and different license.

But petitioner urges that this case "is identical in principle" with the "Tie-in" cases. It is contended that the licensing provision requiring royalty payments of a percentage of the sales of the licensee's products constitutes a misuse of patents because it ties in a payment on unpatented goods. That which is condemned as against public policy by the "Tie-in" cases is the extension of the monopoly of the patent to create another monopoly or restraint of competition – a restraint not countenanced by the patent grant. See, e. g., *Mercoid Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661, *Morton Salt Co. v. Suppiger Co.*, 314 U.S. 488. The principle of those cases cannot be contorted to circumscribe the instant situation. This royalty provision does not create another monopoly; it creates no restraint of competition beyond the legitimate grant of the patent. The right to a patent includes the right to market the use of the patent at a reasonable return.

The licensing agreement in issue was characterized by the District Court as essentially a grant by Hazeltine to petitioner of a privilege to use any patent or future development of Hazeltine in consideration of the payment of royalties. Payment for the privilege is required regardless of use of the patents. The royalty provision of the licensing agreement was sustained by the District Court and the Court of Appeals on the theory that it was a convenient mode of operation designed by the parties to avoid the necessity of determining whether each type of petitioner's product embodies any of the numerous Hazeltine patents. The Court of Appeals reasoned that since it would not be unlawful to agree to pay a fixed sum for the privilege to use patents, it was not unlawful to provide a variable consideration measured by a percentage of the licensee's sales for the same privilege.

The mere accumulation of patents, no matter how many, is not in and of itself illegal. And this record simply does not support incendiary, yet vague, charges that respondent uses its accumulation of patents "for the exaction of tribute" and collects royalties "by means of the overpowering threat of disastrous litigation." We cannot say that payment of royalties according to an agreed percentage of the licensee's sales is unreasonable. Sound business judgment could indicate that such payment represents the most convenient method of fixing the business value of the privileges granted by the licensing agreement. We are not unmindful that convenience cannot justify an extension of the monopoly of the patent.

But as we have already indicated, there is in this royalty provision no inherent extension of the monopoly of the patent. Petitioner cannot complain because it must pay royalties whether it uses Hazeltine patents or not. What it acquired by the agreement into which it entered was the privilege to use any or all of the patents and developments as it desired to use them. If it chooses to use none of them, it has nevertheless contracted to pay for the privilege of using existing patents plus any developments resulting from respondent's continuous research. We hold that in licensing the use of patents to one engaged in a related enterprise, it is not *per se* a misuse of patents to measure the consideration by a percentage of the licensee's sales.

The judgment of the Court of Appeals is Affirmed.

MR. JUSTICE DOUGLAS, with whom MR. JUSTICE BLACK concurs, dissenting.

We are, I think, inclined to forget that the power of Congress to grant patents is circumscribed by the Constitution. The patent power, of all legislative powers, is indeed the only one whose purpose is defined. Article I, § 8 describes the power as one "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." This statement of policy limits the power itself.

The Court in its long history has at times been more alive to that policy than at other times. During the last three decades it has been as devoted to it (if not more so) than at any time in its history. I think that was due in large measure to the influence of Mr. Justice Brandeis and Chief Justice Stone. They were alert to the danger that business – growing bigger and bigger each decade – would fasten its hold more tightly on the economy through the cheap spawning of patents and would use one monopoly to beget another through the leverage of key patents. They followed in the early tradition of those who read the Constitution to mean that the public interest in patents comes first, reward to the inventor second.

Mr. Justice Brandeis and Chief Justice Stone did not fashion but they made more secure one important rule designed to curb the use of patents. It is as follows: One who holds a patent on article A may not license the use of the patent on condition that B, an unpatented article, be bought. Such a contract or agreement would be an extension of the grant of the patent contrary to a long line of decisions. For it would sweep under the patent an article that is unpatented or unpatentable. Each patent owner would become his own patent office and, by reason of the leverage of the patent, obtain a larger monopoly of the market than the Constitution or statutes permit.

That is what is done here. Hazeltine licensed Automatic Radio to use 570 patents and 200 patent applications. Of these Automatic used at most 10. Automatic Radio was obligated, however, to pay as royalty a percentage of its total sales in certain lines without regard to whether or not the products sold were patented or unpatented. The inevitable result is that the patentee received royalties on unpatented products as part of the price for the use of the patents.

The patent owner has therefore used the patents to bludgeon his way into a partnership with this licensee, collecting royalties on unpatented as well as patented articles.

A plainer extension of a patent by unlawful means would be hard to imagine.

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Zenith Radio Corp. v. Hazeltine Research, Inc.

395 U.S. 100 (1969)

WHITE, JUSTICE

Petitioner Zenith Radio Corporation (Zenith) is a Delaware Corporation which for many years has been successfully engaged in the business of manufacturing radio and television sets for sale in the United States and foreign countries. A necessary incident of Zenith's operations has been the acquisition of licenses to use patented devices in the radios and televisions it manufactures, and its transactions have included licensing agreements with respondent Hazeltine Research, Inc. (HRI), an Illinois corporation which owns and licenses domestic patents, principally in the radio and television fields.

Until 1959, Zenith had obtained the right to use all HRI domestic patents under HRI's so-called standard package license. In that year, however, with the expiration of Zenith's license imminent, Zenith declined to accept HRI's offer to renew, asserting that it no longer required a license from HRI. Negotiations proceeded to a stalemate, and in November 1959, HRI brought suit in the Northern District of Illinois, claiming that Zenith television sets infringed HRI's patents on a particular automatic control system. Zenith's answer alleged invalidity of the patent asserted and noninfringement, and further alleged that HRI's claim was unenforceable because of patent misuse as well as unclean hands through conspiracy with foreign patent pools. On May 22, 1963, more than three years after its answer had been filed, Zenith filed a counterclaim against HRI for treble damages and injunctive relief, alleging violations of the Sherman Act by misuse of HRI patents, including the one in suit …

The District Court, sitting without a jury, ruled for Zenith in the infringement action … On the counterclaim, the District Court ruled, first that HRI had misused its domestic patents by attempting to coerce Zenith's acceptance of a five-year package license, and by insisting on extracting royalties from unpatented products.

With respect to Zenith's patent misuse claim, the Court of Appeals affirmed the treble-damage award against HRI, but modified in certain respects the District Court's injunction against further misuse.

We granted certiorari.

[The] only misuse issue we need consider at length is whether the Court of Appeals was correct in striking the last clause from Paragraph A of the injunction, which enjoined HRI from

> Conditioning directly or indirectly the grant of a license to defendant-counterclaimant, Zenith Radio Corporation, or any of its subsidiaries, under any domestic patent upon the taking of a license under any other patent or upon the paying of royalties on the manufacture, use or sale of apparatus not covered by such patent.

This paragraph of the injunction was directed at HRI's policy of insisting upon acceptance of its standard five-year package license agreement, covering the 500-odd patents within its domestic licensing portfolio and reserving royalties of the licensee's total radio and television sales, irrespective of whether the licensed patents were actually used in the products manufactured.

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In striking the last clause of Paragraph A the Court of Appeals, in effect, made two determinations. First, under its view of *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950), conditioning the grant of a patent license upon payment of royalties on unpatented products was not misuse of the patent. [W]e reverse the Court of Appeals. We hold that conditioning the grant of a patent license upon payment of royalties on products which do not use the teaching of the patent does amount to patent misuse.

The trial court's injunction does not purport to prevent the parties from serving their mutual convenience by basing royalties on the sale of all radios and television sets, irrespective of the use of HRI's inventions. The injunction reaches only situations where the patentee directly or indirectly "conditions" his license upon the payment of royalties on unpatented products – that is, where the patentee refuses to license on any other basis and leaves the licensee with the choice between a license so providing and no license at all. Also, the injunction takes effect only if the license is conditioned upon the payment of royalties "on" merchandise not covered by the patent – where the express provisions of the license or their necessary effect is to employ the patent monopoly to collect royalties, not for the use of the licensed invention, but for using, making, or selling an article not within the reach of the patent.

A patentee has the exclusive right to manufacture, use, and sell his invention. The heart of his legal monopoly is the right to invoke the State's power to prevent others from utilizing his discovery without his consent. The law also recognizes that he may assign to another his patent, in whole or in part, and may license others to practice his invention. But there are established limits which the patentee must not exceed in employing the leverage of his patent to control or limit the operations of the licensee. Among other restrictions upon him, he may not condition the right to use his patent on the licensee's agreement to purchase, use, or sell, or not to purchase, use, or sell, another article of commerce not within the scope of his patent monopoly. His right to set the price for a license does not extend so far, whatever privilege he has "to exact royalties as high as he can negotiate." And just as the patent's leverage may not be used to extract from the licensee a commitment to purchase, use, or sell other products according to the desires of the patentee, neither can that leverage be used to garner as royalties a percentage share of the licensee's receipts from sales of other products; in either case, the patentee seeks to extend the monopoly of his patent to derive a benefit not attributable to use of the patent's teachings.

In *Brulotte v. Thys Co.*, the patentee licensed the use of a patented machine, the license providing for the payment of a royalty for using the invention after, as well as before, the expiration date of the patent. Recognizing that the patentee could lawfully charge a royalty for practicing a patented invention prior to its expiration date and that the payment of this royalty could be postponed beyond that time, we noted that the post-expiration royalties were not for prior use but for current use, and were nothing less than an effort by the patentee to extend the term of his monopoly beyond that granted by law. *Brulotte* thus articulated in a particularized context the principle that a patentee may not use the power of his patent to levy a charge for making, using, or selling products not within the reach of the monopoly granted by the Government.

Automatic Radio is not to the contrary; it is not authority for the proposition that patentees have carte blanche authority to condition the grant of patent licenses upon the payment of royalties on unpatented articles.

The Court's opinion in *Automatic Radio* did not deal with the license negotiations which spawned the royalty formula at issue and did not indicate that HRI used its patent leverage to coerce a promise to pay royalties on radios not practicing the learning of the patent. No such inference follows from a mere license provision measuring royalties by the licensee's total sales even if, as things work out, only some or none of the merchandise employs the patented idea or process, or even if it was foreseeable that some undetermined portion would not contain the invention. It could easily be, as the Court indicated in *Automatic Radio*, that the licensee as well as the patentee would find it more convenient and efficient from several standpoints to base royalties on total sales than to face the burden of figuring royalties based on actual use. If convenience of the parties rather than patent power dictates the total-sales royalty provision, there is no misuse of the patents and no forbidden conditions attached to the license.

The Court also said in *Automatic Radio* that if the licensee bargains for the privilege of using the patent in all of his products and agrees to a lump sum or a percentage-of-total-sales royalty, he cannot escape payment on this basis by demonstrating that he is no longer using the invention disclosed by the patent. We neither disagree nor think such transactions are barred by the trial court's injunction. If the licensee negotiates for "the privilege to use any or all of the patents and developments as [he] desire[s] to use them," he cannot complain that he must pay royalties if he chooses to use none of them. He could not then charge that the patentee had refused to license except on the basis of a total-sales royalty.

But we do not read *Automatic Radio* to authorize the patentee to use the power of his patent to insist on a total-sales royalty and to override protestations of the licensee that some of his products are unsuited to the patent or that for some lines of his merchandise he has no need or desire to purchase the privileges of the patent. In such event, not only would royalties be collected on unpatented merchandise, but the obligation to pay for nonuse would clearly have its source in the leverage of the patent.

We also think patent misuse inheres in a patentee's insistence on a percentage-of-sales royalty, regardless of use, and his rejection of licensee proposals to pay only for actual use. Unquestionably, a licensee must pay if he uses the patent. Equally, however, he may insist upon paying only for use, and not on the basis of total sales, including products in which he may use a competing patent or in which no patented ideas are used at all. There is nothing in the right granted the patentee to keep others from using, selling, or manufacturing his invention which empowers him to insist on payment not only for use but also for producing products which do not employ his discoveries at all.

Of course, a licensee cannot expect to obtain a license, giving him the privilege of use and insurance against infringement suits, without at least footing the patentee's expenses in dealing with him. He cannot insist upon paying on use alone and perhaps, as things turn out, pay absolutely nothing because he finds he can produce without using the patent. If the risks of infringement are real and he would avoid them, he must anticipate some minimum charge for the license – enough to insure the patentee against loss in negotiating and administering his monopoly, even if in fact the patent is not used at all. But we discern no basis in the statutory monopoly granted the patentee for his using that monopoly to coerce an agreement to pay a percentage royalty on merchandise not employing the discovery which the claims of the patent define.

Judgment of Court of Appeals affirmed in part and reversed in part, and case remanded.

MR. JUSTICE HARLAN, dissenting in part.

I do not join Part III [of the Court's opinion], in which the Court holds that a patent license provision which measures royalties by a percentage of the licensee's total sales is

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lawful if included for the "convenience" of both parties but unlawful if "insisted upon" by the patentee.

My first difficulty with this part of the opinion is that its test for validity of such royalty provisions is likely to prove exceedingly difficult to apply and consequently is apt to engender uncertainty in this area of business dealing, where certainty in the law is particularly desirable. In practice, it often will be very hard to tell whether a license provision was included at the instance of both parties or only at the will of the licensor. District courts will have the unenviable task of deciding whether the course of negotiations establishes "insistence" upon the suspect provision. Because of the uncertainty inherent in such determinations, parties to existing and future licenses will have little assurance that their agreements will be enforced. And it may be predicted that after today's decision the licensor will be careful to embellish the negotiations with an alternative proposal, making the court's unraveling of the situation that much more difficult.

Such considerations lead me to the view that any rule which causes the validity of percentage-of-sales royalty provisions to depend upon subsequent judicial examination of the parties' negotiations will disserve rather than further the interests of all concerned. Hence, I think that the Court has fallen short in failing to address itself to the question whether employment of such royalty provisions should invariably amount to patent misuse.

[A] possible justification for the Court's result might be that a royalty based directly upon use of the patent will tend to spur the licensee to "invent around" the patent or otherwise acquire a substitute which costs less, while a percentage-of-sales royalty can have no such effect because of the licensee's knowledge that he must pay the royalty regardless of actual patent use. No hint of such a rationale appears in the Court's opinion. Moreover, under this theory a percentage-of-sales royalty would be objectionable largely because of resulting damage to the rest of the economy, through less efficient allocation of resources, rather than because of possible harm to the licensee. Hence, the theory might not admit of the Court's exception for provisions included for the "convenience" of both parties.

Because of its failure to explain the reasons for the result reached … the Court's opinion is of little assistance in answering the question which I consider to be the crux of this part of the case: whether percentage-of-sales royalty provisions should be held without exception to constitute patent misuse. A recent economic analysis argues that such provisions may have two undesirable consequences. First, as has already been noted, employment of such provisions may tend to reduce the licensee's incentive to substitute other, cheaper "inputs" for the patented item in producing an unpatented end-product. Failure of the licensee to substitute will, it is said, cause the price of the end-product to be higher and its output lower than would be the case if substitution had occurred. Second, it is suggested that under certain conditions a percentage-of-sales royalty arrangement may enable the patentee to garner for himself elements of profit, above the norm for the industry or economy, which are properly attributable not to the licensee's use of the patent but to other factors which cause the licensee's situation to differ from one of "perfect competition," and that this cannot occur when royalties are based upon use.

If accepted, this economic analysis would indicate that percentage-of-sales royalties should be entirely outlawed. However, so far as I have been able to find, there has as yet been little discussion of these matters either by lawyers or by economists. And I find scant illumination on this score in the briefs and arguments of the parties in this case. The Court has pointed out both today and in *Automatic Radio* that percentage-of-sales royalties may be administratively advantageous for both patentee and licensee. In these circumstances,

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confronted, as I believe we are, with the choice of holding such royalty provisions either valid or invalid across the board, I would, as an individual member of the Court, adhere for the present to the rule of *Automatic Radio*.

FIGURE 24.5 Decided nearly two decades apart, *Automatic Radio* and *Zenith* both involved licenses by Hazeltine, an early electronics patent aggregator and licensing entity.

Notes and Questions

1. *Total sales royalties*. How is the royalty payable to Hazeltine calculated in each of *Automatic Radio* and *Zenith*, and why does the licensee in each case contend that it constitutes patent misuse?
2. *Convenience versus compulsion*. The Court in *Zenith* distinguishes its earlier decision in *Automatic Radio* by drawing a fine line between "total sales" royalties that are established for the "convenience of the parties" (not misuse) versus those on which the licensor "insists" (misuse). In his dissent, Justice Harlan observes that "District courts will have the unenviable task of deciding whether the course of negotiations establishes 'insistence' upon the suspect provision," and that "[b]ecause of the uncertainty inherent in such determinations, parties to existing and future licenses will have little assurance that their agreements will be enforced." As a result, Justice Harlan argued that package licensing should be "either valid or invalid across the board." Do you agree with Justice Harlan's assessment, or are you comfortable with the majority's confidence in courts' ability to differentiate between these two modes of conduct? If you were representing a licensor of a large portfolio of patents, how would you advise it to approach the negotiation of its royalties with prospective licensees?
3. A *preferred payment*? Justices Douglas and Black dissented from the Court's opinion in *Automatic Radio*. Among other things, they expressed concern that Hazeltine licensed, and required Automatic Radio to pay for, 570 patents and 200 patent applications, of which Automatic Radio used "at most 10." But on what basis would they have preferred Automatic

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Radio to pay for the use of Hazeltine's patents? Should patent aggregators like Hazeltine be required to price patents on an *à la carte* basis? Is that reasonable when hundreds or, today, thousands of patents are involved in a single license?

4. *Inverse dissents? Automatic Radio* and *Zenith* are viewed, in many respects, like inverse images of one another. In addition to many other similarities, each decision drew a pointed dissent. But did the Court in *Zenith* adopt the reasoning of the dissent in *Automatic Radio*, or vice versa? Why not?
5. *Package licensing and market power*. As noted above, in 1988 Congress enacted the Patent Misuse Reform Act, which added "market power" to the elements required to find patent misuse of the tying variety (codified at 35 U.S.C. § 271(d)(5)). This market power requirement also applies to package licensing misuse (i.e., conditioning the license of any rights to a patent on the acquisition of a license to rights in another patent). Yet the enactment of § 271(d)(5) does not seem to have substantially altered the convenience vs. compulsion test established under *Automatic Radio* and *Zenith*.[18] How would § 271(d)(5) have affected the analysis in each of these cases had it been enacted at the time of the licenses in question?
6. *Package licensing and incentives*. In his dissent in *Zenith*, Justice Harlan offers up an alternative rationale supporting the majority's decision: that allowing package licenses will decrease a licensee's incentive to "invent around" the licensed patents or to employ substitute and cheaper technologies in its products, resulting in decreased innovation and higher consumer prices.[19] Why does Justice Harlan believe that this result is possible? Why didn't the majority rely on this line of reasoning in its own opinion?
7. *Patent misuse and irrationality*. Professor Mark Lemley has written:

   > [T]he patent misuse doctrine is indefensible from an economic standpoint for several reasons. First, the sanction imposed bears no relation to the injury caused. Second, the sanction duplicates antitrust remedies in many cases, leading to an excessive level of deterrence. Third, the doctrine often pays the sanction as a windfall to an unrelated third party, thereby encouraging infringement while failing to compensate those actually injured. These economic problems lead one seriously to question the continued vitality of the patent misuse doctrine as a whole.

   What are examples of each of Professor Lemley's three specific critiques of the patent misuse doctrine? Do you agree that the patent misuse doctrine should be abolished?
8. *Packaged patents and standards*. The Federal Circuit considered patent misuse in a series of cases involving the alleged infringement by compact disc manufacturer Princo of a group of pooled patents covering the CD-R and CD-RW standards. In one such case, *U.S. Philips Corp. v. ITC*, 424 F.3d 1179 (Fed. Cir. 2005), Princo asserted that Philips (the administrator of the relevant patent pools) committed patent misuse by offering to license all of the pooled patents as a single package, without the option to license individual patents separately. In other words, by tying undesired patents to desired patents. The International Trade Commission (ITC) found misuse by tying, but the Federal Circuit reversed, reasoning that package licensing does not constitute patent misuse *per se* because it potentially reduces transaction costs and creates other efficiencies, and thus does not lack any

[18] See Burchfiel, supra note 10, at 8–9.

[19] Similar arguments have been made with respect to patent pools. See Section 26.4, discussing complementarity and substitutability of patents included in pools.

redeeming value (the general standard for *per se* illegality). Likewise, the Federal Circuit reversed the ITC's finding of patent misuse under the "rule of reason" because the ITC "failed to consider the efficiencies that package licensing may produce." The court further noted that when "a patentholder has a package of patents, all of which are necessary to enable a licensee to practice particular technology, it is well established that the patentee may lawfully insist on licensing the patents as a package and may refuse to license them individually, since the group of patents could not reasonably be viewed as distinct products." That is, if all packaged patents are essential to the particular standard, then, in theory, all of the packaged patents should be considered part of the same tying product, hence offering them together cannot constitute misuse. However, if some patents not essential to the standard are included in the package, misuse may again be possible. This is among the reasons that antitrust authorities have generally recommended that patent pools include only patents that are complements (essential to a particular standard or technology), and not substitutes. See Sections 26.3 and 26.4.

9. *Packaging non-essential patents*. In *Philips*, Princo also alleged that some of the pooled patents were not actually essential to the relevant CD standards. The Federal Circuit, acknowledging this possibility, reasoned that "in a fast-developing field such as the one at issue in this case, it seems quite likely that questions will arise over time, such as what constitutes an 'essential' patent," and that *per se* liability for patent misuse should not arise due to technological changes that were not foreseeable at the time of licensing. And with respect to the analysis under the rule of reason, "evidence did not show that including those patents in the patent packages had a negative effect on commercially available technology" – in effect, Princo did not meet its burden of establishing a sufficient anticompetitive harm. As a result, the alleged nonessentiality of some of the pooled patents did not give rise to liability for patent misuse in this case, though the Federal Circuit did not rule out the prospect of such liability upon a sufficient showing of evidence. What evidence might this be?

SUMMARY: PATENT MISUSE DOCTRINE TODAY

Enforcement against non-patented components: not misuse (§ 271(d)(1)–(3) [1952])
Refusal to license: not misuse (§ 271(d)(4) [1988])
Tying: rule of reason, requires market power (§ 271(d)(5) [1988])
Package licensing: permitted for mutual convenience, so long as there is no compulsion (*Automatic Radio*, *Zenith*), requires market power (§ 271(d)(5) [1988])
Unpatented articles: no misuse (*Aronson*)
Post-term royalties: *per se* illegal (*Brulotte*, *Kimble*)

24.5 NONCOMPETITION AND COPYRIGHT MISUSE

Misuse of IP is not entirely limited to the patent world. Though far fewer in number, there have been cases involving the misuse of copyrights as well.

Lasercomb v. Reynolds

911 F.2d 970 (4th Cir. 1990)

SPROUSE, CIRCUIT JUDGE

Appellants and defendants below are Larry Holliday, president and sole shareholder of Holiday Steel Rule Die Corporation (Holiday Steel), and Job Reynolds, a computer programmer for that company. Appellee is Lasercomb America, Inc. (Lasercomb), the plaintiff below. Holiday Steel and Lasercomb were competitors in the manufacture of steel rule dies that are used to cut and score paper and cardboard for folding into boxes and cartons. Lasercomb developed a software program, Interact, which is the object of the dispute between the parties. Using this program, a designer creates a template of a cardboard cutout on a computer screen and the software directs the mechanized creation of the conforming steel rule die.

In 1983, before Lasercomb was ready to market its Interact program generally, it licensed four prerelease copies to Holiday Steel which paid $35,000 for the first copy, $17,500 each for the next two copies, and $2,000 for the fourth copy. Lasercomb informed Holiday Steel that it would charge $2,000 for each additional copy Holiday Steel cared to purchase. Apparently ambitious to create for itself an even better deal, Holiday Steel circumvented the protective devices Lasercomb had provided with the software and made three unauthorized copies of Interact which it used on its computer systems. Perhaps buoyed by its success in copying, Holiday Steel then created a software program called "PDS-1000," which was almost entirely a direct copy of Interact, and marketed it as its own CAD/CAM die-making software. These infringing activities were accomplished by Job Reynolds at the direction of Larry Holliday.

There is no question that defendants engaged in unauthorized copying, and the purposefulness of their unlawful action is manifest from their deceptive practices … When Lasercomb discovered Holiday Steel's activities, it registered its copyright in Interact and filed this action against Holiday Steel, Holliday, and Reynolds on March 7, 1986. Lasercomb claimed copyright infringement, breach of contract, misappropriation of trade secret, false designation of origin, unfair competition, and fraud. Defendants filed a number of counterclaims. On March 24, 1986, the district court entered a preliminary injunction, enjoining defendants from marketing the PDS-1000 software.

Holliday and Reynolds [do] not dispute that they copied Interact, but they contend that Lasercomb is barred from recovery for infringement by its concomitant culpability. They assert that, assuming Lasercomb had a perfected copyright, it impermissibly abused it. This assertion of the "misuse of copyright" defense is based on language in Lasercomb's standard licensing agreement, restricting licensees from creating any of their own CAD/CAM die-making software.

The offending paragraphs read:

D. Licensee agrees during the term of this Agreement that it will not permit or suffer its directors, officers and employees, directly or indirectly, to write, develop, produce or sell computer assisted die making software.

E. Licensee agrees during the term of this Agreement and for one (1) year after the termination of this Agreement, that it will not write, develop, produce or sell or assist others in the writing, developing, producing or selling computer assisted die making

> software, directly or indirectly without Lasercomb's prior written consent. Any such activity undertaken without Lasercomb's written consent shall nullify any warranties or agreements of Lasercomb set forth herein.

The "term of this Agreement" referred to in these clauses is ninety-nine years.

Defendants were not themselves bound by the standard licensing agreement. Lasercomb had sent the agreement to Holiday Steel with a request that it be signed and returned. Larry Holliday, however, decided not to sign the document, and Lasercomb apparently overlooked the fact that the document had not been returned. Although defendants were not party to the restrictions of which they complain, they proved at trial that at least one Interact licensee had entered into the standard agreement, including the anticompetitive language.

The district court rejected the copyright misuse defense for three reasons. First, it noted that defendants had not explicitly agreed to the contract clauses alleged to constitute copyright misuse. Second, it found "such a clause is reasonable in light of the delicate and sensitive area of computer software." And, third, it questioned whether such a defense exists. We consider the district court's reasoning in reverse order.

The philosophy behind copyright … is that the public benefits from the efforts of authors to introduce new ideas and knowledge into the public domain. To encourage such efforts, society grants authors exclusive rights in their works for a limited time.

Although the patent misuse defense has been generally recognized since *Morton Salt*, it has been much less certain whether an analogous copyright misuse defense exists. This uncertainty persists because no United States Supreme Court decision has firmly established a copyright misuse defense in a manner analogous to the establishment of the patent misuse defense by Morton Salt. The few courts considering the issue have split on whether the defense should be recognized, and we have discovered only one case which has actually applied copyright misuse to bar an action for infringement.

We are of the view, however, that since copyright and patent law serve parallel public interests, a "misuse" defense should apply to infringement actions brought to vindicate either right.

[And] while it is true that the attempted use of a copyright to violate antitrust law probably would give rise to a misuse of copyright defense, the converse is not necessarily true – a misuse need not be a violation of antitrust law in order to comprise an equitable defense to an infringement action. The question is not whether the copyright is being used in a manner violative of antitrust law (such as whether the licensing agreement is "reasonable"), but whether the copyright is being used in a manner violative of the public policy embodied in the grant of a copyright.

Lasercomb undoubtedly has the right to protect against copying of the Interact code. Its standard licensing agreement, however, goes much further and essentially attempts to suppress any attempt by the licensee to independently implement the idea which Interact expresses. The agreement forbids the licensee to develop or assist in developing any kind of computer-assisted die-making software. If the licensee is a business, it is to prevent all its directors, officers and employees from assisting in any manner to develop computer-assisted die-making software. Although one or another licensee might succeed in negotiating out the noncompete provisions, this does not negate the fact that Lasercomb is attempting to use its copyright in a manner adverse to the public policy embodied in copyright law, and that it has succeeded in doing so with at least one licensee.

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The language employed in the Lasercomb agreement is extremely broad. Each time Lasercomb sells its Interact program to a company and obtains that company's agreement to the noncompete language, the company is required to forego utilization of the creative abilities of all its officers, directors and employees in the area of CAD/CAM die-making software. Of yet greater concern, these creative abilities are withdrawn from the public. The period for which this anticompetitive restraint exists is ninety-nine years, which could be longer than the life of the copyright itself.

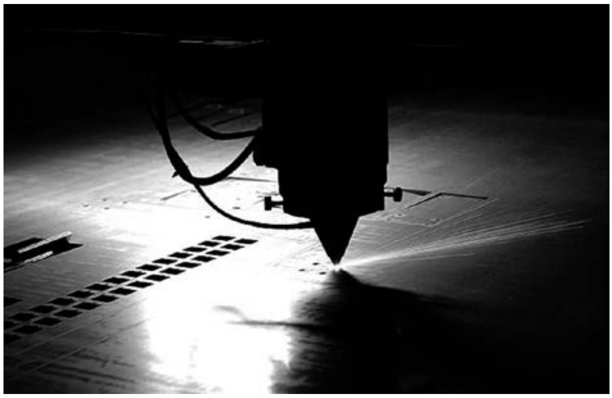

FIGURE 24.6 Lasercomb's software related to the computer-aided design of steel rule dies for cutting cardboard.

We previously have considered the effect of anticompetitive language in a licensing agreement in the context of patent misuse. *Compton v. Metal Products, Inc.*, 453 F.2d 38 (4th Cir.1971), cert. denied, 406 U.S. 968 (1972). Compton had invented and patented coal auguring equipment. He granted an exclusive license in the patents to Joy Manufacturing, and the license agreement included a provision that Compton would not "engage in any business or activity relating to the manufacture or sale of equipment of the type licensed hereunder" for as long as he was due royalties under the patents. Suit for infringement of the Compton patents was brought against Metal Products, and the district court granted injunctive relief and damages. On appeal we held that relief for the infringement was barred by the misuse defense, stating:

> The need of Joy to protect its investment does not outweigh the public's right under our system to expect competition and the benefits which flow therefrom, and the total withdrawal of Compton from the mining machine business … everywhere in the world for a period of 20 years unreasonably lessens the competition which the public has a right to expect, and constitutes misuse of the patents.

We think the anticompetitive language in Lasercomb's licensing agreement is at least as egregious as that which led us to bar the infringement action in *Compton*, and therefore amounts to misuse of its copyright. Again, the analysis necessary to a finding of misuse is similar to but separate from the analysis necessary to a finding of antitrust violation. The misuse arises from Lasercomb's attempt to use its copyright in a particular expression, the Interact software, to control competition in an area outside the copyright, i.e., the idea of computer-assisted die manufacture, regardless of whether such conduct amounts to an antitrust violation.

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In its rejection of the copyright misuse defense, the district court emphasized that Holiday Steel was not explicitly party to a licensing agreement containing the offending language. However, again analogizing to patent misuse, the defense of copyright misuse is available even if the defendants themselves have not been injured by the misuse. In *Morton Salt*, the defendant was not a party to the license requirement that only Morton-produced salt tablets be used with Morton's salt-depositing machine. Nevertheless, suit against defendant for infringement of Morton's patent was barred on public policy grounds. Similarly, in *Compton*, even though the defendant Metal Products was not a party to the license agreement that restrained competition by Compton, suit against Metal Products was barred because of the public interest in free competition.

Therefore, the fact that appellants here were not parties to one of Lasercomb's standard license agreements is inapposite to their copyright misuse defense. The question is whether Lasercomb is using its copyright in a manner contrary to public policy, which question we have answered in the affirmative.

Notes and Questions

1. *Patent versus copyright*. Why do you think that there have been comparatively few cases involving copyright misuse in comparison to the number of cases involving patent misuse? Is this difference due to a fundamental difference between copyright and patent law, or the licensing practices of copyright versus patent owners, or something else?
2. *What is copyright misuse*? In *Lasercomb*, the court finds that "the anticompetitive language in Lasercomb's licensing agreement is at least as egregious as that which led us to bar the infringement action in *Compton*, and therefore amounts to misuse of its copyright." What kind of standard of review is this? *Compton* was a patent misuse case. As discussed in Supreme Court cases since *Morton Salt*, the standard for assessing patent misuse is whether or not the licensor impermissibly attempted to expand the scope of the patent grant. Is this the standard for copyright misuse according to the Fourth Circuit? Or should copyright misuse, as suggested by the Fourth Circuit, be determined based on whether or not the offending licensing language is more or less egregious than the language in one or more patent misuse cases? How should one measure egregiousness? How would you describe a better test for copyright misuse?
3. A *need for statutory reform*? Why did the 1988 Patent Misuse Reform Act cover only patents? Is a statutory reform effort needed to address copyright misuse?
4. *Copyright misuse through suppression of speech*. In *Video Pipeline, Inc. v. Buena Vista Home Entertainment, Inc.*, 342 F.3d 191 (3d Cir. 2003), Video Pipeline created and displayed "clip previews" (short, two-minute segments) of approximately sixty-two Disney films on its website without Disney's permission. Disney accused Video Pipeline of copyright infringement and Video Pipeline responded that Disney had misused its copyright and, as a result, should not receive the protection of copyright law. Specifically, Video Pipeline pointed to the licensing agreements that Disney entered into with other websites authorizing them to display trailers of Disney films. Those agreements contained the following clause:

   > The Website in which the Trailers are used may not be derogatory to or critical of the entertainment industry or of [Disney] (and its officers, directors, agents, employees, affiliates, divisions and subsidiaries) or of any motion picture produced or distributed by [Disney] … [or]

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> of the materials from which the Trailers were taken or of any person involved with the production of the Underlying Works. Any breach of this paragraph will render this license null and void and Licensee will be liable to all parties concerned for defamation and copyright infringement, as well as breach of contract.

According to Video Pipeline, this prohibition leveraged Disney's copyright in its trailers to suppress free speech and criticism of Disney, and is thus copyright misuse. In assessing Video Pipeline's claim, the Third Circuit recognized the defense of copyright misuse, but held that Video Pipeline had not established misuse in this case. The court explained:

> Misuse often exists where the patent or copyright holder has engaged in some form of anti-competitive behavior. More on point, however, is the underlying policy rationale for the misuse doctrine set out in the Constitution's Copyright and Patent Clause: "to promote the Progress of Science and useful Arts." The "ultimate aim" of copyright law is "to stimulate artistic creativity for the general public good." Put simply, our Constitution emphasizes the purpose and value of copyrights and patents. Harm caused by their misuse undermines their usefulness.
>
> Anti-competitive licensing agreements may conflict with the purpose behind a copyright's protection by depriving the public of the would-be competitor's creativity. The fair use doctrine and the refusal to copyright facts and ideas also address applications of copyright protection that would otherwise conflict with a copyright's constitutional goal. But it is possible that a copyright holder could leverage its copyright to restrain the creative expression of another without engaging in anti-competitive behavior or implicating the fair use and idea/expression doctrines.
>
> The licensing agreements in this case do seek to restrict expression by licensing the Disney trailers for use on the internet only so long as the web sites on which the trailers will appear do not derogate Disney, the entertainment industry, etc. But we nonetheless cannot conclude on this record that the agreements are likely to interfere with creative expression to such a degree that they affect in any significant way the policy interest in increasing the public store of creative activity. The licensing agreements do not, for instance, interfere with the licensee's opportunity to express such criticism on other web sites or elsewhere. There is no evidence that the public will find it any more difficult to obtain criticism of Disney and its interests, or even that the public is considerably less likely to come across this criticism, if it is not displayed on the same site as the trailers. Moreover, if a critic wishes to comment on Disney's works, the fair use doctrine may be implicated regardless of the existence of the licensing agreements. Finally, copyright law, and the misuse doctrine in particular, should not be interpreted to require Disney, if it licenses its trailers for display on any web sites but its own, to do so willy-nilly regardless of the content displayed with its copyrighted works.

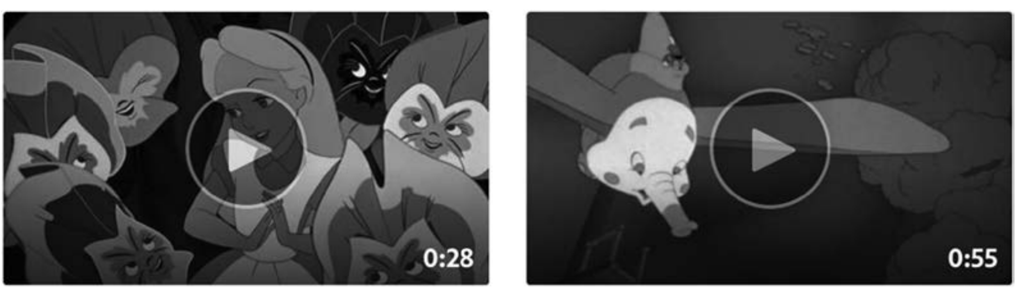

FIGURE 24.7 Video Pipeline allegedly displayed short clips of more than sixty Disney films on its website without authorization.

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Indeed such an application of the misuse doctrine would likely decrease the public's access to Disney's works because it might as a result refuse to license at all online display of its works.

Thus, while we extend the patent misuse doctrine to copyright, and recognize that it might operate beyond its traditional anti-competition context, we hold it inapplicable here. On this record Disney's licensing agreements do not interfere significantly with copyright policy (while holding to the contrary might, in fact, do so).

How convincing is Video Pipeline's case for copyright misuse? Is the Third Circuit's test for copyright misuse in *Video Pipeline* any clearer than the Fourth Circuit's test in *Lasercomb*? Under what fact patterns might a claim for copyright misuse be established based on suppression of speech?