PATENT LICENSING REFORM ACT OF 1988

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES, AND THE ADMINISTRATION OF JUSTICE

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

H.R. 4086

PATENT LICENSING REFORM ACT OF 1988

MAY 11, 1988

Serial No. 103

F/w H.R. 4972

F/w P

Printed for the use of the Committee on the Judiciary

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PATENT LICENSING REFORM ACT OF 1988

WEDNESDAY, MAY 11, 1988

HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES, AND THE ADMINISTRATION OF JUSTICE,
COMMITTEE ON THE JUDICIARY,
Washington, DC

The subcommittee met, pursuant to notice, at 2 p m , in room 2226, Rayburn House Office Building, the Honorable Robert W Kastenmeier (chairman of the subcommittee) presiding

Members present Representatives Kastenmeier, Cardin, Moorhead, DeWine, and Coble

Staff present David W Beier, counsel, Thomas E Mooney, associate counsel, and Veronica L Eligan, clerk

Mr KASTENMEIER The committee will come to order

This afternoon the subcommittee will be conducting the first of a series of hearings on patent misuse, especially on H R 4086 and earlier Senate legislation

[A copy of H R 4086 follows]

I

100TH CONGRESS
2D SESSION

H. R. 4086

To amend title 35, United States Code, to set forth the basis for determining whether a person has engaged in conduct constituting misuse or illegal extension of a patent, and for other purposes

---

IN THE HOUSE OF REPRESENTATIVES

MARCH 3, 1988

Mr KASTENMEIER introduced the following bill, which was referred to the Committee on the Judiciary

---

A BILL

To amend title 35, United States Code, to set forth the basis for determining whether a person has engaged in conduct constituting misuse or illegal extension of a patent, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1 SHORT TITLE

This Act may be cited as the "Patent Licensing Reform Act of 1988"

SEC 2 DETERMINATION OF PATENT MISUSE OR ILLEGAL EXTENSION OF A PATENT

Section 271 of title 35, United States Code, is amended by striking out subsection (d) and inserting in lieu thereof the following

"(d)(1) Any patent owner who engages in conduct constituting misuse or illegal extension of the patent shall be denied relief under this title for infringement of the patent until such misuse or illegal extension terminates and the consequences of such misuse or illegal extension have dissipated

"(2) For purposes of this title, the term 'misuse or illegal extension' of a patent means, except as provided in paragraph (3), includes—

"(A) tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have market power,

"(B) unreasonably imposing as a condition of granting a license for a patent that the licensee may not produce or sell competing goods,

"(C) unreasonably imposing as a condition of granting a license under one patent that the licensee accept another license under a different patent,

"(D) unreasonably entering into a royalty agreement that provides for payments beyond the expiration

of the term of a patent, except when the parties have mutually agreed to such payments after the issuance of the patent,

"(E) unreasonably entering into an agreement to fix prices or engage in resale price maintenance with respect to a patented product or process, and

"(F) unreasonably granting a patent license which requires the licensee to grant back to the licensor patent rights which the licensee may develop or acquire, except to the extent that the requirement is to grant back a nonexclusive license with respect to improvements in the licensed product or process when alternatives exist to produce the product or process

"(3) For purposes of this title, a patent owner shall not be considered to have engaged in conduct constituting misuse or illegal extension of the patent because that patent owner—

"(A) derives revenue from acts which, if performed by another person without the consent of the patent owner, would constitute contributory infringement of the patent,

"(B) licenses or authorizes another person to perform acts which, if performed without the consent of the patent owner, would constitute contributory infringement of the patent,

"(C) seeks to enforce his or her patent rights against infringement or contributory infringement,

"(D) refuses to license or use any rights to the patent,

"(E) imposes an obligation on a licensee of the patent to pay royalties that—

"(i) differ from those payable to the licensor by others,

"(ii) are allegedly excessive, or

"(iii) are in amounts not related to the licensee's sale of the patented product or a product made by the patented process, or

"(F) grants licenses which impose territorial or field of use restrictions on the patented product or process."

SEC 3 FRAUD OR OTHER INEQUITABLE CONDUCT

(a) INVALIDATION OF PATENT.—Section 271 of title 35, United States Code, is amended by adding at the end thereof the following

"(g)(1) Notwithstanding the preceding provisions of this section, it shall be an affirmative defense in an action for infringement of a patent under this title that a person engaged in fraud or other inequitable conduct in procuring or enforcing the patent

"(2) For purposes of paragraph (1), 'fraud or other inequitable conduct' in procuring a patent includes the inten-

tional or grossly negligent failure of an individual to disclose to the Patent and Trademark Office information—

"(A) of which the individual has actual knowledge,

"(B) which that individual has a duty to disclose to the Patent and Trademark Office with respect to the patent claim, and

"(C) which the individual knows or should have known would render the claim unpatentable

"(3) The Commissioner of the Patent and Trademark Office shall, for purposes of paragraph (1), define by regulation who has a duty of disclosure and other matters necessary to avoid fraud as described in paragraph (1) "

(b) CONFORMING AMENDMENTS —(1) The section caption for section 271 of title 35, United States Code, is amended to read as follows

"§ 271 Infringement of patent, patent misuse, fraud"

(2) The item relating to section 271 in the table of sections for chapter 28 of title 35, United States Code, is amended to read as follows

"271 Infringement of patent, patent misuse, fraud "

SEC 4 EFFECTIVE DATE

The amendments made by this Act apply to cases filed on or after the date of the enactment of this Act

O

Mr KASTENMEIER The subjects addressed in H R 4086—patent misuse and fraud in obtaining or enforcing a patent—are extremely complex areas of law The basic thrust of the bill is to restate in statutory language much of the judicially developed doctrine of patent misuse

There are at least two possible arguments in favor of legislation relating to misuse The best argument is that innovations are not reaching the consuming public because of a fear on the part of patent owners that if they engage in patent licensing, then they risk the chance of not being able to enforce the patent because of a finding of misuse

The proponents of this view will attempt to substantiate this view despite the obviously widespread licensing of patents which occurs today

Another argument offered in support for changes in the law of patent misuse is derived from doctrinal consistency Proponents of change have frequently relied on the Chicago school of economics theories of Judge Posner Supporters of this view argue that patent misuse doctrine grew up in response to allegedly anti-competitive behavior and that an antitrust standard is the only appropriate criteria to use in judging such effects Whether this view represents sound public policy will clearly be the focus of the hearings

H R 4086 continues the policy of considering the property rights granted by the issuance of a patent different from those which attach to other forms of property The bill also ratifies the proposition that the enforcement of patents is a matter of great moment to the public We will also examine whether this approach to patent enforcement has continued vitality

On the other hand, under the Senate passed bill, S 1200, proof of an antitrust violation must occur before a misuse defense can be established

An examination of this approach raises other questions For example

(1) Whether all forms of misuse are covered by the antitrust laws?

(2) And will reference to antitrust laws make it impossible to sustain a misuse defense?

It is my hope that this hearing will stimulate debate on this topic Because the existing doctrine of patent misuse has been developed by the courts sitting in equity, it is important for the Congress to completely understand the practices that are being approved or disapproved when the concept of misuse is statutorily codified or modified

Some of our witnesses will suggest that H R 4086 is too complex Others will argue that the better way to go on this question is to tie patent misuse to findings of an antitrust violation There is some merit to each of these views

From the perspective of the legislative process, it is my hope that this hearing will stimulate debate about the nature of patent protection, the attributes of patent protection, and whether the misuse doctrine is, or should be, exclusively a matter of anti-competitive concern

[The statement of Mr Kastenmeier follows]

OPENING STATEMENT

OF

THE HONORABLE ROBERT W KASTENMEIER

MAY 11, 1988

This morning the Subcommittee will be conducting the first of a series of hearings on Patent misuse, especially on H R 4086 and earlier Senate passed legislation

The subjects addressed in H R 4086 -- patent misuse and fraud in obtaining or enforcing a patent -- are extremely complex areas of law. The basic thrust of the bill is to restate in statutory language much of the judicially developed doctrine of patent misuse.

There are at least two possible arguments in favor of legislation relating to misuse The best argument is that innovations are not reaching the consuming public because of a fear on the part of patent owners that if they engage in patent licensing then they risk the chance of not being able to enforce the patent because of a finding of misuse The proponents of this view will attempt to substantiate this view despite the obviously widespread licensing of patents which occurs today

The other argument offered in support for changes in the law of patent misuse is derived from doctrinal consistency Proponents of change have frequently relied on the "Chicago school of economics" theories of Judge Posner Supporters of this view argue that patent misuse doctrine grew up to response to allegedly anti-competitive behavior and that an antitrust standard is the only appropriate criteria to use in judging such

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H R 4086 continues the policy of considering the property rights granted by the issuance of a patent different from those which attach to other forms of property The bill also ratifies the proposition that the enforcement of patents is a matter of "great moment to the public " We will also examine whether this approach to patent enforcement has continued vitality

On the other hand under the Senate passed bill, S 1200, proof of an antitrust violation must occur before a misuse defense can be established

An examination of this approach raises other questions, for example

(1) whether all forms of "misuse" are covered by the anti-trust laws, and

(2) will reference to antitrust laws make it impossible to sustain a misuse defense?

It is my hope that this hearing will stimulate debate on this topic Because the existing doctrine of patent misuse has been developed by the courts sitting in equity, it is important for the Congress to completely understand the practices that are being approved or disapproved when the concept of misuse is statutorily codified or modified Some of our witnesses will suggest that H R 4086 is too complex Others will argue that the better way to go on this question is to tie patent misuse to findings of an antitrust violation There is some merit to each of these views From the perspective of the legislative process, it is my hope that this hearing will stimulate debate about the

nature of patent protection, the attributes of patent protection, and whether the misuse doctrine is -- or should be -- exclusively a matter of anti-competitive concern

Mr KASTENMEIER I would like now to go to our very distinguished witnesses today We are pleased to have two representatives of the Executive Branch of the Administration The Assistant Attorney General, Mr Rule, on behalf of the Department of Justice, and the Assistant Commissioner, Rene Tegtmeyer, appearing on behalf of the Patent and Trademark Office of the Department of Commerce

Gentlemen, we are delighted to have you both here We have a copy of your written statements They will be, without objection, made part of the permanent record and you may proceed as you wish, as you see fit

Would the Department of Justice care to go first?

Mr RULE That is fine

TESTIMONY OF CHARLES F RULE, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U S DEPARTMENT OF JUSTICE, AND RENE D TEGTMEYER, ASSISTANT COMMISSIONER FOR PATENTS, PATENT AND TRADEMARK OFFICE, U S DEPARTMENT OF COMMERCE

Mr RULE Thank you, Mr Chairman, and members of the subcommittee It is a pleasure to be here this afternoon to testify on patent misuse legislation in general and specifically on H R 4086 and S 1200, which would codify and clarify the judicially created doctrine of patent misuse While the Administration prefers the approach in H R 1155, which reflects language first proposed by the Administration two Congresses ago, or S 1200, we congratulate this subcommittee on moving forward to clarify the law

I think I can summarize my views rather quickly this afternoon Let me emphasize at the outset the importance the patent system plays as one of the primary engines for technological change in our economy I think, properly viewed, patents should be considered to be pro-competitive, not anti-competitive, and the importance of patent licensing to insuring that patent owners reap the full reward from their efforts and that society enjoys efficient and widespread use of the patented technologies also should be recognized as one goes through consideration of these various pieces of legislation

Our view is, and has been for several years now, that it is important to scrutinize legal obstacles on patent licensing, and where those legal obstacles are unwarranted or unjustified, they should be modified or perhaps eliminated

In the area of antitrust enforcement and interpretation in the courts, in this Administration we have tried to articulate a sound and economically sensible approach to analyzing licensing restrictions under the antitrust laws We have, for example, renounced the so-called "nine no-nos," announced over 10 years ago, and instead, indicated that we would approach patent licensing restrictions on a rule of reason basis, condemning only those that on balance are anti-competitive

Initially, of course, the Administration has proposed legislation introduced in this Congress as part of H R 1155 (that is almost identical to H R 557), which would prohibit condemnation of licensing practices under the antitrust laws on a per se basis and would

detreble damages in violations involving patent licensing under the antitrust laws

Perhaps a more significant deterrent to pro-competitive licensing is the misuse doctrine It is purely judicially created, as you mentioned, Mr Chairman, at the outset, and its contours are somewhat unclear

For example, there is some dispute because there are some cases—albeit old cases—that say excessive royalties may constitute misuse, although I think it is generally viewed that courts would not condemn excessive royalties as a misuse Nevertheless, the doctrine is not always clear

Some misuse rules are even more restrictive, moreover, than their antitrust counterparts Rather than the rule of reason which generally, almost without exception, applies in the antitrust realm, there are a number of per se rules of automatic misuse under current law that undoubtedly catch within their scope some pro-competitive practices

Lastly, the penalty for misuse, the inability to enforce one's own patent, may, when improperly applied, be far more devastating than even treble damages under the antitrust laws Thus, we believe that legislation is needed to contain the discretion of judges to label licensing practices as misuse

S 1200 simply makes clear that the touchstone of misuse is the licensing practices' effect on competition This really returns the misuse doctrine to its origins Misuse as originally articulated by the courts was based on the concepts of competition contained in the antitrust laws We believe that is the right standard to use

We also believe that S 1200 would give judicial flexibility to apply that standard—those antitrust principles—in any context, and to any practice, even to those that are utterly without precedent and that we can't foresee today

H R 1155 largely does the same thing as S 1200, although it provides five examples of licensing practices that might be challenged as misuse, and then contains a sixth catch-all provision But all the practices would be subject to an antitrust analysis

H R 4086 takes a somewhat different approach It provides two lists of practices—one group of practices would be misuse Generally, though, they would constitute misuse only if unreasonable

There is a second list of practices that would never be misuse In our view, while this legislation would be a substantial improvement over current law, there are two possible problems

First, by failing to refer to antitrust or competition related principles, the bill may not provide the clarity of S 1200 or H R 1155, which draw on known antitrust principles

Second, by creating some indication of per se non-misuse practices, there is at least a risk that some anti-competitive manifesta*tions of the practice listed may escape misuse condemnation* I think this concern is minor, because there would still be the antitrust laws to condemn such practices

Despite these two possible problems, however, Mr Chairman, we certainly believe that H R 4086 moves in the right direction, and we are willing and indeed anxious to work toward a bill acceptable to the supporters of both S 1200 and H R 4086

Once again, congratulations on this hearing and the progress it represents I, of course, will be happy to answer any questions the subcommittee might have

[The statement of Mr Rule follows]

Department of Justice

STATEMENT OF

CHARLES F RULE
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON COURTS CIVIL LIBERTIES
AND THE ADMINISTRATION OF JUSTICE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

CONCERNING

H R 4086 AND S 1200 (TITLE II)
PATENT MISUSE LEGISLATION

ON

MAY 11 1988

Mr Chairman and Members of the Subcommittee

I appreciate the opportunity to appear before the Subcommittee today to present the views of the Department of Justice on H R 4086 and the patent misuse title of S 1200 These bills and related bills before Congress focus on the legal treatment of technology licensing and seek to encourage the development of new technologies by ensuring that procompetitive licensing of technologies is not unreasonably discouraged Legislation in this area is very important and could substantially benefit our economy

In recent years there has been an increased awareness of the importance to our economy of innovation and the development of new technologies New technologies help address some of the most important economic issues of our day--productivity, inflation, unemployment and our international balance of trade Advances in technology bring dramatic increases in productivity that permit products to be made at a fraction of their old cost With lower costs comes also a tempering of inflation Even during the 1970s, high technology industries such as electronics bucked the trend of runaway inflation by providing equivalent products at ever-decreasing costs With respect to unemployment, new technology has resulted in the creation and growth of new industries that were not previously

envisioned For example, millions of people are currently employed in computer-related fields that were not even in existence 20 years ago With respect to our balance of trade, which is of such significant concern today, the development of new technologies can have a dramatic effect in improving the ability of U S firms to compete in foreign markets

The ability of our industries consistently to produce major innovations is a major advantage that the U S has in the international marketplace The combination of a tremendously creative citizenry with a free-market economic system that encourages those citizens to devote their resources to innovation has produced an economy with an unsurpassed ability to discover and develop new technologies

Incentives for innovation are directly related to the ability of innovators to obtain an adequate return on their investment During the past 7 years this Administration and the Congress have been very active in crafting new legislation to increase the level of intellectual property protection available to innovators By making such protection available, we encourage increased investment in R&D and hence increased innovation

In our free-market, profit-oriented economy, the amount a firm will invest in developing new technologies typically will depend upon the perceived financial rewards from its investment--the higher the perceived rewards, the greater the R&D investment The anticipated rewards from any particular R&D investment can diminish significantly, however, if once the new technology is brought into the marketplace, others are free to use it in competition with the creator If potential creators of new technologies expect substantial diversion of profits due to uncompensated use of the technology by others, the expected economic reward of R&D investments will be lessened, the incentive to make such investments will be reduced, fewer technological breakthroughs by American firms will occur, American competitiveness will suffer, and consumers will face fewer choices and higher prices Intellectual property protection addresses this problem by restricting the unauthorized use of a new technology developed by others It thereby promotes innovation and results in consumers and firms having access to inventions and technologies that otherwise might not have been discovered

The modification of the scope of intellectual property protection that has occurred in recent years has not eliminated all existing counterproductive disincentives to invest in innovation, however In addition to assuring that the scope of

available intellectual property protection is adequate to promote innovation, it also is crucial that the law encourage the efficient use of that intellectual property This is an area that is ripe for legislative improvement, and the Department regards title II of S 1200, H R 4086, and other related pending bills as a welcome sign that Congress shares the Administration's interest in accomplishing it

One of the key methods of encouraging the efficient use of intellectual property is through licensing arrangements Because the possessor of exclusive rights in intellectual property has no obligation to share his property, any licensing increases the number of people with access to the property Moreover, licensing has the potential for significant procompetitive benefits The creator of a new technology often will not be in the best position to commercialize the technology to the maximum extent desirable in all possible fields For example, others may have superior manufacturing or distribution capabilities This is particularly likely to occur in instances where the creator of the new technology is a small firm or an individual

Licensing permits the owner of the technology in effect to convey part of his proprietary right in the technology for fair value, thus combining his assets with the manufacturing or

distribution assets of others and encouraging the development and utilization of the technology in the most efficient way possible When licensing leads to more efficient use of technology, it improves the competitiveness of American firms and benefits consumers By permitting the owner of a patent or other intellectual property to realize efficiencies, licensing increases the perceived value of the patent and thereby increases the incentive to invest in the procompetitive development of new technologies

Because of the importance of intellectual property licensing to competition and competitiveness, it is crucial that our laws not unnecessarily discourage such licensing Both the introduction of H R 4086 by Chairman Kastenmeier and today's hearings reflect this Subcommittee's interest in assuring that licensing arrangements receive proper treatment under the patent misuse doctrine And in the Senate, the Judiciary Committee has reported, as title II of S 1200, legislation supported by the Administration aimed at clarifying and reforming the misuse doctrine's treatment of licensing practices 1/ As I will describe more fully in a moment, that provision appears to accomplish the same result as the

---

1/ The Senate adopted title II of S 1200 as an amendment to H R 3 The provision did not emerge from Conference

Administration's own proposal, which is part of title III of H R 1155, introduced by Minority Leader Michel with 25 co-sponsors, and S 539, introduced by Minority Leader Dole with Senators Simpson and Cochran as co-sponsors

In addition to assuring that the procompetitive licensing of technology is not deterred by its possible mistreatment under the misuse doctrine, we must also assure that such licensing is not deterred by its possible mistreatment under the antitrust laws Bills with broad bipartisan sponsorship--H R 557, introduced by Congressman Fish, with Congressmen Frank, Moorhead, Synar, Lungren, Hyde and Dannemeyer as co-sponsors, and S 438, introduced by Chairman Leahy, with Senators Hatch, Thurmond and Humphrey as co-sponsors--would improve legal treatment of intellectual property licensing by assuring that licensing arrangements receive full and proper consideration under the antitrust laws The Administration has submitted a very similar proposal (as part of title III of H R 1155) While I will not discuss these bills today, I do want to stress their importance and close relation to the goals of the bills that the Subcommittee is considering today

Licensing and Misuse

The Department believes it is important to clarify and reform the doctrine of patent misuse so as to ensure that that

body of law does not deter procompetitive licensing arrangements

Misuse is a judicially created doctrine founded in the courts' equitable powers and is used as a defense to patent infringement to attack patent licensing practices that are alleged to be undesirable from a public policy standpoint

The claim of misuse by one who has used or would like to use another's patent rights without adequate compensation is a powerful weapon The sanction for misuse is harsh, the patent is unenforceable against anyone, not just a party allegedly injured by such misuse, until the misuse has been eliminated and its effects purged from the marketplace Therefore, patent owners can be expected to avoid entering into patent licensing arrangements that they fear may be deemed to constitute patent misuse should they be required to defend their patent rights in infringement actions In order to reassure creators of new technology that the courts will not interfere with procompetitive patent licensing, we must assure that the misuse doctrine is not applied in a manner that condemns c _etitively desirable licensing

Unfortunately, patent misuse has been applied as a <u>per se</u> doctrine prohibiting conduct that careful analysis demonstrates

is not necessarily anticompetitive and, in fact, often is procompetitive 2/ Indeed, the U S Court of Appeals for the Federal Circuit, which has jurisdiction over a variety of intellectual property matters, has questioned the rationale appearing in Supreme Court opinions dealing with misuse, 3/ but has regarded itself as "bound to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or the Supreme Court " 4/

Congress should provide that direction, and make clear that licensing conduct is to be condemned as misuse on competitive grounds only when sound antitrust analysis demonstrates the conduct to be anticompetitive Specifically, since the

---

2/ Two basic lines of patent misuse cases have developed involving licensing conduct perceived to be anticompetitive The primary line involves alleged efforts to use the patent to control commerce outside the scope of the patent claims The secondary line of misuse cases involves decisions of the patent owner as to whether or not to license a particular party and, if so, at what royalty A more detailed discussion of the development of the misuse doctrine and analysis of the case law is contained in a speech by former Deputy Assistant Attorney General Roger B Andewelt before the Patent, Trademark and Copyright Section of the Bar Association for the District of Columbia, "Competition Policy and the Patent Misuse Doctrine" (Nov 3, 1982)

3/ See Windsurfing Int'l, Inc v AMF, Inc , 782 F 2d 995, 1001-02 n 9 (Fed Cir), cert. denied, 106 S Ct 3275 (1986)

4/ Senza-Gel Corp v Seiffhart, 803 F 2d 661, 665 n 5 (Fed Cir 1986)

antitrust laws are the appropriate vehicle for separating conduct having anticompetitive effect from conduct that is not harmful to competition, allegedly anticompetitive licensing practices should not be condemned as patent misuse unless those practices are unlawful under an antitrust analysis 5/ Patent licensing practices such as requiring a licensee to buy unpatented materials from the licensor, grantbacks, and package licensing are not necessarily anticompetitive, and antitrust analysis should be used to determine whether any particular instance of such a practice is anticompetitive

It was in order to clarify and reform the doctrine of patent misuse in that manner so as to ensure that it does not deter procompetitive licensing arrangements that the Administration developed its proposal, section 3105 of H R 1155 Section 3105 effectively provides that licensing arrangements will not be condemned on grounds related to

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5/ Courts also have refused to enforce a valid patent where the patentee engaged in inequitable conduct before the Patent Office Such refusals, however, are based on an independent public policy, it is felt that unless patent applicants are held to a high level of ethical conduct, the ex parte patent examination process will be unacceptably unreliable Regardless of the rationale, it is essential that whenever courts decline to enforce a valid patent, there be a clear and definite public need to do so Any other course of action will tend to devalue the patent and interfere with the incentive structure envisioned in the patent laws, to the ultimate detriment of consumers and American competitiveness

competition unless an evaluation of the competitive effects of the conduct demonstrates a violation of the antitrust laws Section 3105 lists several patent licensing practices that cannot be the basis for a finding of misuse unless such practices, in the circumstances in which they are employed, violate the antitrust laws The first five practices listed are categories of conduct that have, at least in some instances, been hastily condemned under the misuse doctrine All are potentially procompetitive, and in many or most circumstances can foster the procompetitive benefits of licensing In addition to these specific categories of practices, section 3105 also lists "otherwise [using] the patent allegedly to suppress competition" among the conduct to be evaluated under the antitrust laws Under section 3105, courts still would have the discretion to refuse to enforce a valid, infringed patent on competitive grounds whenever the challenged conduct violates the antitrust laws Judicial analysis of claims not related to competition would not be affected by the Administration's proposal--those claims would not require antitrust analysis

Title II of S 1200 has the same purpose and accomplishes the same result as the Administration's proposal by using a more generalized approach instead of listing types of practices Essentially, S 1200 provides that licensing

practices (including actions or inactions relating to the patent) shall not constitute misuse unless such practices, in view of the circumstances in which they are employed, violate the antitrust laws 6/ Because title II of S 1200 would make clear that licensing conduct may not be condemned as misuse on grounds related to competition unless analysis under antitrust standards demonstrates such conduct to be anticompetitive, the Department stated in a June 4, 1987, letter to Senator DeConcini that we would enthusiastically support the more generalized approach embodied in that title if Congress opted for it instead of the Administration's more detailed proposal We continue to adhere to that position

H R 4086 takes an analytically different approach to misuse challenges, but may nonetheless produce results in individual cases very similar to those of H R 1155 and S 1200 7/ H R 4086 creates two lists of practices The

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6/ The Senate Judiciary Committee's report on S 1200 makes clear that the judicial doctrine involving conduct alleged to constitute fraud on or inequitable conduct before the Patent Office remains unaffected by title II S Rep No 83, 100th Cong , 1st Sess 62 (1987)

7/ We are limiting our analysis to section 2 of H R 4086 Section 3 codifies that "fraud or other inequitable conduct" in procuring or enforcing a patent is a defense to infringement, defines that term, and authorizes the Commissioner of the Patent and Trademark Office to issue regulations concerning it The Administration's proposal and title II of S 1200 do not address this issue

first is a list of licensing practices that would constitute misuse The second is a list of practices that are not to be regarded as misuse

In listing practices constituting misuse, H R 4086 allows courts to evaluate a particular licensing practice in light of the facts of a particular case In most instances, H R 4086 provides this flexibility by including the word "unreasonably" in the description of the practice 8/ The bill does not define "unreasonably" or explicitly indicate the basis upon which courts are to determine whether a licensing practice is unreasonable in the circumstances While the term "unreasonably" could be so vague as to leave courts with unfettered discretion, the term does have meaning and bounds under the antitrust laws Courts using the antitrust rule of reason are routinely called upon to determine whether a particular agreement "unreasonably" restrains trade, and those courts can rely on precedent limiting the focus of that inquiry

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8/ In the case of tie-ins, instead of the "unreasonably" limitation, H R 4086 provides that the tie-in shall not fit within the bill's list of misuse practices where the patent owner does not have market power Chairman Kastenmeier, in introducing the bill, recognized that "the mere ownership of a patent does not by itself confer market power" and stated that under the bill, there would be no presumption of market power based on ownership of a patent 134 Cong Rec H698 (daily ed March 3, 1988)

to effects on competition and consumer welfare See, e.g., National Society of Professional Engineers v. United States, 435 U S 679 (1978) If the term "unreasonably" is intended to require courts to undertake an antitrust analysis to determine whether a licensing practice constitutes misuse, then that licensing practice is treated as it would be under both H R 1155 and S 1200

The practices contained in the second list in H R 4086 are not to be considered misuse, regardless of the circumstances in which they are employed These practices, which include territorial and field-of-use restrictions in patent licenses, would be afforded a safe harbor under the misuse doctrine by the bill--they would be "per se" not misuse under Title 35 Under H R 1155 and S 1200, those licensing practices would not come within any automatic safe harbor under the misuse doctrine--they would, however, like all other licensing practices, constitute misuse only if analysis under antitrust standards demonstrated the particular conduct to be anticompetitive in the circumstances in which it is employed While it may be the case that the licensing practices on this second list in H R 4086 would very seldom violate the antitrust laws, H R 1155 and S 1200 would preserve the courts' ability to find misuse in those few instances where antitrust analysis indicated the particular practice was

anticompetitive We note, however, that since H R 4086 does not affect the antitrust laws, conduct appearing on its second list, while immune from challenge as misuse, could still be subject to antitrust challenge Thus, the consequences of letting an occasional anticompetitive practice escape the misuse doctrine under H R 4086 may not be significant

As I have described, H R 4086 is analytically quite different from the misuse provisions of H R 1155 and S 1200 It does not explicitly reference antitrust analysis and creates, in effect, a safe harbor under the misuse doctrine for certain enumerated practices Nonetheless, the net effect, in terms of whether a particular practice would be found to constitute misuse, could be quite similar to H R 1155 and S 1200

While the results may be similar, the Department continues to prefer the analytical approach reflected in H R 1155 and S 1200--that misuse should not be found on grounds related to competition unless the challenged conduct violates the antitrust laws We reiterate our view that since the antitrust laws are the appropriate vehicle for distinguishing anticompetitive conduct from conduct that is not harmful to competition, allegedly anticompetitive conduct should not be condemned under the misuse doctrine unless that conduct is

deemed anticompetitive based on antitrust analysis Otherwise we risk deterring licensing that benefits consumers As our support for both the Administration's own proposal and title II of S 1200 demonstrates, we believe there is more than one effective way to draft the legislation needed We would be happy to work with the the Subcommittee on this important endeavor

Conclusion

A healthy R&D environment is crucial to the continued success of our economy An important step in nurturing a healthy R&D environment is enacting new statutes that encourage procompetitive licensing of intellectual property We encourage prompt attention to the pending legislation

Mr KASTENMEIER Thank you very much for that brief but cogent review of the several bills, and also review of how the misuse doctrine developed

We do have a vote on How long is your statement, Mr Tegtmeyer?

Mr TEGTMEYER Approximately five minutes

Mr KASTENMEIER We have two members here Why don't you start? If we need to go—and perhaps we will shortly—you can complete your statement when we return

Mr TEGTMEYER Thank you, Mr Chairman

We appreciate the opportunity also to present our views to your committee on the issues in H R 4086 and S 1200 As the Assistant Attorney General also did, I would like to make reference to H R 1155 We also feel that patent licensing is an important element of the intellectual property system which encourages the development of new technology and, accordingly, increases the ability of the United States to compete in world markets

Unfortunately, courts have sometimes condemned licensing practices as economically contrary to "public policy" even where that conduct is not anti-competitive, because they have not undertaken the analysis necessary to determine whether such conduct is in fact anti-competitive under the antitrust laws

In fact, the Supreme Court in *Zenith Radio* v *Hazeltine* observed that a finding of patent misuse does not necessarily mean a violation of the antitrust laws Consequently, some existing patent misuse precedent, such as a *per se* condemnation of royalty payments beyond the life of a patent is an unsound basis for rendering a patent unenforceable, in our view

Such cases clearly point to the need for rigorous economic analysis under the antitrust laws rather than under a patent misuse doctrine in patent licensing cases We believe the appropriate standard is whether a questioned practice violates the antitrust laws with the application of a rule of reason, taking into account all the circumstances, including the existence of a patent right

Such a standard is mandated by S 1200 and H R 1155 Both bills would require a finding of an antitrust violation, with the requisite economic analysis, for a holding of misuse Section 3105 of H R 1155—the Administration proposal—in limiting the patent misuse doctrine, refers to the specific practices that place in doubt a patent owner's entitlement to relief for infringement and includes a catchall for other practices left to assessment under the antitrust laws

While S 1200 does not list specific practices, but applies to all licensing practices or actions or inactions related to the patent, this bill sets the same standard as that proposed by the Administration, and we would therefore also support the enactment of S 1200

Mr Rule has pointed out the different approach taken by H R 4086, and I will later discuss briefly section 3 of H R 4086, which would establish a standard for fraud or inequitable conduct

With regard to the activities defined as misuse, we strongly prefer the approach of H R 1155, especially section 3105 of that bill, which would clarify that the antitrust rule of reason should apply to intellectual property licensing agreements, or the similar approach of S 1200

Defining misuse in terms of proscribed practices appears to require the patent owner to justify a negotiated arrangement if it includes one or more of the listed practices In addition, some of the activities included in the definition of misuse may be acceptable in broader circumstances than those that are listed

The term "unreasonably" may not give the courts adequate guidance, since they have rarely given weight to the economic considerations in patent misuse cases, and that term leaves open the question of whether the test of unreasonableness would be looked at in a misuse context or, on the other hand, in an antitrust law violation context

Rather than defining specific arrangements as misuse, we think it is preferable to focus on the effects of these arrangements on competition in the antitrust context and specify the standard, the antitrust standard, by which the conduct is to be judged

As to the practices that would not constitute misuse under H R 4086, we believe both H R 1155 and H R 4086 would ordinarily give the same result, as Mr Rule has already pointed out While declaring these practices not to be misuse would be helpful to patent holders, we believe that the approach in H R 1155 and S 1200 would provide a more consistent basis for analyzing the challenged licensing practices

Section 3 of H R 4086 would add a new section 271(g) to Title 35, U S Code, to provide that the procurement or enforcement of a patent by fraud or other inequitable conduct is a defense to an action for infringement Proposed section 271(g) would define fraud or other inequitable conduct We believe including such provisions in Title 35 would be useful

A single fair standard for the duty of disclosure for both updating and enforcing patents would be beneficial to both inventors and the public Making this duty statutory would create certainty and give better notice to applicants and their attorneys

In this regard, we have some suggestions to eliminate the possibility of additional and inconsistent definitions of the the duty of disclosure and to assure that the standard covers all relevant proceedings and misconduct The Patent and Trademark Office is considering revising its rules regarding the duty of disclosure The standard should be such that the information should be disclosed to the Patent and Trademark Office to assist in locating relevant documents necessary for a quality examination without overburdening the applicant, the bar or the Office

The standard we are presently considering is very similar to that set forth in proposed section 271(g)(2)(C), and with a few changes that I will mention, would be consistent with it Under this standard an individual would be required to disclose to the Office information the individual knows or should have known would make a claim unpatentable

We would suggest that the proposed section 271(g)(2)(C) be amended to make explicit what we believe is intended, that is, that the word "claim" covers both the claims in the patents and claims in pending applications, and that the individual must have had knowledge at the time the claim was pending or at the time the individual sought to enforce the claim

Mr KASTENMEIER I am going to interrupt you I regret to, because I know you are almost complete, but it does appear that we may otherwise miss the vote, so we will need to recess for ten minutes We will return to you, Mr Tegtmeyer

[A short recess was taken]

Mr KASTENMEIER The committee will come to order and resume its hearing

At the point of our recess, we were hearing the concluding remarks of Mr Tegtmeyer, the witness, and perhaps you can conclude your statement

Mr TEGTMEYER Thank you, Mr Chairman

At the point you recessed the hearing, I was indicating our general support for Section 3 of H R 4086 and indicating that there are some changes that we would think would be desirable in that section

We note among additional changes that I might refer to that the question of fraud or other inequitable conduct could arise in the Patent and Trademark Office or in a declaratory judgment action as well as an infringement action The term, "affirmative defense," in section 271(g)(1) is limited to the latter and, therefore, is a little bit too narrow in our view

Another difficulty with the term is that it implies that in every case where there has been an improper withholding of information, all of the claims of a patent should be automatically unenforceable or that the remedy should always be unenforceability While this may be appropriate in some cases, we are not prepared to say at this time that it is appropriate for all cases

With respect to the standard of actual knowledge set forth in H R 4086, we prefer not to change the current practice Ordinarily an individual is not charged with failure to disclose something that he or she did not know, but one should not be able to cultivate ignorance at the same time We construe the term actual knowledge to encompass this later type of conduct as well

We suggest that consideration be given to the situation where there is not a failure to disclose, but an intentional misrepresentation or other misconduct We are not sure that this situation would be covered by the proposed section By changing the word "includes" to "means" in Section 271(g)(2) and covering misrepresentation, the proposal would provide a complete and certain test

We recognize that this topic is complex and that there is still a great divergence of opinion as to the correct formulation We would like to work with you on an appropriate statutory provision covering duty of disclosure or inequitable conduct because we believe that the need to settle the law in this area is extremely urgent

Thank you, Mr Chairman

Mr KASTENMEIER Thank you, Mr Tegtmeyer

[The statement of Mr Tegtmeyer follows]

STATEMENT OF

RENE D TEGTMEYER

ASSISTANT COMMISSIONER FOR PATENTS

BEFORE THE

SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES
AND THE ADMINISTRATION OF JUSTICE
COMMITTEE ON THE JUDICIARY
U S. HOUSE OF REPRESENTATIVES

MAY 11, 1988

Mr Chairman and Members of the Subcommittee

I appreciate the opportunity to offer comments to this Subcommittee on patent misuse Proposals to reform current law on patent licensing are included in H R. 1155, H R 4086, and S 1200, and I will address points in these bills

The licensing of patents and other proprietary technology is an important element of an intellectual property system, and a nation's licensing rules often indicate its level of support for intellectual property While patent holders should not engage in anticompetitive behavior, we also must not overly restrict a patent owner's ability to profit from an invention Licensing restrictions limit the flexibility of patent owners and potential users of the technology to negotiate arrangements suitable to their particular situation Where the sanctions for violating these restrictions are harsh and the permissible kinds of arrangements too narrowly circumscribed, patent owners are reluctant to grant licenses even where they are otherwise unable to profit from the invention

Internationally, inappropriate restrictions on licensing diminish the ability of our industry to compete effectively in the world market In many developing countries, private patent licensing arrangements require government approval, which is conditioned on the arrangement's furtherance of national economic objectives In most cases, these rules were developed to protect a country's recipients of technology in negotiations with the suppliers of the technology. In practice, these requirements generally have the opposite effect of that intended By subjecting private contractual arrangements to government scrutiny and severely restricting the terms on which technology can be transferred, these rules discourage technology transfer and foreign investment Small and medium-sized companies with technology that may be useful to a

developing country often cannot cope with the license restrictions imposed and bureaucratic clearances needed to license their technology abroad, while large businesses must evaluate the effect of one nation's technology transfer rules on the company's operations in other markets

We think such government regulation is inappropriate. Commercializing a new invention frequently entails great expense, not only to recover research and development costs but also for the subsequent investments necessary to manufacture and market new products Licensing arrangements offer the flexibility to get products to the marketplace more quickly or at lower cost than might otherwise be possible using only the patentee's own resources Where the patentee lacks the resources to bring an invention to the marketplace, licensing may be the only avenue to commercialize an invention Good licensing rules are therefore essential to help domestic industry compete effectively with foreign goods Any licensing arrangement that aids this process provides some procompetitive benefits We think it is only reasonable to take these into account in judging the propriety of a licensing arrangement

Despite the efficiencies resulting from the licensing of intellectual property, courts have sometimes condemned licensing practices without sufficient sensitivity to their basic procompetitive nature and purpose In evaluating the conduct of patentees under the antitrust laws, some courts have characterized the patent system as being inherently in conflict with antitrust goals This overlooks the fact that a patent for a new invention, unlike an illegal monopoly, does not deprive the public of anything it has had before By encouraging the introduction of new products that diversify the market, innovation increases competition. Rather than being inherently at odds with a competitive economic system, the protection of intellectual property is an important part of that system Ironically, judicial hostility to patents and patent licensing arrangements discourages the rapid dissemination of new technology, either because the patent owner fears patent misuse sanctions or because a satisfactory business arrangement cannot be reached without greater flexibility

Provisions that address patent licensing and the issue of patent misuse are found in H R. 4086, the "Patent Licensing Reform Act of 1988," in section 3105 of the "Omnibus Intellectual Property Rights Improvement Act of 1986," Title III of H R 1155, and in Title II of S 1200, the "Process Patent Amendments Act of 1987 " While we prefer the approach of H R 1155 and S 1200, H R. 4086 includes some valuable points not present in the other bills.

All three bills would reform the doctrine of patent misuse, the judicially created doctrine that can be invoked to deprive a patentee of the right to enforce a patent While the antitrust statutes were enacted to prevent anticompetitive behavior, the law of misuse was judicially created to prevent patent owners from inequitably extending their rights In circumstances where a patentee's behavior is said to be a "misuse" of the patent right, courts have refused to enforce the inventor's exclusive rights, thereby destroying the value of the patent

Judicial holdings of misuse have been predicated on the theory that certain practices have anticompetitive overtones and are beyond the rights afforded patentees by the patent system Courts have condemned certain conduct as economically contrary to public policy, even where that conduct is not anticompetitive, because they have not undertaken the analysis necessary to determine whether such conduct is in fact anticompetitive Consequently, some existing patent misuse precedent is unsound

This problem of sound analysis has been noted by the judiciary In Brulotte v Thys Co , 379 U S 29, 143 USPQ 264 (1964), reh'g denied, 379 U S 985 (1965), the Supreme Court held that the use by a patentee of royalty agreements that project beyond the expiration date of the patent is unlawful per se In that case, the patentee sold patented hop-picking machines for a flat sum and licensed their use for a period that extended after the expiration of the last patent whose mechanism was incorporated into the machines In dissent, Justice Harlan observed that a royalty payment extending beyond the term of the patent could not constitute misuse of the patent leverage since the agreement neither prevented the licensee from the purchase or use of any other machine nor prevented others, after the expiration of the patent, from producing machines of the type patented Pointing out that such an arrangement would often be preferred by the licensee, Justice Harlan characterized the distinction between long-term use payments and long-term installment payments of a flat-sum purchase price as primarily a matter of the technical framing of the contract

In the more recent case of USM Corporation v SPS Technologies, Inc , 694 F 2d 505, 216 USPQ 959 (7th Cir 1982), cert denied, 462 U S. 1107 (1983), the Seventh Circuit reviewed the law on patent misuse and cited a number of practices that had been held to be misuse These included fixing the price at which the purchaser of a patented item could resell it, see Bauer & Cie v O'Donnell, 229 U S. 1 (1913), requiring a licensee to buy an unpatented staple item used with the patented device, see generally Dawson Chem Co v Rohm & Haas Co , 448 U S. 176, 188-93, 206 USPQ 385, 393-95,

reh'g denied, 448 U S 917 (1980), the payment of royalties beyond the expiration of the patent, Brulotte v Thys Co , supra, measuring royalties by the sales of the unpatented end products containing the patented items, Zenith Radio Corp v Hazeltine Research, Inc , 395 U S 100, 133-40, 161 USPQ 577, 590-93 (1969), or requiring licensees not to make any items competing with the patented item, Steward v Mo-Trim, Inc , 192 USPQ 410 (S D Ohio 1975) Commenting on these cases, the USM court said, 694 F 2d at 510-511, 216 USPQ at 963-964

> As an original matter one might question whether any of these practices really "extends" the patent The patentee who insists on limiting the freedom of his purchaser or licensee -- whether to price, to use complementary inputs of the purchaser's choice, or to make competing items -- will have to compensate the purchaser for the restriction by charging a lower price for the use of the patent If, for example, the patent owner requires the licensee to agree to continue paying royalties after the patent expires, he will not be able to get him to agree to pay as big a royalty before the patent expires.

With regard to tying arrangements the USM court further noted, "It is hard to understand why in these circumstances, where if any presumption is warranted, it is that the tie-in promotes efficiency rather than reduces competition, the burden of proof on the issue of misuse should be shifted to the patentee " Id. at 511, 216 USPQ at 964

We find Justice Harlan's dissent and the USM court's observations superior to the views expressed in many misuse cases and believe rigorous economic analysis should be required for a finding of patent misuse. As the USM court said, Id. at 512, 216 USPQ 964-965, "If misuse claims are not tested by conventional antitrust principles, by what principles shall they be tested? Our law is not rich in alternative concepts of monopolistic abuse, and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty."

This analysis is mandated by S. 1200 and by H.R 1155

Section 3105 of H R 1155, the Administration proposal on patent misuse, identifies five specific practices which, if engaged in today, would place in doubt a patent owner's entitlement to relief for infringement and a more general provision to cover practices

not enumerated The five practices are 1) licensing under terms affecting commerce outside the scope of the patent's claims, 2) restricting the licensee in the sale of a patented product or product made by a patented process, 3) charging royalties that are allegedly excessive or that differ from those charged to other licensees, 4) charging royalties unrelated to the sale of the patented product or a product made by a patented process, and 5) refusing to grant a license. The general provision covers uses of a patent allegedly to suppress competition This legislation would bring the patent misuse doctrine within appropriate boundaries by assuring that patent owners engaging in one or more of these practices would not be precluded from enforcing a patent against infringement unless their conduct, in view of surrounding circumstances, violated the antitrust laws Courts would be required to subject the practice in question to a rigorous economic analysis before condemning, on competitive grounds, patent licensing practices previously classified as misuse As a consequence, patentees would have greater flexibility in realizing the full benefits of their patents, thereby further encouraging industry to invest in research and development aimed at discovering new products and new processes

S. 1200 takes a similar approach in that it requires a finding of an antitrust violation for a holding of patent misuse However, S. 1200 does not list specific licensing practices that could be held to be misuse S. 1200 thus makes an antitrust violation a requirement generally for a holding of misuse and applies to all licensing practices or actions or inactions relating to the patent. This sets the same standard for a judicial holding of patent misuse as that proposed by the Administration, and we therefore would also support the enactment of S. 1200.

H R. 4086 takes a somewhat different approach. Section 2 would amend 35 U.S C 271(d). Proposed section 271(d)(1) would provide that a misused or illegally extended patent is unenforceable until such misuse or illegal extension terminates and its effects have dissipated Section 271(d)(2) would list six practices that would constitute misuse, including for some a standard by which such practices would be judged Section 271(d)(3) would identify other activities that would not constitute patent misuse Section 3 of H.R. 4086 would establish a standard for fraud or inequitable conduct

Section 271(d)(1), proposed in H R. 4086, would define "misuse" or "illegal extension" by reference to specific licensing activities 1) tying arrangements, except to the extent the patent owner lacks market power, 2) unreasonably imposing a noncompetition

requirement; 3) unreasonably requiring a package license arrangement, 4) unreasonably providing for royalty payments beyond the patent term, except when mutually agreed after the patent issues, 5) unreasonably fixing prices or engaging in resale price maintenance regarding the patented product or process, and 6) unreasonably requiring a grant back, except of a nonexclusive license in improvements when alternatives exist to the subject of the basic license agreement.

With respect to these activities, we strongly prefer the approach of H R 1155, especially as section 3102 of H R 1155 would clarify that the antitrust rule of reason should apply to intellectual property licensing arrangements We believe that reciting a list of proscribed practices will continue to have a chilling effect on licensors' ability to negotiate a workable business arrangement By defining certain activities as misuse or illegal extension, "except to the extent that the patent owner does not have market power" or if the provision is "unreasonably" imposed, H R 4086 appears to place the burden of justifying a negotiated arrangement on a patent owner if that arrangement includes one or more of the listed practices. We believe this approach will continue to burden an honest patent holder's attempt to license a new invention. To remove this fear of litigation from patent holders and help our industry compete more effectively, we must overcome past practice and reassure patent holders of their freedom to contract Rather than defining specific arrangements as misuse, we think it preferable to focus on the effects of these arrangements on competition.

First, we see no reason to burden the patent holder with justifying the reasonableness of engaging in the specific negotiated licensing practices listed This approach seems to presume that license terms are largely dictated by the patent holder. While this may be true on occasion, very few inventions offer the prospect of revolutionizing a field of commerce to such an extent that industry cannot continue to use existing alternative technology For the vast majority of patentees, any prospect of financial gain depends on the inventor's willingness to find interested partners and develop a financial arrangement generous enough to interest potential buyers, users, or manufacturers In the absence of specific facts that indicate a licensing arrangement involves an antitrust violation, it is inappropriate to subject negotiated terms to scrutiny

We also take issue with the inclusion of certain activities in the definition of misuse For example, industry commonly grants licenses under one or more patents together with unpatented

technology This package licensing typically benefits the potential licensee, since it is rare that a single patent encompasses all the technology needed for a business venture This is not to say that a package license arrangement cannot be used as a means to conceal improper activity, but that problem can be satisfactorily addressed by the courts following the test proposed under H R. 1155

We have the same concern for grant back arrangements Grant back arrangements facilitate joint venture agreements Describing such arrangements as misuse will deter our industries from cooperating in research and development while our foreign competitors do not face such restrictions. In the case of joint research and development activities, the exception provided in proposed subsection 271(d)(2)(F) may be inadequate since agreement to grant back, to cross-license, or to pool patent rights may be necessary to make the arrangement work This provision is more sweeping than necessary since, absent anticompetitive intent, courts have generally held grant backs to be acceptable and not to constitute patent misuse

Other provisions are also troublesome. It is not clear that tying should necessarily be considered improper even where the licensor has market power If a licensor has agreed to certain quality or performance guarantees, for example, production requirements using certain unpatented raw materials may be entirely reasonable In addition, the restriction of proposed section 271(d)(2)(D) regarding licensing beyond the expiration of the patent term, appears stricter than is needed Under 35 U.S.C 261, patent applications are assignable, and royalties could therefore be agreed upon before the patent issues A license can also be granted for know-how with the full knowledge that a patent may never issue We therefore believe the exception in proposed section 271(d)(2)(D) is too narrow.

Finally, we are concerned that the term "unreasonably" in subsections (B) through (F) of proposed section 271(d)(2) may not give courts adequate guidance Courts have presumably been able to consider the reasonableness of conduct in fashioning the equitable doctrine of misuse but have rarely given adequate weight to economic considerations The resulting case law has given harsh remedies, a per se standard in many cases, and little consideration of the economic effects of the challenged behavior. While it is preferable to consider the reasonableness of the listed activities rather than adopting a per se approach, it is better to specify that the standard by which the conduct is judged is whether it violates the antitrust laws.

H R 4086 identifies several practices that do not constitute misuse Proposed subsections 271(d)(3)(D), (E), and (F), relating to territorial or field of use licenses and to royalties that differ from those payable to others, that are allegedly excessive, or are in amounts not related to the sale of the product, are identical to practices identified in new subsections 282(b)(3), (4), and (5) proposed in section 3105 of H R 1155 Under H R 4086, these practices would be declared not to constitute misuse, while under H R 1155 they would be subject to the same antitrust analysis as other licensing practices We assume that these practices would continue to be subject to antitrust analysis under H R. 4086 Since these practices are generally procompetitive, we believe both bills would ordinarily give the same result, that is, that these practices would not constitute patent misuse We are confident that the economic analysis that would be required under either S 1200 or H R 1155 would virtually eliminate the possibility that a patent would be held to be misused on these grounds For the exceptional case that might arise in which a refusal to license, royalties that are excessive, or discriminatory, or unrelated to sales, or a field of use or territorial license is an element of an antitrust violation, the approach of H R 1155 would leave patent misuse remedies intact. While declaring these practices not to be misuse would be helpful to patent holders, who are sometimes deterred from engaging in licensing practices out of fear of litigation even if they believe their conduct is not proscribed, we believe the approach of H.R 1155 provides a more consistent basis for analyzing a challenged licensing practice

Section 3 of H R 4086 would add a new section 271(g) to title 35, United States Code, to provide that the procurement or enforcement of a patent by fraud or other inequitable conduct is a defense to an action for infringement Proposed section 271(g)(2) would define "fraud or other inequitable conduct"

We believe including such provisions in title 35 would be useful, as it would alert applicants to their duty of disclosure Applicants and the bar need reasonable and clear notice of the information that should be disclosed to the Patent and Trademark Office The information disclosed must be complete enough to assist the Office in locating relevant documents and examining an application without overburdening the applicant, the bar, or the Office. Establishing a single, fair standard for the duty of disclosure for both obtaining and enforcing patents would be beneficial to both inventors and the public. Making this duty statutory would create certainty and give better notice to applicants and their attorneys. In this regard, we would suggest

that the term "includes" in proposed section 271(g)(2) be changed to "means" so as to eliminate the possibility of additional and inconsistent definitions of the duty of disclosure from arising outside of the statute and implementing rules

The Patent and Trademark Office is actively considering revising its rules regarding the duty of disclosure The standard we are presently considering is very similar to that set forth in proposed section 271(g)(2)(C) and, with a few changes I will mention, would be consistent with it

We note that the question of fraud or other inequitable conduct could arise in the Patent and Trademark Office or in declaratory judgment actions as well as in infringement actions The term "affirmative defense" in section 271(g)(1) is limited to the latter and is therefore too narrow. Another difficulty with the term is that it implies that, in every case where there has been an improper withholding of information, all the claims of a patent should be automatically unenforceable in every case or that the remedy should always be unenforceability While this may be appropriate in some cases, we are not prepared to say that it is appropriate for all cases

Under this standard, an individual would be required to disclose to the Office information that the individual knows or should have known would make any claim unpatentable We would suggest that proposed section 271(g)(2)(C) be amended to make explicit what we believe is intended, that is, that "claim" covers both claims in patents and pending applications Otherwise, the term "claim" could be interpreted as referring only to claims in an issued patent It should also be clarified that the individual must have had the knowledge at the time the claim was pending in an application or at the time the individual sought to enforce the claim.

With respect to the standard of "actual knowledge" proposed in section 271(g)(2)(A), we prefer not to change current practice Ordinarily an individual is not charged with failure to disclose something he or she did not know, and there is generally no duty to conduct a prior art search However, "one should not be able to cultivate ignorance or disregard numerous warnings that material information or prior art may exist, merely to avoid actual knowledge of that information or prior art " FMC Corp v Hennessy Industries, Inc , 836 F 2d 521, 526, n 6, 5 USPQ2d 1272 1275, n 6 (Fed Cir 1987), FMC Corp v Manitowoc Co , 835 F 2d 1411, 1416, 5 USPQ2d 1112, 1116 (Fed Cir 1987) We construe the term "actual knowledge" to encompass the type of conduct referred to in these cases

Finally, we would suggest that consideration also be given to the situation where there is not a failure to disclose, but an intentional misrepresentation or other misconduct We are not sure that this situation would be covered by proposed section 271(g) By changing "includes" to "means" in section 271(g)(2) and covering misrepresentation, the proposal would provide a complete and certain test.

We would also suggest some technical amendments First, since the duty of disclosure is essentially defined by proposed sections 271(g)(2)(A) and (C), proposed section 271(g)(2)(B) should be deleted Secondly, the reference to fraud in subsection (3) should be broadened to include "other inequitable conduct" as referred to in paragraph (g)(1), and the reference to "enforcing" in subsection (g)(1) should be appropriately included in proposed section 271(g)(2)

We recognize that the topic is complex and that there is still a great divergence of opinion as to the correct formulation of a test We would like to work with you in the development of an appropriate statutory provision because we believe that the need to settle the law in this area is extremely urgent.

Mr KASTENMEIER You are saying that one should not be able to cultivate ignorance, is it fair to the inventory to punish the inventory by denying patent protection because of failure, say, of a lawyer to submit prior art or to submit it perhaps in a timely fashion?

Mr TEGTMEYER That is an issue we think needs further consideration

Under normal agency law, of course, and in many cases in the patent field, the attorney's conduct would carry over and have effect upon the client or the patent applicant or patentee

However, our main aim in the duty of disclosure, insofar as the Patent and Trademark Office is concerned in conducting an examination, is to get relevant prior art for the examiner

To the extent that the standard that is set for disclosure to the Office is such as to get the relevant information before us, and with whatever sanctions are necessary for that purpose, then I think our aims are satisfied in this respect

So to the extent that it might be possible not to carry over an attorney's conduct to the client and provide the stimulus to the submission of the information, we are certainly open to that kind of approach

Mr KASTENMEIER Thank you

Mr Rule, with respect to fraud and inequitable conduct in procuring or enforcement of a patent, should Congress, in fact, define these terms and if so, how would you recommend——

Mr RULE We have to this point, we in the Antitrust Division, not really embarked upon a discussion of that topic for the reason that it really is sort of beyond our area of expertise That is why in all the legislation that we have proposed, we simply talked about excluding any such aspect of the doctrine because it really doesn't have its roots in antitrust law, which is to be contrasted with misuse doctrine that has its roots in antitrust law and notions of what is pro-competitive and what isn't

We felt we had something to say about the misuse doctrine for that reason

Mr KASTENMEIER I would ask either of you if the Court of Appeals of the Federal Circuit has given us what you would consider a clear set of nationally applicable precedents on either misuse or patent fraud?

Mr RULE I can speak perhaps with less authority than the Assistant Commissioner of Patents, and I certainly wouldn't feel comfortable opining on fraud before the Patent Office

With respect to misuse, that is a subject that the Federal Circuit has dealt with and has, in my opinion, shown sensitivity to the underlying economic concepts, but has also pointed out that in the area of patent misuse, it has, in effect inherited a doctrine that existed before the court was established, and it has stated that it feels compelled, whether or not it represents sound economics, to follow that precedent unless and until Congress changes the law

So to some extent, that court, I think, has moved in the right direction and has shown sensitivity to the right issues, but it has also invited, I think, Congress to, in effect, wipe the slate clean and make clear what the principles are and certainly indicated its willingness to carry through on those principles

Mr KASTENMEIER I am not sure whether that is precisely what you had in mind, Mr Tegtmeyer, but your last sentence was that there is a need to settle the law in this area It is extremely urgent Therefore, I assume you don't feel the Federal Circuit has settled the law?

Mr TEGTMEYER I think the Federal Circuit has laid out reasonably clearly what the practice is

One of the problems is that the practice is something that, over the years has evolved somewhat and moved around somewhat Our reason for feeling it is desirable to have a provision similar to that in section 3 of H R 4086 is to have a standard in the statute that won't provoke quite as much argument as to whether that is the proper standard or whether it should be changed A statutory provision could also address some of the problems with the existing standard's possibly being or being perceived to be a little too harsh, or more harsh than is necessary to get the desirable result A rule that is more straightforward and one that is founded in the statute would have more certainty and more longevity

If I can comment briefly on the misuse doctrine, one of our problems with continuing the doctrine of misuse is the fact that if you view that doctrine as a separate and distinct doctrine from the antitrust law violation concept and as purely an equitable consideration, we have a very indefinite doctrine, and you don't know how it is going to end up being applied a few years down the road

There are misuse cases that go different directions that enunciate different patent policy concepts Some cases tie misuse to the antitrust law violation approach, some divorce it from the antitrust law violation approach

I think that is one of the big problems—there is no standard, no concept laid out It is up for grabs, and the subject matter really in question is a contractual matter between the patent owner and a licensee and should be judged in the antitrust context The patent owner is merely using the patent in licensing arrangements as it was intended to be used

For these reasons, we feel that getting away from the misuse concept and going towards the antitrust violation concept is a proper way to go

Mr KASTENMEIER I yield to the gentleman from California, Mr Moorhead

Mr MOORHEAD Thank you, Mr Chairman

One of our witnesses this afternoon, Mr Schwartz from the University of Pennsylvania Law School, contends that the doctrine of patent misuse serves a useful purpose and should be permitted to continue to evolve in our courts

Would both of you comment on that statement?

Mr RULE Well, we, neither the Department of Justice nor the Department of Commerce, advocate elimination of the doctrine of patent misuse, but rather we have simply supported, it seems to me, legislation that articulates what is a sound basis for a finding of patent misuse

You don't want judges going around on confused or unprincipled bases and basically expropriating the property of patent owners and that is what misuse amounts to because the patent owner can no longer exclude others from using the patent as long as the taint

of misuse continues and what that amounts to is elimination of the patent

Unless there is some strong public policy, and in my view, economic reason for imposing such a Draconian remedy or sanction on a patent owner, it shouldn't be imposed

While I think that one can argue that the sort of standards that have grown up under the antitrust laws can under some circumstances justify the remedy of misuse, I have yet to see any good arguments for a reason to go beyond the antitrust laws (in the absence of fraud on the Patent Office, which is a different issue) in allowing judges to condemn practices as a misuse

Mr TEGTMEYER I concur in what Mr Rule said

Our concern is that the doctrine of patent misuse doesn't have a good conceptual basis that is good guidance to patent owners, that tells them what is a proper provision in a licensing agreement and what will withstand the misuse challenge Such a situation does limit the patent owner's flexibility to put what we feel are proper competitive provisions in licensing agreements because of some of the existing *per se* rules and because of some of the interpretations that the courts have given to the doctrine of patent misuse

Mr MOORHEAD H R 4086 contains a new idea in that it tries to define fraud or other inequitable conduct

In procuring a patent, is this a good idea?

Mr RULE Again, I would feel more comfortable letting Mr Tegtmeyer address that issue

Mr TEGTMEYER As we indicated in our testimony, we do support the concept of putting a provision similar to that in Section 3 of H R 4086 into the law to add a great degree of certainty and a little stronger foundation for this concept in our practice

Mr MOORHEAD I want to thank you both for coming today

I would like to ask our chairman for unanimous consent to put my opening statement into the record

Mr KASTENMEIER Without objection, we would be delighted to receive your opening statement for the record, and it will be made part of the record

[The statement of Mr Moorhead follows]

OPENING STATEMENT

OF

THE HONORABLE CARLOS J. MOORHEAD

BEFORE THE COURTS SUBCOMMITTEE

ON PATENT MISUSE

MAY 11, 1988

MR. CHAIRMAN,

THANK YOU FOR SCHEDULING THESE HEARINGS ON WHAT I CONSIDER TO BE AN IMPORTANT REFORM OF OUR PATENT LAWS OUR RANKING MINORITY MEMBER, MR FISH HAS BEEN IN THE FOREFRONT OF PATENT MISUSE REFORM FOR THE PAST TWO CONGRESSES. THIS CONGRESS HE INTRODUCED H.R. 1155, WHICH I COSPONSORED, AND IT CONTAINS A PROVISION ON PATENT MISUSE. I BELIEVE, MR CHAIRMAN, YOU WILL FIND A LOT OF SUPPORT FOR THIS LEGISLATION FROM OUR SIDE OF THE AISLE.

WE NOW LIVE IN A TIME WHEN OUR ECONOMY IS AN IMPORTANT PART OF A MUCH BROADER ECONOMY, A WORLDWIDE OR GLOBAL ECONOMY. OUR ECONOMIC DOMESTIC LAW WAS NOT NECESSARILY DRAFTED WITH FOREIGN COMPETITORS IN MIND. WHAT WERE USEFUL RESTRICTIONS 15 YEARS AGO MAY HAVE BECOME HEAVY BURDENS ON OUR INDUSTRY TODAY. IN MY OPINION, GOOD PATENT LICENSING RULES ARE ESSENTIAL IN HELPING OUR DOMESTIC INDUSTRY COMPETE EFFECTIVELY WITH FOREIGN MADE GOODS I ALSO BELIEVE THAT GOOD PATENT LICENSING RULES CAN HAVE MANY, PRO-COMPETITIVE BENEFITS. I AM HOPEFUL THAT I CAN CONVINCE OUR CHAIRMAN OF THIS, WHO IS BY FAR, THE MOST KNOWLEDGEABLE MEMBER OF CONGRESS WHEN IT COMES TO PATENT AND COPYRIGHT LAW. AND I CAN ASSURE YOU HE IS ALSO THE MOST REASONABLE

THANK YOU.

Mr KASTENMEIER I now yield to Mr Coble

Mr COBLE Thank you, Mr Chairman

Mr Tegtmeyer, let me extend on Mr Moorhead's final question

Is the Patent and Trademark Office drafting a new rule on fraud and inequitable conduct in procuring patents, and if so, would such a rule be binding on the courts in the absence of legislation?

Mr TEGTMEYER Yes, sir

We are preparing a revision to the existing rule 56 which covers the duty of disclosure or inequitable conduct in terms of dealing with the Office And we are in the middle of that process right now We have not finalized how we feel the rule should be changed We have had a dialogue with organizations in the user sector and in the bar on it, and we are still working on that

With regard to whether such a standard would be binding on the courts, it would not be binding on the courts in that sense What we would be doing in a revised rule is indicating to the public and to the courts what we feel is a rational approach to getting prior art information before the patent examiner during the examination of the application to get the best quality patent out of the Office, one that the patent owner, competitors and the general public can rely upon with a reasonable degree of certainty when determining their rights under or against that patent

We feel by defining what we think is necessary to achieve that aim, the tendency would be for the courts—if we are satisfied that the rule is meeting these requirements and that it is a good standard—to uphold and follow it

Mr COBLE To apply the doctrine of patent misuse as we know it today, must the party asserting the misuse show injury?

Either of you may answer that

Mr RULE The answer is no

Normally, under the antitrust laws, standing is provided by statute for damages, Section 4 of the Clayton Act, for injunctive relief, section 16, and the Supreme Court has interpreted those as requiring that the party suing actually be injured by the conduct and be injured by that aspect of the conduct that violates the law

My understanding of the misuse doctrine, indeed one of the reasons that it has been a subject of some criticism, is that anyone can raise misuse as a defense regardless of whether or not the alleged misuse was directed at them or even affected them

So it certainly opens up an infringement trial to a lot of issues that may not be relevant to those particular parties

Mr TEGTMEYER I have nothing to add, sir

Mr COBLE Thank you, Mr Chairman

Mr KASTENMEIER Mr Cardin?

Mr CARDIN Thank you, Mr Chairman

Mr Tegtmeyer, in your statement, you indicate that inappropriate restrictions on licensing diminishes the ability of our industry to compete effectively in the world market

I take it that you feel that the doctrine of patent misuse as currently developed by our courts is an inappropriate restriction?

Mr TEGTMEYER Yes, sir

I feel that in many types of situations, patent owners cannot put clauses in their licensing agreements even though the provisions are pro-competitive, make business sense, are for the convenience

of the parties and the like, and even though they have no anti competitive effect in the sense of what is proscribed by the antitrust laws

We feel that accordingly such limitations on licensing clauses are unnecessary They diminish the value of the patent and the ability of the patent owner to use the patent and, therefore, decrease the stimulus to the development and exploitation of technology

Mr CARDIN Do you have specific examples of either industries or cases in which the doctrine as interpreted currently by the courts has impeded our Nation in competition?

Mr TEGTMEYER I can't pick a case out where that is literally what is created in the opinion of the court

If you think of the *Brulotte v Thys* Supreme Court decision, where post-expiration royalties were condemned, as an example, and if that was a desire of the parties and made the most business sense, and if not being able to extend the royalty payments until after expiration of the patent prevented a deal from being made and that deal was necessary for development of the technology, then the technology would not be developed

I think you can pull out a number of decisions related to package licensing and you will find that in the right circumstances the effect would be the same, whereas I don't think that result would necessarily evolve out of an antitrust analysis

Mr CARDIN Have you analyzed which of the Supreme Court or Federal Court decisions would be reversed by S 1200 if enacted, post-expiration payments or grant tie backs or sales? What would be the effect of S 1200 on those Federal Court decisions?

Mr RULE Let me try to address that

I think there would be some cases—for example, the *Morton Salt* decision of the Supreme Court that really involved tying, and to some extent the *Motion Picture Patents* case—that would be changed because under S 1200 or H R 1155, the courts would have to determine under antitrust analysis really whether or not competition was adversely affected, and I think that given the increased knowledge and sophistication of economic analysis these days, the analysis might look a little bit different from what it did back in those days and there would not be the sort of per se rule under those decisions and under lower court cases that have followed those decisions if S 1200 or H R 1155 were to come into being

That means that the courts would be able to be more discriminating in terms of those licensing practices that they strike down as misuse and those allowed to go forward

If a practice does not hurt consumers or the economy or competition, it would not be struck down

It is very difficult in these areas to say what technology didn't get licensed or developed at the margin because of the legal treatment of a particular type of practice It is always difficult to do that

Mr CARDIN I was asking whether there was a particular field that you felt was being particularly adversely impacted

Mr RULE That is a very difficult question to answer

In the antitrust area, I can say, for example, that software licensing, to some extent, has been adversely affected by some antitrust decisions, but that is really under copyright, not here

The problem really is not knowing what people haven't done It is much easier to know what they have done, but it is difficult to know what they haven't done

I will refer to an example with which I think the members of this subcommittee are familiar

There is a piece of legislation that is, in my view, more significant than we thought at the time, the National Cooperative Research Act that was passed and went through this committee in 1984

It turns out that many more joint research and development ventures have been formed in light of that legislation than frankly I or anyone in the Antitrust Division ever contemplated when that bill was enacted

But once you clarified the law and you set up a practice that allowed these joint ventures to be formed, people started getting into them We could never document before the legislation came into being what joint ventures weren't formed because of the state of the law, but certainly once we changed the law and clarified it and removed some of the unwarranted obstacles to such ventures, we saw many more joint research and development ventures formed, and I think that clarifying the law of licensing will also result in that sort of improvement in the state of technology, but I think it will extend across the board

Mr CARDIN I thank the chairman

Mr KASTENMEIER I have a number of other questions, but in courtesy to witnesses who have been here a long while and those that will come after Mr Rule and Mr Tegtmeyer, I would ask that—we probably have four or five, six questions—we would like to submit them to you in letter form and have you reply

One such question is—I will just ask this rhetorically and I will ask for your response in letter form

Does either S 1200 or H R 1155, which is actually in the subcommittee at this time, have the effect of overturning a number of Supreme Court cases?

If so, we would like to know more precisely what impact that would be, that is, what cases and to what degree

Obviously, you were talking about matters of degree as well Sometimes it isn't as explicit, but if it does have that effect, we would like a closer analysis on these cases

[The information follows]

U S Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington D C 20530

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Sub on Courts

Honorable Robert W Kastenmeier
Chairman
Subcommittee on Courts, Civil
Liberties and the Administration
of Justice
Committee on the Judiciary
House of Representatives
Washington, D C 20515

Dear Mr Chairman

This letter is in response to your letters of May 16 1988 to Assistant Attorney General Charles F Rule and to Assistant Secretary and Commissioner of Patents and Trademarks Donald J Quigg in which you submitted lists of additional questions regarding the Subcommittee's recent hearing on H R 4086 and other proposals for legislation in the patent misuse area Most of the questions on the two lists were identical although some of the subject matters were more clearly within the expertise of either the Antitrust Division of the Department of Justice or the Patent and Trademark Office of the Department of Commerce

In consulting with each other regarding the preparation of answers to the Subcommittee's questions, the agencies determined that a joint response would most efficiently present their views and this joint response is enclosed We hope that our answers will be useful to the Subcommittee as it proceeds to consider this timely and important legislation

Sincerely,

Thomas M Boyd
Acting Assistant Attorney
General
Office of Legislative and
Intergovernmental Affairs
Department of Justice

Donald J Quigg
Assistant Secretary and
Commissioner of Patents
and Trademarks
Patent and Trademark Office
Department of Commerce

Enclosure

Q 1 With respect to fraud and inequitable conduct in procuring or enforcement of a patent, should Congress define these terms? If so, how?

A 1 Including a definition in title 35 would be useful It would be helpful to alert applicants to their duty of disclosure and to provide uniform, statutory standards in what appears to be an evolving area of the law Applicants and the bar need reasonable and clear notice of the information that should be disclosed to the Patent and Trademark Office The information disclosed must be complete enough to assist the Office in locating relevant documents and examining an application without overburdening the applicant, the bar, or the Office Establishing a single, fair standard for the duty of disclosure for both obtaining and enforcing patents would be beneficial to both inventors and the public Making this duty statutory would create certainty and give better notice to applicants and their attorneys "Fraud and inequitable conduct" should be defined along lines of your bill with the modifications suggested in PTO's testimony

Q 2 Is it fair to the inventor to punish him/her by denying patent protection because of the failure of a lawyer to submit "prior art" or to submit it in a timely fashion?

A 2 In many if not most cases, the interest of the inventor and of the attorney in securing a patent will coincide Adequate sanctions are needed to assure that both the inventor and his or her attorney will provide the full and complete disclosure needed by the Patent and Trademark Office to ensure an adequate examination

In some cases where there has been an improper withholding of information, rejection of the application or unenforceability of the patent may be an appropriate remedy However, we are not prepared to say that this is an appropriate remedy for all cases Particularly where misrepresentation is solely attributable to the attorney and the inventor is entirely innocent, we believe it would be more equitable to consider other remedies These might include suspension or disbarment of attorney who made the misrepresentation

Q 3 Has the Court of Appeals for the Federal Circuit given us clear set of nationally applicable precedent on either misuse or patent fraud?

A 3 With regard to misuse, the Federal Circuit has been largely unable to move away from the decades of precedent that existed at the time of the court's creation The Federal Circuit has noted that "[c]ommentators and courts have questioned the rationale appearing in Supreme Court opinions dealing with misuse in view of recent economic theory and Supreme Court decisions in non-misuse contexts" but recognized that as a circuit court it is "bound, however, to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or by the Supreme Court " Senza-Gel Corp v Seiffhart, 803 F 2d 661, 665 n 5, 231 USPQ 363, 366 n 5 (Fed Cir 1986)

The Federal Circuit has been reluctant to articulate a single test or definition for patent fraud or inequitable conduct and has used a fact-specific analysis, Argus Chemical Corp v Fibre Glass-Evercoat Co , Inc , 759 F 2d 10, 225 USPQ 1100 (Fed Cir 1985), J P Stevens & Co v Lex Tex Ltd , 747 F 2d 1553, 223 USPQ 1089 (Fed Cir 1984), cert denied, 474 U S 822 (1985) (Lex Tex), Kimberly-Clark Corp v Johnson & Johnson, 745 F 2d 1437, 223 USPQ 603 (Fed Cir 1984) In American Hoist & Derrick Co v Sowa & Sons, Inc , 725 F 2d 1350, 220 USPQ 763 (Fed Cir 1984) (American Hoist), the court described four separate tests that might be used to establish the materiality of uncited prior art The broadest in scope, and therefore the baseline, was PTO Rule 56, which equates materiality with what would be important to a reasonable examiner in deciding whether to issue a patent

Under American Hoist, materiality would be weighed with the evidence of intent to withhold the prior art in order to mislead the examiner, 725 F 2d at 1362, 220 USPQ at 772, the other element of inequitable conduct These elements were considered to be inversely related, i e , a lesser showing of materiality may suffice to establish inequitable

conduct if there was an intentional scheme to defraud, while a greater showing of materiality might create an inference that non-disclosure was improper This weighing or balancing test was subsequently revised in Lex Tex to require a threshold or minimum of materiality and intent Unfortunately, the Court did not provide any standards or criteria for applying the balancing test

The balancing principle of American Hoist has been used by the Court on a number of occasions, In re Jerabek, 789 F.2d 886, 229 USPQ 530 (Fed Cir. 1986), A B Dick Co v Burroughs Corp , 798 F 2d 1392, 230 USPQ 849 (Fed Cir 1986)(A B Dick), The Laitram Corp v Cambridge Wire Cloth Co , 785 F 2d 292, 228 USPQ 935 (Fed Cir 1986), Hycor Corp v Schlueter Co , 740 F 2d 1529, 222 USPQ 553 (Fed Cir 1984), Akzo N V v E I DuPont de Nemours, 810 F 2d 1148, 1 USPQ2d 1704 (Fed Cir 1987), but there are inconsistencies among the cases For example, as to the element of intent, the Court stated in A.B Dick Co v Burroughs Corp , 798 F 2d at 1392, 230 USPQ at 849 (Fed Cir 1986), and Driscoll v Cebalo, 731 F 2d 878, 899, 221 USPQ 745, 751 (Fed Cir 1984) (Driscoll), that where an attorney or applicant knew or should have known that a reference was material, the failure to disclose the reference was sufficient to establish intent More recent cases have raised questions about the evidence required to establish the necessary intent, beginning with FMC Corp v The Manitowoc Co , Inc , 835 F 2d 1411, 5 USPQ2d 1112 (Fed Cir 1987) (FMC I), and FMC Corp v Hennessy Industries, Inc , 836 F 2d 521, 5 USPQ2d 1272 (Fed Cir 1987) (FMC II), and followed by In re Harita et al , 847 F 2d 801, 6 USPQ2d 1930 (Fed Cir 1988) (Harita), and Burlington Industries, Inc v Dayco Corp , 7 USPQ2d 1158 (Fed Cir. 1988)

There is also concern over inequitable conduct in situations in which the examiner becomes aware of uncited prior art Compare Orthopedic Equipment Co v All Ortgioeduc Appliances, Inc , No 88-1024, slip op. (Fed Cir June 14, 1988), with Driscoll and A B Dick Similarly as to the

duty to know about materiality, compare American Hoist, holding that there is no duty to conduct a prior art search, with Lex Tex in which an implied duty arises out of the "should have known" test See also Reactive Metals and Alloys Corp v ESM, Inc , 769 F 2d 1578, 226 USPQ 821 (Fed Cir 1985), which indicated that to avoid a charge of inequitable conduct, applicants do not have to raise and explain to the PTO all the problems they have considered, and Kimberly-Clark Corp v Johnson & Johnson, supra, which mentioned that the applicant is under no obligation to disclose all pertinent prior art or other information of which he is aware

These inconsistencies have concerned a number of patent attorneys, 16 AIPLA Q J 8, 26, 36 (1988), who felt that they would invite more litigation in an area of law that the Court itself considers is already overplayed, "cluttering up the patent system," Kimberly-Clark Corp v Johnson & Johnson, supra Clearly, it would be helpful if the Court would give more specific and consistent guidance on what constitutes inequitable conduct

Q 4 Title 35 section 283 states that when enforcing a patent the court may grant injunctions in accordance with equity Isn't patent misuse really an example of inequitable conduct? For example, should a patentee who refuses to license blacks, be able to enforce a patent? Should a person who refuses to license an important technology (e g Vitamin D or sewage treatment) be allowed to enforce a patent?

A 4 The patent misuse doctrine was judicially created to prevent patent owners from inequitably extending their rights Although it has been characterized by the Supreme Court as "an extension of the equitable doctrine of 'unclean hands' to the patent field," United States Gypsum Co v National Gypsum Co , 352 U.S 457, 465 (1957), the misuse doctrine appears to have developed in ways that depart from traditional principles of equity These include adoption of per se rules, depriving the patent holder of legal as well as equitable remedies, and permitting the misuse doctrine to be raised by individuals who are not personally harmed by the alleged misuse These departures appear to be grounded in the courts' concern that extensions of the patent right permit patent holders to thwart the purpose of the patent laws The Supreme Court has characterized the various activities held to be misuse as subverting public policy Morton Salt Co v G S Suppiger Co , 314 U S 488, 493-94 (1942)

The public policy that is almost always invoked (explicitly or implicitly) in misuse claims is our nation's fundamental policy favoring competition Since the antitrust laws are the appropriate vehicle for evaluating competitive effect, allegedly anticompetitive conduct should not be condemned as patent misuse unless that conduct violates the antitrust laws.

Claims of invidious discrimination in licensing or of refusal to permit any use of an invention that would clearly benefit the public interest raise public policy issues that are not directly related to competition The public policies that such claims involve are addressed most directly, though, not

by the patent or antitrust laws, but by the civil rights laws and the laws regarding public condemnation of private property, and the application of those latter bodies of law may be the best way to handle such claims. Even where legal remedies are inadequate, a holding of misuse would be unnecessary in such cases, since a court of equity may, "in accordance with the principles of equity," 35 U.S C. 283, simply refuse to enjoin the particular infringement at issue

In any event, H R. 1155 is not intended to affect the type of claims raised by your question that are unrelated to competition It is intended only to assure that licensing activities alleged to have anticompetitive effects are thoroughly analyzed using sound antitrust standards before the misuse doctrine is invoked to deprive a patentee of remedies under the patent laws because of those activities If the Subcommittee believes that H R 1155 and S 1200 are not sufficiently clear on this point, we would be happy to work with the Subcommittee to make the point more clearly

Q 5 Should a patent owner be permitted to "tie-in" the sale of a patented product with an unpatented product (e g canning machine and salt or computers and IBM punch cards) regardless of the market position of the patent owner?

A 5 If a tie-in is not likely to have anticompetitive effects, it should be permitted

The Department of Justice believes that economic and legal analysis indicates that there is only a narrow range of conditions under which tie-ins are likely to produce anti-competitive effects The Department believes it is appropriate to focus on whether the seller (patent owner) has substantial market power in the relevant market for the tying product and whether there is a reasonable possibility that the seller will obtain substantial market power in the relevant market for the tied product after the tie-in Where one or both of these factors is absent, the danger of anticompetitive effects is absent and further inquiry is unnecessary Where both factors are present, there may be significant anticompetitive potential, and the seller should have to demonstrate justifications for the packaged sale sufficient to outweigh its potential adverse effects The most complete and current statement of the Department's position on tie-ins is contained in the United States' amicus brief in Jefferson Parish Hospital District No 2 v Hyde, 466 U S 2 (1984), a copy of which is enclosed

In evaluating a tie-in involving a patented invention as the tying product, the Department of Justice also believes it important to recognize that a patent does not necessarily or ordinarily convey market power See Jefferson Parish Hospital District No 2 v Hyde, supra at 37 n 7 (O'Connor, J , concurring)

While the Department of Justice hopes that the Subcommittee finds our competitive analysis of tie-ins persuasive, the Subcommittee need not agree with all aspects of that analysis

in order to agree that legislation is needed to make clear that licensing may not be condemned on grounds related to competition unless analysis under antitrust standards demonstrates such conduct to be anticompetitive The misuse provisions in H R 1155 and S 1200 do not dictate that the Department's antitrust approach or anyone else's be followed -- they merely require courts to condemn tie-ins and other licensing practices only if antitrust analysis demonstrates the conduct to be anticompetitive Because antitrust analysis is the appropriate vehicle for separating conduct having anticompetitive effect from conduct that is not harmful to competition, tie-ins that survive antitrust analysis should be permitted

Under current case law, tie-ins that pass muster under the antitrust laws may nonetheless be condemned as misuse The per se rule against tie-ins in antitrust cases makes some attempt to assess the seller's power in the tying market and to assess foreclosure of competing producers in the tied market--factors more akin to rule of reason analysis employed for other vertical restraints--before judging the conduct to be per se illegal Indeed, some antitrust tie-in decisions have permitted some extended competitive analysis within the "per se" framework [1]

[1]For example, in Hirsh v Martindale-Hubbell, Inc , 674 F.2d 1343, 1347-48 (9th Cir), cert denied, 459 U S 973 (1982), the court observed that it must consider "whether the aggregation serves to facilitate competition by promoting product quality or whether it, in fact, amounts to no more than a naked effort to impede competition on the merits" and that "where . the aggregate sale of ostensibly separate items serves to improve the quality of the product offered by the seller . no tying arrangement is present."

The per se rule applied to tie-ins in misuse decisions may be considerably more rigid

> Unlike an antitrust claim for affirmative relief, the defense of patent misuse based upon a tying arrangement does not require any inquiry into the seller's market power in the tying product or the effect upon commerce in the tied product Any use of the patent to bring about a tying arrangement is considered to be an extension of the patent grant The only essential element for establishing the misuse defense in this circumstance is that the patent owner actually conditions the sale or license upon the purchase of another product Such finding may be based upon express agreement, as in a license, or upon extrinsic conduct

ABA Antitrust Section, Antitrust Law Developments 506 (2d ed 1984) (footnotes omitted) Thus, the Federal Circuit considered itself bound by precedent to approve a three-step analysis for determining patent misuse in a tying context (1) whether there were separable items tied, (2) whether the "thing" tied to the patented item was a staple item in commerce, and (3) whether they were in fact tied Senza-Gel Corp v Seiffhart, 803 F 2d 661, 231 USPQ 363 (Fed Cir 1986) The court in approving that rigid per se test stated that it was "bound to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or by the Supreme Court", while noting that "[c]ommentators and courts have questioned the rationale appearing in Supreme Court opinions dealing with misuse in view of recent economic theory and Supreme Court decisions in non-misuse contexts " Id at 665 n 5

Q 6 If Congress were to pass a bill which merely states that a "tie-in" is not misuse unless the patent owner had market power, would this be a fair compromise? If we go in that direction how should "market power" be defined (e g in terms of patent claims or antitrust market demand)?

A 6 We do not believe that the approach suggested in the question is adequate Misuse legislation should address all patent licensing practices that might be found to constitute misuse on grounds related to competition, and not just tie-ins Licensing practices that have been found to constitute misuse on competition-related grounds include

tie-outs or exclusive dealing (requiring the licensee to refrain from dealing in products that compete with the patented product) -- see, e g , National Lockwasher Co v George K Garrett Co , 137 F 2d 255, 58 USPQ 460 (3d Cir 1943),

compulsory package licensing (requiring the licensee to take additional patents where the licensee seeks a license under only one patent) -- see, e g , American Securit Co v Shatterproof Glass Corp , 268 F 2d 769, 122 USPQ 167 (3d Cir), cert denied, 361 U S 902 (1959),

territorial restrictions on the sale of unpatented products made with a patented process -- see, e g , Robintech, Inc v. Chemidus Wavin, Ltd , 628 F 2d 142, 205 USPQ 873 (D C Cir 1980),

total sales royalties (requiring the licensee to pay royalties on the basis of the licensee's total sales without regard to its actual use of the patent) -- see, e g , Zenith Radio Corp. v Hazeltine Research, Inc , 395 U S. 100 (1969),

post-expiration royalties (requiring royalties on use after expiration of a patent) -- see, e g Rocform Corp. v Acitelli-Standard Concrete Wall, Inc , 367 F 2d 678, 151 USPQ 305 (6th Cir 1966), and

charging licenses differing royalty rates (see Laitram Corp v King Crab, Inc , 244 F Supp 9, 146 USPQ 640 (D Alaska), modified, 245 F Supp 1019 (D Alaska 1965)), rates that are "exorbitant and oppressive" (see American Photocopy Equipment Co v. Rovico, Inc , 359 F 2d 745, 148 USPQ 631 (7th Cir 1966)), or refusing to license a patent that had been licensed to others (see Allied Research Products, Inc v Heatbath Corp , 300 F. Supp 656, 161 USPQ 527 (N D Ill 1969))

We doubt that it would be possible with regard to tie-ins and each of these other practices to state in statutory language particularized rules for determining when the practice should be found to constitute misuse, and we think that by far the better approach is to require antitrust analysis, as H R 1155 and S 1200 would do Otherwise, Congress would be locking in by statute the precise test to be applied in evaluating the competitive effects of particular practices, an approach that Congress has, we think wisely, avoided since passage of the Sherman Act in 1890 Under the approach of H.R 1155 and S 1200, misuse analysis of licensing practices challenged on competitive grounds would both keep pace with advances in antitrust analysis made by the courts and be sufficiently flexible to take account of all relevant facts and circumstances

As for the misuse rule for tie-ins suggested in the question, we do not think it is a complete and adequate statement of how the competitive effects of tie-ins involving patents should be evaluated While a tie-in should not be condemned, either as misuse or under the antitrust laws, where the patent owner lacks market power (in a property defined relevant market), we do not think that a finding of market power should itself be sufficient to dictate a finding that the tie-in is anticompetitive Rather, the danger of anticompetitive effects is absent unless there is also a reasonable possibility that the patent owner will obtain substantial market power in the relevant market for the tied product after the tie-in See Answer to Question 5 and Jefferson Parish brief, enclosed

Q 7 The Subcommittee recently received a letter from a former official of the European Economic Community (Harmut Johannes, who was responsible for intellectual property licensing and antitrust issues) that takes the view that despite the absence of an explicit "patent misuse" doctrine that patent licensing agreements are more carefully scrutinized as a result of European antitrust laws Do you agree? Isn't it fair to say that the presence or absence of a patent misuse doctrine in the United States is not relevant to international trade?

A 7 Patent licensing agreements in Europe are regulated under European Communities Commission regulations implementing Article 85 of the Treaty of Rome This article is similar to U S antitrust law in that it prohibits agreements and practices whose object or effect is to prevent, restrict or distort competition within the common market Its primary purpose, however, is to remove impediments to competition among the EC member states, not to maintain or promote competition within a member state It does appear that patent licensing agreements are more carefully scrutinized under Commission Regulation (EEC) No 2349/84, which provides guidance as to practices that "are generally not restrictive of competition" and conditions that negate this presumption, than under the various per se misuse rules adopted by U S courts We do not believe, however, that the "black list" of Article 3 of the Regulation reflects rigorous antitrust analysis

We believe the patent misuse doctrine may in many instances affect the United States' competitiveness in international trade As our prepared statements indicate, innovation is important to competitiveness in international trade, and licensing is a key method of promoting efficient use of innovation Therefore, anything that needlessly discourages licensing, as we believe the current patent misuse doctrine does, may have a negative impact on our international trade This impact may be particularly pronounced with respect to inventions made outside a corporate research establishment

because the development and commercialization needed in order to export may depend on the flexibility to negotiate satisfactory licenses Even if an invention is developed and commercialized, the patent misuse doctrine may discourage licensing for export For example, a U S manufacturer who can supply the U S but not foreign markets may be willing to grant licenses to permit manufacture for export only but may be unwilling to risk the consequences of a holding that a territorial restriction on sales (or other provision in the license) constitutes misuse, and therefore may refrain altogether from licensing for export

Q 8 Professor Mansfield has established that patent protection is more important in some industry sectors (e.g , prescription drugs) than others Do you agree that some patents are more important than others in terms of market power or influence?

A 8 Yes It is important to recognize that patents and other types of intellectual property are not monopolies They do not necessarily or even ordinarily convey market power Patents simply create property rights -- the right to exclude others from using the patented technology, typically in competition with other technologies in the marketplace Some courts have recognized this basic point See, e g., Schenck v Nortron Corp , 713 F 2d 782, 786 n 3, 218 USPQ 698, 701 n 3 (Fed Cir 1983). As recently as 1984, however, the Supreme Court in dictum referred to "the patent monopoly" and "the market power it confers," Jefferson Parish Hospital District No 2 v. Hyde, 466 U S 2, 16 (1984) Four Justices, in concurring in the Court's decision, described the notion that a patent necessarily conveys market power as "a common misconception " Id at 37 n.7 (O'Connor, J , concurring)

Q.9 Does the Administration approach on misuse (either H R 1155 or S 1200) in effect overturn the result of numerous Supreme Court cases? If so, please provide the Committee with an explanation of the impact of your proposals on these cases (attached)?

A.9 It is difficult to assess at this date whether the Administration-supported approach on misuse reflected in H R. 1155 and S 1200 would produce different results, in terms of whether misuse would be found, in cases decided many decades ago In order to perform such an analysis, one would need to analyze the conduct at issue in each such case under the antitrust laws as those laws would be applied today For several cases where misuse was found based upon facts stated in the opinion, it is likely that additional facts would be required to support a finding of an antitrust violation today This is particularly likely with respect to tie-ins, where analysis under the misuse doctrine has been substantially more truncated than under the antitrust laws, as we have described in response to question 5 We note that many of the Supreme Court cases that you have listed in your attachment were tie-in cases Motion Picture Patents Co v. Universal Film Manufacturing Co., 243 U S 502 (1917), Carbice Corp v American Patent Development Corp , 283 U S 27 (1931), Leitch Mfg Co v Barber Co , 302 U S 458 (1938), Morton Salt Co v G S Suppiger Co , 314 U S 488, reh'g denied, 315 U S. 826 (1942), B B Chemical Co v Ellis, 314 U S. 495 and International Salt Co v United States, 332 U S 392 (1947) (antitrust case)

The practices addressed in other cases -- such as total sales royalties (Zenith Radio Corp. v. Hazeltine Research, Inc , 395 U S 100 (1969), Automatic Radio Mfg Co v Hazeltine Research, Inc., 339 U S 827 (1950), reh'g denied, 340 US 846 (1950)) and grantbacks (Transparent-Wrap Machine Corp v. Stokes & Smith Co., 329 U S 637 (1947), reh'g denied, 330 U S. 854 (1947))-- would also be analyzed under the antitrust laws as they apply to such practices today. It would be somewhat difficult for us to perform this

analysis based on the facts presented in Supreme Court opinions, in part because Supreme Court antitrust analysis has over the years become more careful and complete and less likely to result in per se condemnation where the competitive effects of a practice are ambiguous E g , Northwest Wholesale Stationers, Inc v. Pacific Stationery & Printing Co , 472 U S 284 (1985); National Collegiate Athletic Association v Board of Regents, 468 U.S. 85 (1984); Broadcast Music, Inc. v Columbia Broadcasting System, 441 U S 1 (1979); Continental T V , Inc v GTE Sylvania, Inc , 433 U S 36 (1977)

The legislation supported by the Administration would overturn -- indeed, is intended to overturn -- those parts of Supreme Court decisions that held that misuse could be established on grounds related to competition without a finding of an antitrust violation Zenith Radio Corp v. Hazeltine Research Inc , 395 U S at 140-1, Transparent-Wrap Machine Corp v Stokes & Smith Co , 329 U S at 641; Morton Salt Co v G.S. Suppiger Co , 314 U S at 494 Thus, while we cannot state with great certainty which particular practices held to be misuse in particular Supreme Court decisions would be found not to be misuse under H R 1155 and S. 1200, we can state with certainty that the practices would be analyzed differently, with courts focusing on whether a practice, in the circumstances in which it was employed, violated the antitrust laws

Q 10 Should we legislate greater freedom with respect to copyright trademark and trade secret licensing? If not, why not?

A 10 We do not believe such legislation is needed at present with regard to misuse The Supreme Court has never squarely ruled that a copyright is not enforceable because it has been misused While some courts have assumed that a defense of copyright misuse can be asserted in a copyright infringement case, many district court decisions have rejected the notion that even an antitrust violation provides the basis for an unclean hands defense to a copyright infringement action See ABA Antitrust Section, Antitrust Law Developments 518-519 (2d ed. 1984), W Holmes, Intellectual Property and Antitrust Law §4 09 (1983) There thus does not appear to be any discernible trend toward condemning procompetitive copyright licensing under a copyright misuse doctrine

We see no need for misuse legislation with respect to trademarks and trade secrets. The property rights enjoyed by an owner of a trademark or trade secret do not result from a Federal grant, and the public policy basis for a holding of misuse -- that the patentee has extended the Federal grant improperly -- does not exist Accordingly, no misuse doctrine has developed for trademarks and trade secrets

While we see no need for patent misuse legislation to reach other types of intellectual property, we do believe that owners of other types of intellectual property as well as patent owners should be provided assurance that their licensing arrangements will not be hastily condemned under the antitrust laws Accordingly, the antitrust licensing legislation proposed (section 3102 of H R. 1155) and supported (H R. 557) by the Administration covers copyrights and trade secrets (including related know-how) as well as patents

PTO Q 11, DOJ Q.14 It has been suggested that patent infringement would not occur unless the patent owner enjoys market power with respect to the patented product and that the misuse defense, therefore, only arises where the patentee has actual market power Do you agree with this proposition?

PTO A 11, DOJ A 14 No It is plainly incorrect to suggest that patent infringement would not occur unless the patent owner enjoys market power That suggestion confuses market power with the mere existence of a property right and fails to recognize patent infringement as a form of trespass akin to stealing

Patents may and often do have value, just as tangible property has value Just as someone may steal a car, someone may "steal" intellectual property by infringing a patent. The fact that someone would want to infringe a patent only suggests that the intellectual property has some value, just as a car has But just as the unauthorized use or taking of a car does not in any way suggest that the car conveyed market power on its owner, the infringement of intellectual property does not in any way suggest that the intellectual property conveyed market power

PTO Q 12, DOJ Q 15 The misuse defense affects the patentee rather harshly, it results in the complete destruction of a patent right until the misuse is purged Do you consider this more severe than treble damage awards for antitrust violations?

PTO A 12, DOJ A 15 We agree that the sanction for misuse is harsh. The patent is unenforceable against anyone, not just a party who is injured by the alleged misuse, until the misuse has been eliminated and its effects purged from the marketplace Patented technology can be very valuable, and a finding of misuse effectively strips the patent owner of its property rights to that technology

A finding of misuse may be more costly to a patent owner than a treble damage judgment under the antitrust laws The size of a treble damage judgment is dictated by the actual damages found to have been suffered by an antitrust plaintiff (overcharges or lost profits), since it is those damages that are automatically trebled Even trebling those damages may be less costly to the patent owner than depriving it of its valuable patent rights In other instances, particularly where the value of the patent has diminished due to the expiration of much of the 17-year patent term or the development of competing technologies, treble damages may be more costly to the patent owner than a finding of misuse

Thus, whether a finding of misuse will be more costly to a patent owner than a treble damage award varies from case to case and depends upon the value of the patent and the actual damages found to have been suffered by the antitrust plaintiff But we think it is important to recognize, as your question does, that the sanction for misuse is harsh and not a "mild penalty" as suggested by PTO question 14, DOJ question 17

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PTO Q.13, DOJ Q.16 Robert Kline of Dupont and AIPLA has said that "[misuse] negatively affects virtually every license agreement involving technology developed or used in the U S " Do you agree?

PTO A 13, DOC A.16 Yes Given the number of licensing practices that have been held to be misuse and the severity of the consequences of such a holding, a responsible patent attorney must advise caution in license negotiations The threat of a holding of misuse thus has a chilling effect on a patent holder's willingness to consider novel or flexible arrangements to develop the patented technology. No amount of confidence or trust in a business partner can overcome the threat of misuse since a charge of misuse can be raised by an individual who is not a party to the challenged arrangement and cannot show that he or she is injured by it

PTO Q 14, DOJ Q 17 What would be the practical effect of requiring proof of antitrust violation as a prerequisite to establishment of a misuse defense? Is misuse (with its mild penalty of temporary loss of enforceability of a patent, but no damages) a lessor included offense for antitrust violations (with treble damages)?

PTO A 14, DOJ A 17 As your previous question (PTO Q 12, DOJ Q 15) and our response to it indicate, the penalty for misuse is harsh -- the patent owner loses the ability to enforce its patent rights so as to enjoin infringement and collect royalties for past infringement

The practical effect of requiring proof of an antitrust violation as a prerequisite to establishment of a misuse defense is that the harsh misuse sanction would be imposed only against those engaging in truly anticompetitive conduct Procompetitive licensing arrangements -- and intellectual property licensing arrangements are generally procompetitive -- would not be deterred

Where licensing conduct is challenged on grounds related to competition, the challenge should be resolved the way that competitive challenges to other conduct are resolved, by antitrust analysis Conduct that survives antitrust scrutiny should not be deterred by the harsh penalty that follows from a finding of misuse

PTO Q 15, DOJ Q 18 Please describe the licensing practices which courts have found to be "patent misuse" which would not meet the antitrust standard suggested by the Administration? Are all misuse practices aimed at prohibiting anti-competitive behavior?

PTO A 15, DOJ A 18 Patent licensing practices that courts have found to constitute misuse on competition-related grounds are listed in our response to Question 6, and our response to DOJ Question 11 lists practices condemned as misuse on a per se basis Under H R 1155 and S 1200, these practices would not be condemned as misuse unless, in the circumstances in which they were employed, they violated the antitrust laws Rather than trying to summarize the antitrust case law regarding each of the practices listed in our responses to questions 6 and 11[1], we will note three types of practices for which, in some cases, antitrust analysis would most assuredly produce different results than misuse precedent would suggest

Tie-ins -- As our answer to question 5 describes, the per se rule applied to tie-ins may be considerably more rigid in misuse cases than in antitrust cases As a result, tie-ins condemned under the misuse doctrine may pass muster under antitrust analysis, which makes some attempt to assess the seller's power in the tying market and to assess foreclosure of competing producers in the tied market,

Exclusive dealing -- While provisions in patent licenses requiring the licensee not to deal in products that compete with the patented product have consistently been held to constitute misuse

[1]For a summary of antitrust case law pertaining to different types of practices, see ABA Antitrust Section, Antitrust Law Developments (2d ed 1984).

per se, 4 D Chisum, Patents 19-107 (1987), exclusive dealing arrangements are not treated as per se unlawful under the antitrust laws because courts have recognized that they may have procompetitive effects, Antitrust Law Developments, supra, at 95-99,

Territorial restrictions on the sale of unpatented products made with a patented process -- Two decisions by the D C Circuit, just one year apart, illustrate the different outcome that can occur when a court analyzes the competitive effects of a practice under the antitrust laws instead of condemning it as misuse on what amounts to a per se basis without any analysis of market effects Compare Robintech, Inc , v Chemidus Wavin, Ltd , 628 F 2d 142, 205 USPQ 873 (D C Cir 1980) (finding misuse without any analysis of market effects) with United States v Studiengesellschaft Kohle, m b H , 670 F 2d 1122, 212 USPQ 889 (D C Cir 1981) (rejecting the government's antitrust challenge by applying rule of reason analysis and finding the restriction not to be anticompetitive)

In response to the second part of the question, while we cannot state that all judicial findings of misuse are aimed at prohibiting anticompetitive behavior, it does appear, as we stated in response to question 4, that the public policy underlying almost all misuse claims is the policy favoring competition. We emphasize again that the Administration intends its misuse legislation to affect misuse claims related to competition and not other misuse claims that may on occasion arise

PTO Q 16, DOJ Q 19. Is the current case law relating to patent misuse a clearer statement of what is allowed and what is prohibited than the antitrust law provides?

PTO A 16, DOJ A 19 As a judicially created doctrine without a clear theoretical basis, the misuse doctrine is inherently unpredictable As Professor Chisum has recognized, "Unfortunately, decisions considering analogous practices are not always consistent In part, this is attributable to the absence of a clear and general theory for resolving the problem of what practices should be viewed as appropriate exercises of the patent owner's statutory patent rights " 4 D Chisum, Patents 19-91 (1987)

Regardless of one's perception as to which body of law is clearer, we reiterate our view that it does not make sense to use different analyses for determining the competitive effects of a practice depending on the body of law under which the practices is being examined As Judge Posner has stated

> "If misuse claims are not tested by conventional antitrust principles, by what principles shall they be tested? Our law is not rich in alternative concepts of monopolistic abuse, and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty "

USM Corp. v SPS Technologies, Inc , 694 F.2d 505, 512, 216 USPQ 959, 965 (7th Cir 1982), cert denied, 462 U S 1107 (1983) Requiring courts to judge patent misuse by antitrust principles would at least assure that the draconian remedy of unenforceability would be imposed only after strict economic analysis and not on vague and shifting public policy grounds

PTO Q 17, Could you give us some examples of copyright misuse?
DOJ Q 20

PTO A 17, The doctrine of misuse is not as developed with regard
DOJ A 20 to copyrights as it is with regard to patents See generally ABA Antitrust Section, Antitrust Law Developments 518-519 (2d ed 1984), W Holmes, Intellectual Property and the Antitrust Laws § 4 09 (1983) We believe that an important distinction between the law that has developed regarding copyright misuse and patent misuse is that there does not appear to be any tendency by the courts to deprive copyright owners of their intellectual property on grounds related to competition because of licensing practices that would survive antitrust scrutiny

While some court decisions have rejected the notion that even an antitrust violation provides the basis for an unclean hands defense to a copyright infringement action, others have assumed that misuse can be asserted as a defense to copyright infringement [1] Id One Circuit Court, while recognizing the misuse defense in a copyright infringement case, held that "misuse" would produce a valid defense against copyright infringement only after a "balancing of equities." F E L Publications Ltd v Catholic Bishop, 1982-1 Trade Cas (CCH) 64,632, 73,464 n.9 (7th Cir), cert denied, 459 U S 859 (1982) (reversing lower court ruling that a copyright holder had engaged in illegal licensing and tying arrangements and thus could not enforce claim against infringement

[1]Although the Supreme Court has never explicitly recognized a copyright misuse defense, the Court in Broadcast Music, Inc v Columbia Broadcasting System, Inc , 441 U S 1, 24 (1979), may have implicitly recognized such a defense by reversing and remanding for further proceedings under the rule of reason both a per se antitrust judgment "and the copyright misuse judgment dependent upon it "

The one decision that we are aware of that applied a copyright misuse doctrine did so based upon "unclean hands" by the copyright owners in failing to notify licensees of beneficial provisions that a prior antitrust consent decree required them to offer. Tempo Music, Inc v Myers, 407 F.2d 503, 507, 160 USPQ 707, 710 (4th Cir 1969)

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QUESTIONS ADDRESSED ONLY TO

PATENT AND TRADEMARK OFFICE

PTO Q 18. Does the Patent & Trademark Office disbar registered patent attorneys who commit fraud or other inequitable conduct in procuring a patent? Explain how the disbarment proceedings work How many practitioners have been disbarred for this type of conduct? What are the reasons why a practitioner would not be disbarred following a final ruling by a court of fraud or other inequitable conduct?

PTO A 18 The Patent and Trademark Office disciplines registered practitioners who commit fraud or other inequitable conduct in procuring a patent The Commissioner has the authority to exclude (i e , disbar), to suspend or to reprimand an attorney or agent who, after notice and opportunity for a hearing in a disciplinary proceeding, has been found to have committed fraud or other inequitable conduct in procuring a patent Exclusion revokes or withdraws the individual's license to practice before the Patent and Trademark Office (PTO) Suspension of an individual removes the individual from the practice of law before the PTO for a minimum period of time, i e , suspends the individual's license to practice The PTO imposes the sanctions of exclusion or suspension upon attorneys and agents who have been found in a disciplinary proceeding to have committed fraud or other inequitable conduct in procuring a patent The sanction imposed depends upon the facts in the case, the public interest, deterrence, effects deemed necessary, integrity of the legal profession, and aggravating as well as mitigating circumstances

When a complaint is made concerning misconduct by a practitioner, an investigation is conducted by the Office of Enrollment and Discipline (OED) to determine if there has been a possible violation of the PTO Code of Professional Responsibility 37 CFR 10 131(a) and 37 CFR 10 20 to 10.112 If, after conducting the investigation and complying with the provisions of 5 U S C 558(c), the Director of OED is of the opinion that a practitioner has, by clear and convincing evidence,

violated a disciplinary rule, the Director presents to a Committee on Discipline the evidence and proposed formal complaint of the alleged violation of the disciplinary rules 37 CFR 10 132(a) and 10 134 If the Committee determines that probable cause exists to believe that a practitioner has violated a disciplinary rule, it so informs the Director, who institutes a disciplinary proceeding by filing a formal complaint with an Administrative Law Judge (ALJ) in the Department of Commerce 37 CFR 10 132(b) A copy of the complaint is served on the practitioner, or respondent, 37 CFR 10 135, who must file a written answer with the ALJ within a time set in the complaint which is not less than thirty (30) days 37 CFR 10 136

When the respondent files an answer, the disciplinary proceeding is regarded as a contested case If authorized, evidence obtained by subpoena may be considered Motions may be filed, limited discovery is permitted at this stage of the proceeding, 37 CFR 10 1143 and 10 152, and depositions may be taken for use in lieu of personal appearance of a witness before the ALJ 37 CFR 10 151

The ALJ presides at all hearings which are conducted in accordance with 5 U S C 556 37 CFR 10 144(a) The Director has the burden of proving his case by clear and convincing evidence, and respondent has the burden of proving any affirmative defense by clear and convincing evidence 37 CFR 10 149 Although the rules of evidence prevailing in courts of law and equity are not controlling in the disciplinary proceeding, the ALJ may exclude evidence which is irrelevant, immaterial or unduly repetitious. 37 CFR 10 150 No hearing in a disciplinary proceeding is open to the public except upon the Director's granting the respondent's request for the same, provided an agreement is reached between the Director and the respondent in advance of the hearing to exclude privileged or confidential information from public disclosure 37 CFR 10 144(c)

The ALJ makes an initial decision that includes a statement of the findings and conclusions, the reasons or basis therefor, and an order for exclusion (disbarment), suspension, or reprimand, or an order dismissing the complaint Unless appealed to the Commissioner, the initial decision of the ALJ becomes the final decision of the Commissioner 30 days from the date of the decision 37 CFR 10 154

Either the respondent or the Director may appeal the initial decision to the Commissioner within 30 days. The Commissioner decides the appeal on the record made before the ALJ, and the Commissioner's decision is a final agency action Review of the Commissioner's final decision is by a petition filed in the United States District Court for the District of Columbia 35 U S C 32 and 37 CFR 10 157

In the last five years, the PTO has successfully initiated disciplinary proceeding against five practitioners for fraud or other inequitable conduct Two were disbarred for misrepresentations made in petitions to revive abandoned patent applications, and one was suspended for misrepresentation involving answers given in support of a petition to change the filing date of a patent application Disciplinary action against two other practitioners is on appeal to the United States District Court for the District of Columbia These cases involve charges of backdating mailing certificates In addition, several practitioners currently have been served under 37 CFR 10 135 with charges involving fraud or inequitable conduct or are presently under investigation for this type of conduct

In the last 15 years, only one practitioner has been disciplined by the PTO for fraud and inequitable conduct involving failure to disclose material prior art The practitioner was suspended from practice before the PTO for a period of one year

A final ruling by a court on fraud or other inequitable conduct ordinarily occurs in law suits in which the practitioner is not a party Accordingly, practitioners cannot be found guilty of fraud or other inequitable conduct upon the final ruling or upon any evidence in any such suit unless such evidence has been properly admitted in a disciplinary proceeding Before considering the initiation of a disciplinary proceeding, the court's findings and opinions are reviewed by OED to ascertain whether there is any evidence of a violation of the PTO Code of Professional Responsibility In the absence of clear and convincing evidence, there is no reason to consider the matter further If, however, after review of the court's findings and opinion, the Director of OED is of the opinion that there is probable cause to believe that a disciplinary rule has been violated, the matter will be presented to the Committee on Discipline

A practitioner would not be disbarred or otherwise disciplined for fraud or inequitable conduct if the Committee on Discipline does not find probable cause exists to believe that the practitioner has violated a disciplinary rule, or if the ALJ or the Commissioner finds no clear and convincing evidence of misconduct by the practitioner See 37 CFR 10 154 and 10 156 If, after review of the Court's findings and opinion and after any other necessary investigation, the Director is not of the opinion that there is clear and convincing evidence of a practitioner's misconduct in procuring a patent, no disciplinary sanctions would be imposed on the practitioner

PTO Q 19 In the definition of fraud or other inequitable conduct in procuring a patent in H R 4086, which is drawn in part from a draft rule of the Patent & Trademark Office, the standard proposed for judging materiality of information is whether it "would render the claim unpatentable " This is a different standard from that currently applied by the Office and the courts Would the proposed standard leave any incentives for parties who are sued for patent infringement to raise charges of inequitable conduct, considering that they could raise a defense of the claim being "unpatentable" without charging inequitable conduct?

PTO A 19 Yes A party could certainly choose to allege only unpatentability based on nondisclosure, and this would be easier to demonstrate than fraud or inequitable conduct as defined in H R 4086 However, a party sued for infringement may still wish to raise charges of inequitable conduct since, in appropriate cases this could offer an opportunity for the court to hold all claims unpatentable, not only those directly affected by the art withheld In addition, a showing of fraud or inequitable conduct by the patentee could be considered by the court in a request for attorneys' fees

QUESTIONS ADDRESSED ONLY TO

DEPARTMENT OF JUSTICE

DOJ Q.11. In your prepared testimony at p 7, you stated that "patent misuse has been applied as a per se doctrine " Could you provide the Subcommittee with case citations in support of that statement?

a As an "equitable" doctrine, isn't patent misuse a concept that court examines through a balancing of relevant factors bearing on the respective "equities" of the practice involved?

b How can such a "balancing processing" fit into the type of analysis generally connoted by the term a "per se" analysis?

DOJ A 11 Despite the origin of the misuse doctrine as an equitable defense to actions for injunctive relief for infringement of a patent, per se rules have been adopted. As our answer to Question 4 indicates, the use of per se rules is one of the ways that the misuse doctrine appears to depart from traditional principles of equity

In using the term "per se" rules, we mean rules that condemn a practice once it is found to fit within a particular category, without considering the actual effects of the practice or justifications for its use As you know, the term "per se" is well known to antitrust courts, and per se rules apply to conduct such as price fixing and bid rigging that experience and anlysis indicate are almost universally pernicious While courts applying the misuse doctrine have used the term "per se" only occasionally, most likely because they have used neither antitrust analysis nor terminology, courts, nonetheless, have condemned conduct as misuse on what amounts to a per se basis, without considering the actual effects of or justifications for the conduct Patent misue has been applied as a per se doctrine in the following areas

Tie-ins -- see our answer to Question 5 for a discussion of how the per se rule applied to tie-ins may be considerably more rigid in misuse decisions than in antitrust decisions,

Compulsory package licensing -- See American Securit Co v Shatterproof Glass Corp , 268 F 2d 769, 776, 777 (3d Cir), cert denied, 361 U S 902 (1959) (mandatory package license "per se constitutes a misuse of patents", "[w]hatever may be the asserted reason or justification of the patent owner"),

Tie-outs or exclusive dealing -- "The courts have consistently taken the view that a provision in a patent license requiring a party not to deal in products that compete with the patented product constitutes misuse per se " 4 D Chisum, Patents 19-107 (1987) See, e g , National Lockwasher Co v George K Garrett Co , 137 F 2d 255 (3d Cir. 1943) (finding misuse as an attempted extension of the patent "monopoly" without any analysis of market effects),

Territorial restrictions on the sale of unpatented products made with a patented process -- See, e g , Robintech, Inc v Chemidus Wavin, Ltd , 628 F 2d 142, 146-149 (D C Cir 1980) (finding misuse without any analysis of market effects)[1], and

Requiring total sales royalties -- See Zenith Radio Corp v Hazeltine Research, Inc , 395 U.S 100, 139 (1969) ("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"),

[1]The D C Circuit, presented with an antitrust challenge to an almost identical restriction a year later, applied a rule of reason analysis and found the restriction not to be anticompetitive United States v. Studiengesellschaft Kohle, m b H , 670 F 2d 1122 (D C Cir 1981)

Post-expiration royalties -- In Brulotte v Thys Co , 379 U S 29, 32, (1964), the Supreme Court concluded that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful per se " Because the Court barred only the collection of royalties after expiration of the patent and did not bar all enforcement of the patent, the case is best viewed as not really involving misuse (See Chisum, supra, at $19 04[3][d]) Nonetheless, some courts, relying upon Brulotte, have held it to be misuse even to provide for post expiration royalties E g , Rocform Corp v Acitelli-Standard Concrete Wall, Inc , 367 F 2d 678 (6th Cir 1966)

DOJ Q.12 Are you contending that in all instances "tying practices associated with patent licensing are never a per se offense?

DOJ A 12. As is set forth more fully in the Brief For the United States in Jefferson Parrish (enclosed), the antitrust per se rule involving tie-ins differs significantly from other applications of the per se standard Unlike other per se rules, the tie-in rules laid down by the Supreme Court explicitly require an inquiry into facts peculiar to the products and markets at issue to determine whether one product is being tied to a separate product, whether the seller has sufficient economic power in the typing product market, and whether a "not insubstantial" amount of commerce in the tied product market is involved Times - Picayune Publishing Co v United States, 345 U S 594, 608-614 (1953), Fortner Enterprises, Inc v United States Steel Corp., 394 U S 495, 498-500 (1969) These rules thus make some attempt to assess the seller's power in the tying market and to assess foreclosure of competing producers in the tied product -- factors more akin to the rule of reason analysis employed for other vertical restraints -- before judging the arrangement to be per se illegal In addition, some lower courts have accepted evidence of "business justifications" or "lack of anticompetitive effects" to avoid application of the per se rule to tie-ins that do not threaten competition See, e.g., United States v Jerrold Electronics Corp , 187 F Supp 545, 559-560 (E D Pa 1960), aff'd per curiam, 365 U S 567 (1961), Coniglio v Highwood Services, Inc , 495 F 2d 1286 (2d Cir.), cert. denied, 419 U.S 1022 (1974)

DOJ Q 13 Your interpretation of the term "unreasonably" as used in H R 4086 seems directed at placing a "rule of reason" antitrust test on licensing practices Since some licensing practices may be per se illegal, wouldn't such a reading be an attempt to use H R 4086 as a vehicle for making a substantive change in the antitrust laws?

DOJ A 13 The word "unreasonably" is used in H R 4086 in listing several practices that the bill classifies as misuse -- i e , those practices would constitute misuse if engaged in "unreasonably" The bill does not define "unreasonably" or explicitly indicate the basis upon which courts are to determine whether a licensing practice is unreasonable in the circumstances

In my [Mr Rule's] prepared statement, I indicated that while the term "unreasonably" could be so vague as to leave courts with unfettered discretion, the term has meaning and bounds under the antitrust laws The antitrust laws do not condemn all agreements that restrain trade, but only those that do so unreasonably I stated that courts using the antitrust rule of reason are routinely called upon to determine whether a particular agreement "unreasonably" restrains trade, and those courts can rely on precedent limiting the focus of that inquiry to effects on competition I went on to conclude that the term "unreasonably" could be construed as intending courts to "undertake an antitrust analysis to determine whether a licensing practice constitutes misuse", and that would result in that licensing practice being treated as it would be under H R 1155 and S 1200

Courts can and do find certain practices (such as price fixing or bid rigging among competitors) to be unreasonable restraints of trade in violation of the Sherman Act on the basis of per se analysis where experience has demonstrated that those practices in

almost all instances lessen competition and consumer welfare Therefore, requiring courts to determine whether a practice is engaged in "unreasonably" based upon antitrust analysis does not necessarily preclude the use of per se tests Thus, I do not believe that the reading that I suggested of "unreasonably" in H R 4086 would necessarily make any substantive change whatsoever in the antitrust laws This is not to say, however, that such statutory language could not be utilized to alter per se rules if that is Congress' intent

Let me hasten to add that I do believe that we need legislation assuring that intellectual property licensing arrangements receive full and proper consideration under the antitrust laws. The Administration has drafted (section 3102 of H R 1155) and supported (H R. 557) legislation that would assure that licensing arrangements covering a variety of types of intellectual property will not be evaluated under per se rules, but will instead be evaluated under the rule of reason, which permits the patentee to explain to the court any procompetitive benefits that will result from the challenged activity See Statement of Deputy Assistant Attorney General Roger B Andewelt Before the House Subcommittee on Monopolies and Commercial Law Concerning H.R. 557, Intellectual Property Licensing Legislation, on April 30, 1987 Legislation in the area of antitrust treatment of licensing practices is important and we are committed to it, but it would not be accomplished by enactment of H R 4086 (however it is interpreted) or the misuse provisions of H.R 1155 or S 1200.

Do Not Remove

No. 82-1031

In the Supreme Court of the United States

OCTOBER TERM, 1982

JEFFERSON PARISH HOSPITAL DISTRICT NO. 2, ET AL., PETITIONERS

v.

EDWIN G. HYDE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF REVERSAL

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QUESTION PRESENTED

Whether a hospital that combines the sale of anesthesiology services with the sale of operating room facilities, as a result of an exclusive dealing contract between itself and a single group of anesthesiologists, may be held to have engaged in a "tie-in" that is per se unlawful under the Sherman Act.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF REVERSAL

INTEREST OF THE UNITED STATES AND THE FEDERAL TRADE COMMISSION

The United States and the Federal Trade Commission, which have primary responsibility for enforcement of the federal antitrust laws, have a substantial interest in assuring that the Sherman Act is construed in a manner that advances, rather than impedes, the Act's objectives.

STATEMENT

1. This case involves a common practice in the health care industry—an arrangement in which a hospital contracts with a group to be the exclusive provider of a particular service to the hospital and its patients. In considering the legal issues presented it will be helpful to recognize the factual landscape in which they are set. For a hospital to compete effectively in the market for surgical procedures, or indeed for any medical treatment, it must provide the full panoply of associated goods and services: operating, recovery and patient rooms; surgeons, anesthesiologists, nurses, and attending staff, and equipment, medicines,

bandages, beds, etc The failure to offer any of these essential components of surgery would undermine the hospital's competitive posture in relation to other facilities

The hospital will ordinarily have several options in deciding how to procure and provide these services It may (1) hire professionals to fill an allotted number of staff positions, (2) contract with a group of professionals for it to be the exclusive provider of such services, or (3) establish an open staff system that allows any qualified practitioner to obtain staff privileges.

The hospital involved in this case chose to have an exclusive dealing arrangement with a group of anesthesiologists. Thus, the services of that group were among the items provided to surgical patients when they selected the hospital for their medical care

2 Petitioner Jefferson Parish Hospital District No 2 owns East Jefferson District Hospital ("East Jefferson" or "Hospital") Pet. App. 20a. The Hospital is located in Metairie, Louisiana, a suburb of New Orleans Prior to its opening in 1971, the Hospital entered into a contract with Roux & Associates ("Roux"), a professional medical corporation, for Roux to be the exclusive provider of anesthesia services for the Hospital *Id* at 22a In 1976, the contract was renewed, and Roux continues to provide all anesthesia services at the Hospital *Id* at 23a [1] As a result of this contract, patients who are operated on at the Hospital must use the anesthesiology services of the Roux group [2]

Respondent, Dr Edwin Hyde, is a licensed and board certified anesthesiologist who chairs the anesthesiology department at Lakeside Hospital in New Orleans. Pet. App 2a, 30a. When he applied for staff privileges at East Jefferson, the Hospital's Credentials Committee recommended that Hyde be appointed to the staff, but the Board

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[1] At Roux's request the contract language designating Roux as the exclusive provider of anesthesia services was deleted in 1976, the Hospital, however, has maintained its practice of relying exclusively on Roux for these services Pet App 23a

[2] There was testimony at trial that doctors who are not on the Hospital medical staff could apply for temporary privileges on a case by case basis Pet App 23a

of Directors refused him privileges because of the exclusive contract with Roux. *Id* at 25a-26a.

Hyde brought this antitrust suit in the United States District Court for the Eastern District of Louisiana, claiming that the Hospital had tied the use of Roux's anesthesia services to purchase of the Hospital's surgical facilities and that this conduct violated Section 1 of the Sherman Act, 15 U S C 1 Pet App 36a-37a [3]

3 The district court dismissed the complaint. Although it assumed there was a "tie" of two separate services,[4] the district court rejected respondent's claim of per se illegality First, the court held that the professions are not subject to the same per se rules applicable to other businesses Pet App 37a, 39a It also ruled that the arrangement was not illegal per se since the Hospital did not have dominant power in the market for surgical facilities, the tying product *Id* at 38a. This ruling rested on its finding (*id* at 33a-34a) that the geographic market in which the Hospital competes (the New Orleans metropolitan area) included at least 20 other hospitals that provided the same surgical services These hospitals serve the large majority of residents who live in the vicinity of East Jefferson Hospital, indeed 70% of patients who live on the East Bank of Jefferson Parish (where the Hospital is located) go to hospitals other than East Jefferson *Id* at 33a. The court also found that traditional indicia of market power were lacking: the tying product was not unique and similar packages were available from other local facilities; the Hospital's prices were no higher than its competitors' nor were its terms of supply

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[3] Respondent also alleged violations of the Fourteenth Amendment and of state law The district court dismissed those claims Pet App 42a-47a The court of appeals did not reach those issues (*id* at 5a n 3), and they are not before this Court

[4] The only finding on this issue was that anesthesia service appears as a separate item on the patient's bill Pet App 33a

more burdensome, and there was no indication that unwilling patients were coerced to take a product on unsatisfactory terms. *Id* at 37a-38a [5]

The district court therefore applied the rule of reason to petitioners' conduct and found it reasonable It noted significant efficiencies that result from the exclusive contract with Roux. improved round-the-clock coverage, better control and standardization of procedures, and more efficient and less costly operation of the department [6] And it concluded that, given the relevant market, the benefits of the closed system outweighed any "minimal" foreclosure of Roux's competitors

4 The court of appeals reversed (Pet App 1a-19a), concluding that the Hospital's contract with Roux was illegal per se [7] *Id* at 14a-15a The court stated that there was a "tie" of "two distinct services which a buyer should be able to obtain separately," *i e* , surgical services and anesthesia services *Id.* at 5a-6a Next, the court rejected the dis-

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[5] The district court found that most surgeons have privileges at more than one hospital, thus, they can take their patients to another hospital if they prefer a particular anesthesiologist Pet App 34a Patients have the same choice *Ibid*

The court also found that it is common practice in the health care industry for hospitals to enter into exclusive contracts with physicians engaged in certain hospital-based specialties, such as anesthesiology, radiology and pathology, to insure the availability of these services to their patients, and that, generally, a patient does not specifically select a particular specialist to perform these services Pet App 32a In the court's view, these factors increased the hospital's responsibility to provide quality service *Ibid*

[6] The court found that such a system lends flexibility to the scheduling of operations because it is not necessary to accommodate physicians with outside commitments, it permits the doctors, nurses, and technicians in the department to develop a work routine and a proficiency with the equipment, it increases the Hospital's ability to monitor performance because fewer individuals are involved, and maintenance of equipment is simplified and equipment breakdowns reduced as a result of use by fewer doctors Pet App 32a-33a

[7] The court held that per se rules under the Sherman Act are as applicable to the health care industry as to other industries Pet App 14a-18a See *Arizona* v *Maricopa County Medical Society*, 457 U S 332 (1982)

trict court's finding that the proper geographic market for the tying product included hospitals in Orleans Parish because, in its view, imperfections in the health market (due to third-party payors, and inability of patients to compare the quality of medical care) deprive consumers of the incentive to shop for quality or lower costs, consumers were therefore deemed likely to select the hospital closest to their homes *Id* at 9a The court thus found the relevant market to be the East Bank of Jefferson Parish, a market "much smaller than the district court found" and one in which the Hospital "ha[s] sufficient market power * * * to coerce purchase of the tied product " *Id* at 10a. The court's finding of market power was based on the fact that nearly one-third of the patients from the East Bank of Jefferson Parish go to the Hospital. *Ibid*

Addressing the anticompetitive effects of the challenged practice,[8] the court acknowledged that the "tie-in" did not result in higher charges for anesthesia services Pet. App. 11a It found, however, that "it accomplished just as dramatic an effect by increasing the hospital's profit" by enabling the Hospital to "supplement[ ] a small contract group of anesthesiologists with a larger group of lower priced [paraprofessional] anesthetists." *Id* at 11a-12a The court found that the contract produces "a number of anticompetitive effects." it prevents anesthesiologists from entering the portion of the market controlled by the hospital, it indirectly limits the number of anesthesiologists in the area, and reduces the incentive for improving quality; and it limits the surgeon's or patient's choice of anesthesiologist *Id* at 12a In addition, the court rejected the contention that competition still exists at the point where the contract for anesthesiology is awarded by the Hospital, because the Hospital "has not permitted this competition since the original contract was signed over ten years ago " *Id* at 12a n 9 The court also rejected the "business justifications" for the contract because, in the court's view, the

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[8] It was apparently not disputed that the practice involved a "not insubstantial" volume of interstate commerce, as the district court (Pet App 3a) and court of appeals (*id* at 13a n 10) both found

same objectives could be achieved through less restrictive alternatives *Id* at 14a

SUMMARY OF ARGUMENT

1 The court of appeals mischaracterized the exclusive dealing arrangement at issue here as a "tie-in" by focusing solely on the combined sale of surgical facilities and anesthesiology services without appreciating that the combined sale resulted automatically from the exclusive dealing arrangement between the Hospital and the Roux group This mechanical adherence to labels elevated form over substance and led the court to brand the Hospital's conduct as a "tie-in" and, accordingly, to condemn it as illegal per se without fully considering the procompetitive effects the district court had found. Even if the challenged practice is viewed as a "tie-in," the court of appeals' analysis is legally deficient in several respects, first, it erred in concluding that, merely because surgical and anesthetic services *could* be sold separately, they *must* be Second, it improperly rejected the district court's definition of the relevant geographic market and then, within this smaller market, used inappropriate guidelines for assessing the Hospital's market power.

2. The ease with which the court of appeals could transform an exclusive dealing contract, subject to scrutiny under the rule of reason, into a "tie-in" that is illegal per se, illustrates one of the difficulties inherent in the tying doctrine. Although this Court has, since *International Salt Co* v *United States*, 332 U.S 392 (1947), placed tying arrangements in the category of per se offenses, it has not accepted the simplistic approach employed by the court of appeals. Instead, the tying doctrine has evolved in a manner quite unlike other per se rules. Whereas other per se violations are established without regard to competitive impact, the tie-in rules laid down by this Court explicitly require an inquiry into facts peculiar to the products and markets at issue to determine whether a foreclosure effect exists. Moreover, some of the lower courts, following this Court's lead, have scrutinized whether a practice is justified by business

per se condemnation of "tie-ins" that do not threaten competition This is of course more consistent with the rule of reason approach applied to conduct that does not invariably have a "pernicious effect on competition" and that may have some "redeeming [competitive] virtue" *Continental T V , Inc* v *GTE Sylvania, Inc* , 433 U.S 36, 49-50 (1977)· Accordingly, we believe it would now be appropriate for the Court expressly to confirm that alleged tie-ins should be scrutinized to determine whether market conditions are such that anticompetitive effects could be realized and, in those instances, whether sufficient justifications nevertheless exist to permit the challenged practices

3. The course we suggest is not an abrupt or radical departure from current law First, the more discerning opinions have already adopted analyses that incorporate traditional competitive impact factors Second, economists and legal scholars have recognized that the instances in which alleged "tie-ins" in fact produce anticompetitive effects arise only in limited circumstances. These relatively few instances do not justify the proscription of a broad category of conduct that in many cases is procompetitive Moreover, where anticompetitive effects are shown, and they outweigh economically beneficial effects, antitrust liability will still be imposed—but with the assurance that only demonstrably pernicious conduct will be penalized.

ARGUMENT[9]

I THE COURT OF APPEALS MISAPPLIED PREVAILING ANTITRUST LAW IN TREATING THE HOSPITAL'S CONTRACT WITH ROUX AS A TIE-IN AND, HENCE, ILLEGAL PER SE

The court of appeals erred in treating the arrangement between the Hospital and Roux as a "tie-in," governed by a per se standard of illegality, rather than as an exclusive dealing contract whose legality is judged by the rule of reason All other courts of appeals that have addressed the is-

[9] The Federal Trade Commission joins in Section I of this brief, it also supports the general conclusions of Sections II and III, that the legal treatment of tying arrangements should be clarified to take into account the relevant economic and competitive factors

sue have treated exclusive arrangements between hospitals and physicians as vertical restrictions subject to the rule of reason [10] The Fifth Circuit, however, failed to recognize that the combined sale of anesthesiology and surgical services by the Hospital resulted automatically from and, as a practical matter, was required by the arrangement under which Roux provided all of the anesthesiology services in the Hospital Since the legality of the exclusive dealing contract is judged under the rule of reason, *Tampa Electric Co* v. *Nashville Coal Co* , 365 U.S. 320, 333-335 (1961), neither logic nor antitrust policy is served by judging the resultant and ancillary combined sale by a per se standard

In addition to its error in condemning the Hospital's practice as per se unlawful, the court's analytical path to that conclusion reflects additional misapplications of established tie-in principles For example, the court mechanically classified the aggregation of surgical and anesthesia services as a "two-product" package, each component of which patients should be free to obtain separately. In contrast to the automatic approach adopted below, this Court has made clear that the mere separability of combined products or services does not suffice for invocation of the tying doctrine *Times Picayune Publishing Co* v. *United States*, 345 U.S 594, 613-614 (1953) Accordingly, the separability test employed by the court of appeals does not comply with this Court's instruction that the gravamen of the tie-in offense is "the forced purchase of a second *distinct* commodity * * * resulting in economic harm to competition in the 'tied' market." *Id* at 614, emphasis added. See Gov't Pet. Br 7-12 [11]

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[10] *Dos Santos* v *Columbus-Cuneo-Cabrini Medical Center*, 684 F 2d 1346 (7th Cir 1982), *Capili* v *Shott*, 620 F 2d 438 (4th Cir 1980), *Harron* v *United Hospital Center, Inc* , 522 F 2d 1133 (4th Cir 1975), cert denied, 424 U S 916 (1976), *Smith* v *Northern Michigan Hospitals, Inc* , 518 F Supp 644 (W D Mich 1981), aff'd, No 81-1513 (6th Cir Mar 25, 1983) See the recent advisory opinion by the Federal Trade Commission, appended to petitioner's brief at A-1 to A-10 See also *Robinson* v *Magovern*, 521 F Supp 842 (W D Pa 1981), aff'd mem , 688 F 2d 824 (3d Cir 1982), cert denied, No 82-415 (Nov 1, 1982)

[11] "Gov't Pet Br " refers to the government's amicus curiae brief filed in support of the petition for a writ of certiorari

Further, the court's geographic market definition and resulting finding of substantial market power in the market for surgical services ignored clearly supported findings of fact made by the district court See Gov't Pet Br 12-14 This Court's decision in *Tampa Electric Co* v. *Nashville Coal Co supra*, 365 U.S at 331, teaches that a court must identify the "relevant market of effective competition " See *Robinson* v. *Magovern*, 521 F. Supp 842, 878 (W D Pa 1981), aff'd mem., 688 F 2d 824 (3d Cir 1982), cert denied, No. 82-415 (Nov. 1, 1982). In this case, the court of appeals pared down the geographic market determined by the district court[12] and then, on the basis of this reduced area, concluded that the Hospital wielded sufficient power to warrant application of the per se standard In our view, the Fifth Circuit was incorrect in redrawing the borders of the market, and consequently erred in assessing the Hospital's power in that market Indeed, the court below acknowledged that under the "traditional method of economic power analysis" the respondent "has failed to prove an illegal tying arrangement" (Pet. App 8a) Only by relying on its own assessment that patients "select the hospital closest to home" and prefer a "non-profit entity" (*id* at 9a), did the court reject the traditional analysis and the district court's conclusions The court's reliance on these factors was misplaced as a matter of law (see Gov't Pet Br 13-14).

Any one of these errors would suffice to justify reversal by this Court. But we believe that the fundamental error in the court of appeals' decision is its wooden characterization of the contract as a "tie-in" and the resulting condemnation of the arrangement as per se unlawful The court of appeals' opinion is virtually a roadmap showing how the hypertechnical affixing of labels, without meaningful substantive analysis, can lead to results that distort the federal antitrust laws. Because antitrust legality should turn on a reasonable assessment of likely competitive effects, the fact that a practice could fit within a particular rubric—*e g* , "tie-in" or "exclusive dealing"—should not be determina-

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[12] The court of appeals did not conclude that the district court's findings of fact on market definition were clearly erroneous, it therefore erred in substituting its judgment on these factual matters Fed R Civ P 52(a), *Inwood Laboratories, Inc* v *Ives Laboratories, Inc* , No 80-2182 (June 1, 1982), slip op 10-13, *Pullman-Standard* v *Swint*, 456 U S 273, 290-292 (1982)

tive See *Continental T V , Inc* v *GTE Sylvania, Inc* , 433 U S 36, 47 (1977), *Broadcast Music, Inc* v *CBS*, 441 U S 1, 9 (1979) In order to avoid similar errors in future cases, and to assist the court of appeals should the case be decided on narrower grounds and remanded, we urge this Court to articulate criteria that address the primary antitrust inquiry whether a challenged practice is likely to harm competition

II THIS COURT SHOULD ARTICULATE EXPLICITLY THE FACTORS THAT ARE OFTEN IMPLICITLY USED TO CHARACTERIZE AND EVALUATE THE LEGALITY OF TIE-INS

A. Tie-ins Were Placed In The Category Of Per Se Offenses Because They Were Perceived To Be A Monopolization Device

This Court first placed "tying" arrangements in the category of conduct deemed illegal per se under the Sherman Act in *International Salt Co* v *United States*, 332 U S 392, 396 (1947) Tying arrangements were viewed as "serv[ing] hardly any purpose beyond the suppression of competition" (*Northern Pacific Ry* v *United States*, 356 U.S 1, 6 (1958)), they were considered to be a coercive means by which a seller with economic power in one market (the tying product) could extend that power into another market (the tied product) *International Salt Co* v. *United States*, *supra*, 332 U.S at 396, *Standard Oil Co* v *United States*, 337 U.S 293, 305-306 (1949), *Times-Picayune Publishing Co* v. *United States*, 345 U.S 594, 611 (1953) The per se rule against tie-ins, therefore, was based on the desire to prevent the expansion or extension of monopoly power from one market to another. *Times-Picayune*, *supra*, 345 U.S at 611, *Fortner Enterprises, Inc* v. *United States Steel Corp* , 394 U S 495, 498-499 (1969) *("Fortner I")*, *United States Steel Corp* v *Fortner Enterprises, Inc* , 429 U S. 610, 617-618 & n 8 (1977) *("Fortner II")*.

The per se rule involving tie-ins has, from its inception, differed from other applications of that standard in one significant respect Per se rules ordinarily preclude analysis of anticompetitive effects or consideration of defense "justifications." See *Broadcast Music, Inc* v *CBS*, *supra*, 441 U.S at 17 Thus, in a price-fixing case a plaintiff need not

prove anticompetitive effect, nor may defendants justify their behavior because their conspiracy was ineffective or set prices that were in fact at a competitive level In applying the tying doctrine, however, the courts have recognized that not every practice that could literally be characterized as a "tie-in" invariably justifies condemnation under the Sherman Act Indeed, the tie-in rules laid down by this Court explicitly require an inquiry into facts peculiar to the products and markets at issue to determine whether one product is being tied to a separate product, whether the seller has sufficient economic power in the tying product market, and whether a "not insubstantial" amount of commerce in the tied market is involved *Times-Picayune*, *supra*, 345 U.S at 608-614, *Fortner I*, *supra*, 394 U S at 498-500 These rules thus make some attempt to assess the seller's power in the tying market and to assess foreclosure of competing producers in the tied market—factors more akin to the rule of reason analysis employed for other vertical restraints—before judging the arrangement to be per se illegal [13] In addition to this three-part inquiry, moreover, some lower courts have accepted evidence of "business justifications" or "lack of anticompetitive effects" to avoid application of the per se rule to tie-ins that do not threaten competition See, *e g* , *United States* v *Jerrold Electronics Corp* , 187 F Supp 545, 559-560 (E D. Pa 1960), aff'd per curiam, 365 U S 567 (1961),[14] *Conglio* v.

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[13] If an alleged tie-in does not meet the "separate product," tying market power, and "not insubstantial" amount of commerce tests, then it is judged under the rule of reason *Times-Picayune*, *supra*, 345 U S at 614

[14] In *Jerrold Electronics* the district court found that, while the government had elsewhere established a two-product tie-in of community antenna equipment to engineering service contracts, and where the other prerequisites of "economic power" and effects on a "not insubstantial amount of interstate commerce" were met, the unique circumstances of the case nonetheless justified a refusal to condemn the tie-in 187 F Supp at 555-556 The court found the tie-in to be reasonable, hence legal, because it was used "to foster the orderly growth of the industry on which the future of Jerrold depended " *Id* at 557 This "business justification defense," as it has come to be called (see, *e g* , Baker, *The Supreme Court and the Per Se Tying Rule Cutting the Gordian Knot*, 66 Va L Rev 1235, 1249-1251(1980)), is something that per se rules normally do not permit E Singer, *Antitrust Economics and Legal Analysis* 109-110 (1981)

Highwood Services, Inc , 495 F 2d 1286 (2d Cir.), cert denied, 419 U S 1022 (1974), cf *Foremost Pro Color, Inc* v *Eastman Kodak Co* , No. 80-5629 (9th Cir. Feb 23, 1983)

In the following sections, we will examine the unusual application of the per se test as it has been implemented by the courts in cases alleging tie-ins.

B. The Better Reasoned Tie-in Decisions Have Permitted Some Extended Competitive Analysis Within The "Per Se" Framework

1 In this case, the Hospital's provision of surgical and anesthesia services as a single package can literally be characterized as a "tie-in." But the simple fact that a label can be applied to a practice does not necessarily determine its potential for anticompetitive effect and should not, therefore, be dispositive of its legality.[15] *Continental T.V Inc* , v *GTE Sylvania, Inc* , *supra*, 433 U S at 47, *Broadcast Music* v. *CBS*, *supra*, 441 U S at 9. As a consequence, some of the lower courts have recognized the potential procompetitive functions of tie-ins and have, accordingly, applied the per se rules laid down by this Court in a manner that takes into account the competitive effects and business justifications for the conduct at issue.

2. Some courts have used the one-product/two-product test to justify an inquiry into the business considerations relevant to a challenged tying practice, and have avoided classifying a packaged sale as illegal absent a realistic threat of anticompetitive effects. See Baker, *The Supreme Court and the Per Se Tying Rule Cutting the Gordian Knot*, 66 Va L Rev 1235, 1315 (1980) For example, in *United States* v. *Jerrold Electronics Corp* , *supra*, 187 F. Supp at 559-560, the court accepted "a sound business reason" (*i e* , the inability to launch and develop an experi-

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[15] In this case the tie-in was the inevitable result of the Hospital's exclusive dealing contract with Roux If such an exclusive contract were legal under the rule of reason approach that is generally applied to nonprice vertical restraints, then as a matter of logic the tie-in automatically following from that arrangement should be legal Whether the practice is viewed as an exclusive dealing arrangement or a tie-in, therefore, the antitrust analysis should follow the same course

mental business using sensitive and unstable equipment unless service was sold in a package with the equipment) as a legal justification for the sale of a package of various items of equipment designed for community antenna systems [16] Similarly, in *Hirsh* v *Martindale-Hubbell, Inc* , 674 F.2d 1343, 1347-1348 (9th Cir. 1982), cert denied, No 82-570 (Nov. 1, 1982), the court observed that it must consider "whether the aggregation serves to facilitate competition by promoting product quality or whether it, in fact, amounts to no more than a naked effort to impede competition on the merits" and that "where * * * the aggregate sale of ostensibly separate items serves to improve the quality of the product offered by the seller * * * no tying arrangement is present "

Unless a court is as discerning as the *Jerrold* and *Hirsh* courts were to go beneath the surface of the literal tie-in rules to examine competitive realities, it may feel obliged to find a practice per se illegal even though the procompetitive benefits may outweigh any ancillary anticompetitive effects. This more mechanistic approach is demonstrated by the decision below The court of appeals found it "clear," without any analysis, "that we are dealing with two distinct services which a buyer should be able to obtain separately" (Pet. App. 5a-6a) This cursory consideration, amounting to a "separability" test, led the court to ignore both the close functional relationship between the "tied" services, and the vertical integration achieved by the challenged contract [17]

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[16] Accord, *Dehydrating Process Co* v *A O Smith Corp* , 292 F 2d 653, 655-656 (1st Cir), cert denied, 368 U S 931 (1961) ("sound business interests of the seller" warranted treatment of components as "inseparable"), *Foster* v *Maryland State Savings & Loan Ass'n*, 590 F 2d 928, 932 (D C Cir 1978), cert denied, 439 U S 1071 (1979) ("Incidental services purchased by the seller (lender) for legitimate business reasons cannot be viewed as a separate (or tied) product, merely because the buyer is charged for them"), cf *Siegel* v *Chicken Delight, Inc* , 448 F 2d 43, 48 (9th Cir 1971), cert denied, 405 U S 955 (1972) (package may be single product where the amalgamation results in cost savings apart from reduction in sales expenses and the like, or where the items are normally sold or used in fixed proportions)

[17] Many items can be broken down into components that conceivably could be offered for sale separately For example, a pair of shoes is lit-

By contrast, many lower courts have looked beyond the separability of products sold as a package in determining whether to treat an aggregation as an illegal "tie", they have instead looked to the seller's reasons for coupling the products and the policies underlying the tying rule as guides to characterization [18] Unlike the oversimplified ap-

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erally a "tie" of one right and one left shoe and, going further, of shoes and laces, heels and soles It is, of course, preposterous to suggest that the sale of shoes in pairs is an illegal tie-in, but the illustration is instructive in two respects First, it highlights the pitfalls of a hypertechnical approach to the one product/two product issue And, if we analyze the reasons why pairs of shoes are not illegally tied products we can discern rules of more general application A shoe has no commercial utility without its mate, consumers expect to purchase the pair as a unit, there are not separate markets for right and left shoes, negating the possibility that power in one market could be "leveraged" into the other, competitors are easily able to duplicate the "package", and finally, there are efficiencies that can be realized in manufacture and distribution The same factors are present in this case Yet the court of appeals' elevation of formal labels over substance left no place for consideration of the functional and economic justifications for the packaged sale of surgical and anesthetic services

Proper product definition is "not bounded by the minimum product that could be or typically is sold, but rather bounded at the point where the amalgamation appears to have relatively little economic justification " Turner, *The Validity of Tying Arrangements Under the Antitrust Laws*, 72 Harv L Rev 50, 71-72 (1958), R Bork, *The Antitrust Paradox*, 371, 378-379 (1978), L Sullivan, *Handbook of The Law of Antitrust* 455 (1977) "The definition of what constitutes a single product in a tying arrangement * * * may have to change with its economic environment " E Singer, *supra*, at 114 Authors Dolan & Ralston, *Hospital Admitting Privileges and the Sherman Act*, 18 Hous L Rev 707 (1981), suggest that factors relevant to a proper product definition of hospital services include customary practices in the industry, the common understanding of people about such commodities, technological realities, and other economic efficiencies *Id* at 757 The authors also suggest that in specialties like anesthesiology, "custom requires the purchase of those services from the hospital" and "it could be reasoned that no tying agreement exists because of the close identity of the services and the hospital " *Id* at 758

[18] See, *e g , Krehl* v *Baskin-Robbins Ice Cream Co* , 664 F 2d 1348, 1354 (9th Cir 1982), *Principe* v *McDonald's Corp* , 631 F 2d 303 (4th Cir 1980), cert denied, 451 U S 970 (1981), *Dehydrating Process Co* v *A O Smith Corp* , *supra*, *United States* v *Jerrold Electronics Corp* , *supra*

proach adopted by the Fifth Circuit, the better reasoned opinions have "long recognized that the rules governing tying arrangements are designed to strike solely at practices employed to impede competition on the merits" *Hirsh* v *Martindale-Hubbell, Inc*, *supra*, 674 F.2d at 1348 As *Hirsh* and similar cases illustrate, the conclusion that an illegal tying arrangement exists cannot properly be reached without consideration of the purposes of the tying rule and the competitive function of the challenged aggregation of products Because the Hospital's anesthesia contract combines functionally related services in an efficient form of vertical integration, it does not create a "forced purchase of a * * * distinct commodity" and may not cause "economic harm to competition in the 'tied' market" It therefore should not be characterized as the illegal sale of two distinct services *Times-Picayune*, *supra*, 345 U.S at 614 Nevertheless, the court of appeals failed to consider possible justifications for the bundling of anesthesia services with other hospital products and services, even while it acknowledged that the exclusive contract resulted in significant cost savings to the Hospital [19]

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[19] The court of appeals erred in holding that such cost savings brought about an anticompetitive result merely by increasing the Hospital's profits Pet App 11a-12a Arrangements that increase efficiency and lower costs enhance welfare, even if they also increase a firm's profits It is, of course, the profit incentive that motivates firms to innovate and to reduce costs

The court was also incorrect in implying that anesthesiologists require special protection from nurse-anesthetists, their "paraprofessional counterpart[s]" Pet App 11a To the contrary, the antitrust laws were promulgated to promote, not frustrate, the entry of competitive alternatives The antitrust laws should not be transformed into a tool that allows competitors to prevent competition by competent, state-licensed, non-physician health care providers, their purpose, rather, is to assure that where state-authorized alternatives are available consumers have the option to use them

The court's failure adequately to consider cost reductions and other competitive justifications was exacerbated by its invocation of the "less restrictive" alternative standard (Pet App 12a-13a) While the clear availability of such alternatives is a relevant factor in determining the existence of either anticompetitive intent or effect (see *White Motor Co* v *United States*, 372 U S 253, 270-272 (1963) (Brennan, J, concurring), it does not in itself prove that the means selected were ei-

Sellers throughout our economy offer aggregations of parts, products, and services that can be sold separately, but that sometimes may be supplied more efficiently and conveniently when packaged together. It is important that antitrust analysis distinguish aggregations that promote consumer welfare and competition from those that injure competition and coerce consumers Pet App 5a-6a Consequently, we believe that this Court should go beyond its tacit acceptance of the more sophisticated decisions that analyze the economics of a package sale before classifying it as a one- or two-product sale (see *Jerrold Electronics, supra*, 365 U S at 567),[20] and should explicitly require such an analysis in appropriate cases [21]

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ther unreasonable or anticompetitive The court of appeals' use of the rule would make firms

> guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question that would result in a somewhat lesser restriction of trade And courts would be placed in the position of second-guessing business judgments as to what arrangements would or would not provide 'adequate' protection for legitimate commercial interests

American Motor Inns, Inc v *Holiday Inns, Inc* , 521 F 2d 1230, 1249-1250 (3d Cir 1975)

[20] This Court discussed the relevant considerations generally in *Times-Picayune Publishing Co* v *United States, supra* There, the Court looked beyond mere separability, to the nature and function of the allegedly tied products and the realities of the market 345 U S at 613 It then compared the challenged practice with the "common core of the adjudicated unlawful tying [cases]"—"the forced purchase of a second distinct commodity * * * resulting in economic harm to competition in the "tied' market " *Id* at 614 Finding that "neither the rationale nor the doctrines evolved by the 'tying' cases" were involved, the Court refused to dispose of the case under the tying rule, it held instead that the challenged practice must be "tested under the Sherman Act's general prohibition on unreasonable restraints of trade " *Ibid*

[21] Under the tie-in rules presently articulated, the one-product/two-product issue is the first one considered by the courts Under criteria that focus on anticompetitive potential rather than on the form of the challenged conduct, however, one would not need to examine the separate product issue unless analysis indicated that the defendant possessed sufficient market power to enable a court to conclude that the tie-in had significant anticompetitive potential In that situation, the defendant would have the burden of proving as an affirmative defense

3 The second pre-condition of a per se illegal "tie-in"—that the seller have significant economic power in the market for the tying product—has also been used by discerning courts to avoid automatic condemnation of sales of bundled products whose purpose and effect is unlikely to be anticompetitive. See *Fortner II*, *supra*, *Warner Management Consultants* v *Data General Corp* , 545 F. Supp 956, 965-966 (N D. Ill 1982), *In re Data General Corp Antitrust Litigation*, 529 F. Supp. 801, 806-821 (N.D. Cal 1981), *JBL Enterprises, Inc* v *Jhirmack Enterprises, Inc* , 509 F Supp. 357, 377-378 (N.D. Cal 1981); *Refrigeration Engineering Corp* v *Frick Co.*, 370 F. Supp 702, 711-712 (W D. Tex 1974). Yet, the "economic power" test, as enunciated in some of this Court's decisions, may also lead to erroneous predictions of a tie-in's competitive effects While on its face the "economic power" test may "suggest [] a discussion of the available economic evidence in what might appear to be a rule of reason approach" (see E. Singer, *Antitrust Economics and Legal Analysis* 109-110 (1981)), a number of this Court's earlier tie-in decisions indicated that the usual analytical means for ascertaining the existence of significant market power could be eschewed. Thus, under *United States* v. *Loew's, Inc* , 371 U S 38 (1962), it did not appear necessary to determine the relevant geographic market share with any precision because sufficient power in the tying market could be inferred from the unique nature of the tying product, *e g.*, a patent or a copyright.[22] *Id* at 45-46, 48-49. Yet, a patented or

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that a combined sale afforded sufficient benefits to outweigh the anticompetitive potential.

[22] In *Standard Oil Co* v *United States*, 337 U S 293 (1949), the Court noted that in *International Salt* "[i]t was not established that equivalent machines were unobtainable, it was not indicated what proportion of the business of supplying such machines was controlled by defendant * * * " 337 U S. at 305-306 The presumption of market control was based on the assumption that "only [the seller's] control of the supply of the tying device, whether conferred by patent monopoly or otherwise obtained, could induce a buyer to enter [a tying contract] " *Ibid* Some courts of appeals have extended the *Loews'* "uniqueness" rationale to trademarks and franchises, finding not only that the trademark is a separate "product" from the product that the

copyrighted article is not necessarily a market unto itself, in many cases such articles have close substitutes that preclude the exercise of any significant degree of market power by the holder of the patent or copyright. As a result, it should not be presumed that a patent or copyright confers market power. *Walker Process Equipment, Inc.* v. *Food Machinery & Chemical Corp* , 382 U S 172, 177-178 (1965), E Singer, *supra*, at 112 In other tie-in decisions, the Court has said that sufficient economic power could be presumed from the existence of the tie itself *Northern Pacific Ry* v. *United States*, *supra*, 356 U S at 7-8 Yet, further analysis would suggest that the reason a buyer accepts a tie-in is just as likely to be buyer preference as seller coercion, see *Fortner II*, *supra*, 429 U.S at 621-622, and thus the existence of the tie-in itself has no probative value in determining the existence of market power

In *Fortner II* the Court seems to have retreated from the language of *Northern Pacific* and *Loew's* " 'which could be read to make actual market power irrelevant' " (*Fortner II*, *supra*, 429 U.S. at 620 & n.13), and reaffirmed the central importance of market power to the finding of an illegal tying arrangement. However, this apparently has eluded many courts that continue to seek guidance from pre-*Fortner II* precedent See *Ware* v *Trailer Mart, Inc* , 623 F.2d 1150, 1154 (6th Cir 1980), *Moore* v. *Jas H Matthews Co* , 550 F 2d 1207, 1215 (9th Cir. 1977), *In re Data General Corp Antitrust Litigation*, 490 F. Supp 1089, 1112 (N D. Cal. 1980). Even those courts that follow *Fortner II*, moreover, may be led astray For instance, the test of "whether the seller has some advantage not shared by his competitors in the market for the tying product" (*Fortner II*, *supra*, 429 U.S at 620) might appear to encompass a finding that a product with a favorably regarded brand name, or the corner grocery store, or the nearby hos-

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trademark represents (*Siegel* v *Chicken Delight*, *supra*, 448 F 2d at 48 & n 2), but also that the uniqueness of the trademark is sufficient by itself to support a finding of economic power in the tying product market *Id* at 50, *Warriner Hermetics, Inc* v *Copeland Refrigeration Corp* , 463 F 2d 1002, 1015 (5th Cir), cert denied, 409 U S 1086 (1972)

pital, has market power simply by reason of its reputation or close proximity to a core of neighborhood users Indeed, in this case the court of appeals, purporting to rely on *Fortner II* for its economic power analysis (Pet. App 8a), found that the Hospital possessed the significant market power necessary for a per se determination despite the fact that there is nothing in its opinion that indicates the Hospital possessed either market dominance or any distinct advantage over its competitors for offering a unique or differentiated product See *Fortner II*, *surpa*, 429 U.S. at 620-621. The court of appeals' finding of "sufficient market power" based solely on the Hospital's 30% share of patients living on the East Bank of Jefferson Parish (Pet. App 10a), without examination of the proper standards for defining a relevant market, defeats any rational aim of using "economic power" to gauge the likelihood of anticompetitive effects. The district court's finding that the relevant geographic market included the larger group of 20 hospitals in the metropolitan New Orleans area—and that 70 % of patients from the East Bank of Jefferson Parish go to hospitals other than petitioners'—is reasonable on its face and should not have been rejected by the court of appeals absent findings that disclose clear error by the district court.[23]

4. While some courts have been willing to analyze the one/two product issue and the tying product market power issue by focusing on business efficiency and market power, none has analyzed the third element of the per se test—the impact on the tied product market—in terms of actual effects on market structure, behavior, or performance. Although the illegality of tie-ins is said to rest on their potential to extend market power into the tied product market (*International Salt*, *supra*, 332 U.S. at 396, *Times-Picayune*, *supra*, 345 U S. at 611), current tie-in rules focus not on competitive effect in the tied market, but solely on the dollar volume of commerce affected by the arrangement. *Fortner I*, *supra*, 394 U S. at 501, *Northern Pacific*

[23] See pp 8-9, *supra* In *Times-Picayune*, *supra*, 345 U S at 611, this Court instructed that "the whole and not part of a relevant market must be assigned controlling weight" when testing the strength of a firm's tying "lever "

Ry , supra, 356 U.S. at 9. Yet this test tells us nothing about whether the extension of market power or foreclosure of competitors is of a magnitude sufficient to affect market structure or pricing pressures. It does not attempt to assess the seller's ability to affect the tied market, or the likely result of the tie-in on market shares, price, or output For other forms of vertical restraint, however, which are analyzed under the rule of reason, the market inquiry squarely addresses likely competitive effects as they may be predicted from changes in market power and structure. *Tampa Electric Co* v. *Nashville Coal Co* , 365 U S 320, 329 (1961) This disparity in treatment between tie-ins and all other forms of nonprice vertical arrangements elevates form over substance See *Continental T V , Inc* v *GTE Sylvania, Inc , supra*, 433 U.S. at 47. Given the ambiguity of the characterization of the conduct here as "tying" or "exclusive dealing," it is particularly important that formal labels not be the sole determinant of legality See *Broadcast Music, Inc* v. *CBS, supra*, 441 U.S at 9. Since the anticompetitive potential of tie-ins and exclusive dealing contracts is basically identical, both arrangements should be judged by the same criteria See Baker, *supra*, 66 Va L Rev at 1306.[24]

[24] In this case the court of appeals found the contract with Roux to be anticompetitive because it "prevents anesthesiologists from entering that part of the anesthesia services market which the hospital controls", and it "eliminates the surgeon's or patient's choice of anesthesiologist at this hospital " Pet App 12a But this degree of foreclosure and limitation on consumer choice is inherent in any contract for the sale of goods or services Without an assessment of the market, and the effects of foreclosure on competition, the court's findings are meaningless as a test for judging the reasonableness of the restraint. See *Chicago Board of Trade* v *United States*, 246 U S 231, 238 (1918)

III. Economic and Legal Analysis Indicates That There Is Only A Narrow Range Of Conditions Under Which Tie-Ins Are Likely To Produce Anticompetitive Effects

As we have just discussed, the history of the tying doctrine in the federal courts reveals at least a tacit recognition that the doctrine does not fit comfortably within the category of offenses branded illegal per se While this Court has labeled many tie-ins per se offenses, it—and the lower courts—have usually looked to economic factors relevant to a particular sales arrangement before deciding whether to place it in the per se category. The label applied to such an analytical approach—"per se", "modified per se," or "rule of reason"—is ultimately unimportant so long as the analysis aimed at identifying anticompetitive conduct is sound The discussion above indicates that, while some courts have applied the existing per se rules to take into account competitive effects and avoid striking down conduct that is not anticompetitive, courts that have been less discerning or have felt more constrained by the per se label have not undertaken sufficient competitive analysis.[25]

Although the existing rules implicitly acknowledge the need to consider cost justifications for offering a product "package" (the "one-product/two-product" test), and the need for finding a degree of market power in the tying product sufficient to enable a seller to expand that power through a tied sale (the "economic power" test), the rules should be more explicit to demand employment of these two tests as a prerequisite to a finding of illegality in every tie-in case Moreover, the existing rules, which now require

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[25] *E g , Earley Ford Tractor, Inc* v *Hesston Corp* , 1983-1 Trade Cas ¶ 65,232 (W D Mo 1982) (once literal criteria for identifying a tie-in are met, no other justification is appropriate), *Rosebrough Monument Co* v *Memorial Park Cemetery*, 666 F 2d 1130, 1143 (8th Cir 1981) (a cemetery plot is "unique" for market power analysis, volume of commerce is sufficient if it meets the tests established under "interstate commerce" criteria), *Siegel* v *Chicken Delight, Inc , supra*, 448 F 2d at 50, *Photovest Corp* v *Fotomat Corp* , 606 F 2d 704, 722 (7th Cir 1979), cert denied, 445 U S 917 (1980) (franchise can be a separate tying product)

only that a "not insubstantial" amount of commerce be affected in the market for the tied product, should be modified to require instead a true competitive analysis of the effects of the tying arrangement on the tied product market. Such a competitive analysis turns not on the quantitative amount of commerce affected, but rather on the relationship of the tying arrangement to the possibility that the defendant might exercise market power in the tied product market. With these modifications, the rules governing the legality of tying arrangements would be consistent with the approach employed in the more rigorously analytical cases, they would also, as we now discuss, make unlawful those tying arrangements with anticompetitive effects about which this Court was properly concerned in its earlier tie-in cases, without impeding those tying arrangements that are procompetitive or are competitively neutral

1. Since *International Salt* and its immediate progeny, legal scholars and economists have come to recognize that existing precedent both underestimates the extent to which alleged tie-ins may be procompetitive or competitively neutral, and overestimates the frequency with which they pose potential anticompetitive problems.

Profit-seeking firms have strong incentives to find the most efficient ways to distribute their goods and services to consumers, so as to maximize their sales and hence their profits. Efficient distribution benefits consumers as well, providing them with the goods and services they want at the lowest cost A failure on the part of a supplier to distribute its goods and services in the most efficient way opens the possibility that it will be undercut by its more efficient competitors, who will be able to price their products below the higher prices resulting from the supplier's distribution inefficiencies As a result, the interests of a supplier and of consumers in achieving an efficient distribution system are usually coincident.

Accordingly, the strong presumption should be that a supplier will choose that method of distribution that yields the most attractive package to consumers in terms of price, product mix and quality. In particular, where a supplier chooses to offer physically separable products only in a

single package, the choice ordinarily will reflect the supplier's judgment that this method of distribution is the most likely to satisfy consumer preferences at the lowest price and so enhance the supplier's ability to compete in the marketplace

Besides cost efficiencies in distribution, a number of other beneficial uses of tie-ins have been observed (*Fortner I, supra,* 394 U.S at 514 n 9 (White, J., dissenting)):

> They may facilitate new entry into fields where established sellers have wedded their customers to them by ties of habit and custom. *Brown Shoe Co* v. *United States,* 370 U S. 294, 330 (1962), Note, Newcomer Defenses· Reasonable Use of Tie-ins, Franchises, Territorials, and Exclusives, 18 Stan L. Rev 457 (1966). They may permit clandestine price cutting in products which otherwise would have no price competition at all because of fear of retaliation from the few other producers in the market* * * And, if the tied and tying products are functionally related, they may reduce costs through economies of joint production and distribution.

See also E. Singer, *supra,* at 106 Another recognized justification for tying is to protect the seller's goodwill by assuring that the tying product is used with essential complements that do not impair the product's quality or performance *United States* v. *Jerrold Electronics Corp* , *supra,* 187 F. Supp. at 559. See E. Singer, *supra,* at 113-114, R. Bork, *supra,* at 379-380, Bowman, *Tying Arrangements and the Leverage Problem,* 67 Yale L.J. 19, 27 (1957); Markovits, *Tie-ins, Reciprocity, and the Leverage Theory,* 76 Yale L.J. 1397, 1459 (1967), see also *Pick Mfg Co* v. *General Motors Corp* , 80 F 2d 641, 643 (7th Cir. 1935), aff'd per curiam, 299 U.S 3 (1936)

2. However, as this Court has recognized, in some instances the supplier may have an incentive to use an inefficient tying arrangement (*i e.*, one that does not minimize the costs of supplying the products, contrary to the interests of consumers) in order to achieve an anticompetitive effect. The courts and commentators have identified two principal types of anticompetitive harm that might arise from a tying arrangement· (1) where the defendant uses its

market power in the tying product in order to foreclose other sellers and make it more difficult for new firms to enter either the tying product or tied product markets, and (2) where the defendant uses its market power in the tying product in order to extract supracompetitive profits from consumers in their purchase of the tied product (the "leverage" theory) [26]

a Under the foreclosure theory, the supplier uses a tying arrangement to raise barriers that increase the manufacturing or distribution costs of its rivals in the market for one of the products in the tying package and thereby enhances the supplier's ability to obtain supracompetitive profits. See *Hirsch* v. *Martindale-Hubbell, Inc* , *supra*, 674 F 2d at 1349, P Areeda, *Antitrust Analysis* 569-570 (2d ed 1974), L Sullivan, *Handbook of the Law of Antitrust* 447-448 (1977) Under the appropriate conditions, foreclosure through a tying arrangement may increase the relative costs of the supplier's competitors by forcing them to produce both the tying and the tied products [27]

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[26] Other potential uses for a tying arrangement, which may or may not be anticompetitive depending on the circumstances, are where it is used as a counting device for metering demand (see note 30, *infra*) and where the defendant uses the tying arrangement to evade price controls in a regulated tying product market through clandestine transfer of the profit to the tied product See generally *Fortner I*, *supra*, 394 U S at 512-514 (White, J , dissenting), quoted in *Foremost Pro Color, Inc* v *Eastman Kodak Co* , *supra*, slip op 875 n 3, E Singer, *supra*, at 105-109

[27] This may occur where the tying and tied products in the package are complements (i e , products that are used in combination), as in the case of central processing units ("CPU's") and peripheral equipment (punch card readers, storage discs, printers, etc) A monopolist CPU manufacturer might tie peripheral equipment to the sale of the CPU and, as a result, inhibit the entry of independent manufacturers of peripheral equipment because of a lack of potential customers Conversely, entry into the CPU market may also be impeded, for in the absence of an available supply of peripheral equipment from independent producers the new CPU entrant would have to produce peripherals as well

If the degree of foreclosure in the market for the tied product is small, the supplier's competitors simply can turn to other, non-foreclosed customers with little or no negative effect on competition To be anticompetitive, the supplier must have power in the market for the tying product to coerce the purchase of the tied product by those who would otherwise purchase it elsewhere, absent market power, consumers would be free to look to the supplier's competitors as an alternative source of supply and anticompetitive foreclosure could not occur.[28]

Moreover, if the supplier does not also have market power in the tied product, whatever foreclosure might result from a tying arrangement cannot have an anticompetitive effect. Only if the tying arrangement results in the elimination of enough existing rivals in the tied product market to give the supplier power in that market will the arrangement itself be anticompetitive. L Sullivan, *supra*, at 445-446 So long as the remaining independent competitors in the relevant tied product market can produce output for sale at the competitive price, the tying arrangement itself cannot create or enhance the power of the tying firm to obtain supracompetitive profits through foreclosure of other firms.[29]

b. The "leverage" theory can be seen as the consumer counterpart to the foreclosure theory. The anticompetitive harm under the leverage theory flows from the use of a tying arrangement to extract supracompetitive profits from consumers that otherwise would not be available to the ty-

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[28] This explains why true market power in the market for the tying product—and not merely the "economic power" lower courts were willing to find on the basis of the "uniqueness" of the tying product—is necessary for an anticompetitive effect to occur under the leverage theory See pp 17-18, *supra*

[29] Even if the tying arrangement can be shown to reduce the number of the supplier's competitors, this reduction does not necessarily imply less effective competition for consumer dollars Indeed, where a tying arrangement increases the efficiency of a supplier's distribution system, it may well result in the elimination of those competitors who are not as efficient The antitrust laws are designed "for the protection of competition, not competitors " *Brunswick Corp* v *Pueblo Bowl-O-Mat, Inc* , 429 U S 477, 488 (1977)

ing firm These profits arise because entry into one or both product markets has been made more difficult—and thus consumers have been deprived of the extra output and the lower prices that the foreclosed entrants would have provided Thus, again, market power is clearly needed in the tying good; and contrary to the assumption of many lower courts, market power in the tied good is needed as well In the absence of market power in both markets, entry will not be inhibited, and the tying arrangement will not allow the extraction of supracompetitive profits from consumers [30]

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[30] While the terms "leverage" and "extension of monopoly" sometimes refer to enhancement of the supplier's market power, as described above, these terms have more often been used to describe an alternative hypothesis on which the condemnation of tie-ins has been based, i e , that, through tying, a firm can use its market power in the tying product market, to create new market power (typically in the tied product market) and thereby increase overall profitability The deficiency in this version of the leverage argument can be grasped by asking why a firm with monopoly power over a single product does not extend its monopoly to a multitude of other products by insisting that those products also be purchased from it as a condition for purchasing the monopolized product The answer is that there is some limit to the amount each consumer would pay for the tying product, and, if the seller has extracted this maximum amount from each consumer, it cannot "force" consumers to purchase a tied product that would ordinarily be obtained elsewhere It can "force" the purchase of the tied product only to the extent it lowers the price of the tying product See P Areeda, *supra*, at 569, L Sullivan, *supra*, at 446-447 As a result, where they have anticompetitive effects, "tie-ins" are usually a device for exploiting pre-existing market power in the tying market, rather than a means of generating new market power in either the tied or tying market Indeed, many observers believe that "[m]onopoly in the tied product is both rare and not often threatened by most actual tying arrangements " P Areeda, *supra*, at 70, accord, Markovits, *supra*, ~~*Reciprocity, and the Leverage Theory*~~, 76 Yale L J at 1397-1398, Burstein, *A Theory of Full-Line Forcing*, 55 Nw U L Rev 62-63, 93 (1960)

It is possible, of course, that the seller cannot extract the maximum revenue from each consumer solely by manipulating the price of the tying product Consumers might differ in the strength of their preferences for the product, but the seller might be unable to charge them different prices (because he lacked information about individual consumer demands, because he could not prevent arbitrage among con-

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It should not be surprising that both the leverage theory and the foreclosure theory posit the same necessary preconditions for anticompetitive harm market power in both the markets for the tying and tied products. The leverage theory looks at competition through the eyes of the consumer, while the foreclosure theory looks at competition through the eyes of the producer. But since both theories ultimately look at the same thing—competition—the necessary conditions for an adverse effect are identical

3 In view of this economic analysis and the Court's implicit acceptance of competitive impact as a factor in analyzing business conduct, we believe it would now be appropriate for this Court to offer clearer guidance by requiring explicitly a complete, but focused, examination of the factors that are most significant in predicting whether, in particular cases, practices that may be viewed as tie-ins might serve anticompetitive purposes. These factors include, first, whether the defendant has substantial market

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sumers, or because prices or price differences are regulated by law) If so, a tie-in of a complementary product, the demand for which varied in proportion with the frequency or intensity of use of the tying product (*e g* , a stapling machine and staples), could be used both to meter the intensity of demand for the tying product and to extract revenue reflecting this intensity by raising the price of the tied, metering product Cf *IBM Corp* v *United States*, 298 U S 131 (1936), *International Salt Co* v *United States*, 332 U S. 392 (1947), *Henry* v *A B Dick Co* , 224 U S 1 (1912) See P Areeda, *supra*, at 570, Bowman, *supra*, 67 Yale L J at 23 Where tie-ins are used for such metering purposes, the economic effects are ambiguous depending on the specific circumstances The use of a tie-in to meter demand and collect revenue clearly can increase the output of the tying product See O Williamson, *Markets and Hierarchies Analysis and Antitrust Implications* 11-13 (1975), R Bork, *supra*, at 375-376 The use of tie-ins for metering can also, of course, lead to a decrease in output, but we believe that, more often than not, such tie-ins will tend to increase output and will thereby tend to be procompetitive Tie-ins employed for metering purposes need not drive out independent suppliers in the tied market Sellers would be perfectly willing to purchase the tied products from the most efficient independent suppliers, mark up their price, and resell them to buyers of the tying product The ability to charge the higher prices for the tied product derives, not from having obtained market power over the tied product, but from market power possessed over the tying product

power in the relevant product and geographic markets for the tying product and, second, whether there is a reasonable possibility that the defendant will obtain substantial market power in the relevant market for the tied product after the tie-in. Where one or both of these factors is absent, the danger of anticompetitive effects is absent and further inquiry is unnecessary Where both factors are present, there may be significant anticompetitive potential and the defendant should be required to demonstrate justifications for the packaged sale sufficient to outweigh its potential adverse effects

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted

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MAY 1983

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Mr KASTENMEIER In any event, we are most indebted to you both, Assistant Attorney General Rule and Deputy Commissioner Tegtmeyer, for your appearance here today and your efforts to be helpful to the committee in terms of its considering legislation on the patent misuse and other patent policy matters

Thank you

TESTIMONY OF HERBERT F SCHWARTZ, ESQ, MANAGING PARTNER, FISH & NEAVE, NEW YORK, NY, AND PROFESSOR, SCHOOL OF LAW, UNIVERSITY OF PENNSYLVANIA, ROBERT TAYLOR, PARTNER, PILLSBURY, MADISON & SUTRO, SAN FRANCISCO, CA, ON BEHALF OF THE AMERICAN BAR ASSOCIATION, AND ROBERT P MERGES, PROFESSOR, SCHOOL OF LAW, COLUMBIA UNIVERSITY

Mr KASTENMEIER I would now like to call the second panel today Our second panel consists of three distinguished lawyers

Herbert Schwartz is the Managing Partner of the New York firm of Fish & Neave

In addition, Mr Schwartz teaches at the University of Pennsylvania and has recently written a treatise on patent law for the Federal Judicial Center

The second member of the panel is Robert Taylor, a partner in the San Francisco firm of Pillsbury, Madison & Sutro

Mr Taylor has extensive background in antitrust law and is here today representing the views of the American Bar Association

The final member of the panel is Robert Merges, currently a fellow in science and technology at Columbia University Law School, who starting in September will be teaching intellectual property law at Boston University

We have copies of your written statements and, without objection, they will be made part of the record

I think first we will call on Mr Schwartz

Mr SCHWARTZ I appreciate the honor of being invited here today to submit my views

My remarks will be brief I have summarized my thoughts in my statement

Philosophically, S 1200 troubles me in that I think it unduly restricts the patent misuse doctrine and would have the practical effect of overturning some significant precedent

I am in favor of the philosophy of H R 4086, but I am troubled by the difficulties of trying to put 50 years of detailed case law into a precise statutory format

My impression and belief is that in the antitrust area, we really haven't done this We have let antitrust evolve under a broad statutory framework of the Sherman Act and the Clayton Act The patent misuse doctrine, which actually came before the antitrust laws has evolved in a similar fashion I think misuse is best served by continuing to evolve in that way

Now, it seems to me that as someone who practices in the field that the patent area is flourishing at this time This is due to some significant changes from Congress, for example, the enactment of the Court of Appeals for the Federal Circuit and the statutory changes of the 1984 Act This has been beneficial to patents and

has greatly enhanced the value of patents and also licensing Recent statements in the press make that plain I also believe that as far as misuse itself goes, the doctrine is not that arcane or difficult to understand

Just looking at H R 4086 gives a framework of at least a few types of conduct that have been traditionally held to be misuse and also give a framework of a few that have not My trouble is casting those in concrete in language rather than evolving

I believe that the Court of Appeals for the Federal Circuit is a logical and appropriate forum to harmonize the law in this area Up to now, not much has happened in that court on the misuse issue, not because of any failure of the court, but rather because of the relatively few cases that have come to the court which have required resolution of misuse issues

Hearing some of the earlier questions reminds me that there is a sharp contrast between the misuse area and the enforceability for fraud area

In unenforceability, there has been significant clarification of the case law, many decisions and a fairly good view of what the law is now I think in the misuse area that has happened

I say that because the court is forced to choose and decide what comes before it and in the few years of that court's existence, not much has happened

But I believe that the appropriate forum for further refinement of harmonization on the issue of misuse is the Federal Circuit I haven't seen any hint in its decisions that it is seeking Congress to help it out

The Federal Circuit is competent to address the law I suppose that if there are any questions about what they do, Congress can consider whether something should be done about it, but I know of nothing yet that suggests that type of reaction

That summarizes my remarks They are amplified in more detail in my submission

Mr KASTENMEIER Thank you, Mr Schwartz

[The statement of Mr Schwartz follows]

SUMMARY OF THE

PREPARED STATEMENT OF HERBERT F SCHWARTZ

UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

PRIVATE PRACTITIONER

BEFORE THE

SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES AND

THE ADMINISTRATION OF JUSTICE

OF THE

COMMITTEE ON THE JUDICIARY

U S HOUSE OF REPRESENTATIVES

MAY 11, 1988

Mr Chairman and Members of the Subcommittee

My experience has not indicated that the patent misuse doctrine is adversely impacting patent licensing in any significant way today There is room in our law for both patent and antitrust policies Senate bill S 1200, which is directed at limiting patent misuse to only antitrust violations, is inappropriate because it ignores the patent policies behind the patent misuse doctrine In contrast, House bill H R 4086 appropriately takes both patent and antitrust policies into consideration The language of the bill, however, is troublesome because it raises more questions than it answers The patent misuse doctrine should be allowed to continue to evolve as in the past, on a case-by-case basis, much like the antitrust laws

PREPARED STATEMENT OF HERBERT F SCHWARTZ

UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

PRIVATE PRACTITIONER

BEFORE THE

SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES AND

THE ADMINISTRATION OF JUSTICE

OF THE

COMMITTEE ON THE JUDICIARY

U S HOUSE OF REPRESENTATIVES

MAY 11, 1988

Mr Chairman and Members of the Subcommittee

My name is Herbert F Schwartz I teach courses in patents, trade secrets, trademarks and unfair competition at the University of Pennsylvania Law School I am also the Managing Partner of the law firm of Fish & Neave, New York, New York, where I specialize in litigation in these areas I am here at the invitation of the Subcommittee to testify about the proposed reform of the patent misuse doctrine

My prepared remarks are addressed primarily to H R 4086, Patent Licensing Reform Act of 1988, and S 1200, which relates to patent misuse By way of preview and summary, it is my view that the Senate bill (S 1200) is inappropriate because, by narrowing the patent misuse doctrine to be merely coextensive with violations of the antitrust laws, it ignores the patent policies behind the patent misuse doctrine

I agree with the basic philosophy of the House bill (H R 4086), which takes both patent and antitrust policies into consideration However, it is my view that the limitations necessarily imposed by pigeonholing fifty years of law, developed on a case-by-case basis, into the rigid confines of a statutory format outweigh the perceived advantage of certainty

THE PATENT MISUSE DOCTRINE

The patent misuse doctrine is a judicially created, equitable defense to a charge of infringement It is firmly rooted in the ancient equitable doctrine of "unclean hands " See, e g , U S Gypsum Co v Nat Gypsum Co , 352 U S 457, 465 (1957) This doctrine allows a Federal court to deny relief for patent infringement to a patent owner who has misused his or her patent, at least until the misuse has been purged As presently applied, a patent is misused when (1) its use violates the antitrust laws, or (2) when a court perceives that it is exploited in a manner that secures for the patent owner more than the patent laws provide See generally Hoerner, Patent Misuse, 53 Antitrust L J 641 (1984)

It is axiomatic that a common law doctrine such as patent misuse suffers from the lack of a precise definition Like other common law doctrines, patent misuse is understood by reading the case law that created and applies it As with the antitrust laws, understanding patent misuse requires knowledge of a great deal of case law, which changes over time The inherent flexibility in the patent misuse doctrine is one of its great advantages Critics of the patent misuse doctrine

are not really troubled by a lack of precision For example, although greater certainty exists in antitrust law when antitrust violations are fixed and are not determined by a rule of reason, critics do not want to increase the number of per se antitrust violations

The lack of a precise definition for the patent misuse doctrine does not cause any great practical difficulty in applying the doctrine to a given set of facts Attorneys knowledgeable about this doctrine can fairly easily advise clients about many specific situations It happens all the time

Unlike critics of the patent misuse doctrine, my experience has not indicated that the doctrine is adversely impacting patent licensing in any significant way Patent licensing is alive and well and flourishing because the recent changes in our patent system, including the creation of the Court of Appeals for the Federal Circuit and recent substantive legislation, have greatly enhanced the value of patents, thereby stimulating technological growth This is reflected in significant increases in licensing royalties See, e g , New Profits from Patents, Fortune, April 25, 1988 at p 185, Patents Make Money For Oregon, United Press International, April 22, 1988, Business News, The Associated Press, April 11, 1988 (IBM "moving to earn more money on its intellectual property, said it will raise the ceiling on its patent license fees to 5 percent from the current 1 percent "), Patent Licensing Could Generate Millions for Computer Automation,

The Los Angeles Times, January 15, 1988, Business Section, p 4, col 1, and Intellectual Property Turns Into High-Priced Real Estate, Electronics, April 30, 1987 at p 43

The call for reform of the patent misuse doctrine is in reality a desire to narrow it The asserted basis is that the patent misuse doctrine reduces the incentive to innovate and sometimes punishes pro-competitive licensing arrangements My experience in the patent arena is not consistent with this broad complaint Simply because patent misuse affects pro-competitive licensing arrangements in some specific circumstances is not a sufficient reason to drastically curtail its scope as S 1200 proposes The patent laws and the antitrust laws flow from separate policies There is no reason in logic or authority that compels the conclusion that the limits of proper enforcement of patents should be proscribed solely by antitrust policies In the vast majority of situations the patent misuse doctrine's current application is warranted on the basis of patent policy This is not a situation where the baby should be thrown out with the bathwater

PATENT VERSUS ANTITRUST POLICY

An inventor has no innate property rights in his or her intellectual invention Our patent system is based on the idea of an exchange. On one side of the exchange is an inventor who may want to exploit his or her idea without risk that it will be freely appropriated by others On the other side of the exchange is a nation that would like to encourage

innovation and full public disclosure of new inventions Our patent system is the means for effecting the exchange

The quid pro quo to an inventor for fully disclosing his or her invention to the public is directly related to the marketplace value of the invention, which is potentially very high This direct relationship is established by the unique right a patent confers upon its owner, that is, the ability to exclude others from making, using, or selling the patented invention within the United States, its territories and its possessions for the life of the patent Obviously, if someone invents something patentable that everyone else wants, then the right to exclude others from making, using, or selling that patented invention becomes very valuable The right to exclude others is not worth anything if nobody wants the patented invention

Competition and competitiveness are not goals of our patent system Our patent system seeks to promote the progress of the useful arts U S Constitution, art 1, § 8, cl 8 Of course, enhanced competitiveness on an international scale can be a result of a strong patent system. Nonetheless, enhanced competitiveness in domestic markets is neither a goal nor an effect of our patent system In fact, the exact opposite of domestic competition is possible if the patent system is strong and an invention is highly desired Accordingly, critics of the patent misuse doctrine who base their reforms on concerns about domestic competitiveness are not talking patent law or patent policy They are speaking antitrust law and antitrust policy If one is going to criticize

patent law, one should criticize it in the context of patent law and patent policy Surely, there is room in our law for both policies

THE SENATE AND HOUSE BILLS

An appropriate starting point when analyzing the Senate and House bills is that part of the patent misuse doctrine that both bills basically agree upon, that is, that a patent is misused when the conduct complained of violates the antitrust laws If a patentee's conduct in connection with exploiting his or her patent runs afoul of the antitrust laws there is no overriding patent policy which justifies overlooking such activities and allowing a patentee to continue to enforce the patent However, this is not the end of the road

The second prong of patent misuse -- that is, a patent is misused when it is exploited in a manner that secures for the patent owner more than the patent laws provide -- is what the Senate bill is directed at removing and what the House bill is partially directed at codifying This prong owes its existence more to patent law policies than to principles of equity or antitrust law The rationale for this prong is that a patent is given in exchange for full disclosure of a patentable invention and that the patent right is adequate and appropriate compensation and consideration for the disclosure A patent owner's attempt to take more, for example, by expanding the temporal scope of his or her exclusivity beyond the fixed life of the patent, e g , Brulotte v Thys Co ,

379 U S 29 (1964) or by expanding the scope of his or her exclusivity beyond the patented invention, e g , Senza-Gel Corp v Seiffhart, 803 F 2d 661 (Fed Cir 1986), is uncalled for regardless of whether his or her actions are pro-competitive or anti-competitive If Congress wants to change the quid pro quo given to inventors in exchange for full disclosure of their patentable inventions because Congress perceives that innovation needs to be stimulated even more than at present, then Congress should be increasing the scope of the patent grant and not decreasing the scope of patent misuse Regardless of the scope of the patent grant it should always be a misuse for the patent owner to try to take more than the nation, through Congress and through the patent laws, has given him or her

CONCLUSION

The Senate bill drastically and inappropriately narrows the patent misuse doctrine by limiting it only to violations of the antitrust laws The rationale of the House bill which recognizes both antitrust and patent law policies is sound However, the language of the House bill is troublesome because it raises more questions than it answers The patent misuse doctrine should continue to be allowed to evolve as it has in the past, that is, on a case-by-case basis, much like the antitrust laws It should not be subject to rigid codification

This completes my prepared statement, Mr Chairman I am prepared to elaborate on the summary of my views expressed above and to respond to any questions which you or the other members of this Subcommittee may have

Mr KASTENMEIER I take it you are saying that we don't need any of these pieces of legislation with respect to patent misuse, is that correct?

Mr SCHWARTZ Well, I wouldn't see any harm in a piece of legislation that codified the notion that there is such a defense as patent misuse, that it is purgeable and that it renders a patent unenforceable I think that will be useful

I have difficulty with the precise language of the House bill

I took a few stabs at attempting to change it and decided it wasn't a fruitful exercise to try to do that, but I am not opposed to the notion of appropriate language if it could be brought forth, but it doesn't strike me that it is there yet

Mr KASTENMEIER Now we would like to hear from Robert Taylor of the American Bar Association

Mr TAYLOR I also am honored and pleased by the invitation to appear here

The American Bar Association formulated its views on the issue of patent misuse in the context of a piece of legislation which was pending in 1983 and which resembled H R 1155 more than H R 4086 But the general principles are sufficiently common to both bills that I think the ABA position is still applicable

It is our view that the entire body of law relating to patent misuse is one in need of considerable introspective reexamination Under this doctrine, the courts are permitted, in the name of antitrust enforcement, to deny relief for infringement and even for violation of a simple contract for royalties Usually the defense is rooted in some vague notions that the patent owner may have been overly restrictive in dealing with his own customers or his own licensees or that the patent owner may have used the value of his patent to garner some kind of commercial advantage in an area of commerce not covered precisely by the claims of the patent even though the area of commerce may be directly related to the research and development that led to the patent in the first place

The misuse doctrine, while it has its foundations in the antitrust law, exists independently of antitrust principles There is no need to show a violation of the antitrust law and when you remove that requirement, you basically set the courts adrift without any principles or any affirmative guideposts for resolving these questions

Rick Rule, in response to a question alluded to the absence of a standing requirement In ordinary antitrust litigation, one who has been injured by commercial activity which is violative of the antitrust laws can bring a lawsuit, but one who is not injured has no standing to bring such a case With respect to patent misuse, anyone accused of infringement is free to assert misuse and this frequently happens Among the first things to follow a complaint for infringement are subpoenas to all the licensees, to the patent owner with respect to things unrelated to the particular parties in the dispute before the court

Much of the conduct which has been held to be misuse, at least in recent years, is either affirmatively pro-competitive, affirmatively beneficial, or at the very worst is competitively neutral and thus innocuous There is, for example, no reason why the owner of a process patent, should not be permitted to impose some kind of a reasonable restriction on the use or the territory of sale of the un-

patented products made by such a process Yet, the D C Circuit in 1980, in the *Robintech* case, held such a revision to be misuse That case is all the more remarkable, because a year later a different panel of the same court in the *Sena-Gel* v *Seiffhart* case had to resolve the question of whether a similar restriction was a violation of Section 1 of the Sherman Act and came to the conclusion that a restriction on the sale of products made by a patented process in the circumstances in which it came to the court was pro-competitive and socially beneficial and for that reason not a violation of Section 1 The *Sena-Gel* v *Seiffhart* case makes no mention of the *Robintech* case

I think you can see the practical problems that these two cases presents to a lawyer trying to advise a client in the circumstances of having a process and facing a set of commercial conditions where it made no sense at all to license unless you could impose such a restriction

Even where the patent owner requires his customers to purchase something that is not covered by the patent, certainly such a restriction cannot be said in every circumstance to be adverse to the competitive process and certainly should not in every case be held to be unlawful Yet, almost all courts treat that as an automatic case for applying the misuse doctrine

A question was put to one of the Government lawyers with respect to whether the misuse doctrine serves any useful purpose It seems to me that in considering that question—and it is a legitimate question and one that needs further exploration—but in considering it, I would suggest to you that the section 4 of the Clayton Act provides a very powerful remedy for any entity which is injured by conduct which violates the antitrust law

Furthermore, the misuse doctrine—at least in my experience—is an affirmative impediment to licensing in many situations I have had clients propose a viable licensing arrangement, but when I explained that entering into a license with the kinds of restrictions they thought they needed in order to effectively protect their own investment in the technology, they came to the conclusion that the risk of licensing was greater than any benefit to be had, and chose to develop the technology privately themselves I don't know the extent to which my experience should be generalized It is, however, a question you might put to all of the private practitioners who come before the committee

With respect to H R 4086, I think it is safe to say the ABA clearly supports reform Directionally, this bill heads in the right direction As more fully detailed in my statement, however, there are numerous aspects in which the language of H R 4086 is ambiguous and needs to be clarified There are also some aspects in which it fails to come to grips with the full scope and dimensions of the problems The ABA, in its prior deliberations on this subject, preferred a less specific approach to the problem and one in which misuse would be based on an affirmative showing of an antitrust violation if it is to continue

We think that you need to address the issue of market power in this context, because many courts, whenever a patent or a copyright is alleged as a tying product, many courts have simply said that the market power is to be presumed A debate that has gone

on for some time on that issue The most recent manifestation of this debate is found in the decision of the Supreme Court in *Hyde* v *Jefferson Parish,* where the majority opinion accepts—in dicta—the presumption of market power Justice O'Connor, in her concurring opinion, takes the majority to task, calling that a common misconception It seems to me that any reform in this area necessarily must address this issue

Finally, it seems to us that any misuse legislation should address copyrights as well as patents, and that is particularly so because, as the emergent field of computer software becomes more and more important in the economy, copyrights are the principal form of protection for that industry

Thank you very much

Mr KASTENMEIER Thank you, Mr Taylor That raises several interesting questions

[The statement of Mr Taylor follows]

Testimony of Robert P. Taylor

on behalf of

The American Bar Association

before the

Subcommittee on Courts, Civil Liberties,
and the Administration of Justice

Committee on the Judiciary

U.S. House of Representatives

on H.R. 4086 "Patent Licensing
Reform Act of 1988"

May 11, 1988

I am Robert P Taylor, a practicing lawyer with the firm of Pillsbury, Madison & Sutro in San Francisco I am an officer of the Section of Antitrust Law of the American Bar Association I am appearing at the request of President Robert McCrate to state the views of the ABA with respect to H R 4086, a bill dealing with the application of the antitrust laws to the commercialization of patented technology Attached is a copy of a resolution approved by the ABA House of Delegates and the accompanying Report of the Antitrust Section dated February 3, 1984 Although these were specifically addressed to earlier bills in an earlier Congress, the rationale of the ABA position is generally applicable to H R 4086

Section 2 of H R 4086 would codify and define the scope of the so-called misuse defense in patent litigation This vague and imprecise term developed over a period of some fifty years and has meant different things in different settings As used today, the term patent misuse refers generally to an equitable defense which can be asserted to prevent the patent owner from enforcing his rights in the patent In some cases, the defense arises because the patent owner has used the exclusionary power of his patent to gain a commercial advantage in some line of commerce not covered by the patent. In other cases, the defense is applied because the patent owner engaged in anticompetitive

conduct with respect to the marketing of products covered by his patents

The basic misuse case is Morton Salt Co v G S Suppiger Co , 314 U S 488 (1942) There the Supreme Court held that the licensor of patented salt injection machines used in a food canning operation was barred from obtaining injunctive relief against an infringer, because the machines were leased on condition that they be used only with salt purchased from the patent owner Although purportedly an application of the equitable doctrine of "unclean hands," the underlying rationale for the Morton Salt decision resides in antitrust concepts·

> "The use of a patent to suppress competition in the sale of an unpatented article may deprive a patentee of the aid of a court of equity to restrain an alleged infringement" (314 U.S at 491).

The courts have permitted expansive use of the misuse defense created in Morton Salt For example, the doctrine has been applied to actions at law as well as actions in which equitable relief is sought Thus, while an equitable defense such as unclean hands would not normally be appropriate in an action on a contract, the Supreme Court stated in United States Gypsum Co v National Gypsum Co., 352 U.S 457, 465 (1957), that misuse of a patent will operate to deny recovery of patent royalties called for in a license agreement under the patent

The misuse doctrine is applied even though the offending conduct was not directly related to the patent but merely to the sale of goods which were incidentally covered by the patent In Morton Salt, for example, there were no license agreements, as such, but merely machine leases which, so far as the record shows, did not even refer to the patents And in Ansul v Uniroyal, Inc., 448 F 2d 872, 880 (2d Cir 1971), the Second Circuit found patent misuse arising out of price and territorial restrictions imposed informally on the sale of a chemical, the fact that the patent played a significant commercial role in the success of the product provided the only nexus required by the court

There is no standing requirement for the assertion of misuse Unlike private antitrust actions generally, where the plaintiff must show that he was injured by the particular conduct alleged to be unlawful, one can assert misuse even though not injured by the conduct [1] It was assumed by the Supreme Court in Morton Salt that the infringer did not sell salt and thus was unaffected by the

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1 Typical of the more usual application of the standing requirement in private antitrust litigation is the decision of the Ninth Circuit in Exhibitors Service, Inc. v American Multi-Cinema, Inc., 788 F 2d 574 (9th Cir. 1986), holding that a licensing agent, terminated as part of a conspiratorial market division, had no standing to sue because he did not buy or sell services in the particular market which was restrained by the conspiracy

marketing practices in question (314 U S at 491) As a practical matter, this means that every infringement defendant is likely to seek extensive discovery covering the patent owner's outstanding licenses and licensing practices in hopes of uncovering a defense [2] It also means that every license provision of even slightly questionable legality is likely to be at risk whenever an enforcement proceeding is brought

The antitrust concept at work in Morton Salt was that of unlawful tying, i e , the patented machines were being used as a tying product to compel the purchaser to buy ordinary table salt [3] Other antitrust concepts that have supported findings of misuse include imposing unlawful price and territorial restrictions on the sale of patented products,[4] imposing territorial restrictions on the sale of unpatented products made with a patented process,[5] requiring

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2 In addition to discovery from the patent owner, subpoenas seeking an extensive slate of documents from the licensee are commonly served by defendants accused of infringement

3 Unlawful tying has long held a prominent place among the list of transactions deemed illegal per se under the antitrust laws See, e g , the discussion of this point in Jefferson Parish Hosp. Dist No 2 v Hyde, 104 S Ct 1551, 1556-61 (1984)

4 Ansul v. Uniroyal, 448 F.2d 872, 880 (2d Cir 1971)

5 Robintech v Chemidus Wavin, Inc , 628 F 2d 142 (D C Cir 1980)

the payment of a royalty after the expiration of a patent,[6] and requiring a licensee to refrain from dealing in competing products not covered by the patent.[7]

The misuse doctrine is applied without any showing of an actual violation of the antitrust laws. The Supreme Court in Morton Salt specifically stressed the absence of any such requirement

> "It is unnecessary to decide whether respondent has violated the Clayton Act * * * maintenance of the present suit to restrain * * * manufacture or sale of the alleged infringing machines is contrary to public policy * * * (314 U S at 494)

As a result, misuse cases are decided largely through the use of rules of per se illegality, without regard for the economic consequences which would be of vital importance in normal antitrust cases

The misuse doctrine limits significantly the range of options available to a patent owner seeking to commercialize new technology Consequently, the doctrine lowers the incentive to invest in research and development Consider, for example, an industry whose products are not patentable but whose costs of production could be reduced by the development of new technology The only entities with

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6 Rocform Corp v Acitelli-Standard Concrete Wall, 367 F 2d 678 (6th Cir 1966).

7 National Lockwasher Co v George K Garrett Co., 137 F 2d 255 (3d Cir 1943)

the proper incentive to invest in such new technology may be the sellers of these unpatentable products The misuse doctrine, however, because it generally operates to forbid any licensing or marketing scheme designed to extend the commercial value of a patent to some area of commerce not precisely within its claims, often makes it difficult for such a seller to protect his investment through a patent

The recent decision of the Court of Appeals for the Federal Circuit in Senza-Gel Corp v Sieffhart (Fed Cir 1986) 803 F 2d 661 illustrates this point There the court affirmed a misuse holding, thus rendering the patent unenforceable, because the owner of a patented process had made the process available to others only through the purchase of a machine which performed the steps of the process The court appeared to recognize that its decision was not compelled either by policy or economics, but the court nevertheless thought itself constrained to follow years of precedent as to misuse principles

> "We are bound to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or the Supreme Court" (803 F 2d at 667-668, n 5)

The misuse doctrine also makes it difficult, in some situations, to license new technology in ways that do not jeopardize the investment which led to that technology It often happens, for example, that a patent owner will be willing to license only if he can restrict the ability of the licensee to compete with him or his existing licensees

Such restrictions may be perfectly lawful when the patent precisely covers the product sold by the licensee [8] Where the patent is not on the product itself, however, but the process for making the product, the law is not so clear One court recently held that a territorial restriction on the sale of unpatented goods made by a patented process was misuse (Robintech v Chemidus Wavin, Inc , 628 F 2d 142, 146-149 (D C Cir 1980).

At the very least, the misuse doctrine inhibits the willingness of patent owners to explore novel and creative ways to commercialize new technology The loss of all enforceability in patent rights is so drastic and often so out of proportion to any benefit from licensing, that patent owners are forced to forgo licensing altogether or to accept only the most conservative of arrangements

H R 4086 seeks to address these generalized concerns by defining what is and is not misuse The operative provision, Section 2, is in three parts The first part would codify the misuse doctrine, amending 35 U S C § 271 to permit courts to deny "relief for infringement" in situations where the patent owner has

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8 Field of use restrictions imposed by a manufacturing licensor on a manufacturing licensee with respect to a patented product have been held lawful in several cases See, e g., General Talking Pictures Corp. v. Western Electric Co., 304 U S 175, aff'd on reh'g, 305 U S 124 (1938)

engaged in misuse The second part would then define six specific practices which could be considered to be misuse The third part would define six practices which could not constitute misuse

The ABA supports the basic objective of legislative reform in connection with the misuse doctrine It is not at all apparent that the doctrine serves any real purpose, since anyone truly injured by the anticompetitive behavior of a patent owner has ample opportunity for redress in the compensatory provisions of Section 4 of the Clayton Act Certainly there is no reason why enforcement rights should be taken from the owner of new technology in the name of antitrust principles unless the behavior in question actually violates the antitrust laws In this sense, we support the direction and objectives of H R 4086

There are, however, a number of aspects of H R 4086 which the ABA has not considered and which I am not able to support For example, in seeking to define what is "misuse or illegal extension of the patent," the language proposed for Section 271(d)(2) would provide that misuse "includes" the six recited forms of conduct.[9] The clear implication of this inclusive approach is that the misuse defense is intended to reach a broader range of conduct of

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9 Actually, the sentence has two operative verbs, "means" and "includes," one of which appears to be superfluous.

which the specific six are merely exemplary I am concerned that courts, some of which are demonstrably hostile to the entire concept of intellectual property, may treat such a codification of the misuse doctrine as an endorsement rather than an effort to limit its application The likelihood of such an interpretation is reinforced by language proposed for Section 271(d)(3), which exempts certain specific practices from the operation of the doctrine

If the stated approach of H.R 4086 is to be retained, the list of specific exempt practices needs to be expanded One of the more recently litigated issues in this area has to do with restrictions imposed by a patent owner on the sale of unpatented products manufactured by a patented machine or process In United States v. Studiengesellschaft Kohle, m b H (D.C Cir 1981) 670 F 2d 1122, the District of Columbia Circuit rejected an antitrust challenge by the government and upheld such a license restriction The court applied a rule of reason analysis to find the use restriction procompetitive because it facilitated licensing that otherwise could not have occurred As I noted earlier, however, the same court only a year earlier held an almost identical restriction to constitute misuse (Robintech v. Chemidus Wavin, Inc. (D C.Cir. 1980) 628 F 2d 142, 146-149). One of those decisions is clearly wrong, yet H.R. 4086 is totally silent on such a restriction

The legislation, as drafted also contains ambiguities The proposed language for Section 271(d)(2)(A), for example, would cast as misuse

> "tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have market power "

It is not at all clear what is meant by "tying * * * the production of an unpatented product to the use of a patented process " In Dawson Chemical Co v Rohm & Haas Co , 448 U S 176 (1980), the Supreme Court dealt with a refusal to license a patented process except to those who purchased an unpatented product for use in that process That practice might properly be characterized as "tying a license on a process patent to the purchase of an unpatented product " I am unaware of any misuse case depicting a converse circumstance which the statutory language seems to envision

A further difficulty of the language of Section 271(d)(2)(A) is its failure to address clearly the role that market power should play in any antitrust analysis of a patent For a number of years, courts and commentators have debated whether and to what extent market power is properly inferred from the mere existence of a patent or copyright As recently as 1984, in Jefferson Parrish Hospital District No. 2 v Hyde, 104 S Ct 1551, 1561 (1984) a majority opinion of the Supreme Court stated that market

power is to be presumed from the existence of a patent on a tying product A concurring opinion of Justice O'Connor criticized this statement as "a common misconception" (104 S Ct. at 1572, n 7) Any legislation which addresses the subject of misuse in this context should clarify the manner in which market power is to be treated

Section 271(d)(2)(F) is particularly unclear This provision would provide for a finding of misuse when the patent owner has granted a license on condition that the licensee "grant back" patent rights which the license might develop,

> "except to the extent that the requirement is to grant back a nonexclusive license with respect to improvements in the licensed product or process when alternatives exist to produce the product or process "

As I read the final phrase of this provision, the ability of the patent owner to require a grant back is expanded in situations where commercial alternatives to the patent exist and is diminished in situations where commercial alternative do not exist Given that grant backs are usually sought in an effort to expand licensing, the proposed provision would seem to call for precisely the opposite of what is needed In any event, the proposed language is difficult to parse and needs attention

H.R 4086 is written so as to apply only to patents Given the increasing importance of copyrights as the basic form of intellectual property protection used for

computer software, it seems equally appropriate to apply any misuse legislation uniformly to both forms of intellectual property [10]

The report of the ABA which I have attached to this testimony was addressed to S 1841 and H R 3878, legislation introduced in 1983 and known as the National Productivity and Innovation Act of 1983 [11] Title IV of those bills, like H R 4086 in this Congress, would have amended section 271 of the Patent Act (and section 501(a) of the Copyright Act as well) to provide merely that certain enumerated licensing practices could not be held to be misuse unless they were first found to violate the antitrust laws There was no effort to codify the misuse doctrine and no provisions from which proponents could argue that the doctrine had taken on a broader scope than before. The ABA supported those proposed amendments, and we recommend that this Committee consider adopting the same approach

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10 The Supreme Court has never applied the misuse doctrine to copyrights, but many of the lower courts have assumed that an analogous doctrine exists In Tempo Music, Inc. v Myers, 407 F.2d 503, 507 (4th Cir. 1969), a holding of infringement was reversed on the grounds that copyright owners had failed to notify licensees of certain rights accorded those licensees by a prior judgment against the copyright owners and was thereby guilty of unclean hands

11 A portion of that bill changing the antitrust treatment of research joint ventures was enacted as PL 98-462, the National Cooperative Research Act of 1984

Section 3 of the bill deals with what is sometimes called "fraud on the Patent Office" or "inequitable conduct " This problem has presented great difficulty to the courts and practitioners To my knowledge, however, the ABA has not yet addressed the issues involved in Section 3, and I am not prepared to comment on them at this time. I caution the Committee with the observation that these issues are extremely complex and urge that action on this subject not be taken until Section 3 has been fully studied and commented on by interested professional groups.

We appreciate the opportunity to be heard on this bill We are prepared to respond in writing to any questions propounded by the Committee

Robert P. Taylor
Finance Officer,
Section of Antitrust Law
American Bar Association

AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW

REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

BE IT RESOLVED, that the American Bar Association supports the passage of Titles II through V of the National Productivity and Innovation Act of 1983 (S. 1841 and H.R. 3878) (the "Act"), subject to the modifications and qualifications described below.

(a) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title II of the Act which provide that no joint research and development program shall be deemed illegal per se under the antitrust laws and that damages in lawsuits that are based on conduct that is part of a joint research and development program shall be limited to actual damages. FURTHER RESOLVED, that the American Bar Association opposes the provisions of Title II of the Act that would require notification of joint research and development programs.

(b) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title III of the Act which provide that agreements to convey rights to use, practice or sublicense intellectual property shall not be deemed illegal per se under the antitrust laws and damages in lawsuits that are based on intellectual property agreements shall be limited to actual damages. FURTHER RESOLVED, that the American Bar Association proposes that the Act be amended so as not to apply to agreements to convey the right to use trademarks.

(c) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title IV of the Act which provide that a claim of patent or copyright misuse must be based on conduct which violates the antitrust laws and proposes that the Act be amended to clarify that the party asserting misuse need not satisfy antitrust standing or antitrust injury requirements.

(d) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title V of the Act which provide that process patentees may prevent others from using or selling products produced by the patented process to the extent that this Title would allow U.S. process patentees to prevent imports into the United States of products produced abroad in violation of a U.S. process patent.

AMERICAN BAR ASSOCIATION

SECTION OF ANTITRUST LAW

REPORT

TO THE HOUSE OF DELEGATES

I INTRODUCTION

In September 1983, President Reagan proposed legislation entitled the "National Productivity and Innovation Act of 1983 (the "Act"). The Act has been introduced in the Senate as S 1841 and in the House of Representatives as H R 3878 * The proposed legislation is intended to modify the antitrust, patent and copyright laws in a manner that will enhance the nation's productivity and the ability of U S industry to compete in the world market The legislative package is part of a larger Administration program designed to encourage private sector research and development activities by improving the economic and legal climate for such efforts

The Section of Antitrust Law of the American Bar Association endorses proposed legislation and other measures designed to accomplish these objectives In particular, the Antitrust Section supports the passage of those elements of the Act which are reasonably calculated to promote legitimate research and development activities by clarifying the standards under which legality of such activities will be judged and modifying those statutes and doctrines which, as actually applied or as perceived, may tend unduly to inhibit such activities. This Report will set forth the Antitrust Section's position respecting the principal elements of the Act

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* The Administration's bill and the Administration s analysis of the bill, as reported in 45 Antitrust & Trade Regulation Report (BNA) 397-401 (September 15, 1983), are attached as Appendix A to this Report Copies of S 1841 and H R 3878 are attached as Appendix B and Appendix C, respectively

II SUMMARY OF RECOMMENDATIONS

A. The Antitrust Section supports the passage of legislation (in particular, Title II of the Act) which provides that no joint research and development program shall be deemed illegal per se in any action brought under the antitrust laws, and which limits damages in actions brought under Section 4 or Section 4C of the Clayton Act to actual damages in cases based on conduct that is part of a joint research and development program The Antitrust Section opposes the notification provisions contained in Sections 203 and 204 of Title II, however, and it does not believe that the detrebling provisions should be conditioned on the specified notification procedure. The notification provisions should be deleted from the Act

B The Antitrust Section supports the passage of legislation (in particular, Title III of the Act) which provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws, and which limits damages to actual damages in actions based on such agreements brought under Section 4 or Section 4C of the Clayton Act The Antitrust Section believes, however, that Title III should be amended to exclude agreements to convey rights to use trademarks from the coverage of the Title

C The Antitrust Section supports the passage of legislation (in particular, Title IV of the Act) which provides that conduct cannot be found to constitute patent or copyright misuse on the basis of its possible effect on competition unless such conduct violates the antitrust laws Title IV should be amended, however, to clarify that the party asserting misuse need not satisfy antitrust standing or antitrust injury requirements to be entitled to raise the misuse defense

D The Antitrust Section endorses the resolution relating to process patent legislation adopted by the Section of Patent, Trademark and Copyright Law of the American Bar Association at its 1983 Annual Meeting The Antitrust Section therefore supports the passage of legislation (in particular, Title V of the Act) which grants process patentees the right to exclude others from using or selling products made by the patented process to the extent that such legislation applies to products made by the patented process which are imported into the United States.

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III DISCUSSION

A Title II Joint Research and Development Programs

Title II of the Act is intended to promote research and development activities by clarifying the antitrust standards by which the legality of joint research and development programs will be judged Title II provides that no joint research and development program shall be deemed illegal per se under the antitrust laws, thus ensuring that "rule of reason analysis will be applied in assessing the legality of such programs The proposed legislation defines a "joint research and development program' to mean theoretical analysis, exploration or experimentation, or the extension of scientific knowledge into practical application such as the development of prototypes Under Title II, such programs may also include the establishment of research facilities, the collection and exchange of research information, the prosecution of patent applications, the granting of licenses and any other conduct reasonably necessary and appropriate to such program

The Antitrust Section endorses the Administration s proposal that the per se standard be deemed inapplicable to joint research and development programs The proposed legislation, if enacted, would not change the substantive standard for determining the legality of joint research and development programs Rather, the legislation would merely codify the existing 'rule of reason' standard that has been consistently applied in assessing the legality of such programs It does, however, eliminate the possible application of inconsistent legal standards and any corresponding uncertainty (whether or not well-founded) as to the precise standard to be applied In so doing, the proposed legislation will promote legitimate joint research and development programs

The Antitrust Section also supports the passage of Section 203 of Title II, which limits damages to actual damages (plus prejudgment interest, court costs and attorneys fees) in actions brought under Section 4 or Section 4C of the Clayton Act based on conduct that is part of a joint research and development program Title II would modify the existing statutory requirement that plaintiffs' damages be trebled in all actions brought under Sections 4 and 4C of the Clayton Act

The Antitrust Section supports the damage limitation provisions of Title II because the existing treble damage requirement may tend to overdeter legitimate joint research and development activities The actual damages approach contained in Title II would eliminate this overdeterrent potential, yet allows victims of unlawful practices to recover their actual damages Moreoever, Title II preserves antitrust plaintiffs' ability to recover "the cost of suit, including a reasonable attorney's fee " Nor does the proposed legislation affect a plaintiff's ability to seek appropriate injunctive relief pursuant to Section 16 of the Clayton Act. Thus, Title II's modification of the existing treble damage requirement will promote legitimate joint research and development activity while permitting the effective prosecution of meritorious antitrust claims and providing the victims of unlawful practices with compensation for any actual damages sustained

Title II conditions the availability of its detrebling provisions upon the filing of a prescribed notification disclosing the joint research and development program with the Attorney General of the United States and the Federal Trade Commission The notification procedure is set forth in Section 204 of Title II

The Antitrust Section opposes this notification requirement and recommends that Title II be amended to delete the notification provisions contained therein The disclosure option provided for in Sections 203 and 204 of Title II is undesirable for several reasons First, advance disclosure of the features of a research and development joint venture is not needed to protect third parties as long as single damages remain available to compensate persons who may later be injured by the operation of the venture Second, public disclosure may deter companies from taking advantage of the detrebling provisions of the Act and may in fact present a greater disincentive to the formation of research and development joint ventures than do current perceptions of possible antitrust exposure Third, the disclosure provision — with publication requirements, withdrawal rights and confidentiality procedures — adds unnecessary complexity to the bill, and may lead to the imposition of a regulatory burden on the Antitrust Division, the Federal Trade Commission and the business community Fourth, non-disclosure of the joint research and development program could conceivably give rise to a negative inference respecting the legality of the program in subsequent litigation despite the fact that the participants had

independent business reasons for opting against the notification procedure.

More fundamentally, the disclosure provision does not appear to be necessary to protect against potentially anticompetitive conduct The extremely limited number of cases concerning research and development joint ventures and of government enforcement actions challenging joint research activity suggests that most research and development joint ventures do not pose such serious anticompetitive risks as to warrant a separate advance notification procedure Correspondingly, experience in the field provides no rational basis for conditioning detrebling upon advance notification

For the foregoing reasons, the Antitrust Section recommends that Title II be amended to delete the notification provisions contained therein

B Title III Intellectual Property Licensing Arrangements

Title III of the Act would add a new Section 27 to the Clayton Act, providing that '[a]greements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws ' Title III also would limit damages in antitrust cases based on such agreements to actual damages, plus prejudgment interest

The Antitrust Section supports the passage of Title III of the Act, but believes that agreements to convey rights relating to trademarks should be excluded from the legislative proposal Subject to this qualification, the Antitrust Section believes that Title III will promote research and development activity and access to the fruits of such activity by other parties

Title III complements Title II by placing single-firm licensing activities on an equal footing with joint research and development programs with respect to the appropriate antitrust standard to be applied and the damages allowable where challenged practices are found to be anticompetitive Single-firm research and development activities and licensing practices incident thereto should not be subject to a more exacting standard, nor subject to a higher level of potential exposure, than joint research and development programs

Moreover, the Antitrust Section supports the passage of Title III (subject to the exclusion of trademark licensing arrangements) for reasons independent from its logical nexus with Title II The ability to license proprietary technology is an important component of a legal system conducive to innovation See U S Department of Justice, Detailed Analysis of Antitrust Legislative Reforms Proposed by the Department of Justice (March 1983) Impediments to licensing arrangements, including the perceived antitrust risks incident to such arrangements, can deter research and development activities by reducing the commercial attractiveness of R&D efforts Further, such impediments can limit access to proprietary innovations developed by other parties, thereby reducing the potential for more widespread commercialization of the innovation and limiting the number of persons engaged in searching for improvements thereon

By ensuring that the legality of intellectual property licensing arrangements will be judged under rule of reason analysis, Title III of the Act promotes reasonable, commercially attractive licensing arrangements Similarly, by limiting antitrust damages based on such arrangements to actual damages, Title III eliminates the overdeterrent potential of the existing treble damage requirement

It is essential to note that Title III will not allow practices which are proven to be anticompetitive to escape condemnation under the antitrust laws Proscription of the per se approach will merely oblige the courts to receive evidence concerning the probable economic effects of a challenged practice before ruling upon the antitrust legality of the practice Further, the remedial provisions contained in Title III, like the corresponding provisions in Title II, will permit the prosecution of meritorious antitrust claims and will provide the victims of unlawful conduct with compensation for their actual damages

Finally, the provisions of Title III are limited to "[a]greements to convey rights to use, practice or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how or other intellectual property " Title III therefore leaves undisturbed the per se rules and treble damage remedy available to plaintiffs arising out of other alleged violations of the antitrust laws Thus, a naked agreement in restraint of trade would remain subject to the per se standard and the treble damage remedy even if a licensing agreement were adopted as a means of implementing the basic agreement, since the cause of action attacking the

basic agreement would not be "based" on the licensing agreement

As proposed by the Administration, Title III would apply to agreements conveying rights to use trademarks as well as the other enumerated types of intellectual property As previously noted, the Antitrust Section believes that Title III should be amended to delete the reference to "trademarks" in proposed new Section 27(a) of the Clayton Act and to expressly exclude trademarks from its terms Unlike the other types of intellectual property listed in Title III, trademarks are legally protected indicators of origin which are primarily related to the marketing of goods, as opposed to research and development efforts As a result, trademarks are not properly within the same technological innovation framework which supports the other provisions of the Act

C Title IV Patent Misuse

Title IV of the Act would amend 35 U S C § 271 to provide that enumerated patent practices cannot provide the basis for a finding of misuse or illegal extension of the patent unless such practices, in the circumstances in which they are employed, violate the antitrust laws These practices include

(1) licensing the patent under terms that affect commerce outside the scope of the patent s claims (e g , requiring a licensee to purchase unpatented materials from the licensor, requiring a licensee to assign to the patentee a patent that may be issued to the licensee after the licensing arrangement is executed, restricting a licensee s freedom to deal in products or services outside the scope of the patent, requiring the licensee to become a licensee of a second patent),

(2) restricting a licensee of the patent in the sale of the patented product or in the sale of an unpatented product made by the patented process,

(3) obligating a licensee of the patent to pay royalties that differ from these paid by another licensee or that are allegedly excessive,

(4) obligating a licensee of the patent to pay royalties in amounts that are not related to the

licensee s sales of the patented product or an unpatented product made by the patented process,

(5) otherwise using the patent in a manner that allegedly suppresses competition.

Title IV would also enact corresponding amendments to federal copyright law under 17 U S C § 501(a)

The Antitrust Section supports these proposed amendments to 35 U S C § 271 and 17 U S C § 501(a) The proposed modification of the misuse doctrine is a necessary element of the Act s overall purpose of encouraging intellectual property licensing and, correspondingly, investment in research and development activities It would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements, on the one hand, and yet leave undisturbed a misuse doctrine which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which do not even constitute antitrust violations Moreover, the proposed limitation on the misuse doctrine, on its own merits, would represent a positive development on the context of the patent/antitrust interface

At the outset, it should be noted that Title IV would not alter existing law with respect to the misuse doctrine as it applies to improper practices not related to competition (e g , fraud on the Patent Office) Rather, Title IV would merely ensure that a meaningful economic analysis has been performed before a court properly may refuse to enforce a valid patent or copyright under the misuse doctrine as applied to practices which are allegedly anticompetitive

In the patent/antitrust context, two basic lines of patent misuse cases have developed The primary line involved efforts to use the patent to control commerce outside the scope of the patent claims See, e g , Morton Salt Co v G S Suppiger Co , 314 U S 488, reh denied, 315 U S 826 (1942) The second principal line of misuse cases involved practices related to products covered by the patent See, e g , Ansul v Uniroyal Inc , 448 F 2d 872, 880 (2d Cir 1971), F C Russell Co v Comfort Equipment Corp , 194 F 2d 592, 596 (7th Cir 1952)

In both lines of cases, the courts found the patent owners guilty of misuse essentially on the grounds that the challenged practices were anticompetitive in effect and, therefore, contrary to public policy Indeed, in Morton Salt the Supreme Court's holding was expressly premised on its finding that the patent had been used "as a means of restraining competition " 314 U S at 493 See also Mercoid Corp v Minneapolis Honeywell Regulator Co , 320 U S 680, 684 (1943), reh denied, 321 U S 802 (1944) ("The legality of any attempt to bring unpatented goods within the protection of the patent is measured by the antitrust laws not by the patent law ")

Although this aspect of the misuse doctrine is grounded in national economic policy as expressed in the antitrust laws, the courts have stated that various forms of allegedly "anticompetitive" conduct may constitute patent misuse despite the fact that the conduct does not violate the antitrust laws See, e g , Morton Salt Co v G S Suppiger Co , supra As a result, these cases treat market power derived from patents more harshly than market power derived from other lawful means For example, these cases would deny a patent owner the ability to enforce its patent on grounds of misuse even though the challenged conduct falls short of an antitrust violation, but an identical practice employed in the context of a know-how license might well be enforceable Compare A & E Plastik Pak Co v Monsanto Co , 396 F 2d 710, 715 (9th Cir 1968) with Robintech, Inc v Chemidus Wavin, Ltd , 628 F 2d 142, 146-49 (D C Cir 1980)

The Antitrust Section believes this aspect of the misuse doctrine is undesirable and should be addressed by appropriate legislation It is by no means clear that all practices by which a patent holder seeks fully to exploit its patent rights are necessarily anticompetitive in purpose or effect In fact, this aspect of the misuse doctrine is inconsistent with sound competition policy because it can deter procompetitive or otherwise desirable conduct Moreover, the doctrine may inhibit research and development investment by precluding commercially attractive licensing programs

Where licensing activities contravene national competition policy as expressed in the antitrust laws, a finding of misuse should follow On the other hand, conduct should not be condemed as patent misuse on economic grounds unless the conduct is inconsistent with the antitrust laws Title IV codifies these principles, and the Antitrust Section supports this proposed modification of the misuse doctrine

Title IV should be amended, however, to make clear that the proposed modification does not incorporate the antitrust requirements of standing or antitrust injury into the misuse doctrine In other words, it should be made clear that the party asserting misuse need not satisfy antitrust standing and antitrust injury requirements to raise successfully the misuse defense A finding of misuse should be supportable wherever the substantive quality of the conduct violates the antitrust laws without regard to whether the party asserting misuse could properly bring a private antitrust action on the basis of that conduct The Antitrust Section therefore recommends that Title IV be amended to provide that the enumerated practices cannot provide the basis for a finding of misuse unless such practices "would be found to violate the antitrust laws if challenged by the Department of Justice "

D Title V Process Patents

Title V of the Act would amend 35 U S C §§ 154 and 271 to expand the exclusive rights of a process patent holder to products made by the patented process The proposed amendment to Section 154 grants to process patentees the right to exclude others from using or selling such products, the proposed supplementary amendment to Section 271 makes the use or sale of such products infringement

Under existing law, a process patentee can prevent the use of the patented process by domestic manufacturers by means of an infringement action under 35 U S C § 271, but he cannot prevent the use or sale of unpatented products made by the process A manufacturer who employs a process outside the United States to produce unpatented products is not liable as an infringer of a United States patent on the process, despite the fact that the products are ultimately sold in the United States University Patents, Inc v Questor Corp , 213 U S P Q 711 (D Colo 1981), citing Clairol, Inc v Brentwood Industries, Inc , 193 U S P Q 683 (C D Cal 1976) As a result, a process patent owner does not have any civil remedy against a manufacturer who uses the process outside the United States to make products sold in the United States *

Title V of the Act would close this gap in United States process patent protection by providing that the use or

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* Although a limited form of relief may be available to the process patent owner through the United States International Trade Commission pursuant to 19 U S C §§ 1337 et seq , the procedural hurdles, evidentiary burdens and limited relief availabe in USITC proceedings have rendered this avenue of redress largely ineffective

sale of unpatented products of a patented process would constitute an infringement of the patented process The Antitrust Section supports the passage of Title V to the extent that the proposed amendments to the Patent Code are necessary to provide process patent owners with an effective civil remedy against the importation into the United States of products manufactured in another country by a process patented in the United States

The Antitrust Section is not prepared, however, to support this extension of a process patent owner s rights to situations in which the use of the process occurs in the United States Under existing law, process patent owners already have a cause of action against persons using patented processes within the Unites States and such patentees, through discovery, have adequate means to determine whether the processes being used are within their patent grants Thus, while the need for legislation with respect to foreign practice of patented processes is demonstrable, it is less clear that such a need exists with respect to domestic process use Since Title V will expose retailers, distributors and users of unpatented products made by patented processes to charges of infringement, the Antitrust Section believes that the legislative response should be confined to those situations in which a clearly defined need for remedial legislation has been shown to exist

In this regard, the Antitrust Section endorses the following resolution which was adopted by the Section of Patent, Trademark and Copyright Law at its 1983 Annual Meeting

> Resolved, that the Section of Patent, Trademark and Copyright Law favors in principle the enactment of legislation to provide that whoever imports into the United States or uses or sells in the United States a product made in another country by a process patented in the United States and made during the term of that patent shall be liable as an infringer

The Patent, Trademark and Copyright Section's resolution embodies the notion that the legislative response to the process patent problem should be limited to imported products at this time, and the Antitrust Section concurs for the reasons discussed above

IV CONCLUSION

The Antitrust Section believes that the various provisions of the Act are reasonably calculated to promote

domestic research and development activities in a manner that is consistent with national competition policy as embodied in the antitrust laws Subject to the suggested modifications and qualifications set forth in this Report, the antitrust Section supports the passage of the Act

February 3, 1984

Richard W. Pogue, Chairman

Mr KASTENMEIER Let us proceed to Mr Robert P Merges, the last member of our panel, who is at Columbia Law School, and I guess is going to Boston University next

Mr Merges

Mr MERGES Thank you, Mr Chairman I appreciate the opportunity to have a chance to speak on the issue of patent misuse

I would like to emphasize the first word in that phrase "patent" I think it has been under-emphasized here today, with the possible exception of my colleague, Mr Schwartz Patent misuse really grew out of the patent law and cannot really be understood without reference to the full fabric of patent law

There are a number of equitable doctrines that assist the patentee in enforcing his doctrines There is the doctrine of equivalence, which permits a patentee to pursue an alleged infringer who is manufacturing a product that is not technically within the claims of the patentee's patent, but that is within the equitable penumbra of those claims That is an equitable doctrine that assists the patentee

There are several others For example, the doctrine of contributory infringement, which is codified in section 271(c) of the patent law Patent misuse, contrary to what some have said here today, grew at least as much out of those equitable doctrines in the sense that it became a counterweight to those equitable doctrines It grew at least as much out of that impetus as a nascent concern with anti-competitive behavior It is an equitable doctrine that assists licensees and serves as a counterweight to the equitable doctrines that assist the patentee

Professor Schwartz has pointed out in his written testimony, I think, an excellent fact vis-a-vis this point, which is that the patentee in many cases, is against the right to exercise his manufacturing process through the patent law and it is the patent law policies that really form the doctrine of patent misuse, and that operate to constrain the things that the patentee can do in terms of licensing

For example, contributory infringement, in 271(c), helps the patentee when an alleged infringer has sold a component of a patented product, but the component itself is not within the claims of the patent

Likewise, Patent misuse helps the licensee in a similar case proceed against the patentee It is an equitable doctrine

I also agree with Mr Schwartz in that it is difficult to tie the hands of the courts It is bad actually to tie the hands of the court by codifying an equitable doctrine

I take a case that arose in your home district, which is Vitamin Technologies, versus Wisconsin Research Foundation That is the case where the court took the rare step of refusing to enforce a patent because of the public interest It cited the doctrine of Patent misuse and noted as an equitable doctrine that the remedy it was using in the case was rare because it was warranted in that case

I won't go into the facts They are discussed in my written submission I think cases like that are exactly the reason why we don't want codified equitable doctrines in patent use tying the courts' hands

I want to say one thing quickly about the rigorous economic analysis we have been told about today in terms of antitrust I think there are two points worth noting

One, the first generation of the Chicago school scholarship is not alone out in the literature now There is sort of a second wave of economists who began to question some of the basic assumptions While I think it is safe to say their analysis is no less rigorous, it is probably more valid to say that the debate is vigorous and that the analysis is necessarily unified in a rigorous way I would point to the work of Professor Kaplow at Harvard as an example of that second line of work

Very little of the antitrust work concerns itself with the patent laws, which relates to my first point Misuse grew out of the structure of the patent laws It is not best viewed as an antitrust doctrine parading under the banner of the patent laws, it is perhaps at least as well viewed as a doctrine that grew out of the necessity of carrying out the policies underlying the patent laws—specifically the claims of a patent sometimes needs equitable tweaking if justice is to be done

I pointed out cases where equity helps the patentee In that sense, the policy of making sure that the claims of a patent are upheld but that the patentee is not permitted to overstep the claims, really does go to the underlying purpose of the patent law, only secondly does it address and tie competitive behavior What I mean is that the doctrine grew out of patent claim construction, and that to analyze it in terms of its effects on competition is perhaps not fair to the doctrine, and does a disservice to the courts

I also want to say one thing in closing, which is, that the uncertainty opponents of Patent misuse have identified simply doesn't appear to be out there in practice If you take any of the leading treatises on patent law and look up Patent misuse, you get different answers They digest the cases, the cases are well understood, practitioners have a good idea of what practices are and are not misuse, with the exception of the Robintech and Cole cases, as an example However, I think the fact that the Cole case came second, and was automatically ordered by Chief Justice Burger, mitigates the confusion in the District of Columbia Circuit

I would also say that it is difficult to prove the negative That is, it is difficult to say which transactions would not have occurred because of the Patent misuse doctrine But what is very well known is that the licensing activity is vigorous, it is on the upturn There is more of it now than there has been in quite a while, and that patent licensing is alive and well despite the supposed uncertainty brought about by Patent misuse

I think I will end my spoken statement there

Mr KASTENMEIER Thank you very much for that statement

[The statement of Mr Merges follows]

STATEMENT

BY

ROBERT P. MERGES

JULIUS SILVER FELLOW IN LAW, SCIENCE & TECHNOLOGY

COLUMBIA LAW SCHOOL

BEFORE THE

HOUSE JUDICIARY SUBCOMMITTEE

ON

COURTS, CIVIL LIBERTIES, AND

THE ADMINISTRATION OF JUSTICE

HEARINGS ON PATENT MISUSE

United States House of Representatives

Wednesday, May 11, 1988

Robert P Merges

Robert P. Merges is currently the Julius Silver Fellow in Law, Science and Technology at Columbia Law School in New York, and will join the faculty of the Boston University School of Law this summer He is actively engaged in teaching and research in the area of intellectual property law. Prior to his fellowship at Columbia, Mr Merges was a practicing lawyer in Palo Alto, California, where he specialized in intellectual property and other corporate work for start-up companies in the computer and biotechnology industries. Mr Merges received his LL M from Columbia Law School, his J D. from Yale Law School and his B.S from Carnegie-Mellon University He is a member of the California Bar.

SUMMARY

1 Of the two most recent legislative proposals dealing with patent misuse, H R 4086 and S 1200, the House bill, H.R 4086, is superior for two reasons

a It states much clearer and fairer guidelines concerning what licensing activities are legal and illegal as compared to S.1200, due to the latter bill's reliance on the amorphous "rule of reason."

b It retains the special characteristics of patent misuse as an equitable doctrine distinct from antitrust law, characteristics that have evolved to serve a special function within the patent system

2 The proposal under S.1200 to test all alleged patent misuse offenses under antitrust standards would change current law for the worse. By directing courts to analyze licensing practices in light of general antitrust provisions, this legislation would assume away many of the unique features of patent licenses. For example, the often very limited (or "thin") markets for patented technology make it difficult to apply antitrust law's consumer-demand definition of the relevant market Likewise, a central policy of the patent law is to limit the scope of a patent's claims to the legal and equitable boundaries of the patentee's invention, activities that do not "substantially lessen competition" in the antitrust sense may still run afoul of this important policy -- for example, overinclusive grantback clauses and coercive requirements to extend the patent term beyond seventeen years.

Mr Chairman and Members of the Subcommittee

Thank you for the opportunity to testify on the topic of patent misuse. I hope you find useful my comments concerning the two most recently proposed legislative amendments to the patent misuse doctrine, H R 4086 and S.1200.

I will structure my comments as follows I first want to discuss some general points concerning patent misuse, and then move on to a more detailed examination of how H.R.4086 and S 1200 would affect current law on patent misuse.

1 General Considerations

A Dueling Bills H R. 4086 vs. S.1200

In general, I believe that H.R.4086 takes a sounder approach to patent misuse than does its counterpart in the Senate, S.1200 Briefly, there are three reasons I believe this is so

First, the House Bill explicitly states what conduct constitutes misuse, and what conduct does not. I prefer this listing of "white list" and "black list" activities over a more general approach, because even a theoretically unified general approach is not nearly as useful to practitioners as a clear enunciation of what is and is not acceptable conduct. This is borne out by the licensing regulations of the

European Economic Community, promulgated under Article 85(3) of the Treaty of Rome, which list acceptable and unacceptable activities under the Treaty See Official Journal of the European Communities, August 16, 1984, at p L-219

Second, the House Bill retains much of what is good in the current patent misuse doctrine as applied by the courts It codifies the categories of licensing restrictions most courts have identified as misuse, eliminates from misuse some restrictions now recognized as unproblematical, and carries forth -- through continued use of the word "unreasonable" to describe proscribed restrictions -- the flexible judicial approach that has evolved over the years.

Third, the House Bill, unlike S 1200, avoids the pitfall of relying on the "rule of reason." Not only is this a notoriously difficult standard for an antitrust plaintiff to meet, it is also a standard that is very difficult to apply. See, e.g., Prepared Statement of Louis Kaplow, Hearings on H R. 557, April 30, 1987. Thus it is ironic indeed that advocates of greater certainty in the law of patent misuse would propose a unified rule of reason approach when this is arguably one of the least certain legal rules ever propounded.

I must say in conclusion, then, that H.R 4086 is clearly superior to S 1200. The open question in my mind is whether either proposal is superior to existing law. As I argue below, most practicing lawyers seem to have no difficulty determining from the decided cases what does and does not constitute misuse Much boilerplate language in licensing agreements reflects this consensus And, since I argue below that patent misuse has a distinct place in the structure of patent law, I do not believe it should be eliminated altogether. Thus I am not convinced that patent misuse needs adjustment However, if Congress decides to act, the House Bill is the superior alternative

B Objections to the "Unification" of Patent Misuse and Antitrust

Supporters of the Senate Bill and of the general notion of abolishing patent misuse believe the antitrust laws should be the sole means of addressing anticompetitive behavior on the part of patentees. See Title 2 of the Bill "No patent owner . . shall be denied relief . . unless [his or her] . practices or actions or inactions . . violate the antitrust laws." See also Note, Standard Antitrust Analysis and the Doctrine of Patent Misuse: A Unification Under the Rule of Reason, 46 U PITT. L. REV. 209 (1984) But there is a place for restrictions on anticompetitive behavior within patent law, not just in antitrust. The fact is that a

concern with "level playing fields" permeates much of the law applicable to private firms. Consider the law of unfair competition (including trade secret law, the doctrine of "passing off", and covenants not to compete), or the unconscionability doctrine in contract law These are all designed to thwart behavior that is, in one way or another, anticompetitive. Such behavior may not rise to the level of an antitrust violation, yet it is still worth preventing

Why should the patent law be any different? Why, that is, do the proponents of S 1200 believe that patent misuse -- an equitable doctrine arising out of the patent system, which has been applied to a wide variety of behavior deemed anticompetitive -- must be replaced? Some claim it has created uncertainty, because its precise boundaries have evolved through individual decisions, and the doctrine has never been codified in a statute Yet all the commentators and practicing lawyers who examine the cases agree on the categories of anticompetitive behavior that will be characterized as misuse See, e g , P. HOFF, INVENTIONS IN THE MARKETPLACE (1987), 14 BUSINESS ORGANIZATIONS, D. EINHORN, PATENT LICENSING TRANSACTIONS (1970 & Supp 1986), 5 D. CHISUM, PATENTS §§19.04[1] through 19 04[3] (1986). Even Judge Richard Posner, certainly no great advocate of the misuse doctrine, has noted that "apart from the conventional applications of the doctrine we have found no cases where

standards different from those of antitrust law were actually applied to yield different results " USM Corp. v SPS Technologies, Inc , supra (emphasis added) Moreover, it is clear from the lukewarm support shown so far for S 1200 that there is no widespread perception of debilitating uncertainty in this area Thus there may be some analytical loose ends -- a result perhaps of the paucity of scholarly attention misuse has received compared to full-fledged antitrust issues -- but there is no overwhelming sense of incoherence

The second response centers on misuse as an equitable doctrine The nature of equity is that it is somewhat "messy" (This will appear especially true to economists, whose need for analytical boundaries is well documented.) The fact remains that in certain cases an otherwise legitimate use of a patent might just be unfair Classic cases in this vein include Vitamin Technologists, Inc v Wisconsin Alumni Research Foundation, 146 F 2d 929 (9th Cir 1945), and City of Milwaukee v Activated Sludge, Inc., 69 F 2d 577 (7th Cir 1934). In both these cases, the patentee's legitimate exercise of monopoly rights conflicted sharply with a clear and immediate threat to public welfare -- and the patents were not enforced Obviously such cases are very rare; the general, indeed near-universal, rule is that there is no rule of compulsory licensing of patents in

the United States. But it is important that this equitable flexibility not be taken out of the hands of the courts.[1]

A brief contemporary example might help prove the point Suppose a firm developed an AIDS vaccine, but refused to license it to sellers in certain states, on the grounds that those states had excessively stringent product liability laws or doctrines. This is admittedly far-fetched, yet not inconceivable (Genentech, for example, lobbied hard for a state law specifically exempting AIDS vaccines from California's prohibitive product liability standards, contending that under such standards development of a vaccine was not worth the risks, they were successful in this effort.) In such a case, wise public policy would dictate that the patent not be enforced until the patentee agreed to license into those states. (Perhaps at higher rates, to offset the increased risk of product liability.) Again, such cases are rare, but when they arise it would seem essential for courts to have the flexibility to deal with them, whether they present facts amounting to an antitrust violation or --

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[1] In fact, it is arguable that the "rule" announced in these cases is also efficient. In the Vitamin Technologists case, for instance, given the high costs of either (i) supplying butter at subsidized rates, or (ii) financing the development of a non-infringing butter substitute, the court's decision refusing to enforce the patent may well have been the least-cost solution. And, certainly, forcing the patentee to license in this case signalled that where matters of public health were concerned, future patentees would be wise to adopt reasonable licensing policies

as with the AIDS vaccine case -- they do not. The patent misuse doctrine, a branch of the equitable principle of "unclean hands," provides this flexibility This is reason enough why it should be retained

In the same vein, proponents of a unified antitrust analysis overlook the fact that patent misuse serves as a valuable counterweight to equitable doctrines that favor the patentee For example, under the "doctrine of equivalents" -- which patent courts explicitly recognize as a doctrine of equity -- a patentee may prevent an accused infringer from selling a product or process that does not technically fall within the claims of the patentee's patent Moreover, the broad provisions of 35 U S.C § 283 permit courts to use the principles of equity in deciding on the proper relief to grant in a patent infringement case Similarly, the provisions of § 271 concerning contributory infringement grew out of early patent decisions creating an exception in equity to the harsh and mechanistic rule requiring patentees to show that an alleged infringer was selling a product that incorporated each and every element of the patentee's product. See Oddi, Contributory Infringement/Patent Misuse: Metaphysics and Metamorphosis, 44 U. PITT L REV. 73 (1982) Patent misuse offsets these pro-patentee equitable doctrines Whereas they in a sense extend the scope of a patent beyond the terms of its claims, patent misuse prevents such an

extension by the patentee where it is unfair (e g , where the patentee tries to tie the sale of unpatented staple items to the sale of a patented machine or process; see below) Patent misuse thus keeps patent law equitably symmetrical, in a way that antitrust critics, unschooled in the structure and balance of patent law, have overlooked.[2]

2 Specific Practices

I turn now to some specific licensing restrictions whose legality S.1200 is designed to clarify As will become clear, I believe that (i) a lower, antitrust-based standard is an inappropriate way to determine if the practices covered by misuse are anticompetitive in the individual case; and (ii) courts have traditionally applied the misuse doctrine with a great deal of sensitivity to the commercial context of the licensing practice in question, thus demonstrating that

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[2] Note that the patent doctrine's indifference to the antitrust requirement of an anticompetitive effect is also consistent with these other equitable doctrines, which are directed not at policing the economic effects of the patent but at maintaining a fair buffer zone protecting the integrity of the patentee's patent claims. The doctrine of equivalents, for example, does not ask whether the allegedly equivalent infringing product has a substantial effect on the patentee's sales or profits; it assumes that any sale of such products, no matter how insignificant economically, undercuts the patentee's claims and therefore must be enjoined. As a consequence these equitable doctrines -- including patent misuse -- should be seen as part of the larger fabric of patent law, designed to ensure the integrity of claims but also prevent them from becoming too powerful. In this way, the general principles of equity serve to keep patent law internally consistent. Prevention of anticompetitive effects is a desirable but secondary result of this consistency.

the doctrine is not an open-ended excuse to punish patentee/licensees, but a sensible instrument for balancing the costs and benefits of specific patent licensing practices. Since H.R 4086 preserves much of this flexibility, it is superior to S.1200, which relies instead on a "unified" rule of reason analysis for each licensing practice. In only one respect do I take serious issue with the House Bill's treatment of misuse issues [3]

Note that I do not cover all the practices that have been characterized as misuse, only those that are frequently said to be in an uncertain state due to open-ended or inconsistent court opinions: (a) tie-ins; (b) grant-backs; and (c) indirect extensions of the term of a patent.[4]

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[3] This is with respect to section 2(d)(2)(E) of the Bill, relating to resale price maintenance and price fixing I fear that use of the term "unreasonable" in connection with these practices might open the door to serious mischief While I do not believe the Bill intends to adopt a "rule of reason" approach by using this term, I do think others might make such an argument. If successful, they would reverse the very long-standing rule of Doctor Miles Medical Co. v. John D. Park & Sons Co., 220 U.S 373 (1911), which makes it per se illegal for sellers to engage in resale price maintenance or vertical price fixing. Importantly, no serious commentator has ever proposed changing this standard. See, e.g , P. HOFF, INVENTIONS IN THE MARKETPLACE, supra, at 48 (noting the lack of controversy on this issue). Thus it would behoove the Congress to consider changing the Bill to explicitly state that "unreasonable" does not mean "rule of reason," and, at least as important, to remove any doubt that the per se price-fixing rule is NOT being overruled by the Bill.

[4] The other restrictions prohibited by the infamous "Nine No-no's," in addition to being grounded in no more solid authority than an after-lunch speech, are either not

a. Tie-Ins

Under the recently-announced rule of the Court of Appeals for the Federal Circuit, a tie-in not rising to the level of an antitrust violation may be found to constitute misuse Senza-Gel Corp v. Seiffhart, 803 F 2d 661, 231 U S.P Q. (BNA) 363 (Fed Cir. 1986) The court approved of a three-part test to determine whether a tie-in was present in a particular case:

> First. Determine whether there are two things tied, i e., whether there are separable or inseparable items, if so
>
> Second Determine whether the "thing" which is assertedly tied to the patented item is a staple or non-staple item in commerce, if staple
>
> Third: Determine whether in fact they are tied.[5]

The court further explained how the first determination is to be made, and how it differs in a case involving patents

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seriously thought to have any pro-competitive effects by consensus of lawyers and economists (e.g., resale price maintenance), or they have never been seriously questioned by a court, outside the context of a sham arrangement disguising a cartel. See, e g., P. Hoff, Inventions in the Marketplace: Patent Licensing and the U.S. Antitrust Laws 48 (1986) (noting lack of support for horizontal price fixing practices involving patent licenses); USM Corp. v. Technologies, Inc., 694 F.2d 504, 216 U S P.Q. (BNA) 959 (7th Cir. 1982) (differential royalty rates do not amount to patent misuse); General Talking Pictures Co. v. Western Elec. Co., 304 U S. 175 (1938) (field of use restrictions do not constitute patent misuse).

[5] Senza Gel Corp. v. Seiffhart, supra, 231 U S.P.Q. (BNA) at 365.

from an antitrust case where the tie-in is achieved without a patent

> [T]he Supreme Court has stated that "the answer to the question whether two products are involved turns not on the functional relationship between them, but rather on the character of the demand for the two items." Jefferson Parish Hospital District No 2 v Hyde, 466 U.S. 2, 19 (1984) . . . [footnote 14] [However,] [t]he law of patent misuse in licensing need not look to consumer demand (which may be nonexistent) but need look only to the nature of the claimed invention as the basis for determining whether a product is a necessary concomitant of the invention or an entirely separate product. [This is because] [t]he law of antitrust violation [sic] . . . [is] tailored for situations that may or may not involve a patent .[6]

There are two points worth noting in this analysis First, it supplies a cogent rationale for the different standards applied to tie-ins in patent misuse and antitrust cases That is, since the markets for specific technologies are often very "thin," with few direct substitutes available for particular inventions or components, the consumer-demand test of Jefferson Parish is of very limited use in this context.[7] Second, because of these "thin" markets, product separability will often be difficult to determine. It will turn on the specific technology involved -- spelled out in the claims of the patent in suit. Thus only a court intimately familiar with patent claim construction will be in

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[6] Id , 231 U.S.P Q (BNA) 370 & 370 n. 14

[7] See Caves, Crookell & Killing, The Imperfect Market for Technology Licenses, 45 OXFORD BULLETIN OF ECON & STATS. 249 (1983).

a position to make this delicate determination. This illustrates an ancillary benefit of the patent misuse doctrine: it is a doctrine of patent law, to be analyzed by patent courts at the same time other patent issues are resolved To the extent that the effects of allegedly anticompetitive patent behavior turn on specific technologies -- and their place in the businesses of the licensor and licensee -- patent misuse makes sense as a separate branch of patent law Because of this, it is properly seen as being related to, but not coextensive with, antitrust laws and doctrines along similar lines.

Aside from the patent-specific analysis of tie-ins required by the patent misuse doctrine, there are several other, more general reasons to limit licensees' ability to use tie-ins. First, contrary to the assertions of "Chicago School" theorists in this area, there is evidence that market power does in some circumstances permit a licensor to "extend" his monopoly over the tying product into the market for a tied product See Kaplow, Extension of Monopoly POwer Through Leverage, 85 COLUM L. REV 515, 525-532 (1985) Second, also contrary to these theorists, there is little evidence that tie-ins make "metering" more efficient, licensors can just as easily (or even more easily) monitor records of the licensee's output (e.g., receipts) as they can monitor records of input, which is the classic "metering

rationale" for tie-ins Kaplow Testimony, supra, at 8 Finally, the notion that tie-ins are sometimes necessary to allow a patentee to maintain the quality of its patented product -- the "goodwill" or "quality maintenance" rationale -- is well recognized in the antitrust tie-in cases already See United States v. Jerrold Electronics, 187 F Supp. 545 (E D Pa 1960), aff'd per curiam 365 U S. 567 (1961), E GELLHORN, ANTITRUST LAW AND ECONOMICS 295 (2d ed 1981)

b. Grantbacks

Grantbacks are common in technology licensing agreements They usually provide that the licensee will grant a nonexclusive license on any improvements it develops to the licensor -- to prevent the situation where the licensee can block the licensor from practicing an improved version of the licensor's original invention

In some cases, however, licensors have apparently used grantback provisions to maintain exclusivity in a particular technology, by requiring licensees to assign all improvements back to the licensor or to grant an exclusive license back to the licensor. Where undertaken to maintain control over the future development path of a technology, this practice has routinely been condemned as patent misuse. See, e.g., Transparent-Wrap Machine Corp. v Stokes & Smith, 329 U S. 637, 646-647 (1947) (dictum); 4 D. CHISUM, PATENTS

§19 04[3][j] (1986) On the other hand, where the licensee is simply required to grant a nonexclusive license back to the licensor, the practice is not said to constitute misuse Id

Grantbacks provide another example where patent misuse makes sense as a separate and independent doctrine from antitrust law. Again, the reason is that the anticompetitive effects of a grantback clause will depend critically on the particular technology involved -- and especially whether the grantback in question extends to "improvements" that are actually beyond the scope of the claims recited in the licensed patent See, e.g , Duplan Corp. v. Deering Milliken, Inc , 444 F Supp. 648, 700 (D.S.C. 1977) aff'd 594 F 2d 979 (4th Cir. 1979).

As with the tie-in, the grantback may apply to only one patent, most likely one licensed into a relatively "thin" market for technology Thus the restriction may or may not reduce competition in a relevant market, and it may be difficult to tell What is clear is that determining this depends critically on the language of the particular claim involved Moreover, as with tie-ins, it may be difficult or impossible to assess whether there are any realistic substitutes for the improvement granted back to the licensor -- again, because of the thinness of the markets for both the

original patented technology and any improvements on it The upshot is that the patent misuse doctrine is once again superior; it avoids the need for a determination of whether a substantial degree of competition has been foreclosed in a difficult-to-define market, and instead focuses attention on whether the technology involved in the original license is being used in an anticompetitive fashion in the (perhaps small) market into which it was licensed

And, it should be noted, courts have not blindly applied misuse analysis in the area of grantbacks They have instead shown a good deal of sensitivity to the commercial context of the grantback clause See, e.g , Sante Fe-Pomeroy, Inc. v. P & Z Co , 569 F 2d 1084, 197 U.S.P Q (BNA) 449 (9th Cir 1978) (grantback clause in license from owner of patent on excavation process to government agency held not to constitute misuse, since alternative methods for achieving result were available to the licensee).

Since H.R. 4086 retains this flexible approach, for example, by recognizing that nonexclusive grantbacks are usually not anticompetitive, it is superior to S.1200. Again, however, it is difficult to see what, if anything, this legislation would add to the extant case law

c Temporal Extensions of Patent Term

The temporal extension of a patent is another instance where misuse, despite what some critics have said, maintains viability as a separate doctrine. The reason is once again that "relevant market" analysis is difficult and misleading, since the truly relevant market is the small one for a given, licensed technology In such a market, defined once again by the specific claims of the licensed patent at issue (and any substitutes therefor), any extension of the temporal scope of the patent may have severe anticompetitive effects. It is simply immaterial whether, because of substitutes for the patented technology, these effects restrain a less than "substantial" amount of competition in some broadly-defined market. The individual licensee may well be dependent on one technology -- that of the licensor -- and hence be in no position to seriously pursue any of these substitutes.

In Boggild v. Kenner Products, 776 F.2d 1315 (6th Cir. 1985), for instance, the licensee had invented an extruder specifically for use with licensor/defendant's Play Doh product. The license agreement, executed prior to plaintiff's application for a patent but in clear contemplation of such application, called for royalty payments to be made for 25 years -- regardless of whether the patent application resulted in the issuance of a patent. The Sixth Circuit held that the licensee was not obligated to pay royalties beyond the seventeen year term of the patent that

eventually issued See also Meehan v PPG Indus., Inc , 802 F 2d 881 (7th Cir 1986) (same, as to package license of patents calling for royalty payments on entire package until all had expired), Aronson v Quick Point Pencil Co , 440 U S. 257, 263-64 (1980) (noting in dictum that extension of payments beyond patent term constitutes misuse).

These cases properly rely on patent misuse to strike down practices that, although perhaps not substantially injurious to competition in some broadly-defined relevant market, have significant anticompetitive effects -- and, notably, only limited social benefits. Congress has determined that 17 years of exclusivity provides enough incentive to call forth inventive activity in the United States. Parties are simply not free to circumvent this through licensing agreements. See generally 4 D CHISUM, PATENTS §19.04[3][d] (1986)

The provision in H.R. 4086 legalizing voluntary extensions of patent term does little to undercut the logic of these cases, and therefore makes some sense Some practices that have been characterized as patent misuse when forced on a licensee have escaped this characterization when licensors can prove licensees assumed them voluntarily Compare Automatic Radio Mfg. Co. v Hazeltine Research, Inc ,

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339 U.S 897 (1950) with Zenith Radio Corp v. Hazeltine Research, Inc., 395 U.S 100 (1969)

3 Conclusion

There is no sound reason why present misuse doctrines need to be eliminated in favor of antitrust analysis of the same practices Indeed, as I have tried to make clear, there are a number of reasons why misuse has a bona fide claim to a viable, independent existence.

At the same time I think it is important to add one point. I believe that not all legislation favorable to licensors is unreasonable. In fact, some modification of per se antitrust restrictions is probably warranted. See P. HOFF, INVENTIONS IN THE MARKETPLACE (1986), at Chapter 6 (calling for antitrust legislation establishing presumptions in favor of and against certain practices). But this should not be accompanied by modification of the patent misuse doctrine -- a different doctrinal animal with a limited, though viable, independent existence.

Mr KASTENMEIER The three statements are quite interesting and somewhat different in terms of their analysis

I hope you will bear with the committee We now have another recorded vote on I suspect we can not really entertain an adequate question and answer session in the few minutes we have before we must answer the vote So let me put it this way Unless either of my colleagues will not return, I will yield to them now I will reserve my questions until I return

If there is any chance you may not return and have only one or two questions——

Mr CARDIN I am not going to ask questions

Mr COBLE Thank you, Mr Chairman I will not be able to return and I thank you for doing this

I would like to ask—Mr Schwartz, let me start with you

Mr Taylor indicated—and I am not in complete disgareement with this contention—that some courts are hostile to the entire concept of intellectual property As a private practitioner have you witnesses such hostility?

Mr SCHWARTZ Well, I would say that there has been a large change in the past 5 to 8 years in the reception in the District Courts to intellectual property, and I think it has come from a number of sources I think one source is the Court of Appeals for the Federal Circuit

Another source is the changing awareness of the significance of intellectual property

And I think a third source is reading Supreme Court decisions and looking at legislation

My view is that there is a greater receptivity right now in the District Courts than I have ever experienced in 24 years of practice Obviously there are different judges with different philosophies and you can't make a uniform statement, but I think courts are more receptive to intellectual property cases, and decisions bear that out

Mr COBLE One more question I would like to ask each of the three of you, if I may In your opinion, does the doctrine of Patent misuse significantly limit the range of options available to a patent owner seeking to commercialize new technology?

Mr SCHWARTZ I believe it does not In large measure practitioners are aware of the various rules and doctrines and the ones that are at the moment primarily in force I don't believe significant affect licensing I guess I disagree with Mr Taylor on that

Mr COBLE I would be surprised if we get uniformity in this response

Mr TAYLOR I certainly believe the doctrine limits the range of options It often happens that the technology is developed by a company that is already in a particular business Where a company invents a product and gets a patent on a product, it is fairly easy for the patent owner to impose certain restrictions on a licensee, because the law has developed that permits it to do that Where the patent owner, however, is selling something that is old and that doesn't lend itself to a patent on the very thing he sells, the law does not permit him to restrict licensees even though the technology itself is new The whole concept of Patent misuse, if you want to reduce it to kind of some philosophical generalization,

would say that any time a patent owner is using his patent to drive business his way in something that is not precisely covered by the claims, a court can say that the patent becomes unenforcible And yet that is a natural condition in many product lines because of the nature of the product So I think it does, clearly, inhibit licensing

Mr COBLE Do you want to be heard, Mr Merges, on that?

Mr MERGES Just briefly, to round it out

I agree with the first statement by Mr Schwartz I think for the most part it does not limit licensing behavior that is Patent misuse, is not a bar to most licensing agreements

In the case of process patents, I think there are some problems, but I would point out that firms are always agree to develop markets themselves, and they don't necessarily have to license And also I think that the view taken by Mr Taylor is a minority view

That is all I would say

Mr KASTENMEIER We will recess for 10 minutes and we ask the witnesses to bear with us

[A short recess was taken]

Mr KASTENMEIER The committee will come to order and resume sitting

In the last panel, the three witnesses have completed their statements I think a number of us on the subcommittee have a limited knowledge, to be sure, of some of the issues connected with that which is represented by the legislation before us

I am interested, however, Mr Taylor, in your suggestion that this needs to be applied to copyright You point out, of course, that the export of software is important, and with that in mind we, among other things, passed an adherence bill yesterday to the Berne Convention, but how does copyright apply to patent misuse doctrine? I don't really understand the connection

Mr TAYLOR The patent misuse doctrine, at its origin, stemmed basically from the proposition that it was somehow inequitable for a patent owner, to use his statutory monopoly in a way to influence commerce outside the scope, the precise scope, of the statutory grant A copyright is a statutory monopoly of a slightly different type, but still is susceptible of the same kind of legal analysis The argument is that if you take your statutory copyright, which has subject matter limitations that are also carefully defined, and you use that in a way that affects commerce outside the scope of the copyright, that such an action would fall within the same area of inequitable conduct

From an antitrust persective, copyrights historically have been given relatively equal treatment with patents The block booking cases come to mind, where owners of copyrighted films were precluded under section 1 of the Sherman Act from marketing their films in a block and refusing to license them individually

The courts, in applying the concepts of misuse, have not had as much opportunity to address the copyright question There is only, to my recollection, about half a dozen cases, and they are all in the lower courts, meaning the circuit and district courts To my knowledge, the Supreme Court has never considered the question of whether the Morton Salt doctrine would apply in a copyright context

On the other hand, a lot of the circuit courts think it does, and it seems to me, at least as a matter of legal theory, any change you make in the doctrine with respect to patents you might also consider doing with respect to copyrights

Mr KASTENMEIER Well, that is interesting

Mr Schwartz or Mr Merges, do you have any comment on that? Do you think that analogy is correct?

Mr SCHWARTZ I would say that I think the analogy is correct I haven't seen really that much in the law in the area of misuse as to copyrights, and I think probably where it has come up more recently really has been in the antitrust area relating to copyrights in the computer area

I guess, since I don't really see a legislative need at the moment in the patent area, I would see an order of magnitude less in the copyright area, but I understand its philosophical point

Mr KASTENMEIER Sure Mr Merges

Mr MERGES Yes I guess I would have to agree with Mr Schwartz again I really don't see very many opinions that mention the concept of copyright misuse The ones that there are fall into a small number of categories It seems to be mentioned sometimes as a doctrine that is analogous to patent misuse, but I think the differences between copyright and patents are so clear and so distinct that it is a very loose analogy

It is difficult to draw clear parallels between them The exclusivity given by a copyright applies to the work itself There is no real analog to the notion of the scope of a copyrighted work as there is the scope of a patent claim The work is the work If there is access and substantial similarity, you have infringement

The case that I know that did apply the concept of copyright misuse really had to do with straightforward unfair dealing It was an unclean hands case, I think the copyright holder failed to inform certain licensees of a decision that was slightly adverse to its copyright interests

Other than that, I really don't see very many contexts where it has come up, and that is understandable in light of the differences between patents and copyrights

Mr KASTENMEIER I am led to believe that it may well be that copyright proprietors themselves may not care for a legislative answer to this because they may well deny that there is, in fact, copyright misuse as a viable doctrine

But that is interesting because I can see, too, the analogy to copyright and heaven knows what may happen in the future

I take it, Mr Merges, that you do not see the need for any legislation in this area? You would prefer to rely on the courts?

You differ a little bit from Mr Schwartz who says, "Well, legislation is possible," but he doesn't have a formulation at this point, but none of the foregoing is acceptable

Mr MERGES My first instinct is if it ain't broke, don't fix it

On the other hand, if a fix is in order, if the itch is so great to write legislation that we are going to have it, I think, H R 4086 is superior to S 1200

Just like the Europeans have provided corporations residing there with a white list and a black list of activities that are presumptively no good or good

H R 4086 does a similar thing I think that kind of approach is superior to a flat folding of patent misuse into antitrust analysis

So I would say I have some quibbles with 4086, but if an approach must be taken to the problem, that is the superior one

Mr KASTENMEIER Professor Mansfield has established that patent protection is more important in some industry sectors than others

Do you agree, Mr Merges, that, for example, perhaps prescription drugs, that some patents are more important than others in terms of market power and influence?

Mr MERGES Yes, sir I don't think there is a question about that There has been empirical work done subsequent to Professor Mansfield work by Richard Nelson, Rick Levin, Alvin Klavorek at Yale, an imperial survey of patentees and intellectual property holders of the relative merits of various intellectual property forms of protection in various industries, and they came up with a fairly clear answer

In industries like pharmaceuticals, patents are very important

In other industries, for instance, main frame computers, big pieces of equipment, including in the aerospace industry, et cetera, patents are less important

There are other ways to protect your investment in innovative technologies that are superior to patents

Research clearly shows that there is a major difference between the degree of market power that patents confer within industries and cases and other research shows that even within a particular industry patents have a greater and lesser degree of market power that go with them depending on the specific claims and the technology at issue

Mr KASTENMEIER Do you agree with that analysis, Mr Taylor?

Mr TAYLOR Absolutely, Mr Kastenmeier

There is very little I could add to that

Mr KASTENMEIER I might say in terms of the early recommendations of your section, we are responding at least to the process patent recommendation you made a number of years ago in the trade bill, and that also tends to be industry specific almost with respect to at least certain forms of endeavor

I think one of the—my colleagues asked, I think referring to your statement, Mr Taylor, about courts which are hostile to intellectual property, although the question was really directed to Mr Schwartz, but I am going to redirect it to you

Some courts, you said, are hostile to intellectual property

Do you also feel that there are courts which are intellectual property friendly to the same degree?

Mr TAYLOR Yes

I agree with what Mr Schwartz said I think the climate in the courts today is immeasurably more hospitable to intellectual property than it was 20 years ago To some extent, this may be a cyclical thing, I am not sure

We saw a long period of time where the courts got increasingly hostile towards intellectual property and that began to change in probably the late sixties or early seventies and today it is far less noticeable It seems to me, however, that sound policy is sound policy, and if we have had hostile courts in the past, we may get

hostile courts again in the future If there is an opportunity here to focus on a specific problem and deal with it in a legislative fashion, the fact that we are today in a climate that is preferable to what we had 20 years ago to me is not a reason not to address the question

Mr KASTENMEIER Well, the reason I asked the question is we are not only interested in patent misuse As the Subcommittee on Courts, we have created some courts and one of the questions always is would we look for absolute objectivity with respect to judicial review of intellectual property issues or can we tolerate a friendly court, is a friendly court to intellectual property a disservice to the public or is a hostile court to be avoided in some respect?

I guess the question is what should we look for in our courts in the Federal system with respect to their response to dealing with intellectual property issues and indeed that was even an issue with respect to creation of the Federal court for the Federal Circuit Court of Appeals The fear is that creation of a specialized court usually ends up unduly friendly to the industry, in this case to patent proprietors and that the Supreme Court and other courts will deal with it with less knowledge of the subject

When we read that courts are either friendly or hostile, what sort of response in the longer term

Do you have any comment on that, Mr Merges?

Mr MERGES Well, in fact, I do I don't want to bore you too much

I think the Federal Circuit and the debate that surrounded its formation have really marked a watershed in patent law

I think the concerns of its most severe critics have not been borne out so far

However, there is a clear change in the climate surrounding intellectual property law

I think it has been beneficial as a corrective to what went before, but I hear in the tone of your question a concern that I share, are we going to go too far in that direction

A way to guard against that would be to encourage the Supreme Court to end its practice of not reviewing patent decisions It hasn't touched patent law since 1980 and it hasn't reviewed substantively any decision of the Federal Circuit so far

As an observer of the patent scene, I would like to see the patent court discontinue this practice of taking a hands off approach

Eventually, I think an issue will strike it as so important that it will intervene

I think sometimes the Federal Circuit takes too much to heart, the view that it is the final word on the patent law

It is not under our system and I hope that the Supreme Court will recognize that soon

I think the other step that this committee especially can take is to review the potential judges who are potentially going to join the Federal Circuit and look for a balance of views

There is certainly a concern among the patent bar that the Federal Circuit continue to recruit patent experienced judges That is a valid concern

I think it is not the only concern especially in light of the fact that only 50 percent of the Federal Circuits case load is patent work

At the same time, I think you need to recognize that the people often view the patent bar as being fairly monolithic

I think there are a wide range of personalities and viewpoints in the patent bar and that that ought to be taken account of when judges are selected

At the same time, I think it is important to recognize that having passed the patent bar exam is not necessarily the best qualification

There are other ways that one can become experienced in patent law and there are other people besides patent experienced people who can have a stake in the patent system

It is the flip side of the coin for those who advocate strong intellectual property rights, as more and more people become interested in intellectual property rights, the patent community is going to have to open up a little more to a wider and more diverse group of people

Mr KASTENMEIER Thank you

Mr Taylor and Mr Schwartz, would you agree with that? Should it be an aim to get both objectivity and to in certain courts patent expertise that is an objective that you would say was unbiased with respect to the application of intellectual property laws?

Do either of you have any comments?

Mr SCHWARTZ That was just a truism, that it is an aim to get objectivity How that is accomplished or what that means isn't clear to me

Mr TAYLOR I would agree that objectivity is a desirable trait It is hard to be objective in the area of intellectual property, because at bottom the patent system carves out a small segment of what otherwise would be in the public domain and says that the patent owner qualifies for this statutory exclusivity provided that certain statutory criteria are met To a large extent the boundary lines that get drawn are somewhat arbitrary and the way in which a given court will analyze where those lines should be drawn is going to reflect some underlying philosophical beliefs about the value of the patent system and the contribution that it makes to the overall economy

Mr KASTENMEIER Thank you

Let me get back to a question on the subject before us What would be the practical effect of requiring proof of an antitrust violation as a prerequisite to the establishment of a misuse defense? Would that be a—would it mitigate the use, the resort to a misuse defense to a rare case or would that be too great a standard—too difficult a standard to find?

Mr SCHWARTZ I think it would severely circumscribe the use of the doctrine in a few specific ways

First, it would require standing in the antitrust sense, which is not now required for a misuse defense

Second, it would involve the concept of market share in a way different than which it is implied in the patent misuse area and there would be other antitrust requirements

I think the reality is it would have a significant impact

Another easy way to look at it is to see the number of cases that go off on straight patent misuse as distinct from antitrust, because I think if the potential defendant thought he had a valid antitrust claim that he could get treble damages, he would assert that as well, and the reality is there are more patent misuse decisions that have been sustained as contrasted to actual proven antitrust violations and recoveries

So I think it would have a very large impact on the practical application of the doctrine

Mr KASTENMEIER Mr Taylor, you represent the antitrust section of the American Bar Association

Is the current case law relating to patent misuse a clearer statement of what is allowed and what is prohibited than the antitrust law provides?

Mr TAYLOR I think the patent misuse doctrine is relatively clear I certainly agree with Professor Merges in that respect There are some areas the *Robintech* case being one—where I think the law is demonstrably unclear, but otherwise it is clear in a draconian sort of way It says to a patent owner, if you do certain things, you are going to lose the right to enforce your patent

What you have to recognize is that the dynamic which such a rule sets into motion is a reluctance of the patent owner to do anything that even approaches what may be held illegal, because the penalty is so out of proportion with the benefit One of the reasons we don't have a lot of misuse cases in the courts, cases that test the cutting edge of this doctrine, is because licensing practitioners have become extremely conservative, and they simply advise their clients not to do anything that is at all creative

An observation that both Mr Schwartz and I share is that this doctrine probably has a greater adverse impact on emerging technology, small companies in emerging technology areas, where creative financing arrangements and creative licensing arrangements may help them do deals that they couldn't otherwise do Most practitioners are able and, in fact, frequently do advise clients not to enter into creative licensing schemes, and that works to the detriment of a lot of companies

Mr KASTENMEIER Well, there are those who agree with you Robert Klein of DuPont has said that misuse negatively affects virtually every licensing agreement involving technology developed to be used in the U S , which is sort of what I think you are saying

Mr Merges, you don't necessarily agree with that

Mr MERGES Not necessarily, sir I think that, again, it is difficult to prove the negative, it is difficult to prove what transactions would occur without misuse From any point of view, I can count on that by saying it is easy to show the positive which is licensing activity is on the increase, there is plenty of it Certainly in the emerging technologies, taking for example biotechnology, which is an industry I have studied to some extent, patent licensing agreements are extremely important for financing there Most venture capital companies require firms to have patent protection before they will market a new technology, so companies typically get the patent, then go in search of venture capital funds

Likewise, at the stage when the company goes public, their intellectual property portfolio is considered one of their most important

assets, second perhaps only to the skills of the scientists and other founders As far as I can tell, biotechnology licensing is a very active field, in fact every week there comes across my desk a newsweekly that reports on biotechnology licensing transactions, and the pages are full It is not restricted to only a few deals There seems to be plenty of activity in the area

I think it is perhaps true that patent misuse does have some negative effects However, I think that, number one, firms seem to have adapted and perhaps, more importantly, number two, some of those effects are things we just don't want It is true even the antitrust laws have a negative impact on business transactions All of us who own businesses would probably like to fix prices and make sure our prices are maintained at the retail level, but we can't Just because it enhances revenue or helps the business doesn't mean necessarily it is good There is a cost side to the equation too Patent misuse does take that into account

Mr KASTENMEIER Thank you I am going to conclude on that note I want to thank all three of you, Mr Taylor on behalf of the American Bar Association, Professor Herbert Schwartz, University of Pennsylvania Law School, and Professor Robert Merges, Columbia University School of Law, for your participation and your willingness to not only share your own views but to respond to questions on a very complex issue

That concludes today's hearings We will probably have another day of hearings on this at some point in the future, and I hope we will learn something there In any event, we thank our witnesses for their contributions

The committee is adjourned

[Whereupon, at 4 35 p m , the subcommittee adjourned, to reconvene subject to the call of the Chair]

APPENDIX

Congressional Record

Vol 134 WASHINGTON, THURSDAY, MARCH 3, 1988 No 24

PATENT LICENSING REFORM

The SPEAKER pro tempore. Under a previous order of the House the gentleman from Wisconsin [Mr KASTENMEIER] is recognized for 5 minutes.

Mr KASTENMEIER Mr Speaker today I am introducing the *Patent Licensing Reform Act of 1988* This bill reflects the concerns of certain high technology industries regarding the ability of patent owners to fairly and freely license patented products and processes

The basic thrust of the bill is to restate in statutory language much of the judicially developed doctrine of patent misuse The subjects addressed in the bill—patent misuse and fraud in obtaining or enforcing a patent—are extremely complex areas of law I recognize that by introducing the bill in this form it is not realistic to expect it to be enacted with precisely the same language Rather I hope that by raising this subject to the level of legislative debate my colleagues will become more familiar with the issues presented by legislation in this area.

There are two arguments in favor of the legislation. First, innovations are not reaching the consuming public because of a fear on the part of patent owners that if they engage in patent licensing, they will not be able to enforce the patent because of a finding of misuse. The proponents of this view will attempt to substantiate it despite the obvious widespread licensing of patents which occurs today It may be that there is a difference in licensing practices based on the size of the company or the type of product involved.

The other argument offered in support for changes in the law of misuse basically comes down to doctrinal consistency Proponents of change have frequently relied on the Chicago economic school theories of Judge Posner *See USM v SPS Technologies, Inc.*, 694 F 2d 504 (7th Cir 1982) Supporters of this view argue that patent misuse doctrine grew up in response to allegedly anticompetitive behavior and that an antitrust standard is the only appropriate criterion to use in judging such effects. This view has already been adopted by the Senate [1] as a result of the efforts of Senator LEAHY Whether this view represents sound public policy will clearly be the focus of any hearings on this topic.[2]

This bill continues the policy of treating the property rights granted by the issuance of a patent different from those which attach to other forms of property The bill also ratifies the proposition that the enforcement of patents is a matter of "great moment to the public" *Hazel-Atlas Glass Co. v Hartford-Empire Co.*, 322 U.S 238 246

Section 2 of the bill strikes out existing subsection (d) of section 271 of title 35 and replaces it with a new subsection (d) which is further divided into three subparagraphs.

Proposed subsection (d)(1) provides that a person who has been found guilty of patent misuse shall be denied the right to enforce that patent until the misuse terminates and the effect of the misuse is dissipated This provision is derived from current case law [3]

Proposed subsection (d)(2) provides a positive definition of patent misuse The proposed subsection provides six examples of conduct which is deemed to constitute patent misuse First, it provides that it is an act of patent misuse to be the sale of a patented product to an unpatented staple. This provision is derived from current case law [4] In addition, this provision also includes an exception which precludes a finding of misuse when the patent owner cannot fairly be said to hold market power [5] This provision, of necessity means that the mere ownership of a patent does not by itself confer market power there is no presumption of market power based on the ownership of a patent. Unresolved in this bill is the question of what constitutes the relevant market.[6] Parties are invited to comment on whether the concept of market should include only actual market in the relevant product—an antitrust standard—or market according to the scope of the patent claim.[7]

The second example of misuse is the imposition of covenants not to compete This provision is derived in part from current law [8] The third example of misuse is the imposition of a condition in a license that the licensee accept another and different patent license. This formulation is also suggested by current case law [9]

The fourth example of patent misuse is a license royalty agreement which calls for the payment beyond the expiration of the term of the patent. This provision is derived from the Supreme Court decision in *Brulotte v Thys*, 379 U.S. 29 (1964). This provision also contains an exception which authorizes such post-expiration royalties when the parties, for their convenience agree to such an approach after the issuance of a patent.[10]

The fifth example of misuse is price fixing or resale price maintenance. This provision roughly parallels the standards found in the antitrust laws.[11]

The sixth example of patent misuse is a license conditioned on a grant back to the licensor of patent rights which the licensee may develop or acquire. This provision is similar to current case law [12] This provision also includes an exception authorizing a grant back requirement consisting of nonexclusive licenses when alternatives exist for achieving the same result.[13]

The examples of patent misuse are modified by the term "unreasonably" so as to continue the flexibility inherent in the current case law which allows courts to evaluate a particular licensing practice in light of the facts of a particular case

Subsection (d)(3) provides the negative half of the definition of patent misuse by stating six examples of conduct which is not misuse First, patent misuse does not occur if a person derives revenue from acts which, if performed by another without the consent of the person deriving such revenue would constitute contributory infringement. This provision merely restates current law 35 U.S.C. 271(d) Second, it is not an act of misuse for a person to license or authorize another person to perform an act which, if performed without the consent of the person licensing or authorizing the act, would constitute contributory infringement. This provision also derives from section 271(d) of title 35. Third, also from current statutory law the bill states that it is not an act of misuse for a patent owner to seek to enforce his or her rights to the patent Fourth the bill provides that it is not an act of patent misuse for a patent owner to refuse to license or use the rights to the patent. This provision is derived from judicial decisions.[14] Fifth, the bill provides that it is not an act of patent misuse to impose royalty differential or to charge allegedly excessive royalties. This provision is derived from current caselaw [15] Sixth, the bill provides that it is not an act of patent infringement to grant licenses which impose territorial or field of use restrictions on the patented product or process. This provision is derived from the decisions of some courts which have addressed this question.[16] This provision also reiterates the provisions of 35 U.S.C. 261 While there are some older cases which appear to reach a different result,[17] these cases do not appear to represent the better view of the law or desirable public policy

Section 3 of the bill contains proposed subsection 271(g) which provides that fraud or other similar inequitable conduct in procuring or enforcing a patent constitutes misuse. The bill provides a definition of fraud and provides that fraud is an affirmative defense to an infringement action. Fraud is defined as including the intentional or grossly negligent failure to meet the duty to disclose information to the Patent and Trademark Office which would, if disclosed, have resulted in the patent claim being rejected. This definition is derived in part from the proposed rulemaking of the Patent and Trademark Office and, in part, from decisions of the Court of Appeals for the Federal Circuit.[18]

Proposed subsection (g) also authorizes the Commissioner of the Patent and Trademark Office to issue regulations concerning fraud on the Office.

The final provision in the bill establishes an effective date. Because patent owners and licensees have a reasonably well settled set of expectations about current law this bill applies only to cases filed on or after the date of enactment. Thus, these amendments would not apply to pending court cases.

Footnotes at end.

In sum, the proposed legislation represents a modest step forward in the area of patent licensing. It is my hope that this bill will stimulate debate on this topic. Because the existing doctrine of patent misuse has been developed by the courts sitting in equity it is important for the Congress to understand completely the practices that are being codified. Some commentators may suggest that this bill is too complex. Others may argue that the better way to proceed on this question is to be patent misuse to each of these perspectives. From the perspective of the legislative process it is my hope that this bill will stimulate debate about the nature of patent protection, the attributes of patent protection, and answer the question of whether the misuse doctrine is—or should be—exclusively a matter of anticompetitive concern.

Parties with views on this bill should communicate with the Subcommittee on Courts, Civil Liberties and Administration of Justice, 2137B Rayburn HOB Washington, DC 20515, phone (202) 225-3926

FOOTNOTES

The Senate adopted title II of S. 1200 as an amendment to H.R. 3 See Senate Rept. 100-83 at 61-63 (1987)

This bill is not premised on the assumption that enactment of a patent misuse bill will enhance our ability to compete internationally *See* Marks, Patent Licensing and Antitrust in the United States and the European Economic Community 25 Am. Univ. L. Rev. 963 (1986). In addition, to the extent that an American innovator does business overseas and has obtained patent protection in a foreign country the law of that country governs the enforcement of those patent rights.

D Chisum, Patents, section 19 04

See e g International Salt Co v United States, 332 U.S. 392 (1947); D Chisum, Patents, section 19 04[3][a], n. 1

See generally USM Corp. v SPS Tech. Inc., 694 F 2d 505 (7th Cir 1982).

It can be argued that since the markets for specific technologies are often "thin"—with few direct substitutes available for particular inventions—that patent misuse cases should adopt a standard different from that used by the Supreme Court in antitrust cases. *See* Cases, Crookell, and Killing, The Imperfect Market for Technology Licenses, 45 Oxford Bulletin of Econ. & Statistics 249 (1983)

See Senza-Gel v Seiffart, 231 U.S.P.Q. 363 (Fed. Cir 1986).

D Chisum Patents, section 19 04 [3][b]

D Chisum, Patents, section 19 04 [3][b]

Some misuse cases have not prevented the enforcement of the patent for such temporal extensions, but rather have merely barred the collection of royalties beyond the 17th year Boggild v Kenner Products, 776 F 2d 1315 (6th Cir 1985).

D Chisum, Patents, section 19 04[3][g]

Transparent Wrap Machine Corp. v Stokes and Smith 329 U.S. 637 646-647 (1947); D. Chisum, Patents, section 19.04 [3][j] *see also* Duplan Corp. v Deering 444 F Supp 648, 700 (D.S.C 1977), aff d, 594 F.2d 979 (4th Cir 1979).

Sante Fe-Pomeroy Inc. v P and Z Co., 569 F 2d 1084 (9th Cir 1978).

Continental Paper Bag Co. v Eastern Paper Bag Co., 210 U.S. 405 425-430 (1908) SCM Corp. v Zerox 645 F.2d 1195 (2d Cir., 1981)

USM Corp v SPS Technologies, Inc. 694 F 2d 505 (7th Cir., 1982)

S. Chisum, Patents, section 19 04[3][h] and [i]

See Adams v Burke 84 U.S. 453 (1873) and Robintech, Inc., v Chemidus Wavin, Ltd., 628 F 2d 142, 148-49 (D.C. Cir., 1980) but see General Talking Pictures Co. v Western Elec. Co., 304 U.S. 175 (1938) (field of use restrictions do not constitute misuse

There are two well defined elements of a defense of fraud or inequitable conduct. (1) materiality of the information not disclosed, and (2) the intentional failure to disclose In re Jerabek, 229 U.S.P.Q. 520 (Fed Cir 1986) see generally Adamo and Ducatman "The Status of the Rules of Prohibited Conduct Before the [Patent] Office 68 J Pat. and Tr Off Soc. 153 (1986).

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26 April 1988

Mr Robert W Kastenmeier, Esq
Chairman
Subcommittee on Courts, Civil Liberties
and the Administration of Justice
U S. House of Representatives
Committee in the Judiciary
WASHINGTON, D C 20515-6216
USA

Dear Mr Kastenmeier

I thank you very much for your kind letter of March 28, 1988 which I consider to be a great honour since it is rare that a non-American is asked for his advice by the United States Congress in the law-making process because of an article and remarks given before the American Intellectual Property Law Association

Those remarks have been based on the Commission Regulation no 2349/84 of July 23, 1984 on the application of Article 85 (3) of the Treaty to certain categories of patent licensing agreements (Official Journal of the European Communities, L 219 of August 16, 1984, a copy of which I add as annex I)

For your better understanding I add (annex II) an article of mine which was published earlier on the then draft Regulation on patent licensing agreements and has been published in the Annual Proceedings of the Fordham Corporate Law Institute in 1982 This article was written to find - for Europe - a viable way between the Harvard and the Chicago School doctrines

I

European law does - in general - not differentiate between antitrust infringements and patent misuse As far as I can see, even in the United States the borderline between antitrust and patent misuse is vague. What in the United States might be a patent misuse, could constitute in Europe an antitrust infringement under Article 85 (1) of the EEC Treaty (which corresponds to your Section 1 of the Sherman Act)

It must be underlined that the European antitrust law does not know per se rules. For any restriction the application of the Rule of Reason could be argued But this is theory, there are restrictions for which it always has been denied that they are reasonable and there are, on the other hand, restrictions for which there is a presumption that they are reasonable, the latter ones are found in Article 2 of the said Regulation, (the so-called "white list"), the first ones are to be found in Article 3 (the so-called "black list") Please understand why I will not use, as to the European law, the terms "per se rules" but only the terms "presumptively unreasonable" and "presumptively reasonable"

II.

May I refer to each point of your document H.R. 4086 (100th Congress, 2d Session)

1. /The term "misuse or illegal extension" .. includes / Sec 2(d)(2)(A)

"tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have market power,"

The corresponding rule in European law would read

/Presumption of reasonableness in favour of/

> an obligation on the licensee to procure goods or services from the licensor or from an undertaking designated by the licensor, in so far as such products or services are necessary for a technically satisfactory exploitation of the licensed invention, (Article 2 no 1 of Regulation 2349/84 referred to above)

It seems to me that the European solution here is stricter, only such restrictions are considered to be reasonable which are necessary for a technically satisfactory exploitation of the licensed invention It is not only where the products tied are staples or the patent owner has market power that a tying-agreement may be qualified as unreasonable

2 /the term "misuse or illegal extension . means/ Sec 2(d)(2)(B)

"unreasonably imposing as a condition of granting a licence for a patent that the licensee may not produce or sell competing goods",

The corresponding rule in European law would read

/Presumption of unreasonabless where /

> One party is restricted from competing with the other party, with undertakings connected with the other party or with other undertakings within the common market in respect of research and development, manufacture, use or sales, save as provided in Article 1 and without prejudice to an obligation on the licensee to use his best endeavours to exploit the licensed invention, (Article 3 no 3 of Reg 2349/84)

The European rule is much stricter than that suggested in Document H R 4086 The burden of proof as to whether - against the text of the rule - the non-competition clause is reasonable, is with the licensor which is a very difficult burden The European rule makes an exception as to territorial restrictions which corresponds to Sec 2(3)(F) of Document H R 4086

3 /the term "misuse or illegal extention"... means/ Sec. 2(d)(2)(€)

"unreasonably imposing as a condition of granting a licence for a patent that the licensee accepts another licence under a different patent",

The corresponding rule in European law would read
/Presumption of unreasonable~~ness~~ where/

> the licensee is induced at the time the agreement is entered into to accept further licences which he does not want or to agree to use patents, goods or services which he does not want, unless such patents, products or services are necessary for a technically satisfactory exploitation of the licensed invention,
> (Article 3 no. 9 of Reg. 2349/84).

Whereas the solution suggested in Document H R. 4086 envisages the general introduction of the Rule of Reason, the European solution outlaws package licensing unless it is necessary for a technically satisfactory exploitation of the licensed invention, here, once more, the burden of proof is with the licensor.

4. /the term "misuse or illegal extension" . includes / Sec. 2(d)(2)(D)

"unreasonably entering into a royalty agreement that provides for payments beyond the expiration of the term of the patent, except when the parties have mutually agreed to such payments after the issuance of the patent".

If I understand this correctly, the suggested solution in H R 4086 introduces generally, against Brulotte v. Thys, the Rule of Reason for payments of royalties after the term of the licensed patent It stipulates besides that it is per se reasonable when the parties have mutually agreed to such payments after the issuance of the patent

The corresponding rule in European law reads
/Presumption of unreasonableness where/

> the licensee is charged royalties on products which are not entirely or partially patented or manufactured by means of a patented process, or for the use of know-how which has entered into the public domain otherwise than by the fault of the licensee or an undertaking connected with him, without prejudice to

arrangements whereby, in order to facilitate payment by the licensee, the royalty payments for the use of a licensed invention are spread over a period extending beyond the life of the licensed patents or the entry of the know-how into the public domain
(Art 3 no 4 of Reg 2349/84).

These rules allow payments of royalties beyond the term of the patent only if the licensee still uses know how of the licensor while it has not yet entered into the public domain or if those payments facilitate the obligation on the licensee.

5 /the term "misuse or illegal extension" . means/ Sec. 2(d)(2)(E)

"unreasonably entering into an agreement to fix prices or engage in resale price maintenance with respect to a patented product or process",

The corresponding European rule would read

/Presumption of unreasonableness where /

one party is restricted in the determination of prices, components of prices or discounts for the licensed products ,
(Article 3 no. 6 of Reg. 2349/84).

6 /the term misuse or illegal extension". means/ Sec 2(d)(2)(F)

"unreasonably granting a patent licence which requires the licensee to grant back to the licensor patent rights which the licensee may develop or acquire, except to the extent that the requirement is to grant back a non-exclusive license with respect to improvements in the licensed product or process when alternatives exist to produce the product or process

The corresponding rule in European law would read

/Presumption of reasonableness where/

an obligation on the parties to communicate to one another any experience gained in exploiting the licensed invention and to grant one another a licence in respect of inventions relating to improvements and new applications, provided that such communication or licence is non-exclusive,
(Article 2(10) of Reg. 2349/84)

I do not see a great difference between the solution envisaged in Document H.R 4086 and the European rule, except that European law does not require the existence of "alternatives"

III

As far as contributory infringement is concerned, the solutions envisaged in Document H.R 4086 do not differ substantially from the legal situation in Europe.

To give you an example

/a patent owner shall not be considered to have engaged in conduct constituting misuse or illegal extension of the patent because that patent owner/

(C) seeks to enforce his or her patent rights against infringement or contributory infringement,/(Sec 2(3)(c))

The corresponding European rule would read

/Presumption of reasonableness in favour of/

obligations
(a) to inform the licensor of infringements of the patent,
(b) to take legal action against an infringer,
(c) to assist the licensor in any legal action against an infringer,
provided that these obligations are without prejudice to the licensee's right to challenge the validity of the licensed patents,

(Article 2 no 8 Reg.2349/84).

The following points deserve some explicit comments

/it shall not be considered . a misuse or illegal extension to/ Sec 2(3)(D)/

"refuse to license or use any rights to the patent",

There is no counterpart in the Regulation on patent licensing but this does not mean that European law or the laws of the Member States do not foresee remedies in such cases

1 The simple refusal to license is lawful under European law and the laws of the Member States

2 If, however, the patentee has a dominant position in the market (Article 86 of the EEC-Treaty which is roughly the counterpart to Section 2 of the Sherman Act) it might be that he is obliged to license on reasonable terms in certain circumstances There is no precedent yet, above all no judgment of the European Court of Justice, but the Commission is currently pursuing three cases concerning patents and copyright with a view to establishing whether in certain limited circumstances that a company in a dominant position may be obliged to grant licences for reasonable remuneration.

3 Under the laws of most of the Member States the fact, that a patentee does not exploit his patent after a certain period, gives a prospective licensee a right to ask for a "mandatory licence" from the national Patent Office. This system is more effective in some and less effective in other Member States Most cases occur in Great Britain where such licences are granted by the General Comptroller of Patents, generally for drugs The royalties are, if there is no agreement between the parties, fixed by the General Comptroller

Sec 2(3)(E1)

1 As long as a holder of a patent in Europe does not have a dominant position for the patented invention, he may charge differential royalties to his different licensees The Regulation recognizes that in allowing

> an obligation on the licensor to grant the licensee any more favourable terms that the licensor may grant to another undertaking after the agreement is entered into
> (Article 2 no. 11 Reg 2349/84)

2. As long as the holder of a European patent has not a dominant position for the patented invention, he can ask for any royalties. This is deduced from that fact that he is not at all obliged to grant a licence. However, if he holds a dominant position, it might be a forbidden abuse of the dominant position if he asks for 69 percent, whereas market-orientated royalties are from 2 to 5 per cent, or if he discriminates between different licensees.

Sec 2(3)(E)

/It shall not be considered a misuse or an illegal extension if the patent owner imposes an obligation on a licensee to pay royalties that

i..

ii. . .

iii are in amounts not related to the licensee's sales of the patented product or a product made by a patented process,

The European rule which seems to be stricter, reads

/Presumption of unreasonableness where /

> the licensee is charged royalties on products which are not entirelty or partially patented or manufactured by means of a patented process, or for the use of know-how which has entered into the public domain otherwise than by the fault of the licensee or an undertaking connected with him, without prejudice to arrangements whereby, in order to facilitate payment by the licensee, the royalty payments for the use of a licensed invention are spread over a period extending beyond the life of the licensed patents or the entry of the know-how into the public domain,
>
> (Article 3 no 4) Reg 2349/84)

Sec. 2(3)(F)

/It shall not be considered a misuse or an illegal extension if the owner of the patent if he/

grants licenses which impose territorial or field of use restrictions on the patented product or process,

1) The European solution (Art. 1 of the Regulation) allows territorial restrictions

i between the licensor and the licensees for the term of the patent,

ii. between licensees for five years after the first sale of the product within the Common Market,

iii after those five years every licensee may sell everywhere in the Common Market (except in the licensor's own territory), if such sales are sollicited by the purchaser

In all three cases the rule of exhaustion (Adams v Burke) applies once sold, the product can circulate freely throughout the Common Market, even in the licensor's own territory

2 Field of use restrictions are considered to be reasonable

an obligation on the licensee to restrict his exploitation of the licensed invention to one or more technical fields of application covered by the licensed patent,
(Article 2 no. 3 Reg 2349/84).

IV.

Fraud on the Patent Office

In the United States, patent application procedures are "ex parte" proceedings in which the applications are not published and competitors are not heard In Europe, patent applications are published, competitors have the possibility to object.

It is therefore my personal opinion that, as long as the US procedure remains an "ex parte" proceeding, the strict rules against Fraud on the Patent Office should be maintained

V

1 The foregoing explanations show that there is no disadvantage of American patent holders for their American patents compared with European patent holders for their European patents The lack of a specific "patent misuse doctrine" in Europe is compensated by a

- sometimes stricter - application of the European antitrust rules on restrictions in patent licensing agreements.

2 To be complete it must, however, be said that there is a lacuna in the American patent law which disfavours holders of American Patents compared with holders of European patents.

In all Member States of the Common Market and in other European States such as Austria, Switzerland or Sweden, a process patent also covers the product manufacturer under that process, unless the alleged infringer proves - and thus discloses his own process - that he has invented another process

Though there have been several attempts in the United States to close that lacuna, they all failed This leads to the consequence that - even American - competitors of the owner of the American process patent have the product manufactured abroad and import it freely into the United STates Proceedings before the International Trade Commission, though criticised in that due process is not always guaranteed (short delays, difficulties of good-faith non-Americans to comply with those proceedings in English) are only a weak remedy

If American industry wants to have a comparable protection of their inventions in the United States, the American legislator should introduce quickly a patent protection for products manufactured under a process patent

I hope that my remarks will help you in your legislative efforts May I ask you to consider them as my personal opinion.

With kind regards

Sincerely



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Annex I

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Legislation

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I *Acts whose publication is obligatory*

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Acts whose titles are printed in light type are those relating to day to-day management of agricultural matters and are generally valid for a limited period

The titles of all other Acts are printed in bold type and preceded by an asterisk

I

(Acts whose publication is obligatory)

COMMISSION REGULATION (EEC) No 2347/84

of 31 July 1984

on dried grapes eligible for production aid

THE COMMISSION OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 516/77 of 14 March 1977 on the common organization of the market in products processed from fruit and vegetables (1), as last amended by Regulation (EEC) No 988/84 (2), and in particular Articles 3b (4), 3c (5) and 3d (4) thereof,

Whereas Article 3 of Regulation (EEC) No 516/77 provides for a system of production aid for certain products, whereas under that system a minimum price must be paid to the producer and production aid is to be paid on the basis of the net weight of the processed product,

Whereas the quality of dried grapes intended for processing and of dried grapes ready to be offered for direct consumption varies, whereas the minimum price and the production aid should be fixed for a specified category, whereas the minimum price and the amount of aid for categories other than that for which they have been fixed should be derived from that category, whereas the prices and amounts so derived should take into account the characteristics of the different categories, whereas these categories must be defined,

Whereas Article 3d (1) (b) of Regulation (EEC) No 516/77 provides that processed products must meet minimum Community quality standards to be laid down, whereas such standards are already in application for certain dried fruit, pursuant to Commission Regulation (EEC) No 2425/81 (3), whereas that Regulation is applicable only to products harvested before the 1984/85 marketing year, whereas new minimum quality standards should be established,

Whereas the measures provided for in this Regulation are in accordance with the opinion of the Management Committee for Products Processed from Fruit and Vegetables,

HAS ADOPTED THIS REGULATION

Article 1

1 The minimum price payable to the producer for unprocessed dried grapes shall be fixed per 100 kilograms of sultanas of category 4

For other categories of sultanas and for currants, the minimum price shall be multiplied by the coefficient listed in Annex I

2 To qualify for payment of the minimum price, unprocessed dried grapes shall comply with the requirements and one of the classifications set out in Annex II

Article 2

1 The production aid for dried grapes shall be fixed per 100 kilograms net of sultanas of category 4

For other categories of sultanas and for currants, the amount of aid shall be multiplied by the coefficient listed in Annex I

2 To qualify for payment of aid, the dried grapes shall comply with the requirements and one of the classifications set out in Annex III

Article 3

1 In respect of unprocessed dried grapes, verifications of the requirements and the classifications shall be made

(1) OJ No L 73, 21 3 1977, p 1
(2) OJ No L 103, 16 4 1984, p 11
(3) OJ No L 240, 24 8 1981, p 1

on the basis of samples taken by the processor from a lot For this purpose a lot' means the number of containers presented jointly by the same producer or his recognized producers' group or association of groups handing over to the processor or his processors group or association of groups The samples shall be examined by the processor or alternatively on his behalf

2 The result of the examination referred to in paragraph 1 shall be recorded The Member States may prescribe a special form to be used for this purpose

Article 4

The processor shall after processing take an appropriate number of samples of dried grapes to verify that the requirements laid down in Annex III are respected The result of each verification shall be included in a format which shall contain at least the particulars referred to in Annex IV

Article 5

1 The processor shall inform the competent authorities in writing each time a consignment of dried grapes is ready for inspection The consignment may leave the processor only on the third working day after the day on which the information was received hy the competent authorities, or with their authorization

2 The competent authorities shall examine each consignment, in particular by opening between 3 and 5 % of the packings of a size which are not intended for retail sale, and shall take samples from at least one in every 20 for further verification The result of each verification shall be included in a format which shall contain at least the particulars referred to in Annex IV

3 In cases where the authorities have established that a consignment or a part thereof does not comply with the requirements laid down in Annex III, no production aid shall be payahle for the whole consignment A consignment for which production aid has been refused may be reprocessed

Article 6

The Member States shall ensure that samples taken under Article 5 may, on request of the processor and on his behalf, be tested by a different agency from that having made the first test

Article 7

This Regulation shall enter into force on the day of its publication in the *Official Journal of the European Communities*

It shall apply from 1 September 1984

This Regulation shall be binding in its entirety and directly applicabie in all Member States

Done at Brussels, 31 July 1984

For the Commission
Poul DALSAGER
Member of the Commission

ANNEX I

COEFFICIENTS

I Coefficients applicable to the minimum price

SULTANAS

Category	Coefficient
1	1,05588
2	1,03383
5	0,95588

CURRANTS

Category	Coefficient
1 'Shade Eghion region	1 04264
2 'Select Sun Eghion region	1 02058
3 'Shade Corinth region	1,01323
4 'Select Sun Corinth region	0,98332
5 Regular' Eghion region	0,96911
6 'Select Sun from Patras, the Ionian Islands, the Prefecture of Illias Triphilias	0,95588
7 Regular' Corinth region	0,95588
8 'Select Sun remainder of Messenia	0,94117
9 Regular' from Patras, the Ionian Islands the Prefecture of Illias, Triphilias	0,92647
10 Regular', remainder of Messenia	0,91176
11 'Regular' other regions	0,83382

II Coefficients applicable to the production aid

SULTANAS

Category	Coefficient
00, 0, 1, 21	1 05588
2, 22	1 03383
24	1 00000
25	0,95588

CURRANTS

Category	Designation		
	Voutsa	Gulf	Provincials
	Coefficient	Coefficient	Coefficient
Extra choicest	1,14264	1 11323	—
Choicest	1 12058	1,08332	1 05588
Choice	1 06911	1,05588	1 04647

ANNEX II

QUALITY REQUIREMENTS AND CLASSIFICATION OF UNPROCESSED DRIED GRAPES

Definition

Sultanas shall be obtained from grapes of varieties (cultivars) Vitis Vinifera L variety Apyrena

Currants shall be obtained from grapes of varieties (cultivars) Vitis Vinifera L variety black currant from Corinth

A Minimum requirements

1 The fresh grapes must comply with existing rules, in particular concerning residues of pesticides, and the drying must be carried out without direct contact with the ground and with adequate protection against animals Initial pre-cleaning (winnowing) must be made in particular to remove large stalks

2 The unprocessed dried grapes shall be

(a) well-dried and with a moisture content not exceeding 16 %,

(b) sound, that is to say free of mould, rot fermentation, insect eggs or any other defect or condition which could detract from the quality or presentation of the product,

(c) practically free from stones, discernible pieces of grit, metal fragments and other mineral impurities,

(d) free from foreign materials other than those referred to in (c)

(e) practically free of stalks and other pieces of harmless vegetable matter arising from the vine,

(f) free from abnormal smell or taste,

(g) free from stickiness arising from any cause whatsoever,

(h) loose or become loose when removed from their container

(i) transported and stored in clean new packings, or clean second hand packings

3 The following tolerances are allowed

Criteria	Tolerance
Sound	4 % by number of affected fruit
Practically free from stone discernible pieces of grit, metal fragments and other mineral impurities	0,2 % by weight
Practically free of stalks and other harmless vegetable matter arising from the vine	0,3 % by weight

4 In respect of currants the berries shall be uniform in size between 8,5 and 4 mm However, the following tolerances are allowed

— 6 % maximum by weight of berries of a diameter greater than 8,5 mm,

— 2 % maximum by weight of berries of a diameter less than 4 mm This tolerance is increased to 4 % for currants produced in Aegialia, in Corinth or the Ionian Islands

B Classification

1 Sultanas shall be classified as follows

Category	Colour	Dark brown/black fruit allowed (% by number)	Size consistency
1	Yellow to amber	8	Fruit must be large, with 10% of smaller fruit allowed
2	Yellow to pale brown	14	Not required (fruit must nevertheless be fairly large)
4	Yellow to brown	20	Not required
5	Yellow to dark brown	50	Not required

Large fruit means fruit which would be retained in a sieve with mesh of 8 mm in diameter

The number of dark brown/black fruit allowed shall from 1 November to 1 August of each marketing year be increased by 0,5 % on the first of each month

2 Currants shall be classified according to the following criteria

— drying process,

— colour of berries

— texture of berries

Category (denomination)	Drying process	Berry colour	Berry texture
'Shade'	In the shade	Blue-black	Dry and velvety
'Select Sun	Sunlight	Black	Not specified
'Regular'	Sunlight	Reddish-black	Not specified

ANNEX III

MINIMUM QUALITY STANDARDS FOR DRIED GRAPES

Definition

Dried grapes shall be obtained from unprocessed sultanas and currants complying with the requirements laid down in Annex II

General requirements

Dried grapes shall have undergone washing in a sufficient quantity of potable water They may be coated *with paraffin oil or authorized vegetables oil*

They shall be

(a) sound that is to say free of mould, rot fermentation insect eggs or any other defect or condition which could detract from the quality or presentation of the product

(b) free of live insects and pests,

(c) free from stones, discernible pieces of grit glass metal fragments and other visible foreign matter however currants may contain harmless visible foreign matter of vegetable origin as provided for under B 'Currants' I 'Classification and defect'

(d) practically free from other foreign matter than those referred to in (c) such as sand and earth

(e) free from abnormal smell or taste The slight odour of sulphur dioxide (SO_2) is not considered abnormal for bleached sultanas,

(f) free running and free flowing

(g) free from stickiness arising from any cause whatsoever

The dried grapes other than bleached sultanas shall be subject to proper fumigation prior to the moment when the examination of the quality is carried out by the competent authorities and not more than seven days prior to the day when they are finally dispatched to the consignee

A SULTANAS

I General conditions

Sultanas shall have undergone drying in warm air ovens or similar equipment so that the moisture content is between 15 and 13 % They may be bleached by sulphur dioxide (SO_2) However 'natural' sultanas must not have undergone any bleaching treatment

II Defects

Common defects may be found when they do not exceed the limits specified in the following table

Defect	Tolerance
1 Pieces of stalk per 2,5 kilograms of categories 00 0 and 1	1
2 Pieces of stalk per 2,5 kilograms of the other categories	2
3 Fruits with cap stem	8 % by weight
4 Immature or undeveloped fruits	2 % by weight
5 Sugared fruits	2 % by weight
6 Damaged fruits, including chewed	2 % by weight
7 *Visible mould, rot fermentation insect eggs or any other defect or* condition which could detract from the quality or the presentation of the product	1 % by weight
8 Not visible foreign matter	0,01 % by weight

For the purposes of the determination of defects

(a) Immature or undeveloped fruits shall mean fruits that are

— extremely light-weight, lacking in sugary tissue indicating incomplete development

— completely shrivelled with practically no flesh.

(b) 'Sugared fruit' shall mean fruit with external or internal sugar crystals which are readily apparent and seriously affect the appearance of the fruit

(c) 'Damaged fruit' shall mean fruit affected by sunburn scars, mechanical injury or other similar means which seriously affect the appearance, edibility keeping quality or shipping quality

(d) In exceptional cases where the competent authorities find a maximum of one stone in a consignment, it shall even so be considered free from stones

III. Classification and sizing

Sultanas, bleached or natural are classified into two groups, large and small with six and three categories respectively The classification into categories shall be based on

— colour,

— colour uniformity

— quantity of dark brown and black fruits

— size

The classification shall be made in accordance with the following table·

(a) *Bleached sultanas*

Category	Colour	Colour uniformity (% by number)	Maximum of dark brown/ black fruit (% by number)	Retained on a sieve with mesh of the following diameter while passing a sieve with mesh applicable to the nearest higher size
		Large sultanas		
00	Pale to golden	95	0	10 mm
0	Pale to amber	85	4	9 mm
1	Pale amber	85	5	8 mm
2	Pale to pale brown	80	10	7,5 mm
4	Pale to brown	70	17	7 mm
5	Dark brown	Not required	40	6 mm
		Small sultanas		
21	Pale to golden	85	10	6 mm
22	Pale	80	10	6 mm
24	Dark brown	Not required	20	6 mm

(b) *Natural sultanas*

		Large sultanas		
00	Amber yellow to pale brown	85	5	10 mm
0	Amber yellow to pale brown	85	7	9 mm
1	Amber yellow to pale brown	85	7	8 mm
2	Amber yellow to brown	80	12	7,5 mm
4	Amber yellow to brown	70	20	7 mm
5	Brown to black	Not required	Unlimited	6 mm
		Small sultanas		
21	Amber yellow to pale brown	85	10	6 mm
22	Amber yellow to pale brown	70	15	6 mm
24	Amber yellow to brown	Not required	30	6 mm

For the category 00 of both bleached and natural sultanas, no maximum size shall apply

As from 1 March each year a slightly darker colour is allowed in each category for sultanas harvested as from 1 September in the previous year

The following size tolerances are allowed

(a) Fruit of a lower size category may be found up to an amount of

— 3 % by weight or number for category 00,

— 5 % by weight or number for the other categories

(b) Fruit of a higher size category may be found up to an amount of

— 15 % by weight or number for categories 0, 1, 2, 4 and 5

— 30 % by weight or number for categories 21, 22 and 24

IV Marking

Each immediate container shall bear the following information clearly and indelibly marked in words grouped together on one of the large sides and easily visible from the outside

A *Identification*

Name, address and brand name of either the processor distributor importer, exporter or vendor

B *Type of product*

'Sultanas or 'natural sultanas

C *Origin of the product*

Country of production and as the case may be production zone or national regional or local designation

D *Commercial characteristics*

— category,

— net weight with optionally, the expression at the time of packaging',

— year of harvest

Transport containers shall bear the name and address of the processor or a code approved by the competent authorities They shall also bear a reference showing that quality control has been completed

B CURRANTS

I Classification and defects

Currants are to be classified in three categories extra choicest choicest and choice Common defects may be found when they do not exceed the limits referred to for the classifications

Classification of currants is to be on the basis of the following criteria

— colour

— moisture content

— foreign matter (grit metal fragment pieces of stalk and others),

— thin fruit

— reddish fruit

— damaged fruit

— large fruit that is to say exceeding 8,5 mm,

— small fruit, that is to say less than 4 mm

— fruit with cap stem

The requirements for classifying currants are as follows

	Extra choicest	Choicest	Choice
1 Colour	Dark blue/black	Blue/black	Reddish black/ reddish
2 Moisture content			
— maximum %	16	16	16
— minimum %	13	13	13
3 Foreign matter			
(a) Stones discernible pieces of grit, glass and metal fragments	0	0	0
(b) Not visible matter (weight %)	0 01	0 01	0 01
(c) *Harmless visible foreign matter* of vegetable origin (number out of 100 fruit)	0,01 maximum	0 05 maximum	0 1 maximum
(d) Pieces of stalk per 2,5 kilograms of fruit	1 maximum	1 maximum	1 maximum
4 Thin fruit (number %)	0,1	0 7 maximum	1,5 maximum
5 Reddish fruit (number %)	10 maximum	15 maximum	20 maximum
6 Damaged fruit (number %)	0,5 maximum	2 maximum	3 maximum
7 Large fruit (number %)	0,5 maximum	1 maximum	1 maximum
8 Small fruit (number %)	2 maximum	2 maximum	2 maximum
9 Fruit with cap stem (number %)	2 maximum	3 maximum	3 maximum

In exceptional cases where the competent authorities find a maximum of one stone in a consignment, it shall even so be considered free of stones

II Size

Size of currants is to be determined by

— fruit passing through a sieve with holes of a given diameter, and

— fruit not passing through a sieve with holes of a diameter lower than that employed previously

The size denominations and characteristics are as follows

Denomination	Passing through a sieve with holes of diameter	Retained in a sieve with holes of diameter
Bold	8,5 mm (sieve No 11)	7 mm (sieve No 14)
Medium	8,5 mm (sieve No 11)	6 mm (sieve No 16)
Small	7 mm (sieve No 14)	4,5 mm (sieve No 19)
Siftings	6 mm (sieve No 16)	4 mm (sieve No 20)
Ungraded	8,5 mm (sieve No 11)	4 mm (sieve No 20)

Currants of siftings size may be classified only in categories choicest' or choice

III Tolerances

Classification and size tolerances are allowed in each package as follows

A. *Classification tolerances*

(i) Extra choicest category

5 % of fruit by number not conforming to the colour for the category but conforming to that for the category immediately below ('choicest')

(ii) Choicest category

10 % of fruit by number not conforming to the colour for the category but conforming to those for the category immediately below (choice')

B *Size tolerances*

For all categories 5 % of fruit by number not corresponding to the size in question but corresponding to the size immediately below However, for siftings the maximum tolerance is 1,5 % by number of fruit less than 4 mm

IV Marking

Each container shall bear the following statements in clear and indelible lettering

A. *Identification*

Name address and brand name of either the processor distributor importer exporter or vendor

B *Type of product*

Currants and the relevant designation

C *Origin of the product*

Country of production

D *Commercial characteristics*

— category of the currants,

— size stated by means of the corresponding denomination

— net weight with optionally, the expression at the time of packing

— year of harvest

Transport containers shall bear the name and address of the processor or a code approved by the competent authorities They shall also bear a reference showing that quality control has been completed

C PACKING

The dried grapes shall be packed in such a way that the quality of the fruit is suitably protected and maintained The following conditions shall be observed

(a) Packaging materials shall be new and clean,

(b) Adhesives used to seal packages or containers shall be non toxic and shall not be such as to contaminate the fruit in any way,

(c) Boxes of wood which could transfer abnormal smell to the dried grapes e g pine wood, shall not be used as immediate packings,

(d) Staples shall not be used in packaging

(e) For products in immediate containers packed in the same outer package (transport container), the net weight of the content in the outer package shall not exceed 15 kilograms,

(f) Dried grapes from different harvests must not be packed in one and the same immediate container

ANNEX IV

VERIFICATION FORMAT

A FOR SULTANAS

Name of processor	Category of sultanas	Weight of sample	Identification of consignment or period of processing	Quantity to which the sample relates

Description of verification	Result
	Number
1 Pieces of stalk per 2,5 kilograms	
	% by weight
2 Moisture content	
3 Fruit with cap stem	
4 Immature or undeveloped fruits	
5 Sugared fruits	
6 Damaged fruits including chewed	
7 Not sound fruits	
8 Not visible foreign matter	
	Norms respected (Yes/No)
9 Free running, free flowing and free of stickiness	
10 Colour and colour uniformity	
11 Sizes	
12 Packings and marking	

Other remarks

Date Signature

B FOR CURRANTS

Name of processor	Category of currants	Weight of sample	Identification of consignment or period of processing	Quantity to which the sample relates

Description of verification	Result
	Number
1 Pieces of stalk per 2,5 kilograms	
	% by weight
2 Moisture content	
	% by number
3 Allowed foreign matter other than stalks 4 Thin fruit 5 Reddish fruit 6 Damaged fruit 7 Large fruit 8 Small fruit 9 Fruit with cap stem	
	Norm respected (Yes/No)
10 Free running free flowing and free of stickiness 11 Colour and colour uniformity 12 Sizes 13 Marking	

Other remarks

Date Signature

COMMISSION REGULATION (EEC) No 2348/84

of 31 July 1984

fixing for the 1984/85 marketing year the minimum price to be paid to producers for unprocessed dried grapes and the amount of production aid for dried grapes

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 516/77 of 14 March 1977 on the common organization of the market in products processed from fruit and vegetables (1), as last amended by Regulation (EEC) No 988/84 (2), and in particular Articles 3b and 3c thereof,

Whereas, under Article 3b (1) of Regulation (EEC) No 516/77, the minimum price to be paid to producers is to be determined on the basis of

(a) the minimum price applying during the previous marketing year,

(b) the movement of basic prices in the fruit and vegetables sector,

(c) the need to ensure the normal marketing of fresh products for the various uses,

Whereas Article 3c of the said Regulation lays down the criteria for fixing the amount of production aid, whereas in respect of dried grapes a minimum import price is fixed pursuant to Article 4a of the same Regulation, whereas the production aid for these products is calculated by reference to the minimum import price,

Whereas Article 3b (2) of Regulation (EEC) No 516/77 provides that the minimum price to be paid to producers for unprocessed dried grapes shall be increased each month during a certain period of the marketing year by an amount corresponding to storage costs, whereas in fixing this amount the technical storage costs and interest cost should be taken into consideration,

Whereas the measures provided for in this Regulation are in accordance with the opinion of the Management Committee for Fruit and Vegetables,

HAS ADOPTED THIS REGULATION

Article 1

For the 1984/85 marketing year

(a) the minimum price referred to in Article 3b of Regulation (EEC) No 516/77 to be paid to producers for unprocessed dried sultanas of category 4, and

(b) the production aid referred to in Article 3c of the same Regulation for dried sultanas of category 4

shall be as set out in the Annex

Article 2

The amount by which the minimum price for unprocessed dried grapes is to be increased on the first of each month for the period 1 November to 1 August is fixed at 1,557 ECU per 100 kilograms net of sultanas of category 4

For other categories and for currants the amount shall be multiplied by the coefficient applicable to the minimum price listed in Annex I to Commission Regulation (EEC) No 2347/84 (3)

Article 3

This Regulation shall enter into force on the day following its publication in the *Official Journal of the European Communities*

This Regulation shall be binding in its entirety and directly applicable in all Member States

Done at Brussels, 31 July 1984

For the Commission
Poul DALSAGER
Member of the Commission

(1) OJ No L 73 21 3 1977 p 1
(2) OJ No L 103 16 3 1984, p 11

(3) See page 1 of this Official Journal

ANNEX

I Minimum price to be paid to producers

Product	ECU per 100 kilograms ex producer
Unprocessed sultanas of category 4	133 17

II Production aid

Product	ECU per 100 kilograms net
Dried sultanas of category 4	75,55

COMMISSION REGULATION (EEC) No 2349/84

of 23 July 1984

on the application of Article 85 (3) of the Treaty to certain categories of patent licensing agreements

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation No 19/65/EEC of 2 March 1965 on the application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices [1] as last amended by the Act of Accession of Greece, and in particular Article 1 thereof,

Having published a draft of this Regulation [2],

After consulting the Advisory Committee on Restrictive Practices and Dominant Positions,

Whereas

(1) Regulation No 19/65/EEC empowers the Commission to apply Article 85 (3) of the Treaty by Regulation to certain categories of agreements and concerted practices falling within the scope of Article 85 (1) to which only two undertakings are party and which include restrictions imposed in relation to the acquisition or use of industrial property rights, in particular patents, utility models, designs or trade marks or to the rights arising out of contracts for assignment of or the right to use, a method of manufacture or knowledge relating to the use or application of industrial processes

(2) Patent licensing agreements are agreements whereby one undertaking, the holder of a patent (the licensor), permits another undertaking (the licensee) to exploit the patented invention by one or more of the means of exploitation afforded by patent law, in particular manufacture, use or putting on the market

(3) In the light of experience acquired so far, it is possible to define a category of patent licensing agreements which are capable of falling within the scope of Article 85 (1) but which can normally be regarded as satisfying the conditions laid down in Article 85 (3) To the extent that patent licensing agreements to which undertakings in only one Member State are party and which concern only one or more patents for that Member State are capable of affecting trade between Member States it is appropriate to include them in the exempted category

(4) The present Regulation applies to licences issued in respect of national patents of the Member States Community patents [3], or European patents [4] granted for Member States, licences in respect of utility models or certificats d utilité issued in the Member States and licences in respect of inventions for which a patent application is made within one year Where such patent licensing agreements contain obligations relating not only to territories within the common market but also obligations relating to non member countries, the presence of the latter does not prevent the present Regulation from applying to the obligations relating to territories within the common market

(5) However, where licensing agreements for non member countries or for territories which extend beyond the frontiers of the Community have effects within the common market which may fall within the scope of Article 85 (1), such agreements should be covered by the Regulation to the same extent as would agreements for territories within the common market

(6) The Regulation should also apply to agreements concerning the assignment and acquisition of the rights referred to in point 4 above where the risk associated with exploitation remains with the

[1] OJ No 36 6 3 1965 p 533/65
[2] OJ No C 58 3 3 1979 p 12

[3] Convention for the European patent for the common market (Community Patent Convention) of 15 December 1975 (OJ No L 17 26 1 1976 p 1)
[4] Convention on the grant of European patents of 5 October 1973

assignor, patent licensing agreements in which the licensor is not the patentee but is authorized by the patentee to grant the licence (as in the case of sub-licences) and patent licensing agreements in which the parties' rights or obligations are assumed by connected undertakings

(7) The Regulation does not apply to agreements concerning sales alone, which are governed by the provisions of Commission Regulation (EEC) No 1983/83 of 22 June 1983 concerning the application of Article 85 (3) of the Treaty to categories of exclusive distribution agreements (1)

(8) Since the experience so far acquired is inadequate, it is not appropriate to include within the scope of the Regulation patent pools, licensing agreements entered into in connection with joint ventures, reciprocal licensing or distribution agreements, or licensing agreements in respect of plant breeder's rights Reciprocal agreements which do not involve any territorial restrictions within the common market should, however, be so included

(9) On the other hand, it is appropriate to extend the scope of the Regulation to patent licensing agreements which also contain provisions assigning, or granting the right to use, non-patented technical knowledge, since such mixed agreements are commonly concluded in order to allow the transfer of a complex technology containing both patented and non-patented elements Such agreements can only be regarded as fulfilling the conditions of Article 85 (3) for the purposes of this Regulation where the communicated technical knowledge is secret and permits a better exploitation of the licensed patents (know-how) Provisions concerning the provision of know-how are covered by the Regulation only in so far as the licensed patents are necessary for achieving the objects of the licensed technology and as long as at least one of the licensed patents remains in force

(10) It is also appropriate to extend the scope of the Regulation to patent licensing agreements containing ancillary provisions relating to trade marks, subject to ensuring that the trade-mark licence is not used to extend the effects of the patent licence beyond the life of the patents For this purpose it is necessary to allow the licensee to identify himself within the 'licensed territory', i e the territory covering all or part of the common market where the licensor holds patents which the licensee is authorized to exploit, as the manufacturer of the 'licensed product', i e the product which is the subject matter of the licensed patent or which has been obtained directly from the process which is the subject matter of the licensed patent, to avoid his having to enter into a new trade-mark agreement with the licensor when the licensed patents expire in order not to lose the goodwill attaching to the licensed product

(11) Exclusive licensing agreements, i e agreements in which the licensor undertakes not to exploit the 'licensed invention', i e the licensed patented invention and any know-how communicated to the licensee, in the licensed territory himself or to grant further licences there, are not in themselves incompatible with Article 85 (1) where they are concerned with the introduction and protection of a new technology in the licensed territory, by reason of the scale of the research which has been undertaken and of the risk that is involved in manufacturing and marketing a product which is unfamiliar to users in the licensed territory at the time the agreement is made This may also be the case where the agreements are concerned with the introduction and protection of a new process for manufacturing a product which is already known In so far as in other cases agreements of this kind may fall within the scope of Article 85 (1), it is useful for the purposes of legal certainty to include them in Article 1, in order that they may also benefit from the exemption However, the exemption of exclusive licensing agreements and certain export bans imposed on the licensor and his licensees is without prejudice to subsequent developments in the case law of the Court of Justice regarding the status of such agreements under Article 85 (1)

(12) The obligations listed in Article 1 generally contribute to improving the production of goods and to promoting technical progress, they make

(1) OJ No L 173, 30 6 1983, p 1

patentees more willing to grant licences and licensees more inclined to undertake the investment required to manufacture, use and put on the market a new product or to use a new process, so that undertakings other than the patentee acquire the possibility of manufacturing their products with the aid of the latest techniques and of developing those techniques further The result is that the number of production facilities and the quantity and quality of goods produced in the common market are increased This is true, in particular, of obligations on the licensor and on the licensee not to exploit the licensed invention in, and in particular not to export the licensed product into, the licensed territory in the case of the licensor and the 'territories reserved for the licensor', that is to say, territories within the common market in which the licensor has patent protection and has not granted any licences, in the case of the licensee This is also true both of the obligation of the licensee not to conduct an active policy of putting the product on the market (i e a prohibition of active competition as defined in Article 1 (1) (5)) in the territories of other licensees for a period which may equal the duration of the licence and also the obligation of the licensee not to put the licensed product on the market in the territories of other licensees for a limited period of a few years (i e a prohibition not only of active competition but also of 'passive competition' whereby the licensee of a territory simply responds to requests which he has not solicited from users or resellers established in the territories of other licensees — Article 1 (1) (6)) However, such obligations may be permitted under the Regulation only in respect of territories in which the licensed product is protected by 'parallel patents', that is to say, patents covering the same invention, within the meaning of the case law of the Court of Justice, and as long as the patents remain in force

(13) Consumers will as a rule be allowed a fair share of the benefit resulting from this improvement in the supply of goods on the market To safeguard this effect, however, it is right to exclude from the application of Article 1 cases where the parties agree to refuse to meet demand from users or resellers within their respective territories who would resell for export, or to take other steps to impede parallel imports, or where the licensee is obliged to refuse to meet unsolicited demand from the territory of other licensees (passive sales) The same applies where such action is the result of a concerted practice between the licensor and the licensee

(14) The obligations referred to above thus do not impose restrictions which are not indispensable to the attainment of the abovementioned objectives

(15) Competition at the distribution stage is safeguarded by the possibility of parallel imports and passive sales The exclusivity obligations covered by the Regulation thus do not normally entail the possibility of eliminating competition in respect of a substantial part of the products in question This is so even in the case of agreements which grant exclusive licences for a territory covering the whole of the common market

(16) To the extent that in their agreements the parties undertake obligations of the type referred to in Articles 1 and 2 but which are of more limited scope and thus less restrictive of competition than is permitted by those Articles, it is appropriate that these obligations should also benefit under the exemptions provided for in the Regulation

(17) If in a particular case an agreement covered by this Regulation is found to have effects which are incompatible with the provisions of Article 85 (3) of the Treaty, the Commission may withdraw the benefit of the block exemption from the undertakings concerned, in accordance with Article 7 of Regulation No 19/65/EEC

(18) It is not necessary expressly to exclude from the category defined in the Regulation agreements which do not fulfil the conditions of Article 85 (1) Nevertheless it is advisable, in the interests of legal certainty for the undertakings concerned to list in Article 2 a number of obligations which are not normally restrictive of competition so that these also may benefit from the exemption in the event that, because of particular economic or legal circumstances they should exceptionally fall within the scope of Article 85 (1) The list of such obligations given in Article 2 is not exhaustive

(19) The Regulation must also specify what restrictions or provisions may not be included in patent licensing agreements if these are to benefit from the block exemption The restrictions listed in Article 3 may fall under the prohibition of Article 85 (1), in these cases there can be no general

presumption that they will lead to the positive effects required by Article 85 (3), as would be necessary for the granting of a block exemption

(20) Such restrictions include those which deny the licensee the right enjoyed by any third party to challenge the validity of the patent or which automatically prolong the agreement by the life of any new patent granted during the life of the licensed patents which are in existence at the time the agreement is entered into Nevertheless, the parties are free to extend their contractual relationship by entering into new agreements concerning such new patents, or to agree the payment of royalties for as long as the licensee continues to use know how communicated by the licensor which has not entered into the public domain, regardless of the duration of the original patents and of any new patents that are licensed

(21) They also include restrictions on the freedom of one party to compete with the other and in particular to involve himself in techniques other than those licensed, since such restrictions impede technical and economic progress The prohibition of such restrictions should however be reconciled with the legitimate interest of the licensor in having his patented invention exploited to the full and to this end to require the licensee to use his best endeavours to manufacture and market the licensed product

(22) Such restrictions include, further, an obligation on the licensee to continue to pay royalties after all the licensed patents have expired and the communicated know how has entered into the public domain, since such an obligation would place the licensee at a disadvantage by comparison with his competitors, unless it is established that this obligation results from arrangements for spreading payments in respect of previous use of the licensed invention

(23) They also include restrictions imposed on the parties regarding prices, customers or marketing of the licensed products or regarding the quantities to be manufactured or sold, especially since restrictions of the latter type may have the same effect as export bans

(24) Finally, they include restrictions to which the licensee submits at the time the agreement is made because he wishes to obtain the licence, but which give the licensor an unjustified competitive advantage, such as an obligation to assign to the licensor any improvements the licensee may make to the invention, or to accept other licences or goods and services that the licensee does not want from the licensor

(25) It is appropriate to offer to parties to patent licensing agreements containing obligations which do not come within the terms of Articles 1 and 2 and yet do not entail any of the effects restrictive of competition referred to in Article 3 a simplified means of benefiting, upon notification, from the legal certainty provided by the block exemption (Article 4) This procedure should at the same time allow the Commission to ensure effective supervision as well as simplifying the administrative control of agreements

(26) The Regulation should apply with retroactive effect to patent licensing agreements in existence when the Regulation comes into force where such agreements already fulfil the conditions for application of the Regulation or are modified to do so (Articles 6 to 8) Under Article 4 (3) of Regulation No 19/65/EEC, the benefit of these provisions may not be claimed in actions pending at the date of entry into force of this Regulation, nor may it be relied on as grounds for claims for damages against third parties

(27) Agreements which come within the terms of Articles 1 and 2 and which have neither the object nor the effect of restricting competition in any other way need no longer be notified Nevertheless, undertakings will still have the right to apply in individual cases for negative clearance under Article 2 of Council Regulation No 17 (1) or for exemption under Article 85 (3),

HAS ADOPTED THIS REGULATION

Article 1

1 Pursuant to Article 85 (3) of the Treaty and subject to the provisions of this Regulation, it is hereby declared

(1) OJ No 13 21 2 1962 p 204/62

that Article 85 (1) of the Treaty shall not apply to patent licensing agreements, and agreements combining the licensing of patents and the communication of know-how, to which only two undertakings are party and which include one or more of the following obligations

1 an obligation on the licensor not to license other undertakings to exploit the licensed invention in the licensed territory, covering all or part of the common market, in so far and as long as one of the licensed patents remains in force

2 an obligation on the licensor not to exploit the licensed invention in the licensed territory himself in so far and as long as one of the licensed patents remains in force,

3 an obligation on the licensee not to exploit the licensed invention in territories within the common market which are reserved for the licensor, in so far and as long as the patented product is protected in those territories by parallel patents,

4 an obligation on the licensee not to manufacture or use the licensed product, or use the patented process or the communicated know how, in territories within the common market which are licensed to other licensees, in so far and as long as the licensed product is protected in those territories by parallel patents,

5 an obligation on the licensee not to pursue an active policy of putting the licensed product on the market in the territories within the common market which are licensed to other licensees, and in particular not to engage in advertising specifically aimed at those territories or to establish any branch or maintain any distribution depot there, in so far and as long as the licensed product is protected in those territories by parallel patents,

6 an obligation on the licensee not to put the licensed product on the market in the territories licensed to other licensees within the common market for a period not exceeding five years from the date when the product is first put on the market within the common market by the licensor or one of his licensees, in so far as and for as long as the product is protected in these territories by parallel patents,

7 an obligation on the licensee to use only the licensor s trade mark or the get up determined by the licensor to distinguish the licensed product provided that the licensee is not prevented from identifying himself as the manufacturer of the licensed product

2 The exemption of restrictions on putting the licensed product on the market resulting from the obligations referred to in paragraph 1 (2), (3), (5) and (6) shall apply only if the licensee manufactures the licensed product himself or has it manufactured by a connected undertaking or by a subcontractor

3 The exemption provided for in paragraph 1 shall also apply where in a particular agreement the parties undertake obligations of the types referred to in that paragraph but with a more limited scope than is permitted by the paragraph

Article 2

1 Article 1 shall apply notwithstanding the presence in particular of any of the following obligations, which are generally not restrictive of competition

1 an obligation on the licensee to procure goods or services from the licensor or from an undertaking designated by the licensor, in so far as such products or services are necessary for a technically satisfactory exploitation of the licensed invention,

2 an obligation on the licensee to pay a minimum royalty or to produce a minimum quantity of the licensed product or to carry out a minimum number of operations exploiting the licensed invention,

3 an obligation on the licensee to restrict his exploitation of the licensed invention to one or more technical fields of application covered by the licensed patent,

4 an obligation on the licensee not to exploit the patent after termination of the agreement in so far as the patent is still in force,

5 an obligation on the licensee not to grant sub-licences or assign the licence,

6 an obligation on the licensee to mark the licensed product with an indication of the patentee s name,

the licensed patent or the patent licensing agreement,

7 an obligation on the licensee not to divulge know how communicated by the licensor, the licensee may be held to this obligation after the agreement has expired,

8 obligations

(a) to inform the licensor of infringements of the patent,

(b) to take legal action against an infringer,

(c) to assist the licensor in any legal action against an infringer,

provided that these obligations are without prejudice to the licensee s right to challenge the validity of the licensed patent,

9 an obligation on the licensee to observe specifications concerning the minimum quality of the licensed product, provided that such specifications are necessary for a technically satisfactory exploitation of the licensed invention, and to allow the licensor to carry out related checks,

10 an obligation on the parties to communicate to one another any experience gained in exploiting the licensed invention and to grant one another a licence in respect of inventions relating to improvements and new applications, provided that such communication or licence is non-exclusive,

11 an obligation on the licensor to grant the licensee any more favourable terms that the licensor may grant to another undertaking after the agreement is entered into

2 In the event that, because of particular circumstances, the obligations referred to in paragraph 1 fall within the scope of Article 85 (1), they shall also be exempted even if they are not accompanied by any of the obligations exempted by Article 1

The exemption provided for in this paragraph shall also apply where in an agreement the parties undertake obligations of the types referred to in paragraph 1 but with a more limited scope than is permitted by that paragraph

Article 3

Articles 1 and 2 (2) shall not apply where

1 the licensee is prohibited from challenging the validity of licensed patents or other industrial or commercial property rights within the common market belonging to the licensor or undertakings connected with him, without prejudice to the right of the licensor to terminate the licensing agreement in the event of such a challenge,

2 the duration of the licensing agreement is automatically prolonged beyond the expiry of the licensed patents existing at the time the agreement was entered into by the inclusion in it of any new patent obtained by the licensor, unless the agreement provides each party with the right to terminate the agreement at least annually after the expiry of the licensed patents existing at the time the agreement was entered into, without prejudice to the right of the licensor to charge royalties for the full period during which the licensee continues to use know-how communicated by the licensor which has not entered into the public domain, even if that period exceeds the life of the patents,

3 one party is restricted from competing with the other party, with undertakings connected with the other party or with other undertakings within the common market in respect of research and development, manufacture, use or sales, save as provided in Article 1 and without prejudice to an obligation on the licensee to use his best endeavours to exploit the licensed invention,

4 the licensee is charged royalties on products which are not entirely or partially patented or manufactured by means of a patented process, or for the use of know how which has entered into the public domain otherwise than by the fault of the licensee or an undertaking connected with him, without prejudice to arrangements whereby, in order to facilitate payment by the licensee, the royalty payments for the use of a licensed invention are spread over a period extending beyond the life of the licensed patents or the entry of the know how into the public domain,

5 the quantity of licensed products one party may manufacture or sell or the number of operations exploiting the licensed invention he may carry out are subject to limitations,

6 one party is restricted in the determination of prices, components of prices or discounts for the licensed products,

7 one party is restricted as to the customers he may serve, in particular by being prohibited from supplying certain classes of user, employing certain forms of distribution or, with the aim of sharing customers, using certain types of packaging for the products, save as provided in Article 1 (1) (7) and Article 2 (1) (3),

8 the licensee is obliged to assign wholly or in part to the licensor rights in or to patents for improvements or for new applications of the licensed patents,

9 the licensee is induced at the time the agreement is entered into to accept further licences which he does not want or to agree to use patents, goods or services which he does not want, unless such patents, products or services are necessary for a technically satisfactory exploitation of the licensed invention,

10 without prejudice to Article 1 (1) (5) the licensee is required, for a period exceeding that permitted under Article 1 (1) (6), not to put the licensed product on the market in territories licensed to other licensees within the common market or does not do so as a result of a concerted practice between the parties,

11 one or both of the parties are required

(a) to refuse without any objectively justified reason to meet demand from users or resellers in their respective territories who would market products in other territories within the common market,

(b) to make it difficult for users or resellers to obtain the products from other resellers within the common market, and in particular to exercise industrial or commercial property rights or take measures so as to prevent users or resellers from obtaining outside, or from putting on the market in, the licensed territory products which have been lawfully put on the market within the common market by the patentee or with his consent,

or do so as a result of a concerted practice between them

Article 4

1 The exemption provided for in Articles 1 and 2 shall also apply to agreements containing obligations restrictive of competition which are not covered by those Articles and do not fall within the scope of Article 3, on condition that the agreements in question are notified to the Commission in accordance with the provisions of Commission Regulation No 27 [1], as last amended by Regulation (EEC) No 1699/75 [2], and that the Commission does not oppose such exemption within a period of six months

2 The period of six months shall run from the date on which the notification is received by the Commission Where, however, the notification is made by registered post, the period shall run from the date shown on the postmark of the place of posting

3 Paragraph 1 shall apply only if

(a) express reference is made to this Article in the notification or in a communication accompanying it, and

(b) the information furnished with the notification is complete and in accordance with the facts

4 The benefit of paragraph 1 may be claimed for agreements notified before the entry into force of this Regulation by submitting a communication to the Commission referring expressly to this Article and to the notification Paragraphs 2 and 3 (b) shall apply *mutatis mutandis*

5 The Commission may oppose the exemption It shall oppose exemption if it receives a request to do so from a Member State within three months of the transmission to the Member State of the notification referred to in paragraph 1 or of the communication referred to in paragraph 4 This request must be justified on the basis of considerations relating to the competition rules of the Treaty

6 The Commission may withdraw the opposition to the exemption at any time However, where the opposition was raised at the request of a Member State and this request is maintained, it may be withdrawn only after consultation of the Advisory Committee on Restrictive Practices and Dominant Positions

7 If the opposition is withdrawn because the undertakings concerned have shown that the conditions

[1] OJ No 35, 10 5 1962 p 1118/62
[2] OJ No L 172 3 7 1975, p 11

of Article 85 (3) are fulfilled, the exemption shall apply from the date of notification

8 If the opposition is withdrawn because the undertakings concerned have amended the agreement so that the conditions of Article 85 (3) are fulfilled, the exemption shall apply from the date on which the amendments take effect

9 If the Commission opposes exemption and the opposition is not withdrawn, the effects of the notification shall be governed by the provisions of Regulation No 17

Article 5

1 This Regulation shall not apply

1 to agreements between members of a patent pool which relate to the pooled patents,

2 to patent licensing agreements between competitors who hold interests in a joint venture or between one of them and the joint venture, if the licensing agreements relate to the activities of the joint venture,

3 to agreements under which the parties, albeit in separate agreements or through connected undertakings, grant each other reciprocal patent or trade-mark licences or reciprocal sales rights for unprotected products or exchange know how, where the parties are competitors in relation to the products covered by those agreements,

4 to licensing agreements in respect of plant breeder s rights

2 However, this Regulation shall apply to reciprocal licences of the types referred to in paragraph 1 (3) where the parties are not subject to any territorial restriction within the common market on the manufacture, use or putting on the market of the products covered by these agreements or on the use of the licensed processes

Article 6

1 As regards agreements existing on 13 March 1962 and notified before 1 February 1963 and agreements, whether notified or not, to which Article 4 (2) (2) (b) of Regulation No 17 applies, the declaration of inapplicability of Article 85 (1) of the Treaty contained in this Regulation shall have retroactive effect from the time at which the conditions for application of this Regulation were fulfilled

2 As regards all other agreements notified before this Regulation entered into force, the declaration of inapplicability of Article 85 (1) of the Treaty contained in this Regulation shall have retroactive effect from the time at which the conditions for application of this Regulation were fulfilled, or from the date of notification, whichever is the later

Article 7

If agreements existing on 13 March 1962 and notified before 1 February 1963 or agreements to which Article 4 (2) (2) (b) of Regulation No 17 applies and notified before 1 January 1967 are amended before 1 April 1985 so as to fulfil the conditions for application of this Regulation, and if the amendment is communicated to the Commission before 1 July 1985 the prohibition in Article 85 (1) of the Treaty shall not apply in respect of the period prior to the amendment The communication shall take effect from the time of its receipt by the Commission Where the communication is sent by registered post, it shall take effect from the date shown on the postmark of the place of posting

Article 8

1 As regards agreements to which Article 85 of the Treaty applies as a result of the accession of the United Kingdom, Ireland and Denmark Articles 6 and 7 shall apply except that the relevant dates shall be 1 January 1973 instead of 13 March 1962 and 1 July 1973 instead of 1 February 1963 and 1 January 1967

2 As regards agreements to which Article 85 of the Treaty applies as a result of the accession of Greece, Articles 6 and 7 shall apply except that the relevant dates shall be 1 January 1981 instead of 13 March 1962 and 1 July 1981 instead of 1 February 1963 and 1 January 1967

Article 9

The Commission may withdraw the benefit of this Regulation, pursuant to Article 7 of Regulation No 19/65/EEC, where it finds in a particular case that an agreement exempted by this Regulation nevertheless has

certain effects which are incompatible with the conditions laid down in Article 85 (3) of the Treaty, and in particular where

1 such effects arise from an arbitration award,

2 the licensed products or the services provided using a licensed process are not exposed to effective competition in the licensed territory from identical products or services or products or services considered by users as equivalent in view of their characteristics, price and intended use

3 the licensor does not have the right to terminate the exclusivity granted to the licensee at the latest five years from the date the agreement was entered into and at least annually thereafter if, without legitimate reason, the licensee fails to exploit the patent or to do so adequately,

4 without prejudice to Article 1 (1) (6), the licensee refuses, without objectively valid reason, to meet unsolicited demand from users or resellers in the territory of other licensees,

5 one or both of the parties

(a) without any objectively justified reason, refuse to meet demand from users or resellers in their respective territories who would market the products in other territories within the common market, or

(b) make it difficult for users or resellers to obtain the products from other resellers within the common market, and in particular where they exercise industrial or commercial property rights or take measures so as to prevent resellers or users from obtaining outside, or from putting on the market in, the licensed territory products which have been lawfully put on the market within the common market by the patentee or with his consent

Article 10

1 This Regulation shall apply to

(a) patent applications,

(b) utility models,

(c) applications for registration of utility models,

(d) 'certificats d utilité and 'certificats d'addition under French law, and

(e) applications for certificats d utilité' and certificats d addition under French law,

equally as it applies to patents

2 This Regulation shall also apply to agreements relating to the exploitation of an invention if an application within the meaning of paragraph 1 is made in respect of the invention for the licensed territory within one year from the date when the agreement was entered into

Article 11

This Regulation shall also apply to

1 patent licensing agreements where the licensor is not the patentee but is authorized by the patentee to grant a licence or a sub-licence,

2 assignments of a patent or of a right to a patent where the sum payable in consideration of the assignment is dependent upon the turnover attained by the assignee in respect of the patented products, the quantity of such products manufactured or the number of operations carried out employing the patented invention,

3 patent licensing agreements in which rights or obligations of the licensor or the licensee are assumed by undertakings connected with them

Article 12

1 'Connected undertakings' for the purposes of this Regulation means

(a) undertakings in which a party to the agreement, directly or indirectly

— owns more than half the capital or business assets, or

— has the power to exercise more than half the voting rights, or

— has the power to appoint more than half the members of the supervisory board, board of directors or bodies legally representing the undertaking, or

— has the right to manage the affairs of the undertaking,

(b) undertakings which directly or indirectly have in or over a party to the agreement the rights or powers listed in (a),

(c) undertakings in which an undertaking referred to in (b) directly or indirectly has the rights or powers listed in (a)

2 Undertakings in which the parties to the agreement or undertakings connected with them jointly have the rights or powers set out in paragraph 1 (a) shall be considered to be connected with each of the parties to the agreement

Article 13

1 Information acquired pursuant to Article 4 shall be used only for the purposes of this Regulation

2 The Commission and the authorities of the Member States, their officials and other servants shall not disclose information acquired by them pursuant to this Regulation of the kind covered by the obligation of professional secrecy

3 The provisions of paragraphs 1 and 2 shall not prevent publication of general information or surveys which do not contain information relating to particular undertakings or associations of undertakings

Article 14

This Regulation shall enter into force on 1 January 1985

It shall apply until 31 December 1994

This Regulation shall be binding in its entirety and directly applicable in all Member States

Done at Brussels, 23 July 1984

For the Comission
Frans ANDRIESSEN
Member of the Commission

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Annex II

ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE

ANTITRUST, TECHNOLOGY TRANSFERS AND JOINT VENTURES IN INTERNATIONAL TRADE

This volume contains articles based upon lectures delivered in condensed form, followed by panel discussions, during the Ninth Annual Fordham Corporate Law Institute on Antitrust, Technology Transfers and Joint Ventures in International Trade in New York City on October 18 and 19, 1982 The opinions expressed in this volume are those of the authors and not, necessarily, those of Fordham University or the Fordham Corporate Law Institute

Editor
Barry E. Hawk

Fordham Corporate Law Institute

1982



MATTHEW
BENDER

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Chapter 4

TECHNOLOGY TRANSFER UNDER EEC LAW—EUROPE BETWEEN THE DIVERGENT OPINIONS OF THE PAST AND THE NEW ADMINISTRATION: A COMPARATIVE LAW APPROACH

Hartmut Johannes†

SUMMARY

I. Some questions of terminology

II. Limitation of this paper

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† Head of Division for Industrial Property Rights, Directorate General for Competition, Commission of the European Communities, Brussels The views expressed are strictly personal

This paper follows an earlier one, *Recent Developments in Technology Transfer in Europe*, in International Antitrust, Fifth Annual Fordham Corporate Law Institute (B Hawk ed 1979)

The author expresses his gratitude to Fordham University and Professor Barry Hawk for enabling American and European lawyers to exchange their opinions and to learn from one another The author also thanks Robert Strivens for his help in legal and in language problems

III. The importance of comparative law in antitrust

A Europe facing important changes in American antitrust policy

B The teacher-pupil relationship

C Robert H Bork's *Antitrust Paradox*—the new gospel

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2 The limited horizon United States of America

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a Factual differences between American and European economics

b The use of national laws of the member states to split up the Common Market - vertical market division

c Resale price maintenance

d The consumer welfare theory - the three anti-trust classes of the American society

D The nine no-no's, Abbott Lipsky's approach and the European solutions

1 The imprecise or even careless use of the term "vertical" in patent licensing

2 The nine no-no's for patent licensing

a No-no number 1 tying arrangements

b No-no number 2 grantbacks and obligations to assign improvements

c No-no number 3 restrictions on a purchaser of the patented product on resale

d No-no number 4 restrictions outside the scope of the patent

e No-no number 5 sole or exclusive licences and closed patent pools

f No-no number 6 package licensing

g No-no number 7 calculation of royalties

h No-no number 8 restrictions on an unpatented product manufactured with a patented process

i No-no number 9 restrictions on licensee's prices

3 Final evaluation

I. SOME QUESTIONS OF TERMINOLOGY

For an American lawyer the terms "national commerce," "domestic commerce" or "interstate commerce" are clear if they are used in contrast with "international commerce" or "commerce with foreign nations "[1] Commerce between New York City and Albany is intrastate, between New York and New Jersey interstate and between New York and Paris international commerce

If one applies that terminology to the European Community, then commerce between London and Edinburgh is commerce within one member state (intra-member state commerce), commerce between London and Paris is commerce between two member states (inter-member state commerce or Community commerce) and commerce between London and New York international commerce (commerce between the Community and third countries) This new terminology, due to European unification, is not so easy to understand But if an American lawyer wants to become acquainted with Community problems, he has to face the new Community terminology that—in Community terms—trade between member states is—in American terms—interstate commerce

[1] U S Const art I, § 8, cl 3

This is relatively new, even for some traditional Europeans, but above all for those American lawyers who have in the past worked on the laws of the different European countries For instance we have been confronted with the American case *Dunlop Co v Kelsey-Hayes Co* [2] (right of the American patentee to invoke his American patent in order to stop imports of genuine goods coming from and manufactured in Great Britain) for the purpose of convincing us that the French patentee should also have the right to stop imports into France from Great Britain under his French patent, as if *Dunlop v Kelsey-Hayes* concerned a case of the shipping of goods from New York just across the Hudson river to New Jersey

American lawyers know that the leading case on this problem is *Adams v Burke*[3] (patent law and interstate commerce) and not *Dunlop v Kelsey Hayes* (patent law and international commerce) It is one of the main tasks of the interface of Community law and patent law to convince everybody that the rule in *Adams v Burke* is also the law in Europe in 1982 [4] For European antitrust lawyers or those lawyers who are acquainted with Community constitutional questions, this result is evident But traditionally thinking patent lawyers still find it difficult to face this consequence of the reality of European unification, even though the European Court of Justice has decided that a Dutch patentee cannot invoke his Dutch patent to stop imports from Great Britain where the goods have been legitimately sold under a parallel patent of the same patentee[5] and that the Dutch patentee cannot invoke his Dutch patent to stop imports from Italy where the goods have been sold by the patentee himself and where no patent protection was available for the goods in question.[6]

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[2] 484 F 2d 407 (6th Cir 1973)

[3] 84 U S 453 (1873)

[4] I leave aside the problem whether § 261 of the Patent Act allows territorial assignments or licences within the United States *See* Moraine Prods v ICI America, Inc , 538 F 2d 134, 137 (7th Cir 1976), Roger Andewelt, Remarks before the Houston Patent Law Association (December 3, 1981) It is not contested in American law that, once a patented product has been sold legitimately, it can circulate freely throughout the United States

[5] Centrafarm B V v Sterling Drug, 1974 E Comm Ct J Rep 1147, Common Mkt Rep (CCH) ¶ 8246

[6] Merck & Co v Stephar B V , 1981 E Comm Ct J Rep Common Mkt Rep (CCH) ¶ 8707

II. LIMITATION OF THIS PAPER

This paper was originally designed to deal with three specific problems, namely

- Europe in the face of a new antitrust policy of the American Administration (the comparative law aspect)
- Europe and the application of its antitrust laws to intermember state technology transfer (the history and the impact of the *Maize-Seed* judgment of the European Court of Justice[7] and
- Europe and the application of its antitrust laws to international technology transfer between the Community on the one hand and third countries (United States, Japan, Latin America, Russia, China, etc) on the other

Since my friend Mario Siragusa has so masterfully dealt with the second problem—technology transfer and antitrust in Europe up to the *Maize-Seed* judgment and the *Coditel II* judgment,[8] I shall, to avoid any reiteration, confine my paper to the comparative law aspect This is the most important, because there are such profound changes in the United States, compared with a more steady evolution in Europe where there has not been so much development as to the international problem since I read my previous paper at Fordham University in 1978

Although I fully support Mario Siragusa's explanation of technology transfer and antitrust in the Community, I have to declare some reservations as to the conclusions to be drawn from the *Maize-Seed* judgment for other antitrust questions than those decided by the European Court One must be cautious in generalizing court judgments beyond the issues at stake, and this caution has recently been confirmed by one of the judges [9]

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[7] Judgment of June 8, 1982, Nungesser and Eisele v Commission, Case 258/78 Common Mkt Rep (CCH) ¶ 8805

[8] Judgment of October 6, 1982, Coditel v Ciné Vog Films, Case 262/81 (not yet published)

[9] Ulrich Everling, Zur neueren Rechtsprechung des Gerichtshofes der Europäischen Gemeinschaften zum Wettbewerbsrecht, remarks before the Deutsche Liga für Internationales Wettbewerbsrecht (September 20, 1982), in 17 Europarecht 301 (1982)

III. THE IMPORTANCE OF COMPARATIVE LAW IN ANTITRUST

In comparative law there is a presumption that the same facts require the same legal results, although sometimes with completely different means This presumption, of course, is rebuttable on historical or political grounds But if the legal results differ considerably, and if a foreign law comes to opposite results, then as a general rule there are important differences in facts One should try to find these out and, if it transpires that there are no important differences in the facts, one should review one or both legal results

For twenty-two years now I have followed the major developments in American antitrust law In my view there has always been a relatively steady evolution which culminates in the slowly growing insight that joint ventures are an antitrust problem [10] But the most recent developments are—at least for the foreign observer of American antitrust—astonishing

A Europe facing important changes in American antitrust policy

At the beginning the foreign observer has to state some facts and opinions, and the fact that a certain opinion is expressed by somebody with a certain importance constitutes in itself a relevant fact in comparative law. English judges call that a "writer of authority," but contrary to English court traditions that only those writers of authority are quoted who have passed away, in America and on the European continent also persons still alive

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[10] In 1974 I characterized joint ventures as the modern way to restrain trade in oligopolistic markets *See Antitrust in the EEC in 1974*, in n 10 *See Antitrust in the EEC in 1974*, Inst on Priv Inv & Inv Abroad (1975), referring to Mobay, 1967 Trade Cas (CCH) ¶ 72,001 The Federal Trade Commission is pursuing this policy, *see* Brunswick Corp , 3 Trade Reg Rep (CCH) ¶ 21,623 (FTC 1979) *aff'd sub nom.*, Yamaha Motor Co v FTC, 1981-2 Trade Cas (CCH) ¶ 64,202 (8th Cir 1982) On the other hand, time is obviously not yet ripe to recognize that certain forms of licensing are naked market sharing In my opinion, the Antitrust Division was exactly right in United States v Westinghouse Elec Corp , 471 F Supp 532 (N D Cal 1978) *aff'd*, 648 F 2d 642 (9th Cir 1981), but it was premature to expect that this correct evaluation would be accepted by the courts I am sure that at least the next generation will correct that error

have the honour to be quoted in comparative law [11]

1 The takeover of the oil company Conoco by the chemical giant duPont went unchallenged in 1981 [12]

2 I have read with great interest the following statements or opinions by

— Assistant Attorney General William Baxter before the Subcommittee on Monopolies and Commercial Law of the Committee on the Judiciary,[13]

— Attorney General William French Smith before the District of Columbia Bar,[14]

— Deputy Assistant Attorney General Abbott Lipsky Jr on "Current Antitrust Division Views on Patent Licensing Practices" before the Antitrust Section of the American Bar Association,[15]

— Chief of the Intellectual Property Section of the Antitrust Division Roger Andewelt on "Basic Principles to Apply at the Patent-Antitrust Interface" before the Houston Patent Law Association,[16] and last but not least,

— Robert H Bork, The Antitrust Paradox (1978)

3 May I add a last fact Marathon Oil Company was acquired by United States Steel Corporation in February and March 1982 This fact, by itself, is perhaps not astonishing But a competing takeover bidder was Mobil Oil. This means that there were reasonable and honourable American lawyers and businessmen[17] who—in

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[11] The European Court of Justice quotes nobody; this is, in my opinion, a good thing

[12] Terms used by the Financial Times, *see* The Economist, April 10, 1982

[13] April 29, 1981

[14] June 24, 1981, 1981 Trade Reg Rep (CCH) ¶ 55,972

[15] November 5, 1981, 1981 Trade Reg Rep (CCH) ¶ 55,985

[16] December 3, 1981; Pat., Trademark, Copyright J D-1, Dec 17, 1981

[17] "For Brutus is an honourable man," Shakespeare, Julius Caesar Act III Scene II (stated by Mark Antony)

> 1982—believed that a takeover of Marathon Oil by Mobil Oil was legally possible, a situation which was not even imaginable ten years earlier When Mobil Oil failed, even more astonishing and more unimaginable ten years earlier, there were likewise reasonable and honourable lawyers and businessmen who believed that Mobil Oil could take revenge in taking over United States Steel following the motto if you cannot marry the young lady, of course not for love but for the money she might have or inherit, marry her mother

These changes have not come overnight As Chief Justice Burger said at the Salzburg Seminar in American Studies in August 1982,[18] six out of the nine Supreme Court Justices have been appointed under Republican Presidents, since the regretted deaths of Justice Douglas and Justice Black under President Nixon Under President Carter there was no vacancy on the Supreme Court

The leading event in recent American antitrust law took place before there was any question of the new Administration *GTE Sylvania,*[19] overruling *Schwinn,*[20] was decided in 1977, i e five years ago For the foreign comparative law observer the changes are therefore not just a new fashion or whim, but a deep-rooted shift in American society On the other hand, one should not forget that in 1890 the Sherman Act was made law by the votes of the Midwest farm states, against the so-called liberal East Coast In Europe workable antitrust legislation has always been enacted by conservative majorities and never by socialist or left-wing liberal governments, e g in Germany, in Great Britain and in France. Therefore I strongly believe that—despite the opinions and facts quoted—the present conservative American majority will not substantially lessen the antitrust laws.

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18 Frankfurter Allgemeine Zeitung, August 9, 1982

19 Continental T V , Inc v GTE Sylvania, Inc , 433 U S 36 (1977)

20 United States v Arnold, Schwinn & Co , 388 U S 365 (1967)

B The teacher-pupil relationship

I said at Fordham University in 1978 that

> in the art of antitrust the Americans are the teachers and the Europeans are the pupils

For more than two generations, Americans have been spreading their antitrust ideas all over the world with an almost missionary zeal

> (Antitrust) is even exportable This supposedly peculiarly American growth has spread to and taken at least equivocal root in Europe and even in Asia [21]

I suppose that nobody imagined what would happen if willing and industrious pupils studied and accepted for many years what their teachers told them and then, all of a sudden, the teachers say that this was all only All Fools Day.

I do not exaggerate in this respect. One can read in Lipsky's remarks·

> When one makes the analysis, one finds that the nine no-no's, as statements of rational economic policy, contain more error than accuracy [22]

And the Attorney General speaks of the avoidance of "misguided and mistaken concepts" pursued by past Administrations that have "generated anticompetitive results in the name of antitrust enforcement "[23]

When I call us, the Europeans, the pupils in the art of antitrust, we never have been and we never shall be uncritical pupils For instance, as long as I have been with the Commission of the European Communities, i e exactly 19 years, I successfully opposed all attempts to introduce the so-called intra-enterprise conspiracy doctrine in European antitrust We have always op-

[21] R Bork, The Antitrust Paradox A Policy at War with Itself 3 (1978)
[22] Address by A Lipsky, *supra* note 15
[23] Address by W Smith, *supra* note 14

posed, likewise successfully, all attempts to establish or extend per se rules, we have never followed *Schwinn* (1967), but we established as long ago as 1964,[24] confirmed by the European Court of Justice in 1966,[25] what was not accepted under American law in *GTE Sylvania* until 1977, i e 13 years later than the Commission of the European Communities

C *Robert H Bork's Antitrust Paradox—the new gospel*

This is not the place to enter into a profound discussion on this most interesting book, but a comparative law study would be incomplete if it did not deal with at least those points to which the study relates And it is a pity to note that as to those points on which Bork's opinion is impregnable, even his disciples do not apply correctly his correct standards

1 *Horizontal, vertical and conglomerate restrictions*

> In antitrust's vocabulary, a structure is *horizontal* when it involves only one market Thus, when we speak of a firm's market share we are speaking of horizontal structure, and phenomena such as price fixing by rivals or the merger of rivals are horizontal because the rivals operate in the same market Structure is *vertical* when it links two markets in the same chain of manufacture and distribution, usually through the linkage of two firms that either do or could stand in the relationship of supplier and customer Vertical structures include a manufacturer's ownership of retail outlets, his exclusive contracts with independent outlets, or his control of independent outlets' resale prices Structure is *conglomerate* when it links two separate markets in any manner that is not vertical [26]

This is true But we shall see what will be made out of this truth

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[24] Grundig-Consten, O J Eur Comm (No L 161) 2545 (1964), Common Mkt Rep (CCH) ¶ 9126

[25] 1966 E Comm Ct J Rep 229, Common Mkt Rep (CCH) ¶ 8046

[26] R Bork, *supra* note 21, at 17–18

when applied to patent licensing Besides, there is another point Although it is correct that the foregoing is the "antitrust vocabulary," it is not the vocabulary of either the Sherman Act or of the corresponding Article 85 of the EEC Treaty Therefore the question must be asked whether this vocabulary has supremacy over the language of the law or whether the legislator is autonomous in choosing his own language Article 85 of the EEC Treaty does not distinguish between horizontal and vertical, nor does section 1 of the Sherman Act Since the German antitrust law does, the German government tried to impose the distinction on the construction of Article 85. But the Court of Justice refused to make a distinction where the law does not distinguish and thus rejected the intervention of the German government [27]

2 *The limited horizon. The United States*—This is once more not the place to discuss the general scope of Bork's book, but as a source for comparative law it is meagre. It focusses on the United States and nothing else

a **The legal approach**—This limited horizon could be explained if the book were confined to mere judicial discussion But even for this purpose the history of the Sherman Act, the ironical way in which it deals with the argument that this Act made what were once restraints of trade only under common law into a Federal Act, and the even more ironical allegation that American judges use the term "in restraint of trade" in a completely different way from some English judges who invented and used it several hundred years ago, make the book an unreliable source. It does not mention the influence of Adam Smith on Jefferson's thinking on monopolies, the impact on the American Constitution and on the Supreme Court's and the state courts' reasoning during the 19th century. Nor does it mention the state courts' opinions on the non-signor clause in Fair Trade Acts permitted under the Miller-Tydings and McGuire Acts The European pupils of American antitrust have always thought that the Sherman Act can be correctly understood only if it is read together

[27] Consten and Grundig, 1966 E Comm. Ct. J. Rep 229, Common Mkt Rep (CCH) ¶ 8046

with the Constitution, including the Bill of Rights Interestingly enough Senator Sherman saw this connection

b **The economic approach**—Bork expressly states that he does not want to be confined to mere juridical discussion On the contrary, he always looks for a rational economic explanation of the antitrust laws and, since consumer welfare is the goal of antitrust, all economic arguments are accepted as guidance for the construction of those laws if they improve consumer welfare Therefore, the limitation to the United States is even less convincing because well known examples from other countries in the world show that Bork's economic reasoning on what will benefit consumer welfare can easily be refuted by the experiences of countries other than the United States

3 The European experiences

a **Factual differences between American and European economics**—The Community is not a Union, it only has a unified custom tariff But it has ten Member states, ten different currencies with considerably changing rates of inflation, seven languages and even, since the accession of Greece, two different letter-types The direct taxes are not yet harmonized, indirect taxes only in so far as the basis of calculation is concerned, and the rates of value-added tax (VAT) vary considerably Industrialisation and income are not equally spread over the Community. Traditions and habits are and will remain different.

Retail costs differ considerably and are, as a whole, substantially higher than in the United States Of each dollar the consumer spends, the retailer keeps almost twice as much as an American retailer, so that out of that dollar, the European manufacturer will receive much less than his American colleague.

In the *Maize-Seed* case,[28] the Commission found a price difference of almost 70% between France and Germany for the very same seed This finding, it is true, was vigorously contested before the European court of Justice which, however, did not

[28] O J Eur Comm (No L 286) 23 (1978), Common Mkt Rep (CCH) ¶ 10,083

quash the Commission's decision because of an allegedly wrong statement of facts

Actually, right-hand drive Ford cars - few produced in Great Britain and most in Belgium and Germany - cost in Belgium 1,000 English Pounds less than in Great Britain [29]

In 1980, the former Deputy Assistant Attorney General Ky P Ewing said

> It is not for me to say what is the solution on the issue of territorial restraints in patent licenses in the context of EEC competition and integration policy But seeing the kind of price difference that apparently occurred in the *Maize Seed* case certainly indicates that national boundaries can still be a barrier to trade between the member states of the EEC, giving rise to significant anticompetitive effects That, of course, is a much different setting from ours in the United States where state boundaries seldom divide markets This means the EEC's different social, political and economic circumstances will have to govern your approach. A stricter rule than ours on territorial restraints may just be necessary to achieving your competition and integration objectives under the Treaty of Rome.[30]

b **The use of national laws of the Member states to split up the Common market—vertical market division**—In Europe the differences in the national laws of the member states can still be used to impose vertical market division and thus split up the Common Market into separate territorial submarkets which generally correspond to the territories of the member states. The United States Supreme Court was faced with a similar, less serious, situation between approximately 1825 and 1835

The Community's institutions (Commission, Council of Ministers and Court of Justice) try hard to overcome that situation but

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[29] Ford, O J Eur Comm (No L 256) 20 (1982), Common Mkt Rep (CCH) ¶ 10,419

[30] Address by K. Ewing, *Antitrust Enforcement and the Patent System. Similarities in the European and American Approach*, 11 IIC (1980)

with a different degree of vigour The Commission pushes market integration by applying the antitrust rules insofar as trade between member states has been hindered, the Commission has always been backed by the Court of Justice In addition, the latter has done even better by cutting down abuses of national laws on trademarks, patents, copyright, unfair competition, etc insofar as they were invoked to maintain separate territorial markets [31]

This kind of vertical market division is often maintained both by manufacturers and established retailers Both benefit from higher domestic consumer price levels, the retailer in having a higher selling price, the manufacturer in being less exposed to pressure from the retailer for price reductions, rebates, etc The maintenance of vertical market division agreements (exclusive distributorships) was in the past the main object of the Commission's antitrust activity The Commission has achieved good results, but the struggle is still going on, as the Maize Seed case shows [32] It is established law that a retailer may have a territory of primary responsibility where he will be the only one who represents the manufacturer's brand But he is also allowed to sell to customers from outside his territory if they contact him, thus Community antitrust law allows relative but not absolute vertical market division [33]

Actually the Commission is trying to achieve similar results for territorial patent licences though, for the sake of patent law, a higher degree of protection of the territory of the licensee is granted if he has taken some risks of investment to introduce this new technology in his market.[34] But as shown below, the antitrust

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[31] For a discussion of the struggle to achieve one Common Market against the traditional construction of industrial property and copyright, *see* H Johannes, INDUSTRIAL PROPERTY AND COPYRIGHT IN EUROPEAN COMMUNITY LAW (Leyden 1976)

[32] See Ford, O J Eur Comm (No L 256) 20 (1982), Common Mkt Rep (CCH) ¶ 10,419

[33] Regulation No 67/67 of the Commission of March 22, 1967 on the application of Article 85(3) of the Treaty to certain categories of exclusive dealing agreements, O J Eur Comm (No C 57) 849 (1967), *modified by* O J Eur Comm (No L 276) 15 (1972), Common Mkt Rep (CCH) ¶ 2727

[34] Proposal for a Commission Regulation on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements, O J Eur Comm (No C 58) 11 (1979) The two best American publications on this subject

analogy between clearly vertical distribution agreemeents and mostly horizontal patent licences should only be made with care

c. Resale price maintenance

> We have seen that vertical price fixing (resale price maintenance) [is] beneficial to consumers and should for that reason be completely lawful [35]

This is the most striking and most astonishing statement in Bork's book. Though it is consistent with his personal philisophy that only inter-brand competition is the goal of the antitrust laws and that intra-brand competition can be neglected, it is in blatant contradiction with economic reality.

Bork's legal arguments are not very convincing because he uses ironically a—perhaps wrongly decided—case of maximum resale price maintenance[36] to show how wrong the Supreme Court was in outlawing minimum resale price maintenance It is much more unsatisfactory that Bork, though always emphasizing economic arguments and consumer welfare, closes his eyes to those examples where resale price maintenance was allowed by statute and then forbidden either by repealing those statutes[37] or by court judgments

Despite the fact that inflation makes long term price comparison difficult, the repeal of a statute allowing resale price maintenance has led to a sharp decrease in the consumer price with a later stabilisation at a higher level which, with no exception, was always lower than the price fixed by the producer under the repealed statute One striking example can be given In 1971

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are Hayward, Patent Licensing in the EEC, 35 Bus Law 455 (1980) and Comment, *The Exhaustion of Industrial Property Rights in the EEC Exclusive Manufacturing and Sales Provisions in Paatent and Know-how Licensing Agreements*, 17 Colum J Transnat'l L. 313 (1978) A good European publication in the English language is Demaret, PATENTS, TERRITORIAL RESTRICTIONS, AND EEC LAW, a legal and economic analysis (1978) A good European publication in the English language is Demaret, Patents, Territorial Restrictions, and EEC Law, a Legal and Economic Analysis (1978)

[35] R Bork, *supra* note 21, at 297

[36] Kiefer-Stewart Co v Joseph E Seagram & Sons, Inc , 340 U S 211 (1951)

[37] France, Germany and Great Britain

German law expressly allowed resale price maintenance [38] For a long-playing record the usual maintained price was 20 German marks This price level was threatened by imports from France where records were cheaper, but for a long time German record producers succeeded in keeping those imports out by invoking their or their authors' copyrights On June 8 1971 the European Court of Justice forbade, under Community law, the exercise of copyright against the import of genuine records from one member state into another, i e from France to Germany [39] A few days later, the resale prices collapsed, in some cases down to 12 90 German marks, but some time after there was a tendency to sell at 14 90 German marks which, at the end of the year 1971 and for several years after, was the average price Thus, the abolition of the resale price maintenance led to a consumer benefit of about 25% [40] Despite inflation the average price level today, more than eleven years after the judgment, is still under 20 German marks, and varies between 16 and 18 German marks

It is worthwhile to mention that there was no substantial loss either to record producers or to record retailers, although the breakdown of the resale price system obliged producers to lower their selling prices for retailers who thus tried to compensate for their reduced margins In the long run consumers were willing to spend the same amount of money, or even more,[41] for records so that the turnover of the producers steadily increased But the consumer had five records for the previous price of four It is easy to judge where the consumer welfare is [42]

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[38] Section 16 of the German Statute Against Restrictions of Competition (GWB) was modified in 1973 so that resale price maintenance now remains lawful only for books and similar printed products for the purpose of keeping a greater number of book stores in business This goal goes beyond antitrust and must therefore be paid by the consumer with higher prices For the same cultural reason the French legislators recently reestablished resale price maintenance for books

[39] Deutsche Grammophon GmbH v Metro-SB-Grossmärkte GmbH & Co KG, 1971 E Comm Ct J Rep 487, Common Mkt Rep (CCH) ¶ 8106

[40] This was true with respect to LP pop-music records The prices of classical music records remained higher, but classical music represents only between 8 and 12 per cent of the record market

[41] In 1982 the turnover of all record producers in Germany is about two and a half times as high as it was in 1971

[42] The German Antitrust Division (Bundeskartellamt) can contribute dozens of similar cases

d. The consumer welfare theory—the three antitrust classes of the American society

> Exclusive adherence to a consumer welfare goal is superior in that it (1) gives fair warning, (2) places intensely political and legislative decisions in Congress instead of the courts, (3) maintains the integrity of the legislative process, (4) requires real rather than unreal economic distinctions, and (5) avoids arbitrary or anticonsumer rules [43]

Everyone should subscribe to those five points. But there might be controversy as to what are pro- or anticonsumer rules or what is a real and what is an unreal economic distinction As I have pointed out, it is not true

> that vertical price fixing (resale price maintenance), vertical market division (closed dealer territories), and, indeed, all vertical restraints are beneficial to consumers and should for that reason be completely lawful [44]

The first crucial point in Bork's philosophy is that everything which increases efficiency of the producer and serves the consumer by decreasing prices or increasing quality is good This is true, but who decides what is efficiency and what are consumer benefits? In my opinion, it would be wise to let the consumer decide it, and not a civil servant or a judge, nor a professor of law or economics Since the consumer cannot go shopping to the door of the producer, he needs the retailer. Who decides to which retailer he must or can go? The consumer should decide that himself, perhaps after having had good or bad experiences with the friendliness, the service, the after-sale service, the credit conditions, and—last but not least—the prices of certain retailers In Bork's view, since "closed dealer territories" should be completely lawful, it is the producer who decides which retailer is responsible for the consumer and not the consumer himself, and it is also the producer who decides what price the retailer should charge Of course, in the case of unsatisfactory service or

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[43] R Bork, *supra* note 21, at 81

[44] *See* H Johannes, *supra* note 31, at 297

price, the consumer can choose another brand But what happens when he has just bought or is about to buy a durable product (car, refrigerator, television set, or even a house) for which the retailer in Westchester does not provide adequate after-sales service, whereas the retailer in Long Island would so provide? One day, when the producer learns from the decreasing sales of that retailer that the consumers are not satisfied, he might fire him But this takes at least one, if not two or three years Who helps the consumer in the meantime?

Bork's consumer welfare theory in reality leaves the consumer in the lurch, it is not consumer—but producer—oriented, because it deprives the consumer of the choice of the retailer he wants, imposes on the consumer whichever retailer the producer wants and lets the producer dictate the prices of the bargain between retailer and consumer

The second crucial point is more fundamental Up to now I have understood the antitrust laws to be a guarantee of economic freedom, being in economic life the counterpart of constitutional rights To have in the United States no king in commercial matters as there is no king in constitutional matters was one of the basic concerns of Senator Sherman. This economic freedom is guaranteed by Bork's theory to producers, only to a lesser extent to consumers and not at all to retailers Under Bork's theory they do not enjoy any guarantee of economic freedom, they are the underdogs of antitrust, though the Constitution provides freedom for all Americans This theory splits the American society into three antitrust classes the producer at the top, the consumer in the middle and the retailer at the bottom

D The nine no-no's, Abbott Lipsky's approach and the European solutions

When the Commission published its draft on patent licensing it knew the no-no's but of course not the American critics of these no-no's; the critics all date from 1981 While there was a fertile discussion between officials of the Antitrust Division and the Commission in the second half of the seventies, this came to a

sudden end The officials in Brussels were completely surprised by the new American attitude, it seems to me that this attitude did not take into account the solutions reached in Europe, at least one cannot find any trace of them in the opinions and statements which I have quoted above

I shall deal with the nine no-no's individually I shall compare them with the corresponding European solutions and I shall compare the latter with the new Administration's position I can already give a preliminary result of that appraisal, the European solutions mostly lie between the no-no's and their critics The no-no's are, as a whole, too strict, but they are not as inaccurate as the new Administration claims The European solutions seem in almost all nine points to be more balanced than both American solutions

1. *The imprecise or even careless use of the term "vertical" in patent licensing*—Although Bork gave a clear definition of what he considers to be horizontal, vertical and conglomerate, above all the term "vertical" is used in respect to patent licensing not only imprecisely but even carelessly

In patent licensing clear-cut vertical restrictions are rare, most of them have at least substantial horizontal effects The independent private inventor grants of course a purely vertical licence But how many independent private inventors invent successfully? In the last three decades there may have been half a dozen in America and about the same number in Europe All the other major inventions have been made within more or less important companies

Of course a big company, for instance an oil refinery, may also invent a process or a product which could be used for the production of or as a pharmaceutical If this company is not engaged at all in the pharmaceutical business, its licence to a drug producer might also be qualified as vertical. But I have doubts whether this is still correct if it is not a drug, but a herbicide or a pesticide, because an oil refinery is at least a potential competitor in those fields where fertilizers are by-products I have even more doubts in qualifying a licence as vertical if an

American pharmaceutical company, doing no business at all in Europe, grants a licence to a European drug producer There exist in fact several dozen cases in which American drug producers acquired small or medium-sized European pharmaceutical companies This is always a practical possibility, and as long as such a possibility exists, the licence is at least potentially horizontal though initially intended to be vertical

In the often quoted and already famous *Maize Seed* case, the licence between the state-owned French research institute INRA, which by statute is not allowed to do business, and FRASEMA, a group of French agricultural cooperatives, was vertical The same was true for the licence between INRA and Mr Eisele, the first German licensee But from the moment when, in the licensing agreement between INRA-Eisele, the first was replaced by FRASEMA, the licence became purely horizontal because Eisele was a maize seed producer and FRASEMA was a group of maize seed producers

The experience of the services of the Commission shows that the overwhelming part of all patent licensing agreements is horizontal or has at least substantial horizontal effects This is the important difference between patents and copyrights While the independent inventor is the exception, the independent author is the rule Therefore, a patent licence is generally horizontal whereas a copyright licence between the author and his publisher is generally vertical

2 *The nine no-no's for patent licensing*

a. No-no number 1: tying arrangements

It is clear that it is unlawful to require a licensee to purchase unpatented materials from the licensor.

Lipsky says in his paper [45]

Thus, while it is conceivable that patent tie-ins might be

[45] Address by A Lipsky, *supra* note 15

> anticompetitive under peculiar [not particular!] conditions, a general rule prohibiting them is almost certainly counterproductive

and

> The policy reason one must find in fashioning antitrust-based prohibitions on licensing is that the practice restricts competition and worsens resource allocations

But does the obligation to purchase unpatented materials not exclude the materials of all other producers of such materials including the licensee's own production, thus restricting competition? And does that obligation not hinder the licensee from buying those materials where they are cheaper or from producing them more cheaply himself, thus worsening resource allocations?

The Commission's view[46] is that the following is lawful[47]

> the obligation on the part of the licensee to procure supplies of certain products or services from the licensor or from an undertaking[48] designated by the licensor, so far and so long as this obligation is indispensable in the interests of a technically unobjectionable exploitation of the invention

In American terms this means no per se rule, but a strict rule of reason Those three different opinions also have different consequences as to the burden of proof According to the first no-no, the obligation is unlawful per se In Lipsky's opinion the general rule should be that tie-ins are legal Therefore, the burden of proof for illegality lies on the party who claims that illegality, usually the licensee or an excluded potential seller In the European solution, the burden of proof is on the licensor

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[46] *See* Article 1 (5) of the draft on patent licensing, *supra* note 34, Vaessen-Moris, O J Eur Comm (No L 19) 32 (1979), Common Mkt. Rep (CCH) ¶ 10,107

[47] I deliberately use American terminology here Under Community law there is a theoretical difference between something being lawful because it is outside the scope of the antitrust rules or being lawful because it is covered by the rule of reason under Article 85(3)

[48] This is our official British English term, in American English one would use the word "enterprise"

b. No-no number 2: grant back and obligation to assign improvements

> [T]he Department views it as unlawful for a patentee to require a licensee to assign to the patentee any patent which may be issued to the licensee after the licensing arrangement is executed

In this context Lipsky says [49]

> Let me first discuss the practice in its most inoffensive form a licence between parties not otherwise in actual or potential competition, where the grantback is limited to improvements made possible by practice of the patent, and where the grantback is nonexclusive

As far as I understand, no-no number 2 uses the word "assign" so that the inventing licensee will lose the chance to exploit his own invention, no-no number 2 does not outlaw non-exclusive grant-back licences So the critics aim at something which in reality does not exist

The European solution has two aspects

First, the following is lawful [50]

> the obligation to pass on to the licensor any experience gained in working the invention and to grant back licences in respect of inventions relating to improvements and new applications of the original invention, provided that this obligation is non-exclusive and the licensor is bound by a like obligation

Second, the following is unlawful [51]

> the obligation on the part of the licensee to assign to the

---

49 Address by A Lipsky, *supra* note 15

50 Article 2(8) of the draft, *supra* note 34

51 Article 3(12) of the draft, *supra* note 34 Here I once more deliberately use American terminology Under Community law even this is not a per se rule, but the Commission will be very reluctant to admit that in such a specific case the rule of reason under Article 85(3) could be applied

> licensor rights in or rights to patents for improvements or new applications of the licensed patent,

May I add that the Commission is investigating a case in which 50% of the entire number of a licensor's economically exploitable patents were assigned to him by his licensees under this obligation.

c. No-no number 3: restrictions on a purchaser of the patented product on resale

> The Department believes it is unlawful to attempt to restrict a purchaser of a patented product in the resale of that product

There is no direct counterpart to this no-no in the Commission's opinion, except what is said in the recitals to the draft

> [The Regulation] does not apply to mere sales licences which are subject to the provisions of [the] Commission regulation on certain categories of exclusive dealing agreements

Therefore, I agree in this respect with Lipsky's view when he draws a parallel with other vertical practices

In Community law the rule of exhaustion of the patent right will apply if the patentee sells his patented product So the purchaser is free under the patent law to do whatever he likes with the purchased product But if he is a trader (wholesaler or retailer), he could be bound by an exclusive dealing agreement

Nevertheless, we have had one case in which the product was important and the market power of the patentee substantial and in which the patentee tried to exclude the exhaustion rule by contract So the purchaser was not allowed to sell to specific customers This, in my view, has nothing to do with vertical restrictions because it constitutes a customer allocation between the patentee and the purchaser I consider that to be unlawful under antitrust aspects and therefore, to this extent only, I support no-no number 3

d. No-no number 4: restrictions outside the scope of the patent

[A] patentee may not restrict his licensee's freedom to deal in the products or services not within the scope of the patent

Lipsky says [52]

> Let me first dispose of this last phrase 'I assume that in this context "products or services not within the scope of the patent" means products or services other than those subject to the patent So understood, the analysis of this practice should start with an attempt to determine whether the relationship between the patentee and licensee is vertical or horizontal Where the relationship is vertical, the analysis should proceed on the same basis as the analysis of vertical exclusive arrangements outside the patent field
>
> While the phrasing of this rule suggests strongly that it was fashioned with vertical practices in mind, I should at least mention that the practice could occur in a setting that portends horizontal impact While I have some difficulty imagining a case of this nature, I cannot rule it out, and will therefore leave this discussion with that tenuous caveat to the conclusion that the fourth no-no appears to have no general validity, at least with respect to the category of restraints to which it was apparently intended to apply

The Commission's view to that fourth no-no is as follows [53]

> without prejudice to [lawful exclusivity arrangements] restrictions on one or both parties as to uses of the licensed products going beyond the patent claims, particularly as regards the way in which and the customer to whom the products are to be sold [are unlawful]

Since exclusivity arrangements (so-called vertical arrangements) are excluded, this clause, contrary to Lipsky's view, is intended

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[52] Address by A Lipsky, *supra* note 15

[53] Article 3(8) of the draft, *supra* note 34

to apply to the allocation of customers which is clearly horizontal if the patentee reserves certain groups of customers for himself

e. No-no number 5: sole or exclusive licences and closed patent pools

> [T]he Department believes it to be unlawful for a patentee to agree with his licensee that he will not, without the licensee's consent, grant further licences to any other person

Here I share Lipsky's critical position because the fifth no-no outlaws all exclusive licence agreements, most of which the Commission tries to make lawful under its block exemption for patent licences But one should not forget that exclusivity is a right of the licensee and not of the licensor and this right is granted for a presumed promotion of the patented products Therefore, the Commission reserves its right to intervene if, after five years, the licensee has failed to exploit the invention,[54] and, in fact, the Commission has intervened in such a case,[55] after that intervention the licensee renounced his exclusivity

A specific case is worth mentioning in this context [56] A Dutch company filed a patent application for an allegedly new method of drilling drainage wells for horizontal structures such as roads, highways, pipelines, runways, etc It met the opposition of four competitors who alleged lack of novelty Afterwards all five agreed that the opposition should not be upheld and that the patentee should grant licences to those four competitors but to nobody else without the unanimous consent of all licensees The Commission declared this agreement unlawful [57]

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[54] Article 9(2) of the draft, *supra* note 34

[55] Commission, Eighth Report on Competition Policy ¶ 121 (1978)

[56] Heidemaatschappij/Bronbemaling, O J Eur Comm (No L 249) 27 (1975) Common Mkt Rep (CCH) ¶ 9776

[57] In American terms this would be fraud on the Patent Office by conspiracy It would be unlawful both under patent and antitrust laws

f. No-no number 6: package licensing

> [T]he Department believes that mandatory package licensing is an unlawful extension of the patent grant

Lipsky's position is the following [58]

> One licensee may be willing to pay more for patent A than for patent B, while for another licensee the reverse may be the case Even where all licensees value both patents identically, it would be costly to negotiate separate arrangements for each licence For these reasons, package licensing may allow the patentee to maximize the net return on both patents In any event, his return is necessarily limited to the maximum amount that he could extract lawfully in the world of perfect information and zero transaction costs Thus, the practice of package licensing ought not be subjected to any general prohibition on antitrust grounds

In my opinion this position does not mention the most interesting and most serious case in which the licensee does not need and does not want at all a licence for the second patent, but his need to have the first patent licensed is used as a leverage so that he is obliged to agree on a licence for the second patent

This problem is akin to that of tie-in and should therefore be decided in the same way In a tie-in the patentee uses his patent to oblige the licensee to purchase products outside the scope of the patent, in package licensing the patentee uses his first patent to oblige the licensee to pay royalties for something outside the scope of his first patent, i e for the second patent From the economic point of view there is no difference between the case in which the licensee must buy products he does not want or pay royalties for a licence he does not want Together with the position of the New Administration on tie-ins, that on package licensing is for me the most striking one Do they really want block booking to become a generally lawful way of promoting films?

In the Commission's view it is unlawful if[59]

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[58] Address by A Lipsky, *supra* note 15

[59] Article 3(14) of the draft, *supra* note 34

the licensor makes the granting of a licence for one or more patents dependent on the licensee's acceptance of other licences unwanted by the latter

g. No-no number 7: calculation of royalties

[T]he Department believes that it is unlawful for a patentee to insist, as a *condition* of the licence, that his licensee pay royalties in an amount not reasonably related to the licensee's sales of products covered by the patent—for example, royalties on the total sales of products of the general type covered by the licensed patent

This seventh no-no in fact is none; it does not establish a per se rule but contains a rule of reason in using the words "not *reasonably* related " In the Commission's opinion the following is unlawful [60]

the obligation on the part of the licensee to pay royalties

(a) on products covered neither wholly nor partly by the patent, or manufactured neither wholly nor partly by the patented process or by means of manufacturing processes or other know-how communicated under the licence,

(b) despite the fact that the licensed patent has ceased to be in force,

(c) after expiry of the last licensed patent,

(d) after manufacturing processes or other know-how communicated under the licence have entered into the public domain, unless entry into the public domain is attributable to some default on the part of the licensee, or of an undertaking that has economic connections with him,

without prejudice to any right of the licensor to receive appropriately reduced royalties where the licensing agreement continues in respect of patents or parts of patents that re-

[60] Article 3(4) of the draft, *supra* note 34

> main in force or of manufacturing processes or other know-how that have not entered into the public domain

All former ideas to outlaw generally any method of calculating royalties for each licensed patent separately or otherwise than by the turnover in the specific patented product have definitely been abandoned It seems to be that the future regulation will be even less strict than the aforementioned published draft On the other hand, the Commission will maintain its position as to knowhow having entered into the public domain, because it believes that the *Listerine doctrine*[61] is not consistent with *Brulotte v Thys Co* [62]

h. No-no number 8: restriction on an unpatented product manufactured with a patented process

> [I]t is pretty clearly unlawful for the owner of a process patent to attempt to place restrictions in his licensee's sales of products made by the use of the patented process

This point is outside the scope of European antitrust because in Europe, under national patent law and under the future Community Patent Covention,[63] products made under a patented process are covered by that patent There is even a presumption that the product has been manufactured with the patented process So if someone really has invented a new process for the same product he might be obliged, if he has not filed a patent application for that process before, to reveal it if he wants to avoid being liable for patent infringement

i. No-no number 9: restrictions on licensee's prices

> [T]he Department of Justice considers it unlawful for a patentee to require a licensee to adhere to any specified or minimum price with respect to the licensee's sale of the licensed products

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[61] Warner Lambert Pharmaceutical Co v John J Reynolds Inc , 178 F Supp 655 (S D N Y 1959), *aff'd*, 280 F 2d 197 (2d Cir 1960)

[62] 379 U S 29 (1964)

[63] O J Eur Comm (No L 17) (1976), 2 Common Mkt Rep (CCH) ¶ 5795

Lipsky once more advocates here a distinction based on whether the relationship between patentee and licensee is horizontal or vertical I have expressed above my doubts whether this distinction can be made so easily and that, according to the experiences of the services of the Commission, most patent licences are horizontal or have at least substantial horizontal effects

I deduct from Lipsky's paper that the new Administration, if it admits the horizontal structure, does not claim immunity from the antitrust laws under the *General Electric* doctrine[64] for price fixing in patent licences

The Commission's view corresponds to no-no number 9 [65]

> restrictions on one or both parties concerning prices, price components or rebates, or recommendations from one party to the other concerning any of such matters

3 *Final evaluation*—After my admittedly aggressive attempt to defend part of the nine no-no's of past Administrations against Lipsky's (who belongs to the new Administration) likewise aggressive attempt to bury them individually, I have to do justice to my honourable colleagues of the Antitrust Division by citing another voice from the Department of Justice In the above mentioned remarks by Roger B Andewelt, one reads [66]

> In fact, such a licence can produce horizontal anticompetitive effects in several ways. First, the grant of rights under a patent can dull the licensee's incentive to contest the validity of the patent When the licence places the licensee in an advantageous competitive position vis-à-vis certain of its unlicensed competitors, the licensee may prefer to have the patent in force rather than declared invalid This disincentive to contest the validity of the patent could be competitively important when it significantly decreases the

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[64] This was already established in 1902 in Bement v National Harrow Co , 186 U S 70 (1902), confirmed in United States v General Electric Co 272 U S 476 (1926) and again confirmed, by a 4 to 4 vote, in United States v Huck Mfg Co , 382 U S 197 (1965)

[65] Article 3(7) of the draft, *supra* note 34

[66] See *supra* note 16

likelihood that a particular patent will be challenged Both the patent and antitrust laws envision free and open competition in inventions that do not meet the statutory tests of patentability

If I understand this correctly, Andewelt asserts that the mere fact of licensing might be a disincentive to contest the validity of the patent This gives me the assurance that the new Administration will not offer its assistance to overrule *Lear v Adkins*[67] by trying to claim that non-challenge clauses should be scrutinized under the rule of reason when they are vertical

When I once tried to convince European lawyers that non-challenge clauses are anticompetitive—which is a difficult task because such clauses are expressly allowed by statute in Germany and by court tradition under the doctrine of estoppel in Great Britain—I was supported by a very well-informed patent lawyer who told us that non-challenge clauses are in fact only half the story There are companies in the United States and in Europe, he said, with very efficient patent departments If they find reasons to object to patent applications of other companies, they do not object before the Patent Office but before the applicant. For the price of a non-exclusive, but royalty-free licence they undertake tacitly not to raise objections against the grant of the patent

The lines which I quote from Andewelt's paper show that the Department of Justice is sensitive to those problems

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[67] 395 U S 653 (1969)

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May 16, 1988

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Mr Charles F. Rule
Assistant Attorney General
Antitrust Division
U S Department of Justice
Washington, DC 20534

Dear Mr. Rule

As a follow up to our recent hearing on H R 4086 and patent misuse. I wish to submit a set of additional questions. I look forward to receiving your response.

001010

Questions.

1 With respect to fraud and inequitable conduct in procuring or enforcement of a patent, should Congress define these terms? If so, how?

2 Is it fair to the inventor to punish him/her by denying patent protection because of the failure of a lawyer to submit "prior art" or to submit it in a timely fashion?

3 Has the Court of Appeals for the Federal Circuit given us clear set of nationally applicable precedent on either misuse or patent fraud?

4. Title 35 section 283 states that when enforcing a patent the court may grant injunctions in accordance with equity Isn't patent misuse really an example of inequitable conduct? For example, should a patentee who refuses to license blacks, be able to enforce a patent? Should a person who refuses to license an important technology (e g Vitamin D or sewage treatment) be allowed to enforce a patent?

5. Should a patent owner be permitted to "tie-in" the sale of a patented product with an unpatented product (e.g. canning machine and salt or computers and IBM punch cards) regardless of the market position of the patent owner?

6. If Congress were to pass a bill which merely states that a "tie-in" is not misuse unless the patent owner had market power, would this be a fair compromise? If we go in that

direction how should "market power" be defined (e g. in terms of patent claims or antitrust market demand)?

7. The Subcommittee recently received a letter from a former official of the European Economic Community (Harmut Johannes, who was responsible for intellectual property licensing and antitrust issues) that takes the view that despite the absence of an explicit "patent misuse" doctrine that patent licensing agreements are more carefully scrutinized as a result of European antitrust laws Do you agree? Isn't it fair to say that the presence or absence of a patent misuse doctrine in the United States is not relevant to international trade?

8 Professor Mansfield has established that patent protection is more important in some industry sectors (e.g. prescription drugs) than others Do you agree that some patents are more important than others in terms of market power or influence?

9 Does the Administration approach on misuse (either H R 1155 or S 1200) in effect overturn the result of numerous Supreme Court cases? If so, please provide the Committee with an explanation of the impact of your proposals on these cases (attached)?

10 Should we legislate greater freedom with respect to copyright trademark and trade secret licensing? If not, why not?

11. In your prepared testimony at p 7, you stated that "patent misuse has been applied as a per se doctrine " Could you provide the Subcommittee with case citations in support of that statement?

a. As an "equitable" doctrine, isn't patent misuse a concept that a court examines through a balancing of relevant factors bearing on the respective "equities" of the practice involved?

b How can such a "balancing processing" fit into the type of analysis generally connoted by the term a "per se" analysis?

1? Are you contending that in all instances "tying" practices associated with patent licensing are never a per se offense?

a. If so, could you cite Supreme Court case law for such an assertion?

13 Your interpretation of the term "unreasonably" as used in H R 4086 seems directed a placing a "rule of reason" antitrust test on licensing practices. Since some licensing practices may be per se illegal, wouldn't such a reading be an attempt to use H R 4086 as a vehicle for making a substantive change in the antitrust laws?

14 It has been suggested that patent infringement would not occur unless the patent owner enjoys market power with respect to the patented product and that the misuse defense, therefore, only arises where the patentee has actual market power Do you agree with this proposition?

15 The misuse defense affects the patentee rather harshly, it results in the complete destruction of a patent right until the misuse is purged Do you consider this more severe than treble damage awards for antitrust violations?

16 Robert Kline of Dupont and AIPLA has said that "[misuse] negatively affects virtually every license agreement involving technology developed or used in the U S " Do you agree?

17 What would be the practical effect of requiring proof of antitrust violation as a prerequisite to establishment of a misuse defense? Is misuse (with its mild penalty of temporary loss of enforceability of a patent, but no damages) a lessor included offense for antitrust violations (with treble damages)?

18 Please describe the licensing practices which courts have found to be "patent misuse" which would not meet the antitrust standard suggested by the Administration? Are all misuse practices aimed at prohibiting anti-competitive behavior?

19 Is the current caselaw relating to patent misuse a clearer statement of what is allowed and what is prohibited than the antitrust law provides?

20 Could you give us some examples of copyright misuse?

With warm regards,

Sincerely,

ROBERT W KASTENMEIER
Chairman
Subcommittee on Courts,
Civil Liberties and the
Administration of Justice

RWK dbv

Motion Pictures Patent Co v. Universal Film Mfg. Co., 243 U S 502 (1917);
Carbice Corp. v Am. Pat. Dev Corp , 283 U.S. 27 (1931);
Altoona Publix Theatres Inc., v. American Tri-Ergon Corp., 294 U.S. 477, 492 (1935);
Leitch Mfg Co v Barber Co , 302 U.S. 458 (1938);
Ethyl Gasoline Corp v U.S., 309 U.S. 436, 445 (1940);
Morton Salt Co., v. G.S. Suppiger Co., 314 U.S 488, 492-4 (1942);
B.B. Chemical Co , v. Ellis, 314 U.S. 495, 498 (1942);
Mercoid Corp v Mid-Continental Inv Co., 320 U.S. 661 (1944),
Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery, 324 U.S. 806, 818 (1945)(fraud case),
International Salt Co. v. United States, 322 U.S. 392 (1947);
Transparent - Wrap Machine Corp., v. Stokes - Smith, 329 U-S 637, 641 (1947);(misuse defense valid even though not an anti-trust violation)
Automatic Radio Mfr. v. Hazetine Research, Inc., 339 U.S. 827 (1950);
United States Gypsum Co. v. National Gypsum Co., 352 U.S. 457, 465 (1957);
Brulotte v. Thys, 379 U.S. 29 (1964);
Walker Food Process Equip , Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965)(fraud case);
Zenith Radio Corp v. Hazeltine Research, Inc., 395 U.S. 100, 140-41 (1969)(misuse does not establish an antitrust violation).

Statement By Thomas M. Susman

on Behalf of

Digital Equipment Corporation

to the

Subcommittee on Courts, Civil Liberties
and the Administration of Justice

of the

Committee on the Judiciary

House of Representatives

on H.R. 4086

Patent Licensing Reform Act of 1988

Legislation to clarify and reform the law of patent misuse (H R. 4086) is currently pending before the House Subcommittee on Courts, Civil Liberties and the Administration of Justice _ Digital Equipment Corporation believes that clarification and reform of the patent misuse doctrine would advance the enforcement of intellectual property rights and thus supports enactment of legislation on this subject during the 100th Congress.

With revenues last year of nearly $11.5 billion, Digital is the second largest computer company in the world and the leading supplier of networked computer systems Digital has over 121,000 employees worldwide and sales and manufacturing operations in over sixty countries, as well as in every state

One of the cornerstones of Digital's recent emergence as an industry leader has been the worldwide acceptance of its patented VAX computer family The computer architecture forming the heart of the VAX was reduced to the size of a microchip by Digital engineers in 1984, and the "MicroVAX" computer chip was the first 32-bit computer processor-on-a-chip registered under the Semiconductor Chip Protection Act The software associated with the VAX computer is protected by copyright, trademark, and trade secret law

Digital spends 11 cents of every dollar of revenue on research and development, totalling more than $1.3 billion last year It should thus come as little surprise that Digital is becoming increasingly sensitive to the need for greater rationality, predictability, and clarity regarding enforcement of intellectual property rights.

Like many intellectual property owners, Digital believes that current applications of the doctrine of patent misuse has a highly undesirable impact on the enforcement, development, and dissemination of intellectual property rights. Digital thus supports reform and clarification of the misuse doctrine The integrity of intellectual property and enforcement of intellectual property rights are essential elements of Digital's competitive success, as well as America's high technology future, yet these are imperiled by the currently ill-defined, over-harsh doctrine of patent misuse.

Patent misuse emerged prior to the enactment of the antitrust laws. It is a judicially created doctrine that bars a patent owner from enforcing patent rights in an infringement action on the basis that the patentee has engaged in conduct deemed by the court to constitute a "misuse" of the patent. In the early misuse cases, courts utilized the misuse doctrine to curb the anticompetitive practices of patent owners on the basis of equitable

considerations respecting the promotion of competition. *See, e.g., Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502 (1917). Despite the subsequent development of a substantial body of antitrust case law, however, courts continue to apply the misuse doctrine to regulate behavior challenged as anticompetitive without requiring an actual antitrust violation. As a result, practices involving intellectual property rights may be found to constitute misuse even though they have no demonstrable anticompetitive effect. *See, e.g., Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U S 100, 140-41 (1969).

As an initial matter, the practical implication of the current operation of the misuse doctrine is that it may condemn practices that are in fact procompetitive, while at the same time treating intellectual property rights more harshly than other kinds of economic assets. The misuse doctrine thus becomes particularly troublesome due to the increasingly widespread marketing and distribution of technologically interrelated products protected by intellectual property rights. High technology products, such as those offered by Digital, are often sold as part of integrated systems offering integrated solutions to problems The misuse doctrine overlooks the economically beneficial aspects of these selling arrangements by enabling courts to

invalidate the arrangement without evaluating the anticompetitive effects of the selling practice.

Many distribution arrangements involving intellectual property rights have procompetitive effects merely because someone other than the patentee gains access to the technology protected by the patent. A patent owner who lacks the resources to exploit fully a patent on his or her own may be able, through licensing agreements, to gain additional return on an investment in the patent while at the same time the general public benefits from the broader use of the patent. Licensing likewise provides essential opportunities for small entrants into high technology markets by enabling small firms or individuals to derive returns from patents that are comparable to those gained by large companies without licensing.

Certain distribution arrangements involving bundled products may also be procompetitive or, even if competitively neutral, may nonetheless be highly desirable for marketing technologically related products. Yet the misuse doctrine will prevent these types of arrangements solely where they involve patents, since manufacturers may be inhibited by potential application of the doctrine in a *per se* manner, without regard to purpose or justification.

Thus, the patent misuse doctrine unduly inhibits the willingness of patent owners to engage in practices that will

result in the efficient dissemination of their intellectual property rights and products embodying those rights to the public. As Robert P. Taylor of the American Bar Association Antitrust Section aptly observes:

> In many situations, the misuse doctrine in its present form forces the owner of new technology to choose between either not licensing at all or licensing under circumstances which place at risk the enforceability of his property and contractual rights to that technology. . . . It also means that creative and innovative licensing schemes are rarely if ever used, because any license provision that is even slightly questionable is likely to place the entire patent at risk whenever an enforcement proceeding is brought

Letter from Robert P Taylor to the Subcommittee on Patents, Copyrights and Trademarks of the Senate Committee on the Judiciary (May 11, 1987) (commenting on S. 1200).

Apart from its inhibiting effect on the dissemination of intellectual property to the public, the current operation of the misuse doctrine also undermines the integrity of intellectual property rights by denying patent owners swift and effective relief against infringement. Since the misuse defense, unlike antitrust analysis, rests on equitable considerations that are not necessarily amenable to advance identification, the misuse doctrine enables alleged infringers to routinely to assert in response to infringement claims that the patent owner is guilty of misuse. Thus, as a result of the availability of the misuse defense in its present form, the immediate obstacle facing nearly every

patent owner seeking to redress an alleged infringement is the cost of litigating yet one more issue in already complex litigation. Even more daunting is the prospect that a court might find that the patentee, who in fact may have acted reasonably and procompetively, is nonetheless guilty of misuse, thereby rendering the patent unenforceable.

Even if the misuse claim proves to be groundless, the delay in litigation caused by the allegation of patent misuse works to the detriment of the intellectual property owner and ultimately retards development of intellectual property. On the one hand, corporate resources are diverted toward costly and, in many instances, unnecessary litigation and away from vital research and development efforts. On the other, in an industry where research and development often consumes three, five, or ten years for a product whose competitive life cycle may be less than three years, protracted litigation may easily span the competitive life of the patent and destroy the patent owner's opportunity to recoup his investment. High technology companies such as Digital are becoming increasingly concerned that significant investments in research and development endeavors might yield rights in new products that prove costly to enforce or could be struck down by a court on competitive grounds but without regard to competitive import.

In light of the importance of the creation, dissemination, and protection of intellectual property to our economy, legislation was introduced in the 98th Congress (S. 1841, tit IV) to reform the patent misuse doctrine as part of the administration's proposed National Productivity and Innovation Act S 1841 would have required that certain specified conduct must constitute an antitrust violation in order to support a misuse defense to a patent infringement claim Hearings on S 1841 reflected support for Congressional reform of the doctrine, although concern was expressed over the bill's delineation of the specific practices that would not support a defense of patent misuse

In 1987, misuse legislation modelled after S 1841 was again considered by the Congress as part of the omnibus trade bill (S 635) During the Senate Subcommittee hearings on S. 635, a proposal was made to substitute for the bill's misuse provision the more generic, easily applied approach that had been recommended by the American Intellectual Property Lawyers Association ("AIPLA") in earlier testimony on S 1841. Chairman DeConcini adopted this recommendation in an original bill (S 1200, tit. II), which provided that the misuse defense would not be available with respect to licensing practices or actions or inactions relating to a patent unless such activities violate the antitrust laws S. 1200 cleared both the Judiciary Committee and the Senate

without dissent, and was recently reapproved by the Senate judiciary Committee as title II to S. 438, as amended.

While Digital supports the objective of reforming the misuse doctrine reflected in H/R. 4086, Digital prefers the approach set forth in S. 438. Most significantly, S. 438, unlike H.R. 4086, would uniformly require that patent misuse constitutes a defense in an infringement action only when an actual violation of the antitrust laws has been established. There are several important advantages to linking the patent misuse doctrine to the antitrust laws

First, this approach would enable the misuse doctrine to evolve and reflect changes in competitive practices as represented by the development of antitrust analysis. By contrast, the proposed codification of practices that will and will not constitute patent misuse as set forth in H.R. 4086 may prove static and thus be unable to respond adequately to changes in the competitive environment.

Second, since the practices deemed to constitute misuse under H.R. 4086 will preclude, for the most part, an analysis of the economic factors surrounding the challenged conduct, H.R. 4086 may prohibit conduct that is in fact procompetitive. In this regard, H.R. 4086 does not alleviate the most fundamental problem with respect to the current operation of the doctrine.

Finally, as compared to a misuse doctrine resting on imprecise equitable considerations, the antitrust laws and a hundred years of antitrust precedents provide more appropriate and definitive standards for measuring and condemning anticompetitive conduct. In 1982, the Seventh Circuit Court of Appeals correctly identified the problem inherent in utilizing the misuse doctrine to attempt to regulate the anticompetitive practices of patent owners.

> If misuse claims are not tested by conventional antitrust principles, by what principles shall they be tested? Our law is not rich in alternative concepts of monopolistic abuse; and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty.

USM Corp. v. SPS Technologies, Inc 694 F 2d 505, 512 (7th Cir 1982).

Some commentators question the Seventh Circuit's assertion that the absence of a cogent set of standards governing the application of the misuse doctrine creates uncertainty in our intellectual property laws. They suggest that courts have a clear understanding of the practices that will and will not support a defense of patent misuse and that, accordingly, the case law on misuse provides intellectual property owners with a relatively high degree of certainty respecting prohibited conduct. *See, e.g., Patent Licensing Reform Act of 1988: Hearings on H.R. 4086 Before*

the Subcommittee on Courts, Civil Liberties and the Administration of Justice of the House Committee on the Judiciary, 100th Cong., 2d Sess. 2-3 (May 11, 1988) [hereinafter *Patent Licensing Reform Hearings*] (prepared statement of Herbert F. Schwartz). Others, however, are quick to point out that because the misuse defense rests on equitable considerations, the doctrine is inherently incapable of definitive categorization For example, after identifying several practices that courts have found to constitute misuse, Professor Donald S Chisum cautions that.

> a wide variety of other patent sale and licensing practices have been scrutinized under the misuse doctrine and the antitrust laws. Since the courts have failed to adopt a general theory as to the proper limitations on the exploitation of the patent monopoly, it is necessary to assess a given practice in the light of precedent, custom and history, and the treatment of closely analogous practices.

4 D. Chisum, Patents § 19.104.3 (1987).

Some who argue against the propriety of linking the patent misuse doctrine to the antitrust laws also have suggested that the misuse doctrine serves as an important equitable tool in redressing various public policy considerations implicated by conduct which may not rise to the level of an antitrust violation. *See, e.g., Patent Licensing Reform Hearings* (prepared statement of Robert P Merges). While overlooking the fact that the misuse doctrine departs from traditional equitable principles by operating in

an essentially *per se* manner, they point to cases like *Vitamin Technologists v. Wisconsin Alumni Research Foundation*, 146 F.2d 941, 944-47 (9th Cir 1944), where the Ninth Circuit Court of Appeals utilized the misuse doctrine to invalidate a patent holder's refusal to license a process covering the production of vitamin D in margarine to ensure the availability of vitamin D to the poor. However, linking the misuse doctrine to the antitrust laws will not preclude courts from utilizing their broad equitable powers where matters such as public health, civil rights, or national security are concerned. In this regard, even a casual reading of the *Vitamin Technologists* decision reveals the Ninth Circuit's emphasis on its broad equitable powers with respect to the public health considerations implicated by the patentee's refusal to license its patent; in short, the patentee's conduct would have been invalidated on these grounds in the absence of the rather strained application of the misuse doctrine. Moreover, those commentators who support the availability of the misuse doctrine as an equitable tool concede that cases such as *Vitamin Technologists* occur very rarely; they thus implicitly recognize that the misuse doctrine is principally used to control purportedly anticompetitive behavior of patent owners.

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Digital believes that it makes little sense to resort to the misuse doctrine as an equitable tool to control solely the anticompetitive behavior of patent owners in the face of the substantial body of antitrust case law designed specifically to address this kind of conduct.

For the reasons discussed above, Digital strongly urges the Subcommittee to approve legislation along the lines of title II to S. 438, which will require an actual antitrust violation as a predicate to a finding of patent misuse. In addition to eliminating the disparaging treatment currently accorded intellectual property rights through the application of the misuse doctrine in its present form, this approach will clarify and bring predictability to the intellectual property laws and thereby enhance greatly the creation, development, and enforcement of intellectual property rights

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October 6, 1988

CONGRESS SHOULD REQUIRE A VIOLATION OF THE ANTITRUST LAWS BEFORE A TYING ARRANGEMENT IS CONDEMNED AS PATENT MISUSE

Legislative Background S 438 is presently pending before the Senate and will soon be considered by the House Title II of that bill would reform the patent misuse doctrine by providing that a patent owner shall not be guilty of misuse unless the challenged conduct violates the antitrust laws This proposal, first approved in 1987 by the Senate as S 1200 and incorporated in (but later dropped from) the Omnibus Trade Bill (H R 3), evolved from legislation initiated by the administration It has been endorsed by the American Intellectual Property Lawyers Association, the Computer and Business Equipment Manufacturers Association, and the American Bar Association House hearings were held before the Subcommittee on Courts, Civil Liberties and the Administration of Justice in May 1988

Two witnesses testifying before the Courts Subcommittee questioned whether a broad, generic reform of the misuse doctrine is necessary This memorandum focuses more narrowly on application of the misuse doctrine to tying arrangements

and concludes that if Congress determines not to address generically the issue of patent misuse reform, it should at least tailor legislation to reform application of the misuse doctrine as it is presently applied to tying arrangements

Tying and Misuse The conditioning of a sale of a patented product to the purchase of a separate product, judged under early patent law principles, was held to be legal in a number of early judicial decisions Henry v A B Dick, 224 U S 1 (1912) Only after Congress amended the Clayton Act, specifically proscribing anticompetitive tying arrangements in Section 3, did courts conclude that tie-ins involving patented products constituted patent misuse and deprived the patent owner of the right to enforce his patent Motion Picture Patents Co v Universal Film Mfg Co , 243 U S. 502 (1917) However, while plainly relying on the policy of the antitrust laws to find patent misuse in tying arrangements, courts nonetheless have refused to confine misuse to antitrust violations and now apply the doctrine to a variety of practices, including tying, without regard to competitive implications

Under the antitrust laws, tying may be per se illegal if the party accused of tying commands market power in the tying product's market Jefferson Parish Hosp Dist v Hyde, 466 U S 2 (1984). (This antitrust rule is often exacerbated by judicial application of a presumption of market power attributed to patents United States v Loew's, Inc., 371

U S 38 (1962) Title I of S 438 addresses this problem) But not all tie-ins are illegal under the antitrust laws they may be judged legal under a rule of reason standard if the defendant does not have market power, the products may be found to be "technologically" interrelated, or a court may uphold a "business justification" defense to a tying claim

Although a tie-in thus may not be condemned under the antitrust laws, it may be found to constitute misuse, rendering the patent unenforceable under the patent misuse doctrine

The misuse doctrine, in turn, is supposed to operate as an equitable doctrine -- in that it deprives the patent owner having "unclean hands" of the ability to obtain judicial enforcement of patent rights But as applied to tying, the misuse doctrine has evolved so that it most often works in a per se manner, foreclosing an evaluation of factors that courts of equity would otherwise consider

Proposals for Reform. Proposals legislatively to condemn per se application of the misuse doctrine date back to the 1966 Report of the President's Commission on the Patent System When first made, this proposal was opposed by the Department of Justice, only in 1983, as part of the administration's proposed National Productivity and Innovation Act, did the Justice Department formally support an antitrust-violation standard for patent misuse In 1987 the Senate finally approved a bill (S 1200) establishing

that no patent owner shall be guilty of misuse unless an antitrust violation has been found This identical provision is included in S 438, now pending before the Senate

While the Senate approach generically establishes an "antitrust standard" for a finding of patent misuse, Congressman Kastenmeier has introduced patent misuse reform legislation (H R 4086) that approaches the problem by establishing one list of actions to be deemed per se legal and another to be deemed per se illegal H R 4086 deals with tying by stating that misuse includes

> tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have market power

While the bill unnecessarily adopts a confusing and irrelevant "staple-nonstaple" distinction taken from contributory infringement cases and Section 271 of the Patent Act, this approach does recognize that market power should be an element of the misuse defense where tying is challenged

The generic "antitrust violation" approach to misuse (accepted by the Senate) would cover all areas where judicial application of the misuse doctrine has been unclear or erroneous This approach would reform the law relating to field-of-use restrictions, differential royalties, and other areas where judicial invocation of the misuse doctrine has been harshly criticized. At the same time, it should be emphasized that the Court of Appeals for the Federal Circuit, with plenary appellate court jurisdiction in patent cases,

has moved recently to clarify and unify the patent misuse doctrine generally under the umbrella of rule-of-reason antitrust principles Thus, in the Windsurfing case the Federal Circuit held

> To sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market

Windsurfing Int'l, Inc. v AMF, Inc., 782 F 2d 995, 1001-02 (Fed Cir 1986)(footnote omitted)

While this might well be the first step towards nationwide reform and clarification of the judicially created misuse doctrine, the Federal Circuit specifically recognized that it cannot apply the requirement that conduct "restrain competition unlawfully" where, as with tie-ins, the Supreme Court has held the arrangement anticompetitive per se

Tying Must be Addressed. Against this background Congress may well conclude that, for now, only the application of the misuse doctrine to tying is in need of immediate statutory reform This conclusion is supported by reference to the actual marketplace where tying issues most frequently arise the sale of high technology products as parts of integrated systems

High technology products may have life cycles of only 3-5 years, far shorter than the life of patent protection and often shorter than the life of a patent infringement action in which the misuse defense is raised Therefore, even if

antitrust principles generally applicable to tying, as well as the law applying misuse to tie-ins, is likely to evolve to an antitrust rule of reason standard, such an evolution will be unavailing for the present generation of high technology products on which America's internationally competitive technology industries are based

Should Congress decide only to take a more modest step and not address all practices constituting misuse, the target for reform should be application of the misuse doctrine to tying and to refusals to license patent rights (Any legislation that addresses patent tying must also address refusals to license patent rights, since it is often alleged that refusals to license are used to enforce tie-ins While the right to refuse to license a patent is supposed to be one of the patent owner's most basic rights, the status of this basic right in the courts is not as clear as it should be Congress should act to make this right clear in the context of reforming the law of patent misuse)

Proposed Statute. Two alternative approaches to reforming application of the patent misuse doctrine to tying arrangements are available The first would make possession by the patent owner of market power in the tying product market a predicate for a finding of misuse, the second would make an antitrust violation by the patent owner's tying arrangement a predicate for a finding of misuse

The antitrust approach is preferrable to the market power approach for the following reasons

1 The antitrust laws relating to tying are evolving, for example, in Hyde four Supreme Court justices favored rule-of-reason treatment for tying, while five -- one of whom is no longer on the Court -- favored the more traditional per se approach Moreover, the Court has granted certiorari in the Mercedes Benz case involving allegations of tying of automobile parts and has an opportunity to address at a minimum whether "business justification" is a defense to a tying claim To use the antitrust standard would mean that misuse law, which originated through the application of antitrust tying rules to patent enforcement cases, could evolve along with antitrust law

2 One purpose of S 438 is to provide a level playing field for patent owners -- that is, patented products should not be treated worse in the courtroom than nonpatented products (thus the thrust of title I to eliminate the presumption of market power adhering to patents) Using a market power standard for patent misuse undermines this objective For example, under present legal standards a party accused of tying may be found guilty of an antitrust violation even if he does not have market power if the plaintiff can show an adverse effect on competition (under the rule of reason) Yet with a market

power standard for tying, this antitrust violation would not constitute misuse' Likewise, should the Supreme Court retreat from the per se rule in tying cases, a party with market power may escape antitrust liability if the plaintiff cannot show an adverse effect on competition But he could lose his ability to enforce his patent through misuse Hardly a reform of misuse law

3 Misuse law has been criticized as an equitable doctrine applied through per se rules The use of a market-power standard simply substitutes one inflexible rule for another, since it would constitute misuse to effect a tie-in with market power, despite the absence of any harmful effect in the marketplace or the presence of a substantial business justification

4. It will be difficult and dangerous to define "market power" in the context of this legislation The term has widespread application in antitrust litigation and no standard definition Likewise, it will be equally problematic to indicate the amount of market power needed to support misuse Consider the following observation of Landes and Posner·

> A finding of monopolization in violation of section 2 of the Sherman Act requires an initial determination that the defendant has monopoly power -- a high degree of market power A lesser but still significant market power requirement is imposed in attempted-monopolization cases under section 2. Section 7 of the Clayton Act also requires proof of market power, in fact, the main purpose of section 7 is to limit mergers that increase market power There is increasing

> authority that proof of market power is also required in Rule of Reason cases under section 1 of the Sherman Act Issues of market power arise even in cases involving per se rules of illegality Proof of some market power (though perhaps little) is required in a tie-in case, and in a private price-fixing case, proof of effect on prices (i e , proof of the exercise of market power), while unnecessary to establish liability, is necessary to establish damages

Landes & Posner, "Market Power in Antitrust Cases," 94 Harvard L Rev 937 (1981) (footnotes omitted) In this context, what is the nature and level of market power needed to support a finding of patent misuse?

5 Finally, and perhaps most importantly, is the already close relationship between antitrust principles and patent misuse applied to tying arrangements the latter plainly evolved from the former after enactment of section 3 of the Clayton Act It could be argued that antitrust principles have little to do with, for example, post-expiration royalties and other areas where the misuse doctrine has been applied, that cannot be said for tying Perhaps post-expiration royalties have always been "beyond the scope of the patent," but -- before 1917 -- tying did not constitute misuse and there is no inherent reason (outside the influence of antitrust thinking) that it should now Thus use of the antitrust standard for applying the misuse doctrine to tying merely returns the law to where it should have been before courts took the misuse doctrine beyond logic

For these reasons Congress should resist using a "market power" test for patent misuse where tying is implicated and, instead, utilize the "antitrust violation" standard proposed for misuse generally in S 438

One critique of the antitrust-standard approach has been offered A court that finds itself uncomfortable with a challenged tying arrangement might too readily conclude that an antitrust violation has occurred in order to avoid enforcing the patent in issue It should quickly be noted that there is no evidence supporting this contention, nor is it necessarily intuitive Moreover, rendering a patent unenforceable through a misuse finding is, for the patent owner, not likely to be welcomed as a lesser included offense, especially where the arrangement challenged may be specifically found to have no unreasonable anticompetitive effect

Staple-Nonstaple Distinction H R 4086 proposes that tying the "sale of a patented product to an unpatented staple" constitutes misuse except if the patent owner does not have market power This staple-nonstaple distinction has its origins in contributory infringement cases and section 271 of the patent laws It plays a role in balancing misuse and contributory infringement because, when Congress in 1952 enabled patent owners to redress contributory infringement, it made clear that the patent owners could do (without misusing the patent) that which

they could prevent others from doing This distinction is not relevant to the broader issue of patent misuse. Three other reasons militate against incorporating this staple-nonstaple distinction into the present legislation·

First, there is no affirmative public policy to be served by the distinction It will not benefit consumers, it will not promote competition. Its application will, however, tend to complicate patent litigation and confuse courts (it is perhaps not coincidental that a leading article on the subject is entitled "Contributory Infringement/Patent Misuse· Metaphysics and Metamorphosis," 44 Univ Pitts L Rev 73 (1984)) Introducing this distinction into legislation designed to simplify litigation and clarify rights would be ironic, since it would accomplish the opposite

Second, the provision would leave unclear whether it is misuse or not if a patented product is tied to a nonstaple where the patent owner <u>has</u> market power (That is, saying that "X = misuse unless Y" does not tell us whether "Z = misuse if Y ") Again, if this is something for the courts to work out, then the legislation will not have served a principal purpose

Third, incorporating the staple-nonstaple distinction might actually have perverse consequences from a competitive perspective As one author observes.

> From a competitive perspective, there is no difference between a tie to a nonpatented staple

> and a tie to a nonpatented nonstaple, the latter practice having been expressly sanctioned in Dawson Chemical Co. v Rohn & Haas Co. as a "lawful adjunct" of the patentee's rights The staple is, by definition, capable of "substantial, noninfringing use," however, whereas the tie to a nonstaple may entirely foreclose competition in the market for the nonstaple component of the patented item
>
> It is not clear, beyond the obvious [citing 35 U S C § 271], why a tie to a nonstaple which could eliminate an entire market, is within the patentee's rights, while a tie to a staple that would restrain competition in the tied product's market to a potentially negligible extent is not

Note, "Giving the Patent Owner His Due Recent Developments in the Antitrust/Patent Misuse Interface," 12 Delaware J Corp L 135 (1987) (footnotes omitted)

Proposed Statutory Language Should the Senate's broader approach to misuse reform be rejected, the following language would appropriately narrow the bill's focus to tying arrangements

> Subsection 271(d) of title 35, United States Code, is amended by deleting the period at the end thereof and adding the following --
>
> "refused to license any rights to his patent, (5) conditioned the license of any rights to his patent or the sale of the patented product on the acquisition of a license to rights in another patent or on the purchase of a separate product, unless such conduct, in view of the circumstances in which it was employed, constitutes a restraint of trade or tends to create a monopoly in violation of the antitrust laws of the United States "

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September 28, 1988

David Beier
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Re Patent Misuse

Dear Dave

We are, of course, hard at work to get S 438 approved by the Senate and sent over to your side Michael has also called to arrange an appointment with Congressman Kastenmeier Finally, I am in the process of trying to respond to Jon Yarowsky's concerns by developing alterative ways of dealing with them either through legislative history or, God forbid, amendment to Title I of the bill

That leaves us to work through responding to your substantive concerns on Title II

I will lead with what you have heard all too often There is no need for a "black list" of conduct constituting *per se* misuse, the antitrust standard is a flexible and workable one, field-of-use restrictions and differential royalties and other such conduct erroneously considered misuse in the past should be subjected to the antitrust standard, as well as should tying Having said this, I quickly add that I know your view that, putting it most favorably, if any case has been made for misuse reform it applies only to tying arrangements (or, at least, the best case has been made in this area)

With this in mind, I offer the enclosed memorandum designed to provide support for your conclusion and to propose legislative language to implement it At least this

should help focus the discussion and spur whatever drafting may be needed for resolution

You will quickly note that I have intentionally eschewed any reference to or standard involving the staple-nonstaple distinction The history of tying under the patent laws does not implicate contributory infringement, and the 1952 amendments may be seen as a trade-off between contributory infringement and a very narrow arena of misuse, but not misuse generally My conclusions have been reinforced through a painful education process, most recently involving reading A S Oddi's article in the *Pittsburgh Law Review* appropriately entitled "Contributory Infringement/Patent Misuse Metaphysics and Metamorphosis," which I do not recommend'

Will you give me a call after you have read the enclosed so that we can move to get the technical drafting issues under control? I am all to mindful of the end-of-session countdown

Sincerely,

Thomas M Susman

Enclosure

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APPLICATION OF THE PATENT MISUSE DOCTRINE TO TYING ARRANGEMENTS REQUIRES LEGISLATIVE REFORM

Legislative Background. The Senate Judiciary Committee has approved S 438, soon to be considered by the House Title II of that bill would reform the patent misuse doctrine by providing that a patent owner shall not be guilty of misuse unless the challenged conduct violates the antitrust laws This proposal, first approved in 1987 by the Senate as S 1200 and incorporated in (but later dropped from) the Omnibus Trade Bill, evolved from legislation initiated by the administration, and has been endorsed by the American Intellectual Property Lawyers Association and the American Bar Association House hearings were held before the Courts Subcommittee in May 1988

Some witnesses testifying before the Courts Subcommittee questioned whether a broad, generic reform of the misuse doctrine is needed This memorandum focuses on application of the misuse doctrine to tying arrangements and concludes that, should Congress decide not to address broadly the issue of patent misuse reform, it should in the least tailor

legislation to reform application of the doctrine as applied to tying

Tying and Misuse The conditioning of a sale of a patented product to the purchase of a separate product, judged under early patent law principles, was held to be legal in a number of judicial decisions Henry v A B Dick, 224 U S 1 (1912) Only after Congress amended the Clayton Act, specifically proscribing anticompetitive tying arrangements in Section 3, did courts conclude that tie-ins involving patented products -- even where no antitrust violation was found -- constituted patent misuse and deprived the patent owner of the right to enforce his patent Motion Picture Patents Co v Universal Film Mfg Co , 243 U S 502 (1917) Therefore, while plainly relying on the policy of the antitrust laws to find patent misuse in tying arrangements, courts nonetheless have refused to confine misuse to antitrust violations

Under the antitrust laws, tying may be per se illegal if the party accused of tying commands market power in the tying product's market Jefferson Parish Hosp Dist v Hyde, 466 U S 2 (1984) (This antitrust rule is often exacerbated by judicial application of a presumption of market power attributed to patents United States v Loew's, Inc , 371 U S 38 (1962) Title I of S 438 addresses this problem) Under the antitrust laws, however, all tie-ins are not illegal they may be judged legal under a rule of reason

standard if the defendant does not have market power, the products may be found to be "technologically" interrelated, or a court may uphold a "business justification" defense to a tying claim

Although a tie-in may thus not be condemned under the antitrust laws, it may render a patent unenforceable under the patent misuse doctrine The misuse doctrine, in turn, is supposed to operate as an equitable doctrine -- in that it deprives the patent owner having "unclean hands" of the ability to obtain judicial enforcement of patent rights But as applied to tying, the misuse doctrine works in a per se manner, foreclosing an evaluation of factors that courts of equity would otherwise consider

Road to Reform Proposals legislatively to condemn per se application of the misuse doctrine date back to the 1966 Report of the President's Commission on the Patent System When first introduced, this proposal was opposed by the Department of Justice, only in 1983, as part of the administration's proposed National Productivity and Innovation Act, did the Justice Department formally support an antitrust approach to patent misuse Finally, in 1987, the Senate approved a bill (S 1200) establishing that no patent owner shall be guilty of misuse unless an antitrust violation has been found This identical provision is included in S 438, recently approved by the Senate Judiciary Committee

While the Senate approach generically establishes an "antitrust standard" for a finding of patent misuse, Congressman Kastenmeier's misuse bill (H R 4086) approaches the problem by establishing one list of actions to be deemed per se legal and another to be deemed per se illegal H R 4086 deals with tying by stating that misuse includes

> tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have market power

Thus, although unnecessarily adopting the confusing and, for antitrust purposes, irrelevant "staple-nonstaple" distinction of contributory infringement cases and Section 271 of the Patent Act, this approach does recognize that market power should be an element of the misuse defense where tying is challenged

The generic "antitrust violation" approach to misuse (adopted by the Senate) would cover all areas where judicial application of the misuse doctrine has been unclear or erroneous This approach would reform the law relating to field-of-use restrictions, differential royalties, and other areas where judicial invocation of the misuse doctrine has been harshly criticized At the same time, it should be emphasized that the Court of Appeals for the Federal Circuit, with plenary appellate court jurisdiction in patent cases, has moved recently to clarify and unify the patent misuse

doctrine generally under the umbrella of rule-of-reason antitrust principles Thus, in the Windsurfing case the Federal Circuit held

> To sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market

Windsurfing Int'l, Inc v AMF, Inc , 782 F 2d 995, 1001-02 (Fed Cir 1986)(footnote omitted)

While this might well be the first step towards nationwide reform and clarification of the judicially created misuse doctrine, the Federal Circuit specifically recognized that it cannot apply the requirement that conduct "restrain competition" where, as with tie-ins, the Supreme Court has held the arrangement anticompetitive per se

Tying Must be Addressed Against this background Congress may well conclude that, for now, only the application of the misuse doctrine to tying is in need of statutory reform This conclusion is supported by reference to the actual marketplace where tying issues most frequently arise the sale of high technology products as parts of integrated systems

High technology products may have life cycles of only

3-5 years, far shorter than the life of patent protection and often shorter than the life of a patent infringement action in which the misuse defense is raised Therefore, even if antitrust principles generally applicable to tying, as well as the law applying misuse to tie-ins, is likely to evolve to an antitrust rule of reason standard, such an evolution will be unavailing for the present generation of high technology products on which America's internationally competitive technology industries are based

Should Congress decide only to take a more tentative and modest step than proposed by the Senate misuse legislation, the target for reform should be application of the misuse doctrine to tying and to refusals to license patent rights Any legislation that addresses patent tying must also address refusals to license patent rights, since it is often alleged that refusals to license are used to enforce tie-ins While the right to refuse to license a patent is supposed to be one of the patent owner's most basic rights, the status of this basic right in the courts is not as clear as it should be Congress should act to make this right clear in the context of refining the law of patent misuse

Proposed Statute Two alternative approaches to reforming application of the patent misuse doctrine to tying arrangements are available The first would make possession by the patent owner of market power in the tying product market a predicate for a finding of misuse, the second would

make an antitrust violation by the patent owner's tying arrangement a predicate for a misuse finding

Four arguments favor the second approach The first is the flexibility inherent in utilizing an antitrust standard as antitrust theory and economic analysis relating to tying arrangements evolve, so will the law of patent misuse That the law of patent misuse should be allowed to evolve is perhaps best underscored by the contributions of the Federal Circuit to this area, in this respect, the legislation may be seen as allowing continued evolution, not impeding it The second argument relates to creating a level field for competition among producers Application of the misuse doctrine should not put a patent owner at a disadvantage to another selling an unpatented product, the antitrust standard should be applicable to both

The third argument relates to the potential danger of using "market power" -- an undefined and inconsistently applied term -- as the critical element of the misuse standard In the least, the statute would have to require "substantial market power" to insure that condemnation of the patent-related tying arrangement is warranted on public policy grounds Fourth, and finally, antitrust principles appear increasingly to accommodate business justifications for tying, this important defense would be lost if the misuse standard focused solely on market power

One critique of this antitrust-standard approach has been offered A court that finds itself uncomfortable with a challenged tying arrangement might too readily conclude that an antitrust violation has occurred in order to avoid enforcing the patent in issue It should quickly be noted that there is no evidence supporting this contention, nor is it particularly intuitive Moreover, rendering a patent unenforceable through a misuse finding is, for the patent owner, not likely to be welcomed as a lesser included offense, especially where the arrangement challenged may be specifically found to have no unreasonably anticompetitive effect

Should the Senate's broader approach to misuse reform be rejected, the following language would appropriately narrow the bill's focus to tying arrangements

> Subsection 271(d) of title 35, United States Code, is amended by deleting the period at the end thereof and adding the following --
>
> "refused to license any rights to his patent, (5) conditioned the license of any rights to his patent or the sale of the patented product on the acquisition of a license to rights in another patent or on the purchase of a separate product, unless such conduct, in view of the circumstances in which it was employed, constitutes a restraint of trade or tends to create a monopoly in violation of the antitrust laws of the United States "

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THE NEED FOR LEGISLATIVE REFORM OF THE LAW OF PATENT MISUSE

Pending before Congress are proposals to clarify application of the patent misuse doctrine Legislation proposed by the administration would require that certain conduct alleged adversely to affect competition must constitute an antitrust violation in order to support a misuse defense to a patent infringement action (S 635, § 115, H R 1603, § 107)

The subject of patent misuse is not new to Congress Legislation introduced in the 98th Congress (S 1841, H R 5041) addressed the need for reform of the law of patent misuse through provisions similar to those currently under consideration Hearings were conducted before the Senate Subcommittee on Patents, Copyrights and Trademarks of the Senate Committee on the Judiciary The testimony received at these hearings was overwhelmingly in favor of the proposed reform of the law of patent misuse, however, the provisions for reform of patent misuse law before the 98th Congress were never acted on by the Subcommittee

This memorandum describes the origins of the law of patent misuse and the misconceptions upon which current law is based It argues that the hearings before the 98th Congress have conclusively established the need for reform and urges that Congress act promptly, without further delay, to implement the proposals for reform currently before Congress

I Origin and Development of the Doctrine of Patent Misuse

Patent misuse is a judicially created doctrine that allows a patent owner's overextension of his patent rights to be asserted as a defense in an action by the patent owner to enforce the patent If the patent owner is held to have overextended, or "misused," his patent rights, he will be barred from enforcing the patent so long as the misuse continues Morton Salt Co v G S Suppiger Co , 314 U S 488 (1942)

The doctrine of patent misuse originally emerged as a judicial response to the patent owner's practice of conditioning the sale or license of patented inventions upon the purchase or license of additional products This practice was at first approved by courts, including the United States Supreme Court In Henry v A B Dick Co , 224 U S 1 (1912), the Court upheld a patent owner's practice of requiring, as a condition to sale of a patented invention (mimeograph machine), that the invention be used only with certain supplies (ink) provided by the patent owner

By 1917, however, the Court's attitude had changed Citing the enactment of Section 3 of the Clayton Act as evidence that such conditional sales were against public policy, the Court held that the conditions to the sale were unenforceable regardless of whether they violated the Clayton Act In Motion Picture Patents Co v Universal Film Manufacturing Co , 243 U S 502 (1917), the owner of a patent for a film feeder used in the projection of motion pictures sought to license the feeder on the condition that the licensee show only films leased from persons approved by the patent owner The patented film feeder was dramatically superior to other film feeders on the market, giving the patent owner significant market power The Court refused to enforce the patent, finding that imposing the condition would extend the patent owner's power beyond the scope of his patent rights Id at 518

Cases following Motion Picture Patents continued to expand the doctrine of patent misuse In Morton Salt Co v G S Suppiger Co , 314 U S 488 (1942), in which the term "patent misuse" appears for the first time, the United States Supreme Court held that the defense was available even to a person who knowingly infringed a valid patent and was not affected by the conduct held to be misuse The patent owner in Morton Salt had licensed its patented salt machine upon the condition that the licensee use the machine with salt tablets purchased from the patent owner The Court held that this use of the patent exceeded the limited grant of the Patent Act, that the patent owner had misused the patent, and was therefore entitled to the protection of the Act 314 U S at 491 The Court found it unnecessary to determine whether the patent owner's action had violated the antitrust law 314 U S at 494

In Morton Salt, as in Motion Picture Patents, the Court ignored the antitrust issues presented and based its decision on public policy grounds From this origin courts have developed the well-known principle that a claim of patent misuse need not be supported by a showing of violation of the antitrust laws, but only by a showing of some anticompetitive effect See, e g , Zenith Radio Corp

v Hazeltine Research, Inc , 395 U S 100, 140-41 (1969), Duplan Corp v Deering Milliken, Inc , 444 F Supp 648 (D S C 1977), aff'd in relevant part, 594 F 2d 979 (4th Cir 1979) In most courts, the Morton Salt principles, interpreted as they were in Zenith Radio and Duplan, remain the established law of patent misuse See Section of Antitrust Law of the American Bar Association, Antitrust Law Developments (2d) 488-89 (1984), and cases cited therein

Recently, however, the Seventh Circuit cast doubt upon the reasoning of Motion Picture Patents, Morton Salt, and the line of cases following these decisions In USM Corporation v SPS Technologies, Inc , 694 F 2d 505 (7th Cir 1982), cert denied, 462 U S 1107 (1983), the Seventh Circuit Court of Appeals, in dicta, questioned whether the reasoning of Motion Picture Patents accurately characterized the economic effect of practices held to constitute patent misuse At issue in USM Corporation was whether the inclusion of a differential royalty schedule in a license agreement constitutes patent misuse Citing the facts of several prior findings of patent misuse, including Brulotte v Thys Co , 379 U S 29 (1964) (patent license extending license fees beyond license period), Zenith Radio Corp v Hazeltine Research, Inc , 395 U S 100, 133-40 (1969) (patent royalties measured by the sale of unpatented products containing the patented item), and Stewart v Mo-Trim, Inc , 192 U S P Q 410 (S D Ohio 1975) (licensees required not to make items competing with the patented item), Judge Posner noted that

> As an original matter one might question whether any of these practices really "extends" the patent The patentee who insists on limiting the freedom of his purchaser or licensee will have to compensate the purchaser for the restriction by charging a lower price for the use of the patent True, a tie-in can be a method of price discrimation It enables the patent owner to vary the amount he charges for the use of the patent by the intensity of each user's demand for the patent But since there is no principle that patent owners may not engage in price discrimination, it is unclear why one form of discrimination, the tie-in, alone is forbidden

Id at 510-11

In addition, the USM Corporation court questioned the appropriateness of the low showing of anticompetitive effect required to establish patent misuse Arguing that patent misuse claims should be tested under standard antitrust principles, the court stated that, "Our law is not rich in alternative concepts of monopolistic abuse and it is rather

late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty " Id at 512

II The Misconceptions Embodied in Current Patent Misuse Doctrine Require Correction and Clarification

The evolution of the patent misuse doctrine from A B Dick through Motion Picture Patents to USM Corporation shows the ascent and potential decline of a doctrine that is based on faulty legal and economic principles and is inconsistent with the effect it is intended to achieve The patent misuse doctrine as first enunciated in Motion Picture Patents was based upon the Supreme Court's misinterpretation of the public policy implications of Section 3 of the Clayton Act and its failure to apply the newly enacted antitrust law Later cases perpetuated these errors, especially in accepting the rule that conduct insufficient to constitute a violation of the antitrust laws can support a claim of patent misuse And underlying the development of the doctrine was the faulty assumption that sale or licensing agreements linking patented to unpatented products necessarily had an anticompetitive and undesirable effect

As discussed above, early cases dealing with the "tying" of patented and unpatented goods were favorable to these arrangements The Supreme Court stated that if the right of the patent owner to do so was to be limited, that limitation should be achieved through legislative, rather than judicial, enactment 224 U S at 35.

The Congress did, in fact, address the A B Dick situation of a patent owner's requiring his licensees to buy additional products from the patent owner as a condition to the license agreement Section 3 of the Clayton Act was intended to address the "precise evil" presented in A B Dick See 51 Cong Rec 15, 937 (1914) (Senator Nelson) Section 3 of the Clayton Act, 15 U S C § 14 (1982), provides that it is unlawful to lease or sell

> goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented on the condition that the lessee or purchaser thereof shall not use or deal in the goods of a competitor or competitors of the lessor or seller, where the effect of such condition may be to substantially lessen competion or tend to create a monopoly in any line of commerce (Emphasis added)

The language of Section 3 is unambiguous the specified conduct is to be unlawful only when that conduct has a substantial anticompetitive effect Legislative history

shows that the anticompetitive effect required for violation of Section 3 was intended to be equal to that required for violation of the Sherman Act See Comment, Standard Antitrust Analysis and the Doctrine of Patent Misuse, 46 U Pitt L Rev 209, 219-20 (1984) However, the Supreme Court, in interpreting Section 3 as an indication of "public policy," relied only on the general prohibition and ignored the limitation of that prohibition to actions with substantial, antitrust-type anticompetitive effect

The Supreme Court plainly borrowed selectively from Section 3 of the Clayton Act in formulating the public policy rationale of Motion Picture Patents and Morton Salt In doing so, the Court created a doctrine that is inconsistent with the standard for liability under the antitrust laws and that treats patent owners more harshly than was intended by the legislation upon which the Court relied in creating the doctrine

The law of patent misuse, as developed from these early cases, is essentially a per se rule In Morton Salt the patent owner's license of its patented machine on the condition that the licensee purchase supplies for use with the machine was not shown to have any specific anticompetitive effect Rather, the practice was held to be invalid on grounds of public policy In Laitram Corp v King Crab Inc , 244 F Supp 9, modification den , 245 F Supp 1019 (D Alaska 1965), a patent owner's license of West Coast licensees at a rate different than that charged Gulf area licensees was similarly found to be patent misuse without a showing of any anticompetitive effect In both Morton Salt and Laitram Corp , the court inferred anticompetitive effect from the challenged licensing practice Yet, these practices could in fact have had a procompetitive effect The practice held invalid in Morton Salt could have encouraged competition by linking the price charged for the patented machine directly to the amount of use it received by each licensee Receipt of higher royalties from large-scale users could allow the patent owner to demand lower royalties from small-scale users, thereby increasing the availability of the patent on the market Similarly, in Laitram Corp, the patented device, a shrimp peeler, was more valuable to the West Coast licensees than to the Gulf licensees due to the difference in size between Western and Gulf shrimp (Western shrimp are much smaller) The different royalties merely recognized the greater value of the device to the West Coast licensees and at the same time allowed the device to be made available to a greater number of licensees than it would have been at a median price

These decisions finding patent misuse in the absence of a showing of conduct violative of the antitrust laws may themselves thus be anticompetitive the low standard for finding patent misuse and the harshness of the penalty for such misuse -- unenforceability of the patent -- can discourage patent owners from licensing their patents Because many patent owners do not themselves have the resources to exploit their patents to full potential, this will hinder the development of new technology and reduce its potential contributions to society at large

III The History of Patent Misuse in Congress

The topic of patent misuse is not new to Congress Legislation for reform of the law of patent misuse was introduced in the 98th Congress as title IV, "Patent and Copyright Misuse," of S 1841 Hearings on S 1841 revealed extensive support for the proposed revision of patent and copyright law to provide that certain licensing and other practices should not be held to constitute misuse unless that conduct violates the antitrust laws S 1841, tit IV, § 401(d) Testimony submitted by John C Dorfman, Chairman of the American Bar Association Section on Patent, Trademark, and Copyright Law, supported proposed title IV on behalf of the ABA Mr Dorfman noted that the subject matter of title IV had been "of grave concern to the Association for a least some thirty years," citing the Association's 1967 resolution approving, in principle, legislation for the reform of patent misuse Patent Law Improvements Act, Hearing on S 1535 and S 1841 before the Subcomm on Patents, Copyrights and Trademarks of the Senate Comm on the Judiciary, 98th Cong 2d Sess 105 (1984) [hereinafter cited as "Hearing"] Testimony and statements by Donald W Banner, President of Intellectual Property Owners, Inc , Bernarr R Pravel, President, American Intellectual Property Law Association, and John W Schlicher, Esq , Townsend & Townsend, also supported enactment of title IV Their testimony asserted that the proposed reform would "add predictability to the law governing licensing practices" and "eliminate a hodgepodge of arbitrary rules developed by courts during the era when court were hostile to licensing," (testimony of D Banner, Hearing at 44, 52), that the proposed modifications were "necessary elements of the Act's overall purpose of encourgaging intellectual property licensing," and that "[i]t would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements and leave a misuse doctrine in place which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which, while they may be somewhat anticompetitive, do not even constitute

antitrust violations," (supplemental statement of B Pravel, Hearing at 91)

Significantly, none of the witnesses opposed enactment of Title IV, nor did the correspondence received in connection with the hearings contain any objections to the proposed reform See Hearing at 242-45

Title IV was eventually dropped from S 1841, not because of opposition to the proposal, but more for lack of strong support and an uneasiness over the DOJ's list of covered conduct The need for reform remains, however, and commentators on the topic of patent misuse have continued to reinforce the testimony presented in the hearings of the 98th Congress Congress should act now, on the basis of the hearings before the 98th Congress and the continuing need for reform, to enact the proposed legislation on patent misuse

Thomas M Susman
Wendy R Gerlach
Ropes & Gray

May 11, 1987

mpl DB

digital

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Sub [illegible]

26 October 1986

Dear Mr Kastenmeier

I am writing you to urge that the House retain title 34, which reforms the law of patent misuse, in the Omnibus Trade Bill. Digital Equipment Corporation is joined by IBM; the American Intellectual Property Law Association, the American Bar Association; the Semiconductor Industry Association, the administration; and others in support of this provision.

Although the Supreme Court has recognized that patents embody important property rights and that Congress continues to work to improve protection of intellectual property in these competitive times, the doctrine of patent misuse continues to discriminate against patents as compared with other forms of property Our objective in supporting title 34 is simply to place patents on the same footing as other forms of property when questions are raised concerning the competitive consequences of their use.

I underline the words "competitive consequences" because those who support title 34 do not wish to change application of the misuse doctrine in any outside area which involves activities of the patent holder alleged to be anticompetitive, yet which does not violate the antitrust laws. We are not, for example, attempting to deprive the courts of their ability to apply general equitable principles where fraud or forms of unclean hands not involving competition are alleged. But if the graveman of a complaint against the patent owner (in the form of the misuse defense to an infringement action) is that he or she has acted anticompetitively, then the antitrust laws should guide the court's judgement relating to compliance with our country's competition policies

There is no comparable doctrine of "misuse" which deprives a property owner of rights pertaining to his or her property, unless the challenged conduct violates some other law, no court would seriously consider depriving a property owner of rights because of charges that, though no antitrust violation occurred, the owner was otherwise involved in some lawful form of anticompetitive conduct This same principle should apply to conduct involving patents.

We have provided your staff with background information on this provision, along with a legal memorandum prepared by our outside counsel. We would like very much for a Digital representative to have the opportunity to visit with you on this subject and we will follow through to this end with your staff

Very truly yours,

DIGITAL EQUIPMENT CORPORATION
Edward A. Schwartz,
Vice President, and General Counsel and Secretary

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September 14, 1988

The Honorable Robert W Kastenmeier
Subcommittee on Courts, Civil Liberties
And The Administration Of Justice
Committee On The Judiciary
United States House of Representatives
2137 Rayburn House Office Building
Washington, D C 20515

Re H R 4086 (100th Cong , 2d Sess)
The Patent Licensing Reform Act of 1988

Dear Congressman Kastenmeier

I understand that you are holding further hearings on this bill I write to ask whether you received my letter of May 9, 1988 commenting on this bill? I enclose a copy I am also interested in whether you have considered my request that it be included in the record of the hearings on the bill If you plan to include it in the record, I would like to edit it slightly If that is not possible, you have my permission to publish it as originally sent

Sincerely,

John W Schlicher

JWS chp
Enclosure

CHP-HD/Kast9-14-88 txt

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May 9, 1988

The Honorable Robert W Kastenmeier
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Committee On The Judiciary
United States House of Representatives
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Washington, D C 20515

Re H R 4086 (100th Cong , 2d Sess)
The Patent Licensing Reform Act of 1988

Dear Congressman Kastenmeier

On April 26, 1988, I received a copy of H R 4086 and learned that you scheduled hearings on the bill for May 11, 1988 I ask that you include this letter in the record of those hearings

I write you as a citizen concerned about the incentives for increasing the productivity of the American economy through technical change One indicator of America's ability to achieve productivity gains is to compare its performance to the countries with whom we trade If our trading partners achieve technical productivity gains at a more rapid rate than America, we will experience a decline in the share of worldwide sales of goods and services made by Americans and a decline in the share of the world's wealth owned by Americans Congress has a vital duty to evaluate the effect of its laws on achieving productivity increases by technical innovation

The bill relates to patent law Patent law is the principal body of law on which the American economy relies

to provide correct incentives for the production and use of technical information in the private sector If patent law may be changed to produce a net economic benefit for the country, the law should be changed

Summary

I write to convey five primary thoughts

First, H R 4086 is directed to rules that limit a patent owner's conduct (1) in obtaining the patent from the patent office and (2) in exploiting it by agreements with others The Courts have made the laws under which patent owners engage in those activities, with only one legislative exception I applaud the effort by Congress to evaluate whether the judicial law makes economic sense

Second, those two sets of rules have a tremendous impact on the incentives created by the patent system and, therefore, on the productivity of the American economy Congress could sensibly intervene to create more economically sensible law

Third, certain features of H R 4086 would improve economic performance The bill has other features that would probably impair economic performance The bill could be improved On balance, I do not support H R 4086 it in its current form However, H R 4086 provides a valuable focus for determining sensible economic policy for these parts of the patent law of this country There has been considerable analysis of the economic impact of the laws relating to exploitation of patent rights Some of that analysis may be brought to bear on Section 2 of H R 4086 by May 11, 1988, though without the rigor that a somewhat longer time would permit There has been little analysis of the economic impact of the laws the Courts created to regulate the patent owner's conduct before the patent office Hence, the economic impact of Section 3 of H R 4086 will not be analyzed with the desirable rigor by May 11 However, before you enact Section 3, ask yourself whether you would be willing to be subject to its provisions in carrying out your responsibilities in even one area -- proposing or supporting new legislation Imagine that Congress required Congressmen to make disclosures under an identical rule every time they introduced legislation or spoke in favor of enacting any legislation Surely the quality of legislation in the United States is every bit as important as the quality of patents Surely better

information is as important to passing correct legislation as it is to issuing correct patents Surely some Congressmen introducing or supporting bills have more information about the bill than other Congressmen and the public Suppose that, if any Congressman proposed or supported any legislation without making the required disclosure, all such legislation could be declared unenforceable by the Courts I do not think I need to explain to you the costly and debilitating effects such a rule would have on our system of government Please think about that before permanently imposing these rules on the patent system In this letter, I have outlined some of the things that Congress should consider before legislating on either of these matters I will not attempt in this letter to describe comprehensively the state of the law, the history of the development of that law in the Courts, the theories that lead the Courts to make up those laws, or the economic analysis of the likely effects of each of the provisions of H R 4086 I offer the following summary comments, because of the shortness of time

Fourth, before it acts, Congress should determine whether our major trading partners have laws on these issues providing greater benefits to their economies at less cost than H R 4086 If our major trading partners have more efficient patent laws for their economies and if American innovators rely more on the value of the American patent system than on foreign patent systems to earn returns from innovation, we are shooting our innovators and ourselves in the feet to enact rules that are less efficient than theirs If you believe that is important, I hope you will ask some knowledgeable people to determine whether Japan, West Germany and our other international competitors have laws regulating patent owner conduct in obtaining and exploiting patent rights that provide greater net economic benefits than ours If our international competitors have such laws, and if American innovators rely more on the United States market than foreign markets to earn returns to innovation, that should be a warning to us to consider very carefully whether to enact H R 4086

Fifth, I understand that H R 4086 was introduced in part as the result of the inability of the conference to agree on all the intellectual property provisions of the Omnibus Trade bill, H R 3 That bill contained a patent misuse provision (Title XXXIV of the Senate bill), and a "licensee challenges to validity" provision (Title XXXV of the Senate bill) H R 4086 would be improved by addressing the "validity challenge" issue

The Patent Laws Of Japan And Europe On These Issues
May Be More Efficient Than Current U S Law And H R 4086

If you investigate foreign law, my understanding is that what you will be told that our major trading partners have no patent misuse rule whatsoever Of the two types of conduct H R 4086 regulates, the rules regulating the ways patent owners exploit the rights are probably more important economically than the rules relating to conduct before the patent office It is my understanding that Japan has no patent misuse rule It is my understanding that the European Economic Community has no rule that results in a patent being found unenforceable because a patent owner exploited it in certain ways My understanding is that, in each of those economies, patent agreements that are deemed to impose greater economic costs than economic benefits are declared unenforceable A fine may also be imposed The underlying patent rights are never rendered unenforceable The United States is an anomalous exception The United States Supreme Court created the exception in the late 1930s and early 1940s Japanese and European lawmakers have known about the misuse rule for at least forty years and have decided not to adopt it We should ask ourselves why they have not I believe the reason is that our misuse rule makes no sense If you are a U S automobile manufacturer and your agreements with car dealers violate the antitrust laws, the consequence is not that your dealers keep all the cars sold under the agreements without paying for them, and not that any member of the public is able to steal those cars off the lots However, if you manufacture an invention and your property is the U S patent right, the misuse rule provides exactly that result If the licenses by which you make those rights available to your dealers, called licensees, contain a clause that violates the antitrust laws, your patent is unenforceable against your licensees and anyone else They may use the invention for free The misuse doctrine does give you the right to re-establish enforceability as to future infringement by showing that your offending conduct has ceased and the effects fully dissipated, but in the meantime your rights vanish Japan and the EEC have no such misuse doctrine In addition, if you are a U S automobile manufacturer, you also need to comply with only one standard, the antitrust laws If you are an invention manufacturer, you must comply with antitrust standards and a separate standard the Supreme Court made up based on its view of the public interest Licenses in Japan and the EEC are subject to a single standard, the standard provided by their antitrust laws

H R 4086 also provides that a patent may not be enforced if the patent owner did not behave "equitably" in obtaining the patent from the patent office It is also my understanding that our major trading partners do not regulate the way patent owners conduct themselves in obtaining patents by rules that prevent enforcement of the patent Infringers in Japan and Europe may not escape liability by showing that the patent owner engaged in "fraud or inequitable conduct in procuring or enforcing the patent " Again, if that is correct, the United States is an anomalous exception The Courts made up the most significant fraud and inequitable conduct rules in the 1960's and early 1970's As in the case of the misuse doctrine, Japanese and European lawmakers have decided not to follow us down that path Again, we should ask ourselves why they have not

The rules in the United States relating to licensee challenges to the validity of patents have no counterpart in Japan and a less onerous counterpart in the EEC Agreements that a licensee will not challenge the validity of a patent are enforceable in Japan While the rule is somewhat different in the EEC, I have been told that EEC law has not prevented the parties to agreements from reducing risk and litigation expenses to the same extent that United States law has

For this reason, I would proceed with H R 4086 with great caution

The Patent Misuse Rule

I will not explain here the history of the mistaken economic notions that led the Supreme Court to create the misuse rules Many of my thoughts about the economic significance of the patent misuse rule are set out in my testimony before the Subcommittee on Patents, Copyrights and Trademarks of the Committee on the Judiciary of the United States Senate at hearings on S 1841 (98th Cong 2nd Sess , April 3, 1984) At those hearings, I supported a bill to change the antitrust law and the patent misuse rules in the United States The essence of S 1841 was to (1) provide that license agreements would not be judged under so-called per se rules for antitrust purposes and (2) retain the unique American misuse rule and change the misuse standard so that Courts would decline to enforce the patent only if the patent owner's conduct violated the antitrust laws The Courts have moved in that direction on

patent misuse The United States Court of Appeals for the Seventh Circuit and the United States Court of Appeals for the Federal Circuit have declared that, unless decisions of the Supreme Court require them to do otherwise, they will apply antitrust standards to define whether patent misuse renders a patent unenforceable Those decisions are highly beneficial Their application should be expanded, not restricted as H R 4086 may do

If the antitrust laws create a proper set of limits for exploiting patent rights, then any other set of limits must be wrong If Congress decides that it is most efficient if people drive only 55 miles per hour on the highway, it would be inefficient for the Supreme Court to declare that automobile owners will have no remedies against car thieves if they drive over 35 The misuse rule is a 35 mile an hour speed limit on productivity gains from technical innovation in the United States

Eliminate The Patent Misuse Rule

The misuse rule operates as an "exclusionary rule" for patents Under the exclusionary rule, criminals are freed in order to control the police Under the patent misuse rule, infringers are freed in order to control the patent owner The antitrust and contract laws are adequate to control patent owners The economy gains nothing from freeing infringers Rather, the economy suffers a significant cost -- the whole purpose of the patent system is defeated for a time as the value of inventions is captured by others

The United States would be best off by following our major trading partners and abolishing the patent misuse defense If we abolish the misuse defense, patent owners licensing their patents in violation of the antitrust laws would remain subject to antitrust remedies and the general contract rule that prevents them from enforcing the illegal provisions against their licensees Freeing the licensees from an enforceable obligation to perform the undesirable agreement will eliminate any economic harm in the cases where the patent owner is deemed to have attempted to achieve some anti-competitive effect by coercing some conduct by the licensee The licensee may engage in the conduct under the contract rule In addition, antitrust penalties are adequate to deter both that type of agreement and agreements in which patent owners, or a patent owner and his "licensees" might attempt to secure freedom from

competition with each other under the guise of a license We have not had any example of patent owners and "licensees" attempting to do that in many years However, the risk is real and antitrust penalties are adequate to deter it Indeed, it was antitrust law, not patent misuse law, that stopped that practice

This is not a radical idea That is how we treat all other property rights in the United States Congress has said that patents are supposed to be treated like personal property My proposal is simply that we do what Congress long ago said we should do

If you reject that idea, I offer the following general comments on the specific provisions of Section 2 of H R 4086

The Misuse Provisions Of H R 4086

Section 2 of H R 4086 says a patent owner who engages in conduct "constituting misuse or illegal extension of the patent shall be denied relief under this title for infringement of the patent until such misuse or illegal extension terminates and the consequences of such misuse or illegal extension have been dissipated " That sounds like a sweeping charter to the Courts to continue to do what they have been doing Indeed, one may argue that it gives them an even broader charter, because it encompasses conduct called "misuse" and conduct described as "illegal extension of the patent " It is unclear from that language whether those are the same thing or two different things If they are different things, someone may convince a Court that Section 2 provides an unlimited charter for the Courts to say what is "illegal extension" and that the Court should do so even if the conduct would not be "misuse " The next two subsections do not clarify that issue Paragraph 2 says " the term 'misuse or illegal extension' of a patent means, except as provided in paragraph (3), includes - " This may be a printing error The term "means" is, of course, different from the term "includes " I cannot tell from the bill which Congress means

If the intent of the bill is to confine "patent misuse and extension" to one class of activities which are sometimes misuse, and another class of activities which are not misuse, Section 2 is a step toward more sensible policy The ultimate economic effects depend on how the Courts interpret the "unreasonableness" requirement for finding

misuse However, unless the Courts totally ignore the "unreasonableness" requirement, the bill under that view permits patent owners to use certain terms that are now wrongly prohibited in all situations The bill probably provides a net economic benefit under that view

If Congress is leaving to the Courts discretion to find "misuse or illegal extension" even though the patent owner's conduct is not prohibited under paragraph 2, then it is unclear to me that Section 2 is a step toward more sensible policy If the Courts interpret the Section to prevent a finding of misuse if the patent owner's only conduct is of a type covered by paragraph 2 and the conduct is found "reasonable" under paragraph 2, then we have moved in a sensible direction

Under either view, the economic effect of Section 2 depends on how the Courts define "reasonableness" under paragraph 2 Section 2 does not tell the Courts how to go about deciding "reasonableness " If they are told to apply antitrust standards, we have a reasonably well defined set of rules that will permit us to predict the impact of their decisions If Congress is telling the Courts to apply some other standards, and that is what many will argue Congress seems to be doing here, the results of Section 2 will be highly unpredictable However, as I indicated earlier, I agree with the notion underlying the "reasonableness" requirement of paragraph 2, namely, the types of conduct defined in that paragraph may be economically beneficial to the country, and that conduct should not always be prohibited, as it is today

The first paragraph of Section 2 of the bill says a patent owner, who engages in "misuse or illegal extension of the patent" shall be denied relief The next two subparagraphs provide definitions of "misuse or illegal extension," but each definition is qualified to say the definition applies only "for purposes of this title," namely Title 35, the Patent Act The intent of that language is presumably to leave the antitrust prohibitions unaffected by the bill It has always been unproductive to have patent owner conduct judged by two separate standards The penalties for violating either of those standards is sufficiently severe to prevent patent owners from violating either of them Today, there is much conduct that sensible antitrust law regards as economically beneficial, but that is prohibited by misuse doctrines The purpose of the Section is to restrict somewhat the area of the misuse prohibitions However, the bill seems to say that its

standards will have nothing to do with whether patent owner conduct violates the antitrust laws This will have its principal impact on two areas the bill touches on specifically First, it will have the effect of rendering ineffectual the limitations to the prohibition against tying agreements for misuse purposes The misuse rule will be that there is misuse for "tying the sale of a patented product to an unpatented staple except to the extent that the patent owner does not have market power " The antitrust prohibition may condemn a tying arrangement that would not constitute misuse under that standard Antitrust violations may be established without showing market power in the market for the tying product Moreover, antitrust law has not expressly incorporated any distinction based upon the staple or non-staple character of the tied product and has also, by and large, rejected the notion that there is no tying if the tied product is also patented Therefore, even after this bill, antitrust law will continue to prohibit conduct Congress is apparently trying to permit The second principal area where the "for the purposes of this title" limitation will apply is to the permission for conduct by which a patent owner "grants licenses which impose territorial or field of use restrictions on the patented product or process " That broad permission, if applied to antitrust law, would be undesirable Suppose ninety percent of the automobile manufactures in the world agreed that each would be granted a license under a patent owned by one of them for a new type of nonskid brake pad cover, that each would use the pad, and each would agree to accept a license in an exclusive territory of the United States for automobile sales It would be plainly undesirable to preclude antitrust law from asking whether that license is merely a sham instrument for an agreement to divide markets having no pro-competitive benefits

With respect to the particular constraints Congress would be imposing by Sections 2 and 3, my view is that the bill is somewhat too limited in what it would permit and too broad about what it would prohibit First to the permitted category

Activities That Are Not Misuse

Congress would say in H R 4086 that a patent owner is not "considered to have engaged in conduct constituting misuse or illegal extension," because the owner did one of six things The statute is unclear about whether he may do all of the six acts without misuse, and whether any of six

acts may be combined with other acts to permit a finding of misuse

Assuming those ambiguities are clarified, the first three sections simply repeat the current substance of Section 271(d) of the Patent Act One lesson that we should have learned about any attempt to microregulate patent license agreements was that, after Congress enacted Section 271(d) in 1952, it took about thirty years, until the 1980s, for the Supreme Court to explain what that section meant, and even then the Court was split 5-4 It is fair to say that, to this day, we still do not know exactly what that section means The only apparent change eliminates the personal pronoun "his" from the statute, presumably to make clear that female patent owners have the same privileges in that regard as male patent owners

The fourth type of permitted conduct is that a patent owner "refuses to license or use any rights to the patent " I assume that means any rights "granted by" the patent Except for a few District Court decisions, there has never been any serious question about whether it constitutes misuse for a patent owner not to use the invention protected by the rights and not to license the rights Those rights are the most fundamental rights that must be given to any property owner, if a free market in those rights is to function It is desirable to set them out legislatively I would expect no direct economic benefit from that permission, because I assume patent owners are not granting unprofitable licenses today solely to avoid misuse problems The bill would prevent future judicial lawmaking to the contrary and that is desirable

The next section of permission relates to royalties This area of permission is long overdue and economically sound, assuming that the Courts do not treat the language too narrowly The language says that one never misuses a patent by charging different royalties to different licensees, royalties that are too high, and royalties that are unrelated to whether the licensee uses the rights granted under the license The language of the third exception is "imposes an obligation on a licensee of the patent to pay royalties that are in amounts not related to the licensee's sale of the patented product or a product made by the patented process " If one wanted to assert the proposition that I think Congress intends, Congress should say "agrees to an obligation on a licensee of the patent to pay royalties that are unrelated to any activities that would constitute infringement but for the

license " The current language is also too narrow in that it excuses the patent owner from that type of royalty provision only if he "imposes" such an obligation on the licensee That curious wording leaves it open to an enterprising lawyer to say that if the licensee requested the provision, it was not "imposed" on him and, therefore, the patent owner is not entitled to the permission of the statute

Assuming the bill gets the Courts out of the business of regulating royalty arrangements, that is an exceedingly valuable development The current rules never did make economic sense I applaud a proposal to get rid of them However, I am mystified about why the freedom to define the type of consideration a patent owner may receive for waiving his rights is treated differently, when the payments do not correspond with the term of a patent One of the prohibited items reads, when the language is put together, something like the following "any patent owner who engages in conduct constituting unreasonably entering into a royalty agreement that provides for payments beyond the expiration of the term of a patent, except when the parties have mutually agreed to such payments after the issuance of the patent shall be denied relief under this title for infringement " It never has been patent misuse in the United States to charge royalties that continue after the term In 1964, the Supreme Court said the obligation to pay after all the licensed patents expired was unenforceable It did not say that agreement rendered the patent unenforceable Most lower Court decisions have recognized that such an agreement does not jeopardize the enforceability of the patent It seems to me a clear step backwards for Congress to make this type of an agreement misuse in certain circumstances The ability of the patent owner to impose economic harm by collecting royalties based on activities after the patent expires is no greater than his ability to do so based upon activities that do not involve infringement during the term Both ought to be permissible, since they are highly unlikely to do harm and permit benefits to be achieved by reducing uncertainty and transaction costs

The permission regarding royalties is also too narrow, because Congress should provide freedom to agree to royalty obligations that do not depend on the validity of the patent I have explained elsewhere why that would be economically beneficial

The final type of permitted conduct is to "grant licenses which impose territorial or field of use restrictions on the patented product or process " The bill is unclear whether this permission applies when the restrictions relate to a product that is not patented but was made by a patented process or by use of a product patented The bill is also unclear whether the permission applies to a product that had been sold and some Courts might say the patent rights "exhausted" themselves If the bill does not address those issues, the fifth area of permission seems to involve no economic gain over current law If it would be amended to include them, the economic gains would be clear As I mentioned earlier, if this permission provided an exemption from antitrust liability, it is too broad It does not appear to do so

Activities That Are Sometimes Misuse

The list of prohibited conduct relates generally to tying arrangements, agreements not to deal in "competing goods," package licensing, post-expiration royalties, agreements relating to price and certain grantback provisions On the whole, the list of prohibitions seems to broaden, rather than restrict, the area of permissible provisions The key word is "unreasonably " "Unreasonableness" is a prerequisite under the bill to misuse under each type of activity other than tying I do not understand why it was not applied to tying It is inconceivable to me that there is any justification for a reasonableness test for the others and not for tying arrangements In any event, if the purpose of the term "unreasonably" is to invoke in shorthand fashion the standard of antitrust law, it seems to me that Congress should simply refer to the antitrust laws, apply antitrust standards to all types of conduct, and enact a bill like that proposed in 1983, S 1841 If the intent is to do something else, then the Courts are going to have a terrible time figuring out what the "something else" is, and the economic impact of the bill is uncertain It is terribly difficult to articulate some set of standards other than those developed under antitrust law, although the Courts have proved willing and able to do so

The first prohibition relates to tying arrangements Misuse would be defined as "tying the sale of a patented product to an unpatented staple or the production of an unpatented product to the use of a patented process, except to the extent that the patent owner does not have

market power " I assume that "tying" means an agreement by which a patent owner sells a patented product only on condition that the buyer purchase an unpatented product or licenses the patent only on that condition In some senses, the definition of the bill seems to make it easier to prove misuse In others, it seems to make it more difficult The general prohibition against tying is economically unsound and has been recognized as such by serious students of the patent system for many years However, one can conceive of situations in which the law might sensibly prohibit certain kinds of tying arrangements The antitrust law is moving toward a sensible tying test that, if applied to the sale of patented products and the licensing of the patent, would be economically desirable The current standards are economically harmful The prohibition on tying in H R 4086 is a step in the right direction, if it means there is no reason to worry about economic harm, unless the patent owner has market power in the sale of the patented product or in the licensing of patents in some market for rights However, even if he does have market power, there are many situations in which there ought to be no prohibition The other prerequisites to illegality should be that (1) the patent owner has a reasonable prospect of acquiring market power in the market for the unpatented product for uses other than with the patented product, (2) there is a sensible reason for treating (a) the patented product and unpatented product or (b) the license and the "unpatented" product as separate products, and (3) there is no justification for the agreement (such as being the low cost method of insuring that the buyer or licensee uses the right quality products or pays in proportion to use) This paragraph is also a step in the right direction to the extent that it implies that a patent owner may expressly provide in licensing a combination or a process patent, that the licensee purchase from him a product that, if sold without authority, would constitute contributory infringement The Supreme Court came close to saying that that was permissible in the early 1980's However, I am still somewhat unsure about that result That is plainly economically desirable The bill is somewhat vague in its reference to "tying the production of an unpatented product to the use of a patented process " I assume that the intent is to say that a patent owner may not tie the purchase of an unpatented product to a license to use a patented process The limitation to an unpatented "staple" product would also be entirely sensible in the context of process patents Finally, "tying" is not a terribly well defined term An agreement that simply includes a license and an obligation to purchase does not constitute tying,

unless the patent owner conditions the purchase on granting the license The law on what "conditioning" means is somewhat unclear, but there is some requirement in that regard If Congress is going to continue this prohibition in its current broad form, I would be a little more explicit about what tying means

The second prohibited type of conduct is "unreasonably imposing as a condition of granting a license for a patent that the licensee may not produce or sell competing goods " Under current law, a provision in a license agreement, whether or not "conditioned," that the licensee not produce or sell competing goods is unlawful, but only if that agreement violates the antitrust laws This is so because the Court of Appeals for the Federal Circuit has indicated that it will apply antitrust standards to conduct not expressly condemned by the Supreme Court, and the Supreme Court has never held that conduct to be misuse The Supreme Court has said in dicta that it is To the extent that this "prohibition" incorporates general antitrust standards, it would be an economically desirable provision If it incorporates some other standard, I am not sure what the economic impact will be However, unless "unreasonableness" is read out of the statute, the effects will be desirable The "conditioning" limitation is unnecessary in any event

The third prohibition relates to conduct "unreasonably imposing the condition of granting a license under one patent that the licensee accept another license under a different patent " Assuming we could predict how the Courts will construe the term "reasonably," this statute may improve the economic efficiency of the law The current misuse rule on package licensing operates without respect to reasonableness Package licensing may have a number of beneficial effects that are sacrificed today Hence, the change is likely to be desirable

The fourth prohibition relates to payments beyond expiration I commented on that earlier I did not comment on the provision that would exempt from the prohibition an agreement for royalties that continue after the term and that was agreed to "after the issuance of the patent " I cannot conceive of any reason why the time of the agreement should make any difference If it is not harmful for the parties to enter an agreement calling for such royalties after the patents issued, it is unclear to me how the same agreement can become undesirable if made before one or all

of them issued The effect is the same regardless of the agreement date

The next prohibition is against "unreasonably entering into an agreement to fix prices or engage in resale price maintenance with respect to a patented product or process " It is very difficult to predict the effects of this provision On its face, it seems to go beyond current law by jeopardizing the enforceability of a patent based upon any price "fixing" agreement or "resale price maintenance agreement" with respect to a patented product or, somehow, a process The law today probably does not jeopardize the enforceability of a patent based upon the patent owner entering into any price "fixing" agreement or engaging in "resale price maintenance " In that respect, the provision broadens the prohibited area of conduct To the extent that the "agreement" referred to is a license agreement under the patent, then the prohibition may or may not be broader than the current misuse test depending on how the Court's construe "reasonably "

Finally, the act prohibits "unreasonably granting a patent license which requires the licensee to grant back to the licensor patent rights which the licensee may develop or acquire, except to the extent that the requirements to grant back an nonexclusive license with respect to improvements in the licensed product or process when alternatives exist to produce the product or process " The current law on grantbacks is not so mechanical I am not aware of any decision in which a Court found a nonexclusive grantback to constitute misuse, whether or not it related to an "improvement" and whether or not alternatives exist to produce the "product or process," assuming that means the licensed product or process If the Courts interpret the prohibition and exception to mean that all grantbacks not exempted are prohibited, the effect will be to preclude all grantbacks that are exclusive in any respect, that relate to things other than "improvements," or that arise when no alternatives exist to produce the licensed product or process Those effects are decidedly negative If it is not interpreted in that way, its effects are unclear, but are unlikely to involve significant economic benefits over current law

Fraud Or Inequitable Conduct

As I mentioned earlier, there has been very little thoughtful analysis about the economic implications of the

fraud and inequitable conduct rules The Courts created those rules in the United States to regulate conduct in dealing with the patent office Because that analysis has not been done, it is a mistake to enact legislation at this time We should always keep in mind that the patent system operated quite well for a hundred and seventy-five years without the "inequitable conduct" rules currently in place There should be no legislation until Congress or someone else has analyzed the effect of various rules on the total costs born by the patent owners and the government in prosecuting patent applications, the total costs born by patent owners and potential users in determining the validity and scope of patents after they issue, the total costs born by patent owners, others and the government litigating about those patents, and the costs patent owners and potential users bear from uncertainty about whether a patent should have been issued under the law I expect that analysis to show that the current state of the law is undesirable I also expect that it may be highly desirable for Congress to enact sensible standards so that they will not shift and change as they have over the last twenty-five years

Inventors are the only group of people dealing with the United States government subject to such judicially-created rules and penalties based on the nature of information they provided or failed to provide the government I have never understood why inventors have been singled out for such special attention They are no less honest than anyone else People request government action all the time in a wide variety of other situations without being subjected to any rules or penalties such as those applied to inventors If the government and the economy is functioning well in other areas without rules like these, I have difficulty understanding why special rules are needed to prevent prospective patent owners from lying or withholding information from the government

I also hope you will take into account that the unenforceability device is not the only option for providing correct incentives not to try to obtain an invalid patent There is nothing to gained by acquiring an invalid patent The costs of doing so will probably prevent most of the conduct Congress is concerned about However, let us assume it will not What are the other safeguards? First, the Patent Act requires a patent owner to swear to one thing He must swear that "he believes himself to be the original and first inventor of the process, machine, manufacture

composition of matter, or improvement thereof, for which he solicits a patent " Congress has not asked inventors to do this and hoped that all men are angels and will swear truthfully Rather, Congress imposed criminal penalties to deter those disposed to make willfully false statements to government agencies Second, if patents are obtained through dishonesty, Congress provided in the Patent Act that a person accused of infringement of a patent may show that it should not have been granted based on the true facts and required the Courts to declare such a patent invalid Congress also provided the Courts with discretion to award attorneys' fees to a prevailing party in an exceptional case The Courts long ago found that fraudulent procurement made the case an exceptional one Third, the enforcement of a fraudulently procured patent may give rise to treble damage liability to everyone damaged by those acts Fourth, there are inherent safeguards against dishonesty that arise when one must deal in more than a single transaction with the person to whom one is contemplating lying The costs of deceiving the patent office are not entirely external to the inventor After he has been found out, his deception will come home to roost the next time he comes with an additional application The result for an attorney working for such an inventor and who knew of the deception would be the same In sum, H R 4086 may contribute something if you ignore that the possibility of going to jail for dishonesty to the patent office may be sufficient to deter inventors and their lawyers It may also contribute something if you assume that the high likelihood of having to pay an infringement defendant his attorneys' fees to expose the deception is not a sufficient deterrent It may contribute something if you assume that antitrust liability for enforcing a fraudulently procured patent is not enough

As I noted earlier, my information is that none of our major trading partners impose obligations anywhere close to what we do on applicants for patents, and we should very seriously consider whether it is sensible for us to continue to do so

I will point out here only a couple of things about the current bill that seem to me plainly undesirable or open to very serious question

First, it is entirely unclear to me that it makes economic sense to have any defense to enforcement of a patent based upon any standard other than the standard for common law fraud Hence, the broad charter Congress would

give the Courts in Section 3 of the bill to define "other inequitable conduct" seems to me open to very serious question

Second, that paragraph provides that it is a defense that "a person engaged in fraud or another inequitable conduct in enforcing the patent " The only situations in which the Courts have denied relief to a patent owner because of conduct during the litigation has been where the patent owner suborned perjury or knowingly concocted and used false evidence The standards that are applied for dealings in the patent office have not been applied to the patent owners' conduct in litigation, or in private negotiations with infringers, potential infringers or potential users If this bill imposes some obligation on a patent owner not to conduct himself "inequitably" during litigation, during other types of enforcement efforts, and during private discussions or negotiations with infringers, potential infringers, or users, the bill will do enormous economic harm There is absolutely no justification for that part of the bill

Third, the bill would do nothing to clarify the standards applied in this area because the paragraph that might say what "fraud or another inequitable conduct" means says it is only defining what that conduct "includes " Hence, the bill will have absolutely no benefits, even if it is the standard articulated in the second paragraph of that section was the economically sensible one

Fourth, the second paragraph says that fraud or inequitable conduct in procuring a patent includes "the intentional or grossly negligent failure of an individual to disclose to the Patent and Trademark Office information " It is entirely unclear to me that a negligence standard or even a gross negligence standard is an efficient way to lower information costs and uncertainty costs of the kind I refer to Indeed, it seems to me those standards are the wrong ones However, I have not done the analysis to be confident My current view is that a fraud standard is more likely to be the most efficient standard to apply That is the standard applied in the other federal intellectual property systems -- the trademark and copyright systems

Fifth, the bill is directed only to fraud or inequitable conduct involving nondisclosure of information, and presumably leaves the law where it is with respect to inequitable conduct of the affirmative misstatement variety Analysis may show that different standards ought to apply to

those two types of conduct However, I am not confident enough to say that now Because Congress requires the applicant to make an oath or declaration to certain facts, its definition of the content of the oath effectively converts some potential nondisclosure offenses into misstatement-type offenses

Sixth, fraud and inequitable conduct is said to include intentional or grossly negligent nondisclosure if three other conditions are satisfied, namely, the person has "actual knowledge," the person has a "duty to disclose," and the person "knows or should have known [that the information] would render the claim unpatentable " The next paragraph delegates to the Commissioner of Patents And Trademarks the responsibility for defining who has a "duty of disclosure" and to define "other matters necessary to avoid fraud as described in paragraph (1) " It seems to me that Congress is abdicating its responsibility for making policy in this very critical area by delegating responsibility to the executive branch Part of the problem in this area has been that the standards have changed constantly for the last twenty-five years Simply ordering the executive branch of government to do something seems to me to be a very poor way to run a patent system, even assuming that it is lawful for Congress to do so The standards for the enforceability of patents should not be set by the executive branch I leave to others the issue of whether or not that delegation is lawful

Seventh, to the extent that Congress does take some responsibility for articulating a standard, its three part test probably will prove on analysis to be undesirable to the extent that it says that a patent is unenforceable if someone through gross negligence failed to disclose information that the person knew "or should have known" would render the claim unpatentable I have a difficulty understanding what "should have known" means if it means something other than the Court decides whether or not the information, in fact, rendered the claim unpatentable However, presumably it will be argued that it means something different It is virtually impossible for me to tell whether the standard is gross negligence or negligence Indeed, "should" is such a broad word that it may indeed be something else, such as strict liability for failure to disclose material information

Eighth, the bill seems to be trying to limit the fraud and inequitable conduct defenses to those nondisclosure situations in which the information not

disclosed would, in fact, have rendered the patent invalid That is not the standard today My feeling is that this change is a highly desirable change in the law

H R 4086 Should Change The Law
On Challenges To Patent Validity

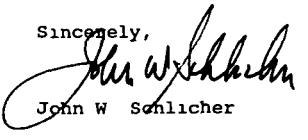
There is no reason for the law to regulate patent license provisions on challenging validity in the way Title XXXV of H R 3 would have or in the way U S law does today I explained the numerous problems with Title XXXV in the form of a story that I called "A Lear v Adkins Allegory" that appeared in 68 Journal of the Patent Office Society 427 (1986) No one has explained why Title XXXV is the most desirable response to some bad law The interests of licensees and the American people in challenging the validity of patents are identical If licensees and patent owners wish to agree that the licensee will not challenge validity, that agreement makes both the licensee and the American people better off than if that agreement is prohibited The licensee will not agree to forego a challenge unless it makes him better off Since this agreement adversely affects no one, it is surprising to me that the law prohibits it and under Title XXXV of H R 3 would continue to prohibit it Section 296(a) of H R 3 would say agreements not to contest validity are unenforceable The only justification I have heard for that provision is that it "codifies" a decision of the Supreme Court I explained in the story why that is wrong and will not explain it again here Even if that section "codified" a Court decision, the decision was economically unsound Congress should not perpetuate the error simply because the Supreme Court allegedly made it That section was an enormously bad idea because it would preclude the most sensible legislation, namely a bill which would provide that an agreement by which patent owner and a licensee agree that the licensee will not challenge validity or that makes any other provision for the consequences of litigation on validity should be enforceable Such an agreement is

TOWNSEND AND TOWNSEND

The Honorable Robert W Kastenmeier
May 9, 1988
Page 21

enforceable today if made in proper form after infringement litigation has commenced The law should permit the parties to make the same agreement earlier

Sincerely,



John W Schlicher

JWS chp

cc The Honorable Carlos J Moorhead
The Honorable Daniel E Lungren
The Honorable Henry J Hyde

HD Kasten txt

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June 13, 1988

Mr Thomas M Susman, Esq
ROBES & GRAY
1001 22nd Street, N W
Washington, DC 20237

Re Patent Misuse Legislation

Dear Tom

Enclosed is a draft of a subcommittee report that was never finalized The thrust of the report, as we discussed, is that the Federal Circuit eliminated per se categories of patent misuse, with the exception of areas where the Supreme Court has explicitly ruled One of those areas is tying, as indicated by the Federal Circuit's Gardco case, which hewed to the Supreme Court's Morton Salt holding Tying is the only activity which the Supreme Court has expressly held to be per se misuse Two other areas, however, have been accorded similar treatment

The first is the Brulotte case, in which the Supreme Court held unenforceable license agreements to extend royalty payments beyond the term of the patent The House Bill would limit the holding of Brulotte to application to agreements entered into before the issuance of the patent However, as the draft points out, there exists no principled basis for applying the holding of Brulotte to that category of cases alone

Second, the lower courts have followed Lear v Adkins by according patent license no-challenge clauses with the same status as post-expiration royalty payments That is, the lower courts have held such clauses unenforceable Some courts have stated that such a clause might be the basis for a misuse holding, but none have so held For a discussion of the Lear v Adkins provision, see my enclosed paper on that topic The Lear v. Adkins situation is different from the Brulotte and Morton Salt situations in that a strict reading of the Federal Circuit's Windsurfing case would mean that no-challenge clauses, which were not before the Lear court, are not per se misuse Nonetheless, the Lear v. Adkins situation should be clarified The appropriate time for such clarification would be with the other misuse provisions

In short, I recommend drafting legislation to overrule the holding of Morton Salt (tying is per se misuse), the holding of Brulotte (post-expiration royalty provision unenforceable), and modifying the progeny of Lear v. Adkins (no-challenge clauses unenforceable) These amendments, coupled with the Federal Circuit's Windsurfing holding would approximate the effect of S 1200

If I can be of any further assistance, or if you have any questions or comments, please do not hesitate to give me a call

Sincerely,

William C Rooklidge

WCR-5071 am vs
Enclosures

DRAFT

REPORT ON DRAFT PATENT MISUSE LEGISLATION

Prepared by the Ad Hoc Subcommittee

of the AIPLA Antitrust Committee*

If a court determines that a patent owner is attempting to exploit his patent in an improper manner, the court will withhold any remedy for infringement of the patent or breach of a license agreement for such misuse The doctrine of misuse has been developed by the courts since the early 1930s The Supreme Court has condemned very few patent licensing practices as constituting misuse per se The lower courts, on the other hand, have gone farther in characterizing such provisions These lower court decisions were considered the law of patent misuse until October 1, 1982, on which date the United States Court of Appeals for the Federal Circuit was created

Congress gave the Federal Circuit exclusive jurisdiction over any appeal from a final decision of a district court "if the jurisdiction of that court was based, in whole or in part, on Section 1338 of [Title 28]," with exceptions not relevant here Section 1338 in turn grants district courts original jurisdiction over "any civil action arising under any Act of Congress relating to patents " The Federal Circuit has determined this grant of jurisdiction broadly, finding exclusive jurisdiction in cases involving complaints of patent infringement as well as

* The Subcommittee consists of Martin Goldstein, Frederick W Powers and William C. Rooklidge

counterclaims of patent infringement [1] Thus, patent misuse as a defense to an assertion of patent infringement will be determined on appeal by the Court of Appeals for the Federal Circuit.

The likelihood of a case involving a patent misuse issue going to the Federal Circuit is particularly important because of the choice of law rule adopted by that court The Federal Circuit has adopted a choice of law rule whereby it applies the law that the regional circuit courts would have used in deciding issues not unique to patent law On the other hand, the court looks to its own law where the question clearly implicates its "jurisprudential responsibilities" regarding the patent law [2] Patent misuse, unlike antitrust law, clearly implicates the Federal Circuit's jurisprudential responsibilities regarding the patent law Accordingly, patent misuse issues are now governed by Federal Circuit law rather than that of the regional circuits

While the Federal Circuit has recognized that it is bound to follow existing Supreme Court guidance in the misuse area,[3] the court requires the following to sustain a misuse defense involving a patent licensing provision

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1 See generally Subcomm on Federal Circuit Jurisdiction of AIPLA Federal Litig Comm , Federal Circuit Jurisdiction Over Appeals from District Court Patent Decisions (1988)

2 See Gardco Mfg , Inc v Herst Lighting Co , 820 F 2d 1209, 1212 (Fed. Cir 1987)

3 Senza-Gel Corp v Seiffhart, 803 F 2d 661, 665 n 5 (Fed Cir 1986)

> To sustain a misuse defense involving a licensing arrangement not held to have been per se anticompetitive by the Supreme Court, a factual determination must reveal that the overall effect of the license tends to restrain competition unlawfully in an appropriately defined relevant market

Windsurfing Int'l, Inc v AMF, Inc , 782 F 2d 995, 1001-02 (Fed Cir 1986) (footnote omitted) [4] Thus, the Federal Circuit has rejected lower court cases holding particular licensing provisions to be per se misuse where the Supreme Court has not done so

The Federal Circuit's case law, including Windsurfing, is the law of patent misuse Therefore, in order to ascertain whether a particular provision constitutes misuse, one must look to see if the Supreme Court has declared it to be misuse per se, and if not, the rule of reason must be applied to determine whether the provision has anticompetitive effect

The purpose of the draft legislation, while somewhat unclear, seems to be to codify the current law of patent misuse in order to impart some stability in this area, thereby encouraging patent licensing Whether this proposal can achieve that purpose depends upon the effect of the proposal upon the current law and the clarity with which this proposal achieves that effect The purpose of this report is to ascertain the effect of the proposed legislation on the current law and point out any potential drafting problems and areas of uncertainty This report will address each paragraph of the proposed legislation in turn

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[4] See generally AIPLA Antitrust Comm , Spring Meeting Comm Report, March-April-May AIPLA Bulletin 120, 122-24 (1986)

SECTION 1

271(d)(1)

Section (d)(1) of the Draft appears to codify the general rule of patent misuse announced in Morton Salt Co v G S Suppiger Co., 314 U S 488 (1942), and B. B Chem Co v Ellis, 314 U S 495 (1942) However, the existing regional circuit case law provides that termination of the misuse alone can sometimes be sufficient to effect a cure where it has not been shown that the misuse had any actual adverse consequences [5] The clear language of the Draft may be interpreted to overrule the above exception to the general rule If that is the intent, it should be made clear in the commentary Otherwise, enactment of this provision will defeat rather than achieve the desired goal of attaining certainty

On a less substantive basis, language such as "the consequences. have been dissipated" may provide a fertile ground for litigation by its vagueness

The foregoing analysis applies only to the misuse, as opposed to the illegal extension of the patent aspect of Section (d)(1) The latter aspect of that section appears to be intended to include the general rule announced by the Supreme Court in Brulotte v Thys Co , 379 U.S 29 (1964), as indicated by Section (d)(2)(D) of the Draft

Sections (d)(1) and (d)(2)(D) of the Draft provide that entering into a royalty agreement providing for payments beyond the expiration of the term of the patent results in unenforceability of

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[5] See, e g , White Cap Co v Owens-Illinois Glass Co , 203 F 2d 694 (6th Cir 1953)

the patent Although some cases have interpreted Brulotte as standing for that proposition,[6] they appear to be based upon an overbroad reading of the facts of that case In Brulotte, the Court merely prohibited the licensor from collecting royalties which accrued after the last of the licensed patents had expired. That suggests no more than mere unenforceability of post-expiration royalty provisions [7] No Supreme Court case has affirmatively held the requirement of payment of royalties beyond the term of the patent to be patent misuse Accordingly, under the Federal Circuit, a provision requiring post-expiration royalties would not constitute misuse per se [8] The Draft in this regard constitutes a significant change of the current law.

271(d)(2)(A)

Section (d)(2)(A) of the Draft up to the first comma codifies the existing rule as announced by the Supreme Court that a tying arrangement is per se misuse[9] as well as a per se violation of the antitrust laws [10] This was the basis of the Federal Circuit's

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6 See, e g , Rocform Corp v Acitelli-Standard Concrete Wall, Inc , 367 F.2d 678 (6th Cir 1966)

7 See Modrey v American Gage & Mach Co , 478 F.2d 470 (2nd Cir 1973)

8 The Federal Circuit displayed a narrow view of Brulotte in Universal Gym Equip , Inc v ERWA Exercise Equip Ltd , 827 F 2d 1542 (Fed Cir 1987), in which the court upheld a post-expiration contract provision prohibiting the licensee from using any of the licensor's "features and designs " Doubtless this provision would have been struck down by the Brulotte court

9 Morton Salt Co v G S Suppiger Co , 314 U S 488 (1942)

10 International Salt Co v United States, 332 U S 392 (1947)

upholding the district court in Senza-Gel Corp. v. Seiffhart, 803 F.2d 661, 665 (Fed. Cir. 1986). However, imposition of the market power requirement in the second clause of this section appears to be a significant change in existing law, a change the Federal Circuit seems to have invited Congress to make. Id. at 665, n. 5. The commentary's reliance on U.S.M. Corp. v. SPS Technologies, Inc., 694 F.2d 505 (7th Cir. 1982), cert. denied, 462 U.S. 107 (1983), ignores the change in the current law effected by this provision.

From the standpoint of statutory construction, phraseology like "the patent owner does not have market power" is meaningless without some reference to both the market share required and the relevant market.

Finally, a possible drafting error exists in the exception clause of Section (d)(2)(A) in that it refers only to market power of the "patent owner." This disregards the situation, for example, where the litigating exclusive licensee, but not the owner, possesses market power.

271(d)(2)(B)

Section (d)(2)(B) appears to codify the consistent holdings in the lower courts condemning covenants not to deal in competing goods as misuse per se.[11] Because, however, no Supreme Court case has held this practice to constitute misuse per se, the Federal Circuit will require a factual investigation into the overall effect of the license to determine its competitive effect. Thus,

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11 See, e.g., National Lock Washer Co. v. George K. Garrett Co., 137 F.2d 255 (3rd Cir. 1943).

this subsection of the Draft would make per se misuse for an activity which, in the absence of the legislation, would require proof of an anticompetitive effect

261(d)(2)(C)

Section (d)(2)(C) condemns as per se misuse mandatory package licensing, which has not been addressed by the Supreme Court Thus, this provision changes the current law Moreover, although the proposal is generally in accord with pre-Federal Circuit lower court authority, it does not recognize that such authority contemplated at least one exception, which would presumably be eliminated by the proposed Draft Some courts recognized an exception to the rule against mandatory package licensing in the case of blocking patents [12] Even if it is considered desirable to change the law back to that in existence before Windsurfing, at least some consideration should be given to the propriety of statutorily precluding this exception

271(d)(2)(D)

The first clause of Section (d)(2)(D) extends the holding of Brulotte, that post-expiration collection of royalties is unenforceable, to render such conduct per se misuse As discussed above, this is a major change in the law

The second clause of the proposed Subsection (d)(2)(D) would statutorily overrule the holding in Brulotte, in which the parties entered into the license agreement after issuance of the subject patents On the other hand, this subsection codifies the progeny

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12 See International Mfg Co. v Landon, Inc , 336 F 2d 723 (9th Cir. 1964).

of Brulotte which extended the true holding in Brulotte to encompass license agreements entered into prior to issuance of the patents Neither the proposed legislation nor the commentary provide any justification for drawing a distinction between entering into a licensing agreement prior to issuance and after issuance of the patent, and such a distinction does not appear to be mandated by Boggild v Kenner Products, 776 F 2d 1315 (6th Cir 1985), which is cited in the commentary accompanying the Draft.

271(d)(2)(E)

Subsection (d)(2)(E) appears to codify an existing per se antitrust violation as per se misuse If it is perceived necessary to codify this violation into the misuse statute, it would appear to finally overrule the Supreme Court's United States v General Elec Co , 272 U S. 476 (1926)

271(d)(2)(F)

Subsection (d)(2)(F) renders exclusive grant back provisions, misuse per se even though they are not under existing law Rather, the Supreme Court has not considered grant-back clauses, so this subsection would change the law to be applied in the Federal Circuit The vast majority of lower court cases considering grant-back clauses, which involved non-exclusive grant-back provisions, have upheld them Although the commentary accompanying the draft states that "this provision is similar to current case law," citing Transparent-Wrap Machine Corporation v Stokes & Smith Company, 329 U S 637 (1947), the Supreme Court held in that case.

> We only hold that the inclusion in the license of the condition requiring the licensee to assign improvement patents is not per se illegal and unenforceable.

Id at 648 (emphasis added)

271(d)(3)(A), (B), (C)

Subsections A, B and C of Section (d)(3) restate the existing provisions contained in Section 271(d).

271(d)(3)(D)

Subsection (d)(3)(D) does not appear to effect any change in accepted principles of law.[13]

271(d)(3)(E)

Subsection (d)(3)(E)(i) appears to codify the current law that a licensor can charge different royalty rates to different licensees.[14] The effect of Subsection (d)(3)(E)(i) on the Shrimp Peeler cases,[15] in which discriminatory royalty rates were held sufficient to constitute misuse per se but not sufficient to give rise to an antitrust violation is unclear however If this section is intended to codify the Federal Circuit's implicit rejection of those cases, they should be explicitly mentioned in the commentary

Subsection (d)(3)(E)(ii) appears to codify the rule of the bulk of authority which rejects the holding in American Photocopy

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13 See SCM Corp v Xerox Corp , 645 F 2d 1195, 1204 (2nd Cir. 1981) ("refusing unilaterally to license his patent . is expressly permitted by the patent laws"), Cataphote Corp v DeSoto Chem Coatings, Inc , 450 F 2d 769, 774 (9th Cir 1971) ("A patentee has the untrammeled right to suppress his patent")

14 Compare Akzo N V v U S Int'l Trade Comm'n, 808 F 2d 1471, 1488-89 (Fed Cir 1986)

15 Laitram Corp v King Crab, Inc , 244 F Supp 9 (D Alas 1965), Peelers Co v Wendt, 260 F Supp 193 (W D Wash 1966)

Equipment v Rovico, 359 F.2d 745 (7th Cir 1966). From a drafting standpoint, language could perhaps more clearly present the exception, by amendment to "royalty rate alone will not give rise to patent misuse "

Subsection (E)(iii) codifies the rule of Automatic Radio Mfg Co v Hazeltine Research, Inc , 339 U.S 827, 834 (1950), that total sales royalties do not constitute misuse per se The effect of the section on the Supreme Court's narrowing of that holding in Zenith Radio Corp v Hazeltine Research, Inc , 395 U S 100 (1969), to provisions inserted for "the convenience of the parties" is unclear and should be explained

271(d)(3)(F)

Section (d)(3)(F)'s approval of territorial or field of use restrictions is consistent with and works no change in current law.[16]

SECTION 2

271(g)(1)

Section (g)(1) dictates that fraud or other inequitable conduct in procuring or enforcing a patent makes such patent invalid This is a change in the current law which provides that fraud or other inequitable conduct in procuring or enforcing a patent renders such patent unenforceable [17] The primary effect of this change in the law is that it seems to preclude the possibility

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16 See e g , 35 U S C. § 261 (permitting territorial restrictions), Aksa N V v U S Int'l Trade Comm'n, 808 F 2d 1471 (Fed Cir 1986) (approving field of use restrictions)

17 See Senza-Gel, 803 F.2d at 668 n 10.

of curing the results of inequitable conduct, which was suggested in dicta in Rohm & Haas v. Crystal Chemical Co., 722 F 2d 1556, 1571-72 (Fed Cir 1983), cert. denied, 469 U S 85 (1984)

271(g)(2)

Section (g)(2) works no change in the existing law Under the current law, inequitable conduct includes the intentional or grossly negligent failure to disclose prior art of "but for" materiality See J P Stevens v Lex Tex, 747 F 2d 1553 (Fed Cir 1984), cert. denied, 106 S Ct 73 (1985)

271(g)(3)

Section (g)(3) constitutes an express grant of legislative authority to define by regulation who has a duty of disclosure, when such disclosures are required to be made, and "other matters necessary to avoid fraud." As an initial comment, the term "fraud" should be expanded to "fraud or inequitable conduct " The purpose and effect of this provision is unclear If the provision is to merely give the Patent Office authority to change current Rule 56, the provision seems unneeded If the provision is intended to give the Patent and Trademark Office authority to overrule the entire body of Federal Circuit case law on inequitable conduct, the commentary should point that out In the absence of clarification, this provision should be expected to engender much litigation

SECTION 3

The effective date provision is somewhat draconian The Draft would make per se violations out of licensing circumstances which may be entirely permissible today, and the provision should be

changed to cover only license agreements executed on or after enactment of the legislation

CONCLUSION

This draft legislation cuts a wide swath through the existing law of patent misuse It does so without apparent recognition of this effect. Rather, the stated purpose of the bill is to codify existing misuse principles in order to lend certainty to this area of the law thereby encouraging patent licensing This draft legislation would not achieve that desired effect

Based on the foregoing, the subcommittee recommends that the antitrust committee recommend that the AIPLA dissuade Congressman Kastenmeier from introducing this bill We make this recommendation fully aware that Congressman Kastenmeier would introduce this bill only to provoke discussion However, on the remote chance that any portion of this bill might be passed into law, it should be redrafted

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August 14, 1987

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David W Beier, III, Esq
United States House of Representatives
Rayburn House Office Bldg , Room 2137
Washington, DC 20515-6216

Dear David

Enclosed is a copy of a letter we sent to Senator DeConcini on the subject of patent misuse The letter is supplementary to hearing testimony presented in 1984 I've enclosed a copy

Also enclosed is your copy of the letter to the Chairman on foreign filing licenses

Regards,

Sincerely,

Michael W Blommer
Executive Director

MB/cc

Enclosures

AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION
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June 4, 1987

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Honorable Dennis DeConcini
Chairman, Subcommittee on Patents
Copyrights & Trademarks
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Senator DeConcini

The American Intellectual Property Law Association (AIPLA) fully supports the decision of the Subcommittee on Patents, Copyrights and Trademarks to reform the "patent misuse" doctrine in S 1200 AIPLA urged this action in hearings before this Subcommittee in the 98th Congress along with other organizations directly familiar with the ownership and enforcement of intellectual property rights

I will not reiterate the statement made to this Subcommittee on April 23, 1984 by Bernarr R Pravel, then President of AIPLA, in support of this reform It is in the record of the Subcommittee However, allow me to make the following brief observations

The "patent misuse" doctrine was created by the federal judiciary Over the years, on a case by case basis, courts have decided the statutory patent rights will not be enforced if the patent owner has somehow misused or overextended those rights The doctrine is based on the perception of various courts as to what economic policy as expressed in the antitrust laws should be regarding patent use In effect, courts have decided to act because Congress has failed to recognize that in a competitive sense business practices involving intellectual property should be regulated differently than business practices involving other types of property We strongly disagree with this premise

Congress enacted patent laws to promote and encourage invention and innovation Congress enacted antitrust laws to ensure fair and productive business competition There is no inherent or actual conflict between these two bodies of law They share common goals Both are procompetitive

The misuse "doctrine" is a shifting set of rules by which courts have narrowed the means by which intellectual property may be profitably exploited This doctrine is not based on business realities but rather on judicial theory This doctrine does not evolve as a rational response to national economic conditions Rather it results from the operation of legal precedents, the predilections of individual judges, and the facts and circumstances of specific cases The doctrine allows courts to conclusively presume that certain types of agreements involving intellectual property are anti-competitive without considering evidence relating to economic harm

The "misuse" doctrine is a counterproductive legal fiction It negatively affects virtually every license agreement involving technology developed or used in the United States The doctrine reduces the incentive to innovate This doctrine does not increase or stimulate competition In our view, this court made law serves neither the purpose of the patent laws nor the purpose of the antitrust laws and deserves to be abandoned

S 1200 is a clear and straight forward solution to the "patent misuse" problem It would merely require and ensure that economic analysis has been conducted before a court would be able, properly, to refuse to enforce a valid patent on anti-competitiveness grounds

We note with regret that the Subcommittee has not seen fit to reform copyright misuse It is true that courts have not been as aggressive in applying the misuse rational to copyrights as they have been with patents The need for reform may not be as apparent or as acute However, the growing economic importance of copyrights is obvious We see no reason for Congress to remain silent and allow copyright misuse to develop as courts see fit

We continue to appreciate the Subcommittee considerations of our views

Sincerely,

Robert C Kline, Esq
President

RC/cc

SUPPLEMENTAL STATEMENT OF

BERNARR R. PRAVEL, PRESIDENT

AMERICAN
INTELLECTUAL PROPERTY LAW
ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON PATENTS, COPYRIGHTS
AND TRADEMARKS

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

APRIL 23, 1984

ON

S. 1841 (TITLES III AND IV)

As this Committee is aware, the American Intellectual Property Law Association (AIPLA) is a national society of more than 4800 lawyers engaged in the practice of patent, trademark, copyright, licensing, and related fields of law affecting intellectual property rights AIPLA membership includes lawyers in private, corporate, and government practice, lawyers associated with universities, small business, and large business, and lawyers active in both the domestic and international transfer of technology

We submit this report in amplification of our support of Titles III and IV of S 1841 AIPLA believes these initiatives by the Congress will materially assist American creators of intellectual property as will the legislation we discussed before the Committee on April 3, 1984

I INTRODUCTION

The AIPLA supports Title III of S 1841 with one exception and supports Title IV of S 1841 in principle although it is not certain that the specific prohibitions are needed if Title III is enacted

As to Title III, the AIPLA believes it is in the public interest, for it provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust

laws, and it limits damages to actual damages in actions based on such agreements which are brought under Section 4 or Section 4C of the Clayton Act While the AIPLA believes that Title III should exclude agreements to convey rights to use trademarks from the coverage of the Title, the unifying principle of Title III will make it clear to courts that the rule of reason is to govern the evaluation of licensing practices involving intellectual property

As to Title IV, while the AIPLA endorses it in principle, it is not certain that the specific practices set forth therein need to be enumerated in order to free up licensing practices from the cloud of the unreasonable threat of the antitrust laws

The AIPLA supports the passage of Title IV of the Act which provides that conduct cannot be found to constitute patent or copyright misuse unless such conduct actually violates the antitrust laws Title IV should probably be amended, however, to make it clear that the party asserting a misuse does not have to satisfy antitrust standing or antitrust injury requirements of the antitrust laws to be able to raise the defense of misuse

II DISCUSSION INTELLECTUAL PROPERTY LICENSING ARRANGEMENTS

Title III of S 1841 would do two things First, it would add a new Section 27 to the Clayton Act which provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws Second, it would limit damages in antitrust cases involving such agreements to actual damages plus prejudgment interest

The AIPLA supports the passage of Title III of the Act, not only because it places single-firm licensing activities on an equal footing with joint research and development programs with respect to the appropriate antitrust standard to be applied and the damages allowable where challenged practices are found to be anticompetitive (which is covered by Title II of S 1841), but because it will encourage innovation by improving the licensing climate for intellectual property As the Department of Justice has noted in its Detailed Analysis of Antitrust Legislative Reforms Proposed by the Department of Justice (March 1983), the antitrust risks incident to licensing arrangements which are perceived can both deter research and development

activities and limit access to proprietary innovations developed by other parties These, in turn, reduce the potential for the widest commercialization of innovations, not to mention their creation in the first instance

The legality of intellectual property licensing arrangements must be judged under rule of reason, as Title III demands, if we are to promote commercially attractive licensing arrangements Limiting antitrust damages which involve such arrangements to actual damages as Title III also provides will have the additional advantage of minimizing the overkill potential of the antitrust laws where they are properly brought into play

While some, for example, Professor Kaplow of Harvard Law School, oppose the adoption of the rule of reason in all cases because economic analysis is complex and difficult, the AIPLA believes it is essential to weigh the competitive effects of challenged practices The Supreme Court has come to this conclusion as it so eloquently stated in Continental T V , Inc v GTE Sylvania, Inc , 433 U S 36 (1977) The AIPLA does not believe Title III will prevent proven anticompetitive practices from being condemned It will, however, require courts to evaluate all the evidence on the probable economic effects of the challenged practice rather than apply a per se rule which may be easy to use, but is not

necessarily just or even economically defensible While it has been suggested that detrebling antitrust damages in situations where the practice is based on a licensing arrangement involving intellectual property goes too far, we believe actual damages plus reasonable attorney fees is more than enough to encourage victims of unlawful conduct to seek redress in the courts Moreover, since the exclusions of Title III only apply where the disputed conduct is based on an intellectual property licensing agreement, if such an agreement is used as a shield for a naked restraint of trade, for example, it should not prevent the application of conventional antitrust principles

III DISCUSSION TITLE IV PATENT AND COPYRIGHT MISUSE

Title IV of the Act would amend 35 U S C § 271 to provide that enumerated patent and copyright licensing practices cannot provide the basis for a finding of misuse or illegal extension of the patent unless such practices, in the circumstances in which they are employed, violate the antitrust laws Although the courts have held that some of the enumerated licensing practices were a misuse, the list includes practices which have never been so categorized

While the AIPLA believes licensing practices of patent and copyright owners should not prevent enforcement of the

property rights unless the practice in light of all the circumstances violates the antitrust laws, we do not believe it is necessary, or even desirable, to set out specific practices unless it is made clear that they are by way of example, rather than by way of limitation Such a clarification would make the statutory language consistent with the Justice Department's statement concerning this Section On balance, the AIPLA believes the desirable results of Section 401(d) pertaining to patents and Section 402 pertaining to copyrights can be attained by changing these two sections to read as follows

> Sec 401 Section 271 of title 35, United States Code, is amended --
>
> (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 licensing practices or actions relating to his patent, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws.
>
> Sec 402 Subsection (a) of section 501 of title 17, United States Code, is amended by adding at the end thereof the following "No copyright owner otherwise entitled to relief for infringement of a copyright under this title shall be denied relief or be deemed guilty of misuse or illegal extension of the copyright by reason of his licensing practices or actions relating to his copyright, unless such conduct, in view of the circumstances in which it is employed, violates the antitrust laws "

These proposed modifications of the misuse doctrine are necessary elements of the Act's overall purpose of encouraging intellectual property licensing There is no reason why intellectual property owners should not be able to enforce their statutory rights in situations where their licensing activities do not violate the antitrust laws It would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements and leave a misuse doctrine in place which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which, while they may be somewhat anticompetitive, do not even constitute antitrust violations

It should be noted that Title IV, with or without our proposed amendments, would not alter existing law with respect to the misuse doctrine as it applies to improper practices not related to competition (e g , fraud on the Patent and Trademark Office and the like) Rather, it would merely require and ensure that economic analysis has been conducted before a court would be able, properly, to refuse to enforce a valid patent or copyright because of anticompetitive practices

Although the misuse doctrine is grounded in national economic policy as expressed in the antitrust laws, as this

Committee is aware, the courts have stated that various forms of allegedly "anticompetitive" conduct may constitute patent misuse even though the conduct does not violate the antitrust laws Where licensing activities contravene national competition policy, as expressed in the antitrust laws, a finding of misuse and unenforceability makes sense However, conduct should not be condemned as patent misuse on economic grounds unless the conduct actually violates the antitrust laws Title IV codifies these principles, and the AIPLA supports the proposed Title, in principle

AIPLA also strongly urges a change in the designation of the new paragraph added to Section 271 of title 35, United States Code, as paragraph "(e)" instead of "(d)", and also leaving present subsections (c) and (d) of Section 271 as now in title 35

It is our concern that some meaning may be read into the re-designation of present subsection 271(d) to subsection 271(c)(2) as proposed in Section 401 of S 1841. The present subsection 271(d) is not limited to contributory infringement, whereas present subsection 271(c) is so limited By the re-designation of those two subsections, i e putting both together, it may create a misconception that the statutory intent was to limit present subsection 271(d) to contributory infringement Although paragraph (d)

does speak in terms of "contributory" infringement in defining these three exceptions, the legislative history of Section 271 and writings by those who drafted the provision clearly indicate that "contributory" infringement as used in paragraph (d) refers both to inducement of infringement under paragraph (b) and the special type of contributory infringement defined in paragraph (c) To cite several examples of this

1 The revision notes to Section 271 state that "Paragraphs (b) and (c) define and limit contributory infringement of a patent and paragraph (d) is ancillary to these paragraphs "

2 In Frederico's Commentary on the New Patent Act, he states "There is apparently some looseness in the use of the terms 'infringement' and 'contributory infringement' which ought to be considered immaterial in construing the Section "

3 Giles Rich, the primary drafter of Section 271, has made it very clear that paragraph (d) applies to both paragraph (b) and (c) In an article by Mr Rich, entitled Infringement Under Section 271 of the Patent Act of 1952, 35 J P O S 476 (1953), Mr Rich stated

> Paragraphs (b) and (c) deal with two kinds of contributory infringement Both of them define and limit contributory infringement and paragraph (d) is ancillary to these paragraphs

> As to paragraph (d), its purpose is to make the appropriate exceptions to the misuse doctrine as it has seemed to exist since the Mercoid case, at least in the Supreme Court and the jurisdictions which accept what it has said as law, and its effect, in the simple words of the Judiciary Committee Report, is this one who merely does what he is authorized to do by statute is not guilty of misuse of the patent The reference to statutory authority is, of course, to the full legal implications of paragraphs (b) and (c)
>
> Clause 1 of paragraph (d) states "derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent " Now visualize any situation in which an unauthorized person would be held liable under paragraphs (b) or (c) and then suppose if the patentee is doing the same thing and profiting from it. If, under Section 271, a patentee could hold someone else liable for doing what he himself is doing businesswise, his business conduct is no misuse. Whether the conduct falls within Section 271(b) or (c) would seem to be immaterial Paragraph (d) applies

To avoid a potential mistaken reading of the statute, AIPLA strongly urges the above change in Section 401

IV CONCLUSION

The AIPLA supports Title III and IV of S 1841 and urges the Committee to report such legislation favorable This completes our Statement We thank the Committee for the opportunity to present this Supplemental Statement

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October 27, 1987

Mr Michael J Remington
Counsel
Subcommittee on Courts, Civil
Liberties & The Administration
of Justice
2137 Rayburn House Office Building
Washington, D C 20515-6219

Dear Mr Remington

Enclosed is a letter that I have sent to Representative Rodino regarding the semiconductor industry s position on the issue of Patent Misuse Doctine Reform I hope that you can appreciate the semiconductor industry s support for the Senate Trade Bill s provision on Patent Misuse Doctrine Reform, and that you will support the recommendations we make in our letter

Thank you for your interest in Patent Misuse Doctrine Reform

Sincerely,

A A Procassini

Andrew A Procassini
President

Enclosure

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October 27, 1987

The Honorable Peter Rodino, Jr
Chairman
Committee on the Judiciary
Subcommittee on Monopolies and Commercial Law
2462 Rayburn House Office Building
Washington, D C 20515-3010

Dear Mr Chairman

I am writing to you to explain the SIA's strong support for legislation that reforms the current patent misuse doctrine contained in Title 34 of The Trade Bill This support is grounded on the importance that patents play in the ability of the industry to protect its intellectual property and to fund ongoing research and development critical to its competitiveness

A semiconductor firm's most important asset often is its inventions, innovations and technological know-how In 1986 the industry spent an unprecedented 12 2 percent of its sales on research and development This level of R&D spending was greater than any other U S industry according to Business Week's annual R&D survey

The ability of innovators to extract a return on their investment is essential to their ability to continue to fund ongoing research and development needs in the industry U S intellectual property laws have always played a critical role in this process, and patents are widely used in our industry to protect inventions in circuitry design, manufacturing processes, and new materials and equipment

The SIA strongly supports the Senate bill's Patent Misuse Doctrine Reform because it confirms a necessary level of patent protection and makes it more rational This reform (i e , clarification) amends Section 271 of title 35 of the United States Code by creating a legislative standard for when a so-called patent-misuse (i e , antitrust law violation) defense against a patent infringement claim can be successful

The current law lacks clarity and predictability and provides the courts with no legislative standard for determining when a patent holder has used his patented invention within the competitive parameters of applicable law that the patent statute mandates so long as an antitrust law violation does not exist This results in a high level of judicial discretion and the resulting unpredictability decreases the value of patents and

weakens the incentives that patents provide to firms to engage in research and development.

The Senate amendment would eliminate the current unpredictability of the law by permitting the patent-misuse defense to be successful in a competitive context only when the patent holder has used his patent in a manner that violates the U S antitrust laws Application of the present judge-made standard often yields irrational, even perverse, results in litigation from both economic and competitive perspectives

The semiconductor industry is encouraged by your efforts in reforming the current patent laws Reform is greatly needed, but it must be reform that will provide U.S industry (including semiconductor manufacturers) with strong and fair protection against patent infringers Creating a legislative standard for the patent misuse defense is a critical part of this reform because it will confirm and clarify protection of intellectual property rights We greatly appreciate your efforts and look forward to the passage of a trade bill containing patent reforms

Sincerely,

Andrew A Procassini
President, SIA

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Julius Silver Fellow
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December 15, 1987

Representative Robert W Kastenmeier
House Judiciary Committee
United States House of Representatives
Washington, D.C 20515

Dear Representative Kastenmeier

I would like to take this opportunity to set forth my comments on a bill currently pending before Congress, S 1200, titled "A Bill to Amend Title 35, United States Code, With Respect to Patented Processes, Patent Misuse and Licensee Challenges to Patent Validity," as amended on June 5, 1987, Sens DeConcini, Hatch, and Lautenberg, sponsors ("the Bill") I understand that the House Subcommittee on Courts, Civil Liberties and the Administration of Justice has responsibility for the Bill in the House, thus I direct my comments to you, the Subcommittee's Chairman

By way of introduction, you should be aware that I have some familiarity with patent law, it is my primary area of scholarly interest I designed and help teach a course on the Biotechnology Industry here at Columbia, which includes a detailed treatment of relevant patent cases. I have also recently completed several articles on patent law Finally, I have some practical experience with technology licensing, this was an area I concentrated on while practicing with Fenwick, Davis & West in Palo Alto, California

I hope my comments are useful.

Sincerely,

Robert P Merges

COMMENTS ON S.1200: THE ROLE OF PATENT MISUSE[1]

1. General Comments

Much has been written about the conflict between patent and antitrust laws. See, e.g., Kaplow, The Patent-Antitrust Intersection: A Reappraisal, 97 HARV. L. REV. 1813 (1984) Thus it is safe to say, as a preliminary matter, that whatever the optimal relationship between the two might be, one piece of legislation can only deal with a limited subset of the issues posed by that relationship. Consequently, I do not wish to speak generally about what that relationship ought to be in these comments; only about specific ways I believe S.1200 is flawed.

My first point, having said that, is to note that I do disagree with one fundamental assumption behind S.1200: that the antitrust laws should be the sole means of addressing anticompetitive behavior on the part of patentees. See Title 2 of the Bill: "No patent owner . . . shall be denied relief . . unless [his or her] . . . practices or actions or inactions . . violate the antitrust laws " The fact is that a concern with "level playing fields" permeates much of the law applicable to private firms. Consider the law of unfair competition (including trade secret law, the doctrine of "passing off", and covenants not to compete), or the unconscionability doctrine in contract law. These are all designed to thwart behavior that is, in one way or another, anticompetitive. Such behavior may not rise to the level of an antitrust violation, yet it is still worth preventing.

Why should the patent law be any different? Why, that is, do the proponents of S.1200 believe that patent misuse -- an equitable doctrine arising out of the patent system, which has been applied to a wide variety of behavior deemed anticompetitive -- must be replaced by antitrust analysis?

The root of the answer is that they believe only the relatively rigorous standards of antitrust analysis can yield predictable results when assessing harm to competition; without the predictability and order such analysis brings,

---

[1] Of course, the views expressed in this letter are purely personal; they do not represent official views of the Julius Silver Program, its Director, any of its participants, or anyone else at Columbia Law School

they fear the harm to business will exceed the benefits society gains by prohibiting certain practices on the part of patentees. See, e.g., USM Corp. v. SPS Technologies, INc, 694 F.2d 504 (7th Cir. 1982) (Posner, J) ("If misuse claims are not tested by conventional antitrust principles, by what principles should they be tested? Our law is not rich in alternative concepts of monopolistic abuse; and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty").

My response to this is that empirically, it is unsupported; case law on misuse has, in fact, been fairly predictable. Thus commentator after commentator lists the same set of practices that have been classified as misuse. See, e.g., P. HOFF, INVENTIONS IN THE MARKETPLACE: PATENT LICENSING AND THE U.S ANTITRUST LAWS (1987); 14 BUSINESS ORGANIZATIONS, D. EINHORN, PATENT LICENSING TRANSACTIONS (1970 & Supp. 1986); 5 D CHISUM, PATENTS §§19.04[1] through 19.04[3] (1986). Even Judge Richard Posner, certainly no great advocate of the misuse doctrine, has noted that "apart from the conventional applications of the doctrine we have found no cases where standards different from those of antitrust law were actually applied to yield different results . . ." USM Corp. v SPS Technologies, Inc , supra (emphasis added). More importantly, it is clear from both (i) the significant volume of licensing activity yearly; and (ii) the lukewarm support shown so far for S.1200, that there is no widespread perception of debilitating uncertainty in this area. Thus there may be some analytical loose ends -- a result in part, perhaps, of the paucity of scholarly attention misuse has received compared to full-fledged antitrust issues -- but there is no overwhelming sense of incoherence.

2. Specific Practices

I turn now to some specific licensing restrictions whose legality S.1200 is designed to clarify As will become clear, I believe that (i) a higher, antitrust-based standard of anticompetitive effect is an inappropriate way to determine whether the practices covered by misuse should be prohibited; and (ii) courts have traditionally applied the misuse doctrine with a great deal of sensitivity to the commercial context of the licensing practice in question, thus demonstrating that the doctrine is not an open-ended excuse to punish patentee/licensees, but a sensible instrument for balancing the costs and benefits of specific patent licensing practices.

Note that I do not cover all the practices that have been characterized as misuse, only those that are frequently said to be in an uncertain state due to open-ended or inconsistent court opinions: (a) tie-ins; (b) grant-backs; and (c) indirect extensions of the term of a patent.[2]

a. Tie-Ins

Under the recently-announced rule of the Court of Appeals for the Federal Circuit, a tie-in not rising to the level of an antitrust violation may be found to constitute misuse. Senza-Gel Corp. v. Seiffhart, 803 F.2d 661, 231 U.S P.Q. (BNA) 363 (Fed. Cir. 1986) The court approved of a three-part test to determine whether a tie-in was present in a particular case:

> First: Determine whether there are two things tied, i.e., whether there are separable or inseparable items; if so
>
> Second: Determine whether the "thing" which is assertedly tied to the patented item is a staple or non-staple item in commerce; if staple
>
> Third: Determine whether in fact they are tied.[3]

The court further explained how the first determination is to be made, and how it differs in a case involving patents from an antitrust case where the tie-in is achieved without a patent:

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[2] The other restrictions prohibited by the infamous "Nine No-no's," in addition to being grounded in no more solid authority than an after-lunch speech, are really not seriously thought to produce uncertainty on the part of licensors. Even many opponents of the "no-no's" concede that several of these practices have no pro-competitive effects (e.g., resale price maintenance); the other practices have never been prohibited by courts, outside the context of a sham arrangement disguising a cartel. See, e.g., P. HOFF, INVENTIONS, supra, at 48 (noting lack of support for horizontal price fixing practices involving patent licenses); USM Corp. v. SPS Technologies, Inc, 694 F.2d 504, 216 U.S.P.Q. (BNA) 959 (7th Cir. 1982) (differential royalty rates do not amount to patent misuse); General Talking Pictures Co. v. Western Elec. Co., 304 U.S. 175 (1938) (field of use restrictions do not constitute patent misuse).

[3] Senza Gel Corp. v. Seiffhart, supra, 231 U.S.P Q. (BNA) at 365.

> [T]he Supreme Court has stated that "the answer to the question whether two products are involved turns not on the functional relationship between them, but rather on the character of the demand for the two items." Jefferson Parish Hospital District No. 2 v Hyde, 466 U.S. 2, 19 (1984) . . . . [footnote 14] [However,] [t]he law of patent misuse in licensing need not look to consumer demand (which may be nonexistent) but need look only to the nature of the claimed invention as the basis for determining whether a product is a necessary concomitant of the invention or an entirely separate product. [This is because] [t]he law of antitrust violation [sic] . . . [is] tailored for situations that may or may not involve a patent . . .[4]

There are two points worth noting in this analysis. First, it hints at a cogent rationale for the different standards applied to tie-ins in patent misuse and antitrust cases. That is, since the markets for specific technologies are often very "thin," with few direct substitutes available for particular inventions or components, the consumer-demand test of Jefferson Parish is of very limited use in certain cases involving patented technology.[5] Second, product separability will often turn on the specific technology recited in the claims of the patent in suit. Thus a court intimately familiar with patent claim construction will be in a better position to determine whether the patented invention is tied to a "separate product." This illustrates an ancillary benefit of the patent misuse doctrine: it is a doctrine of patent law, to be analyzed by patent courts at the same time other patent issues (such as the scope of a patent's claims) are resolved. To the extent that the effects of allegedly anticompetitive patent behavior turn on specific technologies -- and their place in the businesses of the licensor and licensee -- patent misuse makes sense as a separate branch of patent law. Because of this, it is properly seen as being related to, but not coextensive with, antitrust laws and doctrines along similar lines.

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[4] Id., 231 U.S.P.Q. (BNA) 370 & 370 n. 14.

[5] The "thinness" of markets for specific technologies is a well-documented point. See Caves, Crookell & Killing, The Imperfect Market for Technology Licenses, 45 OXFORD BULLETIN OF ECON. & STATS. 249 (1983).

b. Grantbacks

Grantbacks are common in technology licensing agreements. They usually provide that the licensee will grant a nonexclusive license on any improvements it develops to the licensor -- to prevent the situation where the licensee can block the licensor from practicing an improved version of the licensor's original invention

In some cases, however, licensors have apparently used grantback provisions to maintain exclusivity in a particular technology, by requiring licensees to assign all improvements back to the licensor or to grant an exclusive license back to the licensor. Where undertaken to maintain control over the future development path of a technology, this practice has routinely been condemned as patent misuse. See, e.g., Transparent-Wrap Machine Corp. v. Stokes & Smith, 329 U.S. 637, 646-647 (1947) (dictum); 4 D. CHISUM, PATENTS §19 04[3][j] (1986). On the other hand, where the licensee is simply required to grant a nonexclusive license back to the licensor, the practice is not said to constitute misuse. Id.

Grantbacks provide another example where patent misuse makes sense as a separate and independent doctrine from antitrust law. Again, the reason is that the anticompetitive effects of a grantback clause will depend critically on the particular technology involved -- and especially whether the grantback in question extends to "improvements" that are actually beyond the scope of the claims recited in the licensed patent. See, e.g., Duplan Corp. v. Deering Milliken, Inc, 444 F.Supp. 648, 700 (D.S.C. 1977) aff'd 594 F.2d 979 (4th Cir. 1979).

As with the tie-in, the grantback may apply to only one patent, most likely one licensed into a relatively "thin" market for technology. The restriction may or may not reduce competition in a relevant market, then, and it may be difficult to tell. What is clear is that determining this depends critically on the language of the particular claim involved. Moreover, as with tie-ins, it may be difficult or impossible to assess whether there are any realistic substitutes for the improvement granted back to the licensor -- again, because of the thinness of the markets for both the original patented technology and any improvements on it. The upshot is that the patent misuse doctrine is once again superior to straight antitrust analysis; it avoids the need for a determination of whether a substantial degree of competition has been foreclosed in a difficult-to-define market, and instead focuses attention on whether the technology involved in the original license is being used in

an anticompetitive fashion in the (perhaps small) market into which it was licensed.

It should be noted that courts have not blindly applied misuse analysis in the area of grantbacks. They have instead shown a good deal of sensitivity to the commercial context of the grantback clause. See, e.g., Sante Fe-Pomeroy, Inc. v. P.& Z. Co., 569 F.2d 1084, 197 U.S.P.Q. (BNA) 449 (9th Cir. 1978) (grantback clause in license from owner of patent on excavation process to government agency held not to constitute misuse, since alternative methods for achieving result were available to the licensee)

c Temporal Extensions of Patent Term

The temporal extension of a patent is another instance proving that misuse is viable as a separate doctrine. The reason is once again that "relevant market" analysis is difficult and misleading, since the truly relevant market is the small one for a given, licensed technology In such a market, which may be as narrow as the specific claims of the licensed patent at issue, any extension of the temporal scope of the patent has severe anticompetitive effects. It is simply immaterial whether, because of substitutes for the patented technology, these effects restrain a less than "substantial" amount of competition in some broadly-defined market. The individual licensee may well be dependent on one technology -- that of the licensor -- and hence in no position to seriously pursue any of these substitutes. Patent law, unlike antitrust, does and should concern itself with the plight of the individual licensee. Otherwise, antitrust analysis could be used to amend the patent laws surreptitiously: so long as an insubstantial amount of commerce was affected, a patentee could extend the life of his or her patent.

Fortunately, the patent misuse doctrine prevents this from happening. In Boggild v. Kenner Products, 776 F.2d 1315 (6th Cir. 1985), for instance, the licensee had invented an extruder specifically for use with licensor/defendant's Play Doh product. The license agreement, executed prior to plaintiff's application for a patent but in clear contemplation of such application, called for royalty payments to be made for 25 years -- regardless of whether the patent application resulted in the issuance of a patent. The Sixth Circuit held that the licensee was not obligated to pay royalties beyond the seventeen year term of the patent that eventually issued. See also Meehan v. PPG Indus , Inc , 802 F.2d 881 (7th Cir. 1986) (same, as to package license of patents calling for royalty payments on entire package until all had expired); Aronson v. Quick Point Pencil Co., 440 U.S.

257, 263-64 (1980) (noting in dictum that extension of payments beyond patent term constitutes misuse).

These cases properly rely on patent misuse to strike down practices that, although perhaps not substantially injurious to competition in some relevant market, have significant anticompetitive effects -- and, notably, no social benefits. Congress has determined that 17 years of exclusivity provides enough incentive to call forth inventive activity in the United States. Parties are simply not free to circumvent this through licensing agreements. See generally 4 D. CHISUM, PATENTS §19.04[3][d] (1986)

3. Patent Misuse as a Doctrine of Equity

My final objection to S.1200 is more general. In essence, I believe that any attempt to cabin the misuse doctrine in narrow antitrust categories necessarily robs patent law of a flexible "escape hatch." Misuse has served the law well in a very few cases where overriding public policy concerns conflicted with a patentee's use of his patent. Without the misuse doctrine, the courts would have had no legitimate way to do justice in these cases.

Misuse in these cases has been invoked when an otherwise legitimate use of a patent would simply be unfair. Classic cases include Vitamin Technologists, Inc. v. Wisconsin Alumni Research Foundation, 146 F.2d 929 (9th Cir. 1945), and City of Milwaukee v. Activated Sludge, Inc., 69 F.2d 577 (7th Cir. 1934). In both these cases, the patentee's legitimate exercise of monopoly rights conflicted sharply with a clear and immediate threat to public welfare -- and the patents were not enforced. Obviously such cases are very rare, the general, indeed near-universal, rule is that no compulsory licensing of patents may be commanded in the United States. But the rare cases cited demonstrate that equitable flexibility should not be taken completely out of the hands of the courts.[6]

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[6] In fact, it is arguable that the "rule" announced in these cases is also, in a sense, efficient. In the Vitamin Technologists case, for instance, given the high costs of either (i) supplying butter at subsidized rates, or (ii) financing the development of a non-infringing butter substitute, the court's decision refusing to enforce the patent may well have been the least-cost solution. And, certainly, forcing the patentee to license in this case signalled that where matters of public health were concerned, future patentees would be wise to adopt reasonable licensing

A brief contemporary example might help prove the point Suppose a firm developed an AIDS vaccine, but refused to license it to sellers in certain states, on the grounds that those states had excessively stringent product liability laws or doctrines. This is admittedly far-fetched, yet not inconceivable. (Genentech, for example, lobbied hard for a state law specifically exempting AIDS vaccines from California's prohibitive product liability standards, contending that under such standards development of a vaccine was not worth the risks; they were successful in this effort.) In such a case, wise public policy would dictate that the patent not be enforced until the patentee agreed to license into those states. (Perhaps at higher rates, to offset the increased risk of product liability.) Again, such cases are rare, but when they arise it would seem essential for courts to have the flexibility to deal with them, whether they present facts amounting to an antitrust violation or -- as with the AIDS vaccine case -- they do not. The patent misuse doctrine, a branch of the equitable principle of "unclean hands," provides this flexibility. This is reason enough why it should be retained.

4. Conclusion

There is no sound reason why present misuse doctrines need to be eliminated in favor of antitrust analysis of the same practices Indeed, as I have tried to make clear, there are a number of reasons why misuse has a bona fide claim to an independent existence.

At the same time I think it is important to add one point. I believe that not all legislation favorable to licensors is unreasonable. In fact, some modification of per se antitrust restrictions is probably warranted. See P. HOFF, supra, at Chapter 6 (calling for antitrust legislation establishing presumptions in favor of and against certain practices). But this should not be accompanied by modification of the patent misuse doctrine -- a different doctrinal animal that has a valuable, though limited, place in patent law.

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policies. Moreover, given the extreme rarity of such judicial action, it is unlikely that the extra risk this poses would seriously deter an R&D decisionmaker from pursuing a research project.

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November 16, 1987

Representative Robert W Kastenmeier
House Judiciary Committee
2137 B Rayburn Building
Washington, D C. 20515

Dear Representative Kastenmeier·

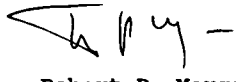
I would like to take this opportunity to set forth my comments on a bill currently pending before Congress, S.1200, titled "A Bill to Amend Title 35, United States Code, With Respect to Patented Processes, Patent Misuse and Licensee Challenges to Patent Validity," as amended on June 5, 1987, Sens. DeConcini, Hatch, and Lautenberg, sponsors ("the Bill") I understand that your subcommittee on Courts, Civil Liberties and the Administration of Justice has responsibility for the Bill in the House; thus I direct my comments to you.

As you may recall from my testimony before your Subcommittee on the issue of Animal Patents, I am quite familiar with patent law; it is my primary area of scholarly interest. I designed and help teach a seminar at Columbia Law School on law and the biotechnology industry, which includes a good bit of discussion on patent law I will also be teaching a seminar on Advanced Topics in Intellectual Property when I join the faculty of the Boston University School of Law next academic year.

My basic conclusion is that the Senate Bill is flawed and should not receive favorable action in your Subcommittee. My reasons for this conclusion are contained in the attached memorandum.

If I can clarify any of the points in the memo, please do not hesitate to have a staff member contact me. Thank you for your attention to this matter.

Sincerely,



Robert P Merges
Julius Silver Fellow

P.S. Of course, the views expressed in this letter are purely personal; they do not represent official views of the Julius Silver Program, its Director, any of its participants, or anyone else at Columbia Law School.

WHY WE SHOULD KEEP PATENT MISUSE

1. General Considerations

Supporters of the Senate Bill believe the antitrust laws should be the sole means of addressing anticompetitive behavior on the part of patentees. See Title 2 of the Bill. "No patent owner . . . shall be denied relief . . . unless [his or her] . . . practices or actions or inactions . . . violate the antitrust laws " But there is a place for restrictions on anticompetitive behavior within patent law, not just in antitrust. The fact is that a concern with "level playing fields" permeates much of the law applicable to private firms. Consider the law of unfair competition (including trade secret law, the doctrine of "passing off", and covenants not to compete), or the unconscionability doctrine in contract law. These are all designed to thwart behavior that is, in one way or another, anticompetitive. Such behavior may not rise to the level of an antitrust violation, yet it is still worth preventing.

Why should the patent law be any different? Why, that is, do the proponents of S.1200 believe that patent misuse -- an equitable doctrine arising out of the patent system, which has been applied to a wide variety of behavior deemed anticompetitive -- must be replaced? Some claim it has created uncertainty, because its precise boundaries have evolved through individual decisions, and the soctrine has never been codified in a statute. Yet all the commentators and practicing lawyers who examine the cases agree on the categories of anticompetitive behavior that will be characterized as misuse. See, e g , P. HOFF, INVENTIONS IN THE MARKETPLACE (1987); 14 BUSINESS ORGANIZATIONS, D. EINHORN, PATENT LICENSING TRANSACTIONS (1970 & Supp. 1986), 5 D. CHISUM, PATENTS §§19.04[1] through 19.04[3] (1986). Even Judge Richard Posner, certainly no great advocate of the misuse doctrine, has noted that "apart from the conventional applications of the doctrine we have found no cases where standards different from those of antitrust law were actually applied to yield different results . ." USM Corp. v. SPS Technologies, Inc., supra (emphasis added). Moreover, it is clear from the lukewarm support shown so far for S.1200 that there is no widespread perception of debilitating uncertainty in this area. Thus there may be some analytical loose ends -- a result perhaps of the paucity of scholarly attention

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misuse has received compared to full-fledged antitrust issues -- but there is no overwhelming sense of incoherence

The second response centers on misuse as an equitable doctrine. The nature of equity is that it is somewhat "messy". (This will appear especially true to economists, whose need for analytical boundaries is well documented) The fact remains that in certain cases an otherwise legitimate use of a patent might just be unfair. Classic cases in this vein include Vitamin Technologists, Inc. v. Wisconsin Alumni Research Foundation, 146 F 2d 929 (9th Cir. 1945), and City of Milwaukee v. Activated Sludge, Inc., 69 F.2d 577 (7th Cir. 1934) In both these cases, the patentee's legitimate exercise of monopoly rights conflicted sharply with a clear and immediate threat to public welfare -- and the patents were not enforced. Obviously such cases are very rare; the general, indeed near-universal, rule is that there is no rule of compulsory licensing of patents in the United States But it is important that this equitable flexibility not be taken out of the hands of the courts [1]

A brief contemporary example might help prove the point. Suppose a firm developed an AIDS vaccine, but refused to license it to sellers in certain states, on the grounds that those states had excessively stringent product liability laws or doctrines. This is admittedly far-fetched, yet not inconceivable. (Genentech, for example, lobbied hard for a state law specifically exempting AIDS vaccines from California's prohibitive product liability standards, contending that under such standards development of a vaccine was not worth the risks; they were successful in this effort.) In such a case, wise public policy would dictate that the patent not be enforced until the patentee agreed to license into those states. (Perhaps at higher rates, to offset the increased risk of product liability.) Again, such cases are rare, but when they arise it would seem essential for courts to have the flexibility to deal with them, whether they present facts amounting to an antitrust violation or -- as with the AIDS vaccine case -- they do not. The patent misuse doctrine, a branch of the equitable principle of

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[1] In fact, it is arguable that the "rule" announced in these cases is also efficient. In the Vitamin Technologists case, for instance, given the high costs of either (i) supplying butter at subsidized rates, or (ii) financing the development of a non-infringing butter substitute, the court's decision refusing to enforce the patent may well have been the least-cost solution. And, certainly, forcing the patentee to license in this case signalled that where matters of public health were concerned, future patentees would be wise to adopt reasonable licensing policies.

"unclean hands," provides this flexibility This is reason enough why it should be retained.

2. Specific Practices

I turn now to some specific licensing restrictions whose legality S 1200 is designed to clarify. As will become clear, I believe that (i) a lower, antitrust-based standard is an inappropriate way to determine if the practices covered by misuse are anticompetitive in the individual case; and (ii) courts have traditionally applied the misuse doctrine with a great deal of sensitivity to the commercial context of the licensing practice in question, thus demonstrating that the doctrine is not an open-ended excuse to punish patentee/licensees, but a sensible instrument for balancing the costs and benefits of specific patent licensing practices.

Note that I do not cover all the practices that have been characterized as misuse, only those that are frequently said to be in an uncertain state due to open-ended or inconsistent court opinions: (a) tie-ins; (b) grant-backs; and (c) indirect extensions of the term of a patent.[2]

a. Tie-Ins

Under the recently-announced rule of the Court of Appeals for the Federal Circuit, a tie-in not rising to the level of an antitrust violation may be found to constitute misuse. Senza-Gel Corp. v. Seiffhart, 803 F.2d 661, 231 U.S.P.Q. (BNA) 363 (Fed. Cir. 1986). The court approved of a

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[2] The other restrictions prohibited by the infamous "None No-no's," in addition to being grounded in no more solid authority than an after-lunch speech, are either not seriously thought to have any pro-competitive effects by consensus of lawyers and economists (e.g , resale price maintenance), or they have never been seriously questioned by a court, outside the context of a sham arrangement disguising a cartel. See, e g., P. Hoff, Inventions in the Marketplace: Patent Licensing and the U.S. Antitrust Laws 48 (1986) (noting lack of support for horizontal price fixing practices involving patent licenses); USM Corp. v. Technologies, Inc., 694 F 2d 504, 216 U.S P.Q. (BNA) 959 (7th Cir 1982) (differential royalty rates do not amount to patent misuse); General Talking Pictures Co. v. Western Elec. Co., 304 U.S. 175 (1938) (field of use restrictions do not constitute patent misuse).

three-part test to determine whether a tie-in was present in a particular case:

> First: Determine whether there are two things tied, i.e., whether there are separable or inseparable items; if so
>
> Second: Determine whether the "thing" which is assertedly tied to the patented item is a staple or non-staple item in commerce; if staple
>
> Third: Determine whether in fact they are tied.[3]

The court further explained how the first determination is to be made, and how it differs in a case involving patents from an antitrust case where the tie-in is achieved without a patent:

> [T]he Supreme Court has stated that "the answer to the question whether two products are involved turns not on the functional relationship between them, but rather on the character of the demand for the two items." Jefferson Parish Hospital District No. 2 v. Hyde, 466 U S. 2, 19 (1984) . . . [footnote 14] [However,] [t]he law of patent misuse in licensing need not look to consumer demand (which may be nonexistent) but need look only to the nature of the claimed invention as the basis for determining whether a product is a necessary concomitant of the invention or an entirely separate product. [This is because] [t]he law of antitrust violation [sic] . . . [is] tailored for situations that may or may not involve a patent . .[4]

There are two points worth noting in this analysis. First, it supplies a cogent rationale for the different standards applied to tie-ins in patent misuse and antitrust cases. That is, since the markets for specific technologies are often very "thin," with few direct substitutes available for particular inventions or components, the consumer-demand test of Jefferson Parish is of very limited use in this

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[3] Senza Gel Corp. v. Seiffhart, supra, 231 U.S.P.Q. (BNA) at 365.

[4] Id., 231 U S.P.Q. (BNA) 370 & 370 n. 14

context.[5] Second, because of these "thin" markets, product separability will often be difficult to determine. It will turn on the specific technology involved -- spelled out in the claims of the patent in suit. Thus only a court intimately familiar with patent claim construction will be in a position to make this delicate determination. This illustrates an ancillary benefit of the patent misuse doctrine: it is a doctrine of patent law, to be analyzed by patent courts at the same time other patent issues are resolved. To the extent that the effects of allegedly anticompetitive patent behavior turn on specific technologies -- and their place in the businesses of the licensor and licensee -- patent misuse makes sense as a separate branch of patent law. Because of this, it is properly seen as being related to, but not coextensive with, antitrust laws and doctrines along similar lines.

b. Grantbacks

Grantbacks are common in technology licensing agreements. They usually provide that the licensee will grant a nonexclusive license on any improvements it develops to the licensor -- to prevent the situation where the licensee can block the licensor from practicing an improved version of the licensor's original invention.

In some cases, however, licensors have apparently used grantback provisions to maintain exclusivity in a particular technology, by requiring licensees to assign all improvements back to the licensor or to grant an exclusive license back to the licensor. Where undertaken to maintain control over the future development path of a technology, this practice has routinely been condemned as patent misuse. See, e.g., Transparent-Wrap Machine Corp. v. Stokes & Smith, 329 U.S 637, 646-647 (1947) (dictum), 4 D. CHISUM, PATENTS §19.04[3][j] (1986). On the other hand, where the licensee is simply required to grant a nonexclusive license back to the licensor, the practice is not said to constitute misuse. Id.

Grantbacks provide another example where patent misuse makes sense as a separate and independent doctrine from antitrust law. Again, the reason is that the anticompetitive effects of a grantback clause will depend critically on the particular technology involved -- and especially whether the grantback in question extends to "improvements" that are

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[5] See Caves, Crookell & Killing, The Imperfect Market for Technology Licenses, 36 OXFORD BULLETIN OF ECON. & STATS. XX (1983).

actually beyond the scope of the claims recited in the licensed patent. See, e.g., Duplan Corp. v. Deering Milliken, Inc., 444 F.Supp. 648, 700 (D.S.C. 1977) aff'd 594 F.2d 979 (4th Cir. 1979).

As with the tie-in, the grantback may apply to only one patent, most likely one licensed into a relatively "thin" market for technology. Thus the restriction may or may not reduce competition in a relevant market, and it may be difficult to tell. What is clear is that determining this depends critically on the language of the particular claim involved. Moreover, as with tie-ins, it may be difficult or impossible to assess whether there are any realistic substitutes for the improvement granted back to the licensor -- again, because of the thinness of the markets for both the original patented technology and any improvements on it. The upshot is that the patent misuse doctrine is once again superior; it avoids the need for a determination of whether a substantial degree of competition has been foreclosed in a difficult-to-define market, and instead focuses attention on whether the technology involved in the original license is being used in an anticompetitive fashion in the (perhaps small) market into which it was licensed.

And, it should be noted, courts have not blindly applied misuse analysis in the area of grantbacks. They have instead shown a good deal of sensitivity to the commercial context of the grantback clause. See, e.g., Sante Fe-Pomeroy, Inc. v. P.& Z. Co., 569 F.2d 1084, 197 U.S.P.Q. (BNA) 449 (9th Cir. 1978) (grantback clause in license from owner of patent on excavation process to government agency held not to constitute misuse, since alternative methods for achieving result were available to the licensee).

c. Temporal Extensions of Patent Term

The temporal extension of a patent is another instance where misuse, despite what some critics have said, maintains viability as a separate doctrine. The reason is once again that "relevant market" analysis is difficult and misleading, since the truly relevant market is the small one for a given, licensed technology. In such a market, defined once again by the specific claims of the licensed patent at issue (and any substitutes therefor), any extension of the temporal scope of the patent may have severe anticompetitive effects. It is simply immaterial whether, because of substitutes for the patented technology, these effects restrain a less than "substantial" amount of competition in some broadly-defined market. The individual licensee may well be dependent on one technology -- that of the licensor -- and hence be in no position to seriously pursue any of these substitutes.

In Boggild v. Kenner Products, 776 F.2d 1315 (6th Cir. 1985), for instance, the licensee had invented an extruder specifically for use with licensor/defendant's Play Doh product. The license agreement, executed prior to plaintiff's application for a patent but in clear contemplation of such application, called for royalty payments to be made for 25 years -- regardless of whether the patent application resulted in the issuance of a patent. The Sixth Circuit held that the licensee was not obligated to pay royalties beyond the seventeen year term of the patent that eventually issued. See also Meehan v. PPG Indus., Inc., 802 F.2d 881 (7th Cir. 1986) (same, as to package license of patents calling for royalty payments on entire package until all had expired); Aronson v. Quick Point Pencil Co., 440 U.S. 257, 263-64 (1980) (noting in dictum that extension of payments beyond patent term constitutes misuse).

These cases properly rely on patent misuse to strike down practices that, although perhaps not substantially injurious to competition in some broadly-defined relevant market, have significant anticompetitive effects -- and, notably, only limited social benefits Congress has determined that 17 years of exclusivity provides enough incentive to call forth inventive activity in the United States. Parties are simply not free to circumvent this through licensing agreements. See generally 4 D. CHISUM, PATENTS §19.04[3][d] (1986).

3. Conclusion

There is no sound reason why present misuse doctrines need to be eliminated in favor of antitrust analysis of the same practices Indeed, as I have tried to make clear, there are a number of reasons why misuse has a bona fide claim to a viable, independent existence.

At the same time I think it is important to add one point I believe that not all legislation favorable to licensors is unreasonable. In fact, some modification of per se antitrust restrictions is probably warranted. See P. HOFF, INVENTIONS IN THE MARKETPLACE (1986), at Chapter 6 (calling for antitrust legislation establishing presumptions in favor of and against certain practices). But this should not be accompanied by modification of the patent misuse doctrine -- a different doctrinal animal with a limited, though viable, independent existence

CONTROL DATA

1201 Pennsylvania Avenue N W
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Washington D C 20004
202/789-6517

Lois D Rice
Senior Vice President
Government Affairs

December 16, 1987

1987 DEC 23 1987

The Honorable Robert W Kastenmeier
U S House of Representatives
2328 Rayburn House Office Building
Washington, D C 20515-4902

Dear Congressman Kastenmeier

Current U S law significantly restricts the competitiveness of American companies in the computer and other high technology industries by subjecting many intellectual property licensing arrangements to a per se antitrust analysis without any consideration of whether a particular licensing arrangement is in fact anticompetitive This problem is of particular concern to the computer industry In some instances, licensing agreements related to the marketing of technologically related products have been found to constitute unlawful "tying" arrangements under the antitrust laws The application of such traditional per se antitrust analysis to the commercialization of new technologies is both inappropriate and unnecessary

Control Data urges your support of the Intellectual Property Antitrust Protection Act of 1987 (S 438, H R 557) which would modify the application of the antitrust laws so as to encourage the licensing and other uses of certain intellectual property This legislation simply requires that licensing agreements that convey patent, copyright or trade secret rights be evaluated for antitrust purposes under the rule of reason, not a per se rule Thus, agreements that create an anticompetitive environment would still be illegal, but procompetitive licensing agreements would be allowed

In our own operations, we have occasionally decided not to enter into intellectual property licensing agreements out of concern that provisions designed to protect the value of our property might be viewed as per se unlawful Similarly, in negotiating the acquisition of license rights, we have adopted a cautious approach and have some times consciously avoided acquiring marketing rights which would have enabled us to enter a market Such practices limit both our flexibility in developing and commercializing new technologies, and our ability to recover major investments in research and development Finally, as a supplier of systems of interconnected equipment and proprietary software and related support and training services, we are concerned that the

current antitrust laws unnecessarily restrict our use of licensing agreements which can help to assure that our products and systems are used appropriately The net result is less competition, not more -- and our country and its consumers suffer the consequences

In summary, we believe that the traditional per se rules of antitrust law should not blindly apply to licensing agreements that convey rights to patents, copyrights and trade secrets Such licensing arrangements are important to the development and commercialization of new technologies and to maintaining America's technological leadership and global competitiveness The goals of the antitrust laws will be adequately maintained by subjecting intellectual property licensing agreements to the rule of reason to determine in the particular case whether an agreement has, on balance, an anticompetitive or procompetitive effect

The legislation, S 438 and H R 557, provides an opportunity for strengthening the American economy When this legislation is approved, antitrust and intellectual property laws will work together to increase incentives for U S industry to innovate and to turn these innovations into competitive products Again, I urge you to support and cosponsor this important legislation

Sincerely,

Lois D Rice

LDR/mlb

BLOCK DRUG COMPANY INC

Manufacturers and Distributors of Drug and Toiletry Preparations

257 CORNELISON AVE JERSEY CITY N J 07302 9988

AREA CODE 201 434 3000

JOHN E PETERS
VICE PRESIDENT
CORPORATE COUNSEL AND SECRETARY

OCT 22 1987

October 20, 1987

The Honorable Robert W Kastenmeier
Chairman
Subcommittee on Courts, Civil Liberties,
and the Administration of Justice
Committee on the Judiciary
2137 Rayburn House Office Building
Washington, D C 20515

Dear Congressman Kastenmeier

Block Drug Company, Inc is an international manufacturer of dental, consumer and pharmaceutical products with worldwide annual sales in excess of $300,000,000 and has recently been noted by Forbes Magazine as one of the two hundred best managed small companies in the United States

As Vice President, Corporate Counsel and Secretary of Block Drug Company, Inc , I want to alert you to our concerns with Bill H R 3 which, if passed in its current version, would be extremely detrimental to the interests of many moderate and small size companies like Block The requirements of H R 3, as now written, would place enormous financial burdens on companies attempting to pursue valid patent defenses as currently provided by law

As a Judiciary Committee Conferee on H R 3, you will review title XXXIV of the bill, as it was amended by the Senate The section would require a defendant, if it is to succeed in claiming patent misuse in a patent infringement suit, to prove that the patentee, in its "licensing practices or actions or inactions", had used its patent in a manner that violated the antitrust laws, a more stringent standard than that which currently exists under case law We believe that this section should be deleted from H R 3

Under existing law, patent misuse can be raised as an equitable defense in a patent infringement suit or as part of the basis for a complaint in an antitrust action If a defendant is successful in establishing that a patentee has "misused" its patent, *e g* , used its exclusive patent rights to expand the scope of the patent to other markets, a court will decline to enforce the patent until

the patentee corrects its practices In contrast, if a party has to prove misuse in an antitrust context, a court will not enforce the patent, and will award the complaining party treble damages, if damages are proven The degree of proof required under existing law may be different for each situation

A defendant in a patent infringement action currently is required to show that the patentee has used its exclusive rights to expand the scope of the patent The defendant does *not* have to present evidence of the patentee's market power or other economic information typically requird in antitrust litigation Title XXXIV would require the defendant in a patent infringement suit, in order to demonstrate misuse, to present the same evidence that would be required in establishing an antitrust claim

For example, under current law, patent owners risk a great deal, if, as a requirement for a license, they require licensees to purchase unpatented products Such a requirement is called a "typing arrangement" and currently is regarded as patent misuse without a showing of market power and other economic factors If the legislation is enacted, the more difficult antitrust standard would be imposed Title XXXIV could encourage patent owners to obligate licensees to purchase non-patented products since the patent misuse doctrine would be effectively eliminated as an equitable defense in a suit for infringement The typing arrangement could be found to be illegal only after full-scale antitrust litigation, the latter complicating already lengthy patent litigation

Alternatively, should Congress believe these changes to existing law are necessary, Title XXXIV should be made effective only with respect to claims raised after the date of enactment The current standards should continue to apply in existing patent litigation in which patent misuse has been raised as a defense, even if the patent owner withdraws its complaint and refiles against the same parties after enactment of H R 3 This would discourage refiling of cases which could increase the case load of the already overloaded federal courts

Congress has crafted U S patent law carefully to ensure that a patent owner can prevent others from infringing its rights without being able to extend those rights beyond the patent's claims If Title XXXIV is enacted, that balance will be destroyed We ask you specifically, therefore, to eliminate Title XXXIV from H R 3 or to amend it to provide expressly that the current standard shall apply to litigation (whether it be existing or refiled) in which patent misuse has been raised as a defense We recommend, however, that Titles XXXIII, XXXIV, XXXV, and XXXVI all be eliminated from H R 3, a trade bill, and that their combined effect on commerce in the United States be considered with full public debate before the House and Senate Judiciary Committees

Sincerely,

John E Peters

JEP/kl

100 Park Avenue Suite 3600 New York, New York 10017 (212) 683 7626 Telex 257272

Industrial Research Institute, Inc

March 28, 1988

RECEIVED
JUDICIARY COMMITTEE

Honorable Peter W Rodino, Jr.
Chairman, Committee on the Judiciary
U S House of Representatives
Washington, D C 20510

Dear Mr Rodino, Jr

On behalf of the Industrial Research Institute, I am pleased to enclose a copy of two new position statements issued recently by the Institute, on "Patents and Copyrights" and "Licensing of Technology "

The Patents and Copyrights statement recommends that (1) Legislative and judicial efforts be made to decrease expense, time, and inequities experienced by patent owners and accused infringers in patents litigation, (2) The U S patent system should go to a first-to-file basis, (3) U S laws should be modified to simplify prior art determinations which lead to unpredictability (4) Patent applications should be published 18 months from their effective filing date, and (5) U S laws should be changed to provide that imported products produced in a foreign country by a process covered by a U S patent constitutes infringement Other changes are also proposed

The statement on Licensing of Technology indicates that (1) I R I does not support the concept of compulsory licensing of privately-owned patents, (2) I R I strongly favors recently enacted laws granting exclusive licenses to government-owned inventions (3) I R I recommends exclusive licenses to government inventions should be of substantial duration (4) I R I believes inventions originating in a university should be the property of the university even if the Federal government provided support for the work, and (5) I R I views faculty inventions as property of the university rather than as personal property

The Industrial Research Institute is an association of 260 major industrial companies representing some 85% of the industrially-funded R&D in the United States The position statements are based on responses to questionnaires from 161 of these companies Survey data are presented with each statement

Your review of the action on the recommendations in these position statements, where appropriate to your personal interests and responsibilities, will be appreciated Please let me know if we can be of assistance

Sincerely yours,

S Allen Heininger
President, Industrial
Research Institute

SAH/sn
Encls

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EXECUTIVE DIRECTOR
CHARLES F LARSON
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POSITION STATEMENT

ON

LICENSING OF TECHNOLOGY

Industrial Research Institute, Inc.
100 Park Avenue, Suite 3600
New York, NY 10017

March 24, 1988

POSITION STATEMENT ON LICENSING OF TECHNOLOGY

INDUSTRIAL RESEARCH INSTITUTE

The Industrial Research Institute (IRI) affirms that licensing of patents, copyrights and know how plays an important part in the transfer of technology between countries or corporations and from universities federal labs, and private individuals to commercial enterprises The U S Government influences this flow of technology through the patent laws, antitrust actions, tax laws research by government employees and by government funded research in universities and contract laboratories Because IRI member companies carry out some 85% of the industrially funded research in this country IRI is uniquely able to identify those factors and practices that aid or impede technological growth

An IRI Subcommittee on Licensing and Technology Transfer studied a number of issues related to licensing and conducted a survey of IRI member companies in 1978 Replies were received from 87 companies with a broad spectrum of research interests Based on the studies of this subcommittee and the survey results IRI issued a Position Statement making recommendations that it believed should be incorporated in government policy regulations and legislation in order to promote technology transfer

This 1988 revision updates and makes minor modifications to the previous Position Statement. The accompanying survey represents 161 replies out of 247 U S based member companies (65% response)

Recommendations

- Privately owned patents should not be subject to any form of compulsory licensing, except for patents of overriding national importance in fields such as health, energy, defense, and environment. In these cases, proper prompt, continuing, and adequate compensation should be assured
- The government should grant exclusive licenses to government owned patents under terms that provide for reasonable royalties and require rapid commercialization
- The no royalty, no fee basis for the granting of non exclusive licenses to government patents should be discontinued The government should require both an administrative fee and modest royalties for the grant of a non-exclusive license
- Government research contracts should not require the grant of rights to previously existing patents
- Innovative efforts of private inventors should be supported the effort of the private inventor to obtain patents should be encouraged by reasonable patent fees and administrative requirements

Survey Results

Licensing In by IRI Member Companies

In a survey carried out during 1987 of IRI members, 92% of the respondents indicated that their companies license in Sources of technology licensed in were identified as

Inventions from outside U S	75% of respondents
Inventions by private individuals	76% of respondents
Universities or university faculty	45% of respondents
U S Government-owned inventions	26% of respondents

In addition 37% of the respondents indicated their company had rights to government inventions as a result of contract research for the government. The survey indicates that government inventions are not an important source of commercial technology However there is increased effort by the government under its Federal Technology Transfer Program and increased interest by industry in accessing federal technology so the situation is expected to improve in the future Licenses from outside the United States were identified as making a significant contribution to profits by 26% of the respondents

Eighteen respondents indicated they knew of government inventions that would have been candidates for commercialization if exclusive licenses could have been obtained

Licensing Out by IRI Member Companies

In the IRI survey 92% of the respondents indicated their companies licensed out. Moreover, nearly 34% of the respondents indicated that licensing income made a significant contribution (more than 1%) to corporate profits and 51% replied that licensing income exceeded royalties paid out. Yet only 11% of the companies represented in the survey generate technologies specifically for licensing.

Licensing to foreign countries is practiced by 91% Moreover 74% of the respondents license to competitors in this country and only 26% limit their licensing activity to technology they do not or will not use commercially

Government policy or actions interact with the licensing activities of member companies. Twenty four percent replied that their companies had granted or received licenses as a result of antitrust decrees and 27% have refused to compete for government research contracts because the contract would require a grant to previously issued patents owned by their company This requirement of grant of prior rights reduces competition for government sponsored research

IRI Position on Licensing Issues

IRI member companies believe that licensing of patents and know how between U S corporations is not only an important segment in the transfer of technology, but is also a practice that results in increased innovation

Compulsory Licensing

IRI does not support the concept of compulsory licensing of privately owned patents However, 61% of the respondents believe that compulsory licensing of privately-owned patents, properly compensated, should be required in cases of overriding national interest, i e health, energy, defense ecology As previously noted, the requirement in government research contracts for granting licenses to private patents has resulted in reduced competition for government contracts, and is a form of compulsory licensing of private patents that the IRI believes is counterproductive

Government Inventions

IRI member companies have not heretofore found government-owned inventions an important source of licensable technology

IRI strongly favors recently enacted laws granting exclusive licenses to government-owned inventions and believes that the government should receive royalties for such licenses In addition an exclusive license from the government should require reasonably rapid commercialization The IRI recommends that exclusive licenses to government inventions should be of substantial duration perhaps to the full life of the patent, provided commercialization is carried out.

IRI does not support the practice of granting non-exclusive licenses to government inventions on a no-royalty, no-fee basis and endorses the concept that even non exclusive licenses to government-owned inventions should require some minimum fee or royalty

University Inventions

Ownership of inventions originating in universities involves questions of academic and government policy IRI broadly favors strengthening university research programs and regards universities as an important and unique source of new technology Federal and State governments should stimulate scientific and technical innovation in the universities wherever possible To this end it is the position of IRI that inventions originating in a university should be the property of the university even if the Federal government provided support for the work.

It is the view of IRI that faculty inventions are a by-product of the basic teaching and research mission of the university and are properly the property of the institution rather than the personal property of the faculty inventor

* * *

IRI Questionnaire on Licensing Practices

Part I Information

A. Licensing in			Yes	No	Skip
1	a	Has your company licensed any patents owned by U S Government?	43	104	18
	b	If answer is NO, would a change in U S licensing policy encourage you to license such patents?	19	72	24
2		Do licenses from the U S Government make a significant (> 1%) contribution to corporate profits?	0	148	6
3		Do you know of any government invention which you would have licensed for commercial exploitation if an exclusive license could have been obtained?	18	128	5
4	a.	Does your company license any patents assigned to universities or owned by university faculty members?	69	82	4
	b	If answer is NO, is this because of university or faculty licensing policies?	8	60	9
5	a.	Has your company licensed or purchased patents from private individuals?	120	36	2
	b	If YES, has the invention been commercialized?	104	23	12
6		Does your company license any patents originating outside the U S.A.?	113	35	3
7		Do licenses from outside the U S.A. make a significant (> 1%) contribution to profits?	39	102	11
8		Do you know of any business venture which was abandoned because licenses to key patents could not be obtained?	42	102	11
9		Does your company have any rights in government inventions as a result of contract research for the government?	58	92	7

10	Does your company use brokers to license in technology?	15	139	3
11	a. Does your company have a single individual or group devoting full time to licensing in?	37	123	1
	b Does that group have full authority to license in?	14	56	45

B. Licensing Out

12	Does your company license out patents, know how, processes or other intellectual property?	147	13	0

IF ANSWER IS "NO" SKIP QUESTIONS 13 23

13	Does license income make a significant (> 1%) contribution to profits?	50	88	8
14	Does your company generate any technology specifically for licensing?	16	124	3
15	Does your company primarily restrict its licensing activity to technology that it does not or will not use commercially?	39	106	3
16	Does the R&D Division initiate or have any responsibility for licensing-out activities?	82	56	8
17	Does your company license competitors in this country?	106	31	7
18	Does your company license outside of the United States?	128	10	3
19	Has your company granted or received any license as a result of antitrust decrees?	37	103	12
20	Does your company have a specific organizational group responsible for licensing out?	79	65	2
21	Does your company use brokers to license out?	9	136	3
22	Is your company's income from licensing greater than royalties you pay out?	73	41	30
23	Has your company refused to compete for or execute any government research contract because the contract would require a grant of rights to previously-issued patents assigned to your company?	39	84	22

Part II Opinions

			Agree	Disagree	No Opinion
24	(a)	Compulsory licensing of privately-owned patents should be prohibited in all cases.	53	62	8
	(b)	The U S should attempt to persuade foreign governments to eliminate compulsory licensing provisions from their laws.	107	25	19

25	Compulsory licensing of privately-owned patents, properly compensated, should be required in cases of overriding national interest, i e health, energy, defense ecology	97	53	8
26	The government should rarely grant exclusive licenses to government-owned inventions	64	85	8
27	The government should have a process to grant exclusive licenses to any of its patents	107	36	14
28	Exclusive licenses to government-owned inventions should			
	a. produce royalties	112	21	21
	b Be limited to a few years	81	54	19
	c require rapid commercialization	101	29	23
29	The government should sell its patent rights at auction	29	89	25
30	Government grants of non-exclusive licenses should continue to be on a no royalty no-fee basis	61	78	18
31	The government should charge for the grant of a non exclusive license a one-time fee sufficient to cover the admin istrative costs	72	57	26
32	Licensing between competitors increases innovation	73	39	27
33	Licensing between competitors reduces innovation and weakens the internal R&D effort.	42	94	19
34	Export of U S technology has weakened the international competitive position of U S corporations	82	55	20
35	The total U S monetary gains from import of technology exceed monetary losses by export of technology	22	59	79
36	Inventions originating in universities should be the sole property of the university even if Federal funds provided partial or complete support for the work	41	104	16
37	Inventions originating in universities should be the sole property of the inventors	9	127	19
38	Inventions originating in universities should be the property of the government if government funds provide more than 50% of the support for the work.	44	81	10
39	The I R I should maintain a standing committee on patents licensing, and technology transfer	108	11	37
40	Inventions originating in government contracts should be the property of the Contractor with a license to the government for government purposes	111	35	10

POSITION STATEMENT

ON

PATENTS AND COPYRIGHTS

Industrial Research Institute, Inc.
100 Park Avenue, Suite 3600
New York, NY 10017

March 24, 1988

POSITION STATEMENT ON PATENTS AND COPYRIGHTS

INDUSTRIAL RESEARCH INSTITUTE

The Industrial Research Institute (IRI) affirms the basic concepts of the U S Patent system as originally premised in the Constitution and as they exist today We believe that the fundamental merits of the patent system are just as important as they ever have been in our country's history The patent system still responds to the Constitutional objective "promote the progress of useful arts by securing for limited times to inventors the exclusive rights to their discovenes ' Continued industrial success of the U S especially with respect to increasing global competitiveness, requires the incentives of proprietary protection for technological innovations through patents not only to encourage the necessary investment of capital and effort in research and the commercialization of inventions so that society can enjoy their benefits, but also to encourage the disclosure of inventive technology

The grant of a limited exclusionary right by the patent laws in return for the prompt disclosure of newly created technology provides the basis for these incentives Such incentives have stimulated the high support for innovative research and development and availability of risk capital that have been the Amencan tradition Without such incentives, the level of innovative R&D would be substantially diminished and the remaining innovative R&D would largely be kept secret to an extent that technological progress would be inhibited The exclusionary right granted under a well-examined patent does not take from the public anything that previously existed, rather, by disclosing new inventions, the patent rights stimulate the creation and the utilization of new technology, thus enhancing our global competitiveness and making available to society the benefits of the developments An exclusionary right often stimulates others to "invent around,' resulting in further technical progress

With the advent of some of the new technologies such as computer programs, integrated circuits, and electronic databases, it has been found that the copyright approach to providing proprietary protection is necessary either in lieu of patent protection or to augment patent protection The copyright system provides similar incentives and benefits and stems from the same provision of the Constitution as does the patent system

The IRI has had a Position Statement on the U S Patent system for a number of years This major revision of 1988 was necessitated by major changes in the laws and attitudes and increasing global competitiveness that have occurred since the original position statement. Many of IRI's earlier recommendations have been adopted into law and some new concerns have surfaced Also, copyrights have become much more important in protecting some technological achievements so, in addition to revising the position statement, this statement has been extended to also embrace the copyright system

Our patent system and copyright system have a number of features of significant merit which should be preserved and strengthened

1 The basic requirements of a patent — novelty, utility, unobviousness and disclosure — are reasonably well developed in the statutes and patent jurisprudence IRI advises against any attempts to legislate detailed additional requirements or to introduce standards of judgment and disclosure that would be stricter than the American inventor executive or patent lawyer can reasonably understand and manage Any changes should be in the direction of simplification, reducing costs making the system easier to use and making the system more readily understood and useable

2 The U S Patent and Trademark Office (PTO) generally performs well in its examination of patent applications In recent years, it has shown improvement in accomplishing its mission It is staffed with many competent and dedicated professional employees with high integrity IRI encourages continued attention to the funding, training, and management of the examining corps and, especially, their administrative support including appropriate and effective automation with the aim of providing and maintaining a PTO whose work product will be of the highest quality

3 The examination of patent applications should be as comprehensive and thorough as practicable so that an issued paten will be respected by competitors of the patent owner and by the courts. Such respect is an essential part of the patent incentive for industry This thorough examination need not be exhaustive, but should be reasonably prompt. Early issuance of patents of reasonably reliable validity adds to the confidence of businessmen when considering the investment of risk capital to make the benefit of new technology available to the public they want to know if they can plan on patents of their own and whether patents of others will cause problems Early disclosure always keeps the published technologies current with the actual state of advance The balance between thorough and prompt examination should be weighted in favor of thoroughness

4 The present one-year grace period between certain events such as first sale or publication and the application filing date has worked well and should be retained This grace period facilitates the thoughtful and thorough refinement of the invention, it also encourages prompt patent disclosure with greater completeness than occurs under the requirements of those foreign countries which require immediate filing without such a grace period

5 The establishment of the Court of Appeals of the Federal Circuit (CAFC) to which all patent appeals must be made has contributed very largely to the improvement of the patent system The CAFC has greatly increased the predictability of results in patent disputes and has supported full damage awards for patent infringement.

6 The use of the copyright system to protect technological innovations such as computer software and integrated circuits has proved to be important and successful

7 The reexamination of patents by the PTO has proved useful and effective and should be expanded to include limited input by an adverse requester such as a single written rebuttal to the patent owner The reexamination procedure should not be expanded to make it an adversarial proceeding nor should reexamination be a mandatory requirement in litigation

The U S patent and copyright systems are basically sound and have had 200 years of valued existence However they can continue to be improved as they have been improved in the past. Based on a recent survey of 161 IRI member companies in the U S, results of which are attached IRI believes the patent and copyright systems should be improved in the following areas

1 Enforceability of a patent is an integral part of the patent system because assertion in litigation is the ultimate test of the basic exclusionary property right of the patent. Many patents are afforded their deserved respect without the necessity of litigation There has, however historically been a need to litigate some patents which involve honest differences of opinion on validity and scope between the patentee and alleged infringer Unfortunately, such litigation has become very complex, lengthy and expensive in a large measure because of the scope of discovery This presents difficulties for both the patent owner and accused infringer Litigation problems have unduly discouraged patent owners, particularly those with limited financial resources, from asserting their patents Also, litigation expense may intimidate a patent owner into accepting unfavorable settlements and thus, tend to diminish the incentives afforded by the patent system

The IRI recommends that legislative and judicial efforts be made to decrease the expense, time, uncertainty, and inequities experienced by patent owners and accused infringers in patent litigation Some specific improvements to cut down the expense and improve the efficiency of patent litigation include tightening the discovery process and continuing to eliminate inequitable technicalities that are used by defendants to challenge patents Several of these technicalities are addressed below

2 The U S patent system should go to a first-to-file rather than a first-to-invent system but in doing so we should seek concessions from other countries towards harmonization of differences in the patent laws Provisions should be made to provide equitable rights to a first inventor who

undertakes development before a patent issues to the first to-file The United States and the Philippines are the only two countries in the world that have a first to-invent system Most large U S corporations with substantial international interests have already adapted themselves to the first to file system in order to deal effectively with the patent systems of other countries It should be noted that, although the response to this question was nearly balanced, with 53% in favor and 45% opposed it was quite different from the response to the same question in 1978 when 87% of the respondents favored patents going to the first-to-invent.

3 The United States laws should be modified to simplify prior art determinations which lead to inequities and/or confusion or unpredictability One modification would be to eliminate all forms of secret" prior art from being considered legally as "prior art." A second modification would be to change the on sale" bar to novelty by requiring that the invention must have been completed and actually placed in commercial use such as by being actually sold or used before the bar would apply

4 Patent applications should be published 18 months from their effective filing date

5 One of the most difficult areas for patentees is the charge of inequitable conduct' for failure to live up to a duty of disclosing prior art to the PTO This standard should be clarified and require that before a finding of inequitable conduct' is found it must be proven that there was an actual intent to withhold prior art that was more material than the prior art considered by the patent examiner when the patent was issued

6 The U S laws should be changed to provide that imported products produced in a foreign country by a process covered by a U S patent constitutes infringement. This would be similar to the law of most manufacturing countries and is long overdue in the United States The principle is already accepted in U S jurisprudence as an unfair method of competition An unqualified application of statutory patent law would enhance the remedy available to the United States inventor/ patent owner and thus encourage innovation and investment when the only patent support is a process patent.

7 The freedom and flexibility to license patent technology is important and there should be legislative changes to the antitrust laws to exclude most if not all the restrictions that have been developed under the so-called "patent misuse doctrine" to permit greater flexibility in licensing patented inventions and to limit damages to actual damages

8 The International Trade Commission (ITC) has proved to be very useful and effective in enforcing patent rights and copyrights when they are infringed by imported goods The ITC proceedings can be improved by eliminating the current requirement of proving an injury to a domestic industry Also, the ITC should be required to rule on all issues ruled on by the administrative law judge including questions of validity, infringement, and injury in order to save the time of a remand if a partial judgment is reversed The standard of review for appeals from the ITC on intellectual property issues should be the same standard of review that applies to appeals from federal district courts

9 Patent term restoration should cover additional subjects Due to federal regulations, the effective time of the patent grant is sometimes foreshortened because of the necessity for getting government clearance before commercialization In order to more equitably balance the rights between the public and the rights of the patent owner under these circumstances and with suitable safeguards the term of the patent grant should be extended for a reasonably limited period This has been done by patent term restoration laws for the drug industry However, laws should also be enacted to grant relief to other industries such as the agricultural chemical industry which are also subject to regulatory delays before product introduction

* * *

IRI QUESTIONNAIRE ON THE U.S PATENT SYSTEM

		Yes	No	Skip
1	Should a U S patent go to the first to-file rather than the first to-invent?	85	72	4
2	If a first-to-file system is adopted, should it provide for any rights to the first inventor who undertakes development before a patent issues to the first-to-file?	99	50	12
3	Is a change in the United States to a first-to-file system acceptable only if the United States obtains concessions from other countries towards harmonization of differences in the patent laws?	80	64	17
4	Should the U S simplify prior art determinations by eliminating all forms of 'secret' prior art?	105	33	17
5	Should patent applications be published 18 months from their effective filing date?	93	52	6
6	Should efforts be made to eliminate deferred examination in other countries?	60	79	17
7	Should efforts be made to eliminate *inter partes* oppositions in other countries?	31	110	16
8	Should the term of the U S patent be 20 years from filing rather than 17 years from issuance with rights retroactive to the filing date?	76	77	8
9	Should a special effort be made to have a reasonable grace period such as one year in foreign patent systems?	126	27	8
10	Should the law of the 'on sale bar to novelty be modified to require that the invention be completed and commercial products available before an on sale' can occur?	95	55	10
11	Do jury trials provide fair resolution of patent disputes?	45	80	32
12	Is the Court of Appeals of the Federal Circuit (CAFC) contributing to predictability of results in patent disputes?	147	7	7
13	Is the CAFC being sufficiently flexible in administering justice and equity?	118	15	26
14	Is the CAFC applying a standard which is too high to inequitable con duct" issues?	56	72	17
15	Should the standard be changed to require an actual intent to withhold prior art before inequitable conduct" is found?	79	68	14
16	(a) Do you use arbitration or other alternative methods of resolving disputes?	78	69	10
	(b) If not, would you use alternative methods in appropriate situations?	88	5	29
17	Should IRI's Position Statement on Patents be expanded beyond patents to include copyright matters relating to technology such as soft ware protection, object code embedded in ROM chips, the extension of copyrights on programs to protect the structure, sequence, operation, and the look and field of the visual interface etc ?	90	31	38
18	Should the U S Patent and Trademark Office be an independent government corporation similar to the Postal Service?	44	95	21
19	Are there any additional efforts beyond what the U S Trade Representative is now doing which can be made to extend protection of U S intellectual property into foreign countries?	17	46	93
20	Should discovery proceedings in patent litigation be reduced in scope?	82	64	15

21	Should the re-examination proceedings in the Patent Office be expanded to include permitting a requester limited input into the proceedings or the addressing of a broader range of issues?	103	48	8
22	Should the lawyer's fees be awarded against the loser in all patent law suits?	27	127	6
23	Should the U S seek a patent treaty with Japan providing for the reciprocal recognition of patents or the creation of a regional patent office?	48	84	21
24	Should licensing of patented technology be encouraged by excluding from the patent misuse doctrine" the following. (a) terms that affect commerce outside the scope of the patent's claims, (b) the restriction of a licensee in the sale of the patented product or in the sale of a product made by the patented process (c) requiring a licensee to pay royalties that differ from those paid by another licensee or that are allegedly excessive (d) requiring a licensee to pay royalties in amounts not related to the licensee s sales of the patented product or a product made by the patented process, (e) refusing to license the patent to any person or (f) using a patent to suppress competition?	68	58	31
25	Should the U S laws be changed to provide for protection against imported products resulting from processes covered by a U S patent?	145	10	4
26	Should the Clayton antitrust act be amended to provide a more flexible standard of review for intellectual property licensing arrangements?	109	23	22
27	Should the impact of the Supreme Court holding in *Lear* v *Adkins* on licensing transactions be clarified and codified through legislation?	84	48	27
28	Should the International Trade Commission proceedings under Section 337 be modified in intellectual property cases to eliminate the current requirement of proving an injury to a domestic industry?	106	37	18
29	Should the term of patents covering agricultural chemical products and animal drugs be extended up to a maximum of five years to compen sate for the period of a patent term lost due to mandatory Federal pre marketing regulatory review and testing?	104	26	23
30	(a) Does the Board of Patent Appeals and Interferences generally take an independent and fresh look at the *factual* basis for rejection of patent claims as opposed to primarily affirming the Examiner?	76	47	36
	(b) If answer to 30(a) is no should the Board take a fresh look at the *factual* base for the rejection without resort to any presumption of correctness?	58	4	35
31	Should patent validity challenges based on patents and printed publications be required in an administrative proceeding such as a re-examination proceeding before going to court?	69	84	8
32	Should the standard of review for appeals from the International Trade Commission on intellectual property issues be the same standard of review that applies to appeals from the Federal District Courts?	102	27	32
33	Should the International Trade Commission be required to rule on all issues ruled on by the Administrative Law Judge including questions of validity, infringement, and injury in order to save the time of a remand if a partial judgment is reversed?	96	29	36
34	Should the statutory minimum damage for patent infringement be increased from the present ' not less than a reasonable royalty?	29	127	5

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COUNCIL OF SCIENTIFIC SOCIETY PRESIDENTS

February 10, 1988

The Honorable Peter W Rodino, Jr
U S House of Representatives
Washington D C 20515

Dear Representative Rodino

The Council of Scientific Society Presidents (CSSP), an organization of presidents of 36 scientific societies whose combined memberships total over 850,000 scientists, urges stronger measures to protect intellectual property rights, including patents, copyrights, trademarks, and semiconductor chip layouts To strengthen our trade position, our international competitiveness, and our incentive to invest in research and development, we endorse the following initiatives

- The intellectual property recommendations contained in the Omnibus Trade Bill, H R 3, pages 254-272, approved by the Senate, July 21, 1987, and now in House-Senate conference This section provides improved methods for the worldwide protection of intellectual property, and more open access to basic research and technology It allows the International Trade Commission to exclude imports that infringe upon U S intellectual property rights, particularly valid and enforceable patents, copyrights, trademarks, and semiconductor layouts

- The recommendations made by the Intellectual Property Committee in its report, "Basic Framework of a General Agreement on Tariff and Trade Agreements on Intellectual Property," September 23, 1987 This committee, with representatives from 12 major U S multinational technology companies, advocates the elimination of trade distortions caused by the piracy of intellectual property, (a) by creating an effective economic deterrent to international trade in products which infringe intellectual property rights (b) by encouraging the adoption and implementation of adequate intellectual property laws in countries which have little or no such protection, and (c) without creating barriers to legitimate trade

- The Omnibus Trade Bill should provide adequate protection for U S process patent owners from offshore competition Congress should grant U S patent owners the same rights that governments of other developed nations give to their inventors

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The views expressed by CSSP are those of its members and do not necessarily represent the official position of their respective organizations.

- o In addition to more equitable laws to protect American ingenuity, we should provide adequate resources to enforce these laws We should strengthen the Office of United States Trade Representative

- o We should encourage scientists in government, academe and industry to recommend that their colleagues in developing countries urge their governments to provide better protection for intellectual property rights

- o In addition there should be measures adopted to recognize intellectual property concerns in international exchanges addressing science and technology, particularly the official bilateral or multilateral exchanges established under formal treaties or agreements among the United States and other nations

We recommend the above actions to reduce our losses due to intellectual property abuses The U S International Trade Commission has estimated that U S companies lost $7 billion in domestic and export sales in 1982 through foreign infringements of U S products rights, in addition to the loss of 131,000 U S jobs The latest estimate places 1984 losses as high as $20 billion These practices also injure developing countries, making it difficult for them to generate investment capital for research and new technology Their scientific workforce either leaves the country or changes from innovation to copying and imitation Problem areas include Latin America and the Pacific and Indian basins In general the countries of Western Europe and Japan respect intellectual property rights However, the 1987 National Trade Estimate on Foreign Trade Barriers reports that U S pharmaceutical makers lose $30 million each year to Spanish pirate products

The intellectual property provisions of the Omnibus Trade Bill and other proposed actions should markedly improve this unfortunate situation

Sincerely

Stephen S Willoughby

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