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Robert P. Merges

SUMMARY

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.

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—

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1 This article has been adapted from Congressional testimony I gave before the Subcommittee on Courts, Civil Liberties, and the Administration of Justice of the House Judiciary Committee. I have made only minor changes. I thank my colleague Professor Joseph Brodley and Professor Donald Chisum of the University of Washington School of Law for their comments, but I take sole responsibility for the contents.

2 Associate Professor, Boston University School of Law. B.S., Carnegie-Mellon University, 1981; J.D., Yale Law School, 1985; LL.M. Columbia Law School, 1987; Member, California Bar. This testimony was prepared while the author was the Julius Silver Fellow in Law, Science and Technology at Columbia Law School in New York.
for example, overinclusive grantback clauses and coercive require-
ments to extend the patent term beyond seventeen years.

I have structured my comments as follows. I first discuss some
general points concerning patent misuse, and then move on to a more
detailed examination of how H.R.4086 and S.1200\(^3\) would affect
current law on patent misuse.

I. 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 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 regu-
lations of the European Economic Community, promulgated under
Article 85(3) of the Treaty of Rome, which list acceptable and un-
acceptable activities under the Treaty. See Official Journal of the

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 ju-
dicial 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 Ka-
plow, 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.

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\(^3\) The provisions of S.1200 were incorporated into S.438, a more comprehensive intellectual
property-antitrust bill. S.438 was subsequently incorporated into the Trade Bill, H.R. 3, from
which it was eventually excised.
To summarize, then, it seems clear to me that H.R. 4086 is 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. PITI'. L. REV. 209 (1984). But there is a place for restrictions on anticompetitive behavior within other branches of law beside 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 reREFERRED to “the conventional application of the doctrine,” USM Corp. v. SPS Technologies, Inc., 694 F.2d 505, 512, 216 U.S.P.Q. 959, 965 (7th Cir. 1982), cert. denied, 462 U.S. 1107 (1983) (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.4

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

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4 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.
would dictate that the patent not be enforced until the patentee agree
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 flex-
ibility 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.

In the same vein, proponents of a unified antitrust analysis over-
look 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 infringe-
ment 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 pa-
tentee tries to tie the sale of unpatented staple items to the sale of a
patented machine or process; see below). Patent misuse thus helps
maintain patent law’s equitable symmetry, in a way that antitrust
critics, unschooled in the structure and balance of patent law, have
overlooked.5

5 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.
This symmetry, it should be noted, does not apply at the “micro-level”; a patentee who has not licensed his patent cannot be charged with misuse, even though he of course can invoke the equitable doctrines of contributory infringement and equivalents. Misuse is simply one of many “swords and shields” patentees and patent challengers have at their disposal. But misuse is an important weapon in the challenger’s arsenal. Even though it cannot always be used to counter pro-patentee equitable doctrines, it is valuable when circumstances permit it to be used. In this sense it contributes to the overall balance of equitable weapons available to the parties. And it should be borne in mind that advocates of an antitrust-based standard for patent misuse would alter this balance without having convincingly demonstrated that there would be net benefits from their approach.

II. 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. Since H.R. 4086 preserves much of this flexibility, without adopting the precise “rule of reason” language (which now has come to mean “per se legality), it is superior to S.1200, which relies instead on a “unified” rule of reason analysis for each

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6 I owe the points in this paragraph to Donald Chisum.
licensing practice. In only one respect do I take serious issue with the House Bill's treatment of misuse issues.\(^7\)

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.\(^8\)

**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

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\(^7\) 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, a broad consensus still exists against changing this standard. See e.g., P. HOFF, INVENTIONS IN THE MARKETPLACE, supra, at 48 (noting the lack of convincing debate on this issue); but cf. W. BOWMAN, PATENT AND ANTITRUST LAW 122-138 (1971) (arguing that resale price maintenance may make economic sense in the patent licensing context); R. GIVENS, ANTITRUST: AN ECONOMIC APPROACH section 8.02 (1983 & Supp. 1987) (describing unsuccessful attempts by Reagan Administration Justice Department to overturn *per se* rule against vertical price-fixing). 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.

\(^8\) 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 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. 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).
Third: Determine whether in fact they are tied.9

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 paten . . . 10

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.11 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.

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9 Senza Gel Corp. v. Seifjhart, supra, 231 U.S.P.Q. (BNA) at 365.
See Caves, Crookell & Killing, The Imperfect Market for Technology Licenses, 45 OXFORD BULLETIN OF ECON. & STATS. 249 (1983). Note also that this explains why the “staple/nonstaple” dichotomy discussed by the Federal Circuit in Senza-Gel is so important to patent misuse.
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 typing 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. GEL-LHORN, 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 es-
pecially 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.*, 339 U.S. 897 (1950) with *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969).
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.