

Harmonization of the IP Misuse Doctrine and Antitrust Law: A Call for Help from the Agencies and Congress

Jeffery B. Fromm and Robert A. Skitol

In recent years, antitrust practitioners have found it necessary to deepen their understanding of intellectual property law while IP practitioners have discovered a need to deepen their understanding of antitrust law. This is not surprising as IP licensing disputes have proliferated throughout the new economy and IP rights have become the most valuable assets—sometimes very powerful weapons—in wars for hegemony across the information technology landscape. During this period of rapid change, courts and enforcement agencies have abandoned old assumptions about conflict between IP and antitrust policies and have instead embraced the idea that these regimes are consistent in their common overriding objective of encouraging innovation.

Notwithstanding much progress in “harmonization” efforts, one area remains in disarray: the intersection between the IP misuse doctrine and antitrust law as applied to a variety of licensing practices. More specifically, Supreme Court decisions from several decades ago have induced lower courts over many years to continue using the IP misuse doctrine to invalidate summarily various kinds of non-compete covenants and royalty payment arrangements that today’s antitrust jurisprudence would not treat as necessarily anticompetitive. In fact, as discussed in this article, some longstanding IP misuse precedents cast a cloud over license provisions that modern antitrust thinking would deem pro-competitive and thus worthy of active encouragement.

Judge Richard Posner highlighted the problem in his opinion for the Seventh Circuit last June in *Scheiber v. Dolby Laboratories*, 293 F.3d 1014 (7th Cir. 2002), affirming dismissal of a patent owner’s suit to enforce a license calling for post-expiration royalties. He based the decision on the authority of the Supreme Court’s holding in *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), that contracting for payments on sales after a patent expires is per se illegal patent extension. His opinion, however, harshly criticized *Brulotte* as out of sync with modern thinking and thus invited the Supreme Court to overrule it. Earlier this month, the Supreme Court passed on that invitation in denying the patent holder’s petition for certiorari.

Particularly given that lost opportunity, the FTC and DOJ should now want to address the more general need for harmonization of IP misuse and antitrust law in their upcoming report on hearings throughout 2002 on “Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy.”

Congress could also play a role on this front: widely-criticized anomalies in patent misuse doctrine instigated amendments to the Patent Code in 1952 and 1988. A case could be made (and promoted by the FTC/DOJ hearings report) for a more definitive legislative solution addressing misuse in both patent and copyright law in 2003.

■
Jeffery B. Fromm
retired in August
2002 as Senior
Managing Counsel for
Intellectual Property
at Hewlett-Packard
Company and now
practices in Denver
and Breckenridge,
Colorado.

Robert A. Skitol
is a partner in the
Washington, D.C.
office of Drinker
Biddle & Reath LLP.

Scheiber and the Brulotte Rule

As Judge Posner tells the story, Scheiber, a musician turned inventor, held U.S. and Canadian patents on the audio system known as “surround sound.” He sued Dolby for infringement, and the parties then settled by agreeing that Scheiber would license his patents to Dolby in exchange for royalties. The last U.S. patent was scheduled to expire in May 1993 while the last Canadian patent was scheduled to expire in September 1995. Dolby suggested and Scheiber agreed that in exchange for a lower royalty rate the agreement would provide for continuation of royalties on all patents until expiration of the last Canadian patent. Dolby nonetheless later refused to pay royalties on any patent after it expired, precipitating Scheiber’s suit to enforce the license agreement. The district court granted summary judgment dismissing the suit on Dolby’s argument that the Supreme Court’s *Brulotte* decision precludes enforcement of royalty obligations on any patent after it has expired. Scheiber thereupon took his case to the Seventh Circuit Court of Appeals.

IP misuse precedents

cast a cloud over

license provisions

that modern antitrust

thinking would deem

procompetitive

As Posner explained, the Supreme Court majority in *Brulotte* “reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and thereby in violation of the law.”¹ In Posner’s view, however, “[t]hat is not true”; after the patent expires, anyone can make the patented process or product and the patent cannot be used to exclude anyone from doing so. “The duration of the patent fixes the limit of the patentee’s power to extract royalties; it is a detail whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time.”² *Brulotte*, Posner said, was a “free-floating product of a misplaced fear of monopoly” emanating from bygone days when every patent was assumed to create monopoly power in an antitrust sense.³ Recognizing, however, that the Seventh Circuit has no authority to overrule a Supreme Court decision “no matter how dubious its reasoning” or “even how out of touch with the Supreme Court’s current thinking,”⁴ his opinion affirmed the district court’s dismissal.

Scheiber’s cert petition asked the Supreme Court to grant review in order to overrule *Brulotte*. He argued that *Brulotte* “is the product of erroneous analysis of monopoly extension”; contractual post-expiration royalties “do not extend the patent monopoly and are consistent with the patent statute”; *Brulotte*’s “rejection of rule-of-reason testing is inconsistent” with more recent judicial rulings on other licensing practices and underlying policy considerations; and its rejection of a rule-of-reason test “inhibits procompetitive patent licensing” arrangements.⁵ *Brulotte*, he contended, “is the product of a bygone judicial era hostile to” IP rights, “when proliferation of per se rules invalidated pro-innovative and even procompetitive licensing practices.”⁶ He more specifically argued as follows:

The *Brulotte* rule creates an island of per se unlawfulness in the temporal domain, with no counterpart in the subject-matter domain. On that island, holding of illegal extension of monopoly does not require factual testing for market power nor for anticompetitive effect. *Brulotte* prohibits per se licensing practices

¹ *Scheiber v. Dolby Labs.*, 293 F.3d 1014, 1017 (7th Cir. 2002).

² *Id.*

³ *Id.* at 1018.

⁴ *Id.*

⁵ Petition for Writ of Certiorari, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689, at 8–21 (Oct. 29, 2002).

⁶ *Id.* at 5.

having advantages for licensees and for the market, devalues intellectual property and thereby discourages innovation.⁷

Dolby in its opposition brief argued that any reconsideration of *Brulotte* should be left to Congress which “has directly considered the *Brulotte* rule and elected not to change it”; and that, on the merits, “overruling *Brulotte* would enable patent holders to circumvent the constitutional mandate that patents have finite duration by leveraging their legally temporary rights into a potentially indefinite stream of future royalties based on post-expiration use.”⁸ Responding to Scheiber’s claim that extension of payments beyond the patent period may be helpful to licensees as well as licensors, Dolby contended that *Brulotte* does not restrict “such financing arrangements” so long as “post-expiration payments are not based on post-expiration use of the invention.”⁹

Four prestigious academic research institutions filed an amicus brief in support of Scheiber’s petition focusing on their experience in negotiating licenses to the fruits of their medical research to pharmaceutical companies that then undertake high-risk investments to develop commercially viable life-saving products.¹⁰ As they explained, ability to contract for payments extending beyond patent expiration (in lieu of higher payments during the patent term) promotes innovation and commercialization efforts by reducing risk to licensees and thereby enhancing their investment incentives:

[A]mici and other academic institutions frequently grant licenses to early-stage technology related to products that have not been developed and that are of unknown or speculative commercial value. In such cases, their prospective licensees face a particular risk that no viable product or service will be developed within the scope of the licensed patents. . . . In circumstances like these, the patent owner has no economic or market power to impose or coerce monopolistic license terms, and the prospective licensee may itself prefer extended royalties in exchange for reduced up-front (or other fixed) payments.¹¹

In short, the patent system’s goal to promote the progress of the useful arts “is served by allowing such parties to negotiate freely the license terms that make sense to them in order to maximize” desirable investment in new products; the per se rule of *Brulotte* “disserves this goal and serves no comparable goal of its own.”¹²

On January 13, 2003, the Supreme Court denied the petition for certiorari.

IP Misuse Generally

There are several kinds of licensing arrangements now susceptible to harsher treatment under misuse law—at least under some outstanding precedents—than they would receive under currently prevailing antitrust law. Examples from the patent law side, in addition to contracting for post-expiration royalties (at issue in *Scheiber*), are covenants not to deal in competing products

⁷ *Id.* at 7–8.

⁸ Brief for Respondents in Opposition, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689, at 8-12 (Dec. 6, 2002).

⁹ *Id.* at 13.

¹⁰ Brief for Memorial Sloan-Kettering Cancer Center et al. as Amici Curiae in Support of Petitioner, *Scheiber v. Dolby Laboratories*, Supreme Court Dkt. 02-689 (Dec. 5, 2002).

¹¹ *Id.* at 14.

¹² *Id.*

¹³ *See, e.g., Compton v. Metal Prods., Inc.*, 453 F.2d 38 (4th Cir. 1971); *Berlenbach v. Anderson & Thompson Ski Co.*, 329 F.2d 782 (9th Cir. 1964).

or technologies¹³ and royalties on a licensee's total product sales, including those that do not implicate the licensed patent rights.¹⁴ Indeed, both of these arrangements have been found to be misuse without any finding that they were the product of the coercive exercise of market power. While misuse law in today's Federal Circuit would seem to call for treating these arrangements more in accordance with antitrust standards, other circuits remain free to follow the older precedents and may well be inclined to do so.

One might add to those examples "package" licensing and any form of "tying" a patent license to use of an unpatented product. The 1988 amendment to the Patent Code requires proof that the patent provides the patent holder with market power before a tying arrangement can be deemed misuse;¹⁵ but antitrust law, at least as applied in recent decisions across several circuits, allows condemnation only with an additional showing of anticompetitive effect in the tied product market and, even then, the licensor may successfully defend upon proof of an off-setting procompetitive effect or business justification.¹⁶ Indeed, in *United States v. Microsoft Corp.*, 253 F.3d 34, 89–97 (D.C. Cir. 2001), the D.C. Circuit held that tying arrangements involving platform software are subject to a full reason of reason analysis.

The Federal Circuit has addressed the application of the patent misuse doctrine to certain kinds of post-sale restrictions, such as "single-use only" provisions. According to the Federal Circuit, such restrictions cannot be deemed misuse unless they are both (1) found outside the scope of the patent grant and then also (2) found anticompetitive under full application of the antitrust rule of reason.¹⁷ Left unclear is whether or under what circumstances various other kinds of arrangements that might also be considered outside the scope of the patent grant can be deemed misuse without additional evidence of anticompetitive effect or even market power. The Federal Circuit declared sixteen years ago that, "[t]o 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."¹⁸

Other circuits and district courts within them, however, appear less inclined to "converge" misuse and antitrust law; and they are free to go their own way in rulings upon misuse defenses in license enforcement suits that come before them. Indeed, the prospect of conflicting standards from circuit to circuit is all the greater after last year's Supreme Court decision in *Holmes Group, Inc. v. Vornado Air Circulations Systems*, 122 S. Ct. 1889 (2000). *Vornado* held that Federal Circuit jurisdiction exists only where the complaint itself raises a substantial question of patent law; it thereby "invites the regional circuits to expand their own role in defining rules of patent law and

*The prospect of
conflicting standards
from circuit to circuit
is all the greater after
Vornado.*

¹⁴ See, e.g., *Zenith Radio Corp. v. Hazeltine Research Inc.*, 395 U.S. 100, 137–40 (1969); *Hull v. Brunswick Corp.*, 704 F.2d 1195 (10th Cir. 1983).

¹⁵ See 35 U.S.C. § 271(d)(5).

¹⁶ See, e.g., *Hack v. President and Fellows of Yale Coll.*, 237 F.3d 81, 86 (2d Cir. 2000); *United Farmers Agents Ass'n v. Farmers Ins. Exch.*, 89 F.3d 233, 235–36 n.2 (5th Cir. 1996); *Gonzalez v. St. Margaret's House Housing Dev. Fund Corp.*, 880 F.2d 1514, 1518–19 (2d Cir. 1989); see also U.S. Dep't of Justice and Federal Trade Comm'n Antitrust Guidelines for the Licensing of Intellectual Property § 5.3 (1995): "The Agencies would be likely to challenge a tying arrangement if: (1) the seller has market power in the tying product, (2) the arrangement has an adverse effect on competition in the relevant market for the tied product, and (3) efficiency justifications for the arrangement do not outweigh the anticompetitive effects."

¹⁷ *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1540 (Fed. Cir. 1998); *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860 (Fed. Cir. 1997); *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992); *B. Braun Med. Inc. v. Abbott Lab.*, 124 F.3d 1419 (Fed. Cir. 1997).

¹⁸ *Windsurfing Int'l Inc. v. AMF Inc.*, 782 F.2d 995, 1001–02 (Fed. Cir. 1986).

related areas of jurisprudence”¹⁹ Complaints seeking enforcement or damages for breach of patent licenses are contract suits that do not raise questions of patent law even though patent misuse may be asserted as an affirmative defense (as exemplified by the *Scheiber* litigation and outcome).

Since 1990, the misuse doctrine has come barreling into copyright law. Appellate courts have held both noncompete covenants and exclusive dealing commitments in copyright licenses to be copyright misuse without even considering whether market power was at play, thereupon dismissing infringement suits.²⁰ This is all the more anomalous because, generally speaking, there is even less basis to presume without evidence that a copyright confers meaningful market power than there is to presume without evidence that a patent confers meaningful market power.

IP owners have at least two major reasons for concern about different standards in this area. The first is that, while antitrust law significantly restricts a licensee’s (or other party’s) standing to challenge a license restriction under prevailing applications of the “antitrust injury” doctrine,²¹ any licensee or indeed even a nonlicensee accused of infringement can assert misuse as a defense.²² The second is that, while an antitrust plaintiff can get treble damages upon proof of an antitrust violation,²³ a finding of misuse may render the IP at issue completely unenforceable and that result may mean far greater loss to the IP owner than any antitrust damage award.²⁴

As a result of those different standing and remedy features, a license arrangement with no consequential anticompetitive effect—yet with significant procompetitive potential—may create severe risk under misuse law even though there would be no prospect of a successful antitrust challenge to it. In turn, this reality may well mean that misuse law discourages license arrangements that antitrust policy encourages or at least condones in the interests of promoting innovation. The misuse doctrine in its current state may thus prevent IP law from being in sync with antitrust law in its encouragement of procompetitive license arrangements.

The Way Forward

There certainly is room for debate—fueled by ambiguous and sometimes conflicting statements over more than eighty years of Supreme Court jurisprudence in this area²⁵—on whether the misuse doctrine in either patent or copyright law should, as a matter of sound public policy, encompass a broader array of practices than those running afoul of antitrust law. To what extent should any license arrangement that can be characterized as an extension of the IP grant be a candidate

¹⁹ Robert Taylor, *New Opportunities for Forum Shopping: The Implications of Vornado*, ANTITRUST SOURCE, Nov. 2002, <http://www.antitrustsource.com>.

²⁰ *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970 (4th Cir. 1990) (noncompete covenant); *Practice Management Information Corp. v. AMA*, 121 F.3d 516, 519–21 (9th Cir. 1997), *amended*, 133 F.3d 1140 (9th Cir. 1998) (exclusive dealing).

²¹ See generally ABA SECTION OF ANTITRUST LAW, ANTITRUST DEVELOPMENTS 844–50 (5th ed. 2002).

²² See generally ABA SECTION OF ANTITRUST LAW, INTELLECTUAL PROPERTY MISUSE: LICENSING AND LITIGATION 29–30 (2000).

²³ See 15 U.S.C. § 15.

²⁴ See generally INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 216–20.

²⁵ Compare, e.g., *Mercoird Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680, 684 (1944) (“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”) with *Transparent Wrap Machine Corp. v. Stokes & Smith Co.*, 329 U.S. 637, 641 (1947) (though “control of the unpatented article or device falls short of a prohibited restraint of trade or monopoly, it will not be sanctioned” because “it is the tendency in that direction which condemns the practice and which, if approved by a court either through enjoining infringement or enforcing the covenant, would receive a powerful impetus”). See generally INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 3–28; see also HERBERT HOVENKAMP, MARK JANIS & MARK LEMLEY, IP AND ANTITRUST 3-3 to 3-10 (2002).

Misuse law [may] discourage license arrangements that antitrust policy encourages or at least condones in the interests of promoting innovation.

for a misuse finding without any showing of either market power or anticompetitive effect and without entertaining evidence of off-setting procompetitive effect or business justification? That question was squarely presented by the now-denied *Scheiber* petition; it is now one that the FTC and DOJ should want to address in some fashion in their final hearings report because it so directly implicates a host of policy considerations wrapped up in the IP/antitrust “harmonization” theme dominating those hearings.

Some participants in this debate who come to it from an antitrust background argue the problem is that misuse as now defined by some courts can condemn what are clearly both innovation-supporting and distinctly procompetitive license arrangements. The academic research institutions’ amicus brief supporting the *Scheiber* petition presented a compelling example from their own experience in licensing patents evolving from their medical research. Another example would be a license provision preventing the licensee from dealing in competing products or technologies but where the licensor is a new entrant into the market at issue and the licensee readily accepts the provision in question as a reasonable way of aligning licensor and licensee market development incentives.

Other participants in this debate who come to it from an IP background may counter that antitrust law has become too permissive, enabling abusive licensing practices to escape liability. This may be, for example, because it is often exceptionally difficult if not impossible to prove that a patent holder possesses market power at an early stage in the evolution of a market that the holder is nonetheless destined ultimately to control. Another example may be that it is all too easy for a patent holder to “leverage” the power of its patent in a given market into the suppression of competition within adjacent markets in situations where antitrust liability may not attach since leveraging that does not rise to the level of attempted monopolization is generally not sufficient to constitute an antitrust violation.²⁶

There may be merit in both perspectives, suggesting that the goal of overall “convergence” or “harmonization” between misuse and antitrust law could be achieved through some adjustments on both sides. As the misuse doctrine has evolved in recent years, there has been at least on the patent law side an increasing tendency to require some showing of market power and of licensor coercion as opposed to contracting for the “mutual convenience” of both licensor and licensee before an arrangement is found to constitute misuse.²⁷ As the antitrust rule of reason has evolved in recent years, it may not take detailed and elaborate economic analysis to warrant an initial inference that a given practice threatens anticompetitive effect and thereupon shift the burden to the defender of the practice in question to establish a persuasive business justification.²⁸ Why not converge or harmonize standards for IP licensing arrangements generally around these aspects of both regimes?

²⁶ See *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993).

²⁷ See generally INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 221–25.

²⁸ See generally *California Dental Ass’n v. FTC*, 526 U.S. 756 (1999). As the Court there observed, “[a]lthough we have said that a challenge to a ‘naked restraint on price and output’ need not be supported by ‘a detailed market analysis’ in order to ‘requir[e] some competitive justification,’ *National Collegiate Athletic Ass’n*, 468 U.S. at 110, it does not follow that every case attacking a less obviously anticompetitive restraint . . . is a candidate for plenary market examination” (*California Dental Ass’n*, 526 U.S. at 779); “[t]here is always something of a sliding scale in appraising reasonableness” and “the quality of proof required should vary with the circumstances” (*id.* at 780 quoting PHILLIP AREEDA, ANTITRUST LAW § 1507 at 402 (1986)); “there is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment” (*id.* at 780–81); and “[t]he object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one” (*id.* at 781).

The courts, enforcement agencies, and/or Congress could constructively come to agreement along the following lines. A finding of misuse should in most cases require some proof of market power exercised to coerce the licensee into accepting some significant restraint on its ability to innovate and compete; that showing can appropriately support a misuse presumption. Some practices such as a clear extension of the scope of a restraint beyond the scope of the IP grant—perhaps including an insistence upon patent royalties after the patent has expired—may well warrant a misuse presumption even without an initial showing of market power. In all cases, however, the law should allow the IP holder to establish a persuasive business justification. In short, in our view, no practice warrants irrebutable condemnation as “per se” misuse.

On the other hand, licensees and other adversely affected parties as well as the enforcement agencies should be able to make effective use of the antitrust laws against a licensor shown to possess market power in a relevant market who is undertaking coercively to extend the scope of its IP rights with a discernable anticompetitive effect; the IP holder should thereupon have the ability to defend by establishing mutual convenience of both parties or some other persuasive business justification. Again, consistent with the predominant thrust of antitrust jurisprudence as now applied to IP licensing arrangements generally, licensors should enjoy considerable latitude in maximizing the value of their IP rights. On the other hand, their exploitation of market power to suppress competition or raise barriers to new competition should be as susceptible to antitrust challenge as their anticompetitive exploitation of market power involving any other kind of property.

Under these formulations, a given licensing practice might in some exceptional situation be found to constitute IP misuse without necessarily also being an antitrust violation. Conversely, a given licensing practice might in some exceptional situation be found to constitute an antitrust violation without necessarily also being IP misuse. But inconsistencies or conflict in the sense that one body of law encourages what the other body of law discourages would be avoided or at least minimized.

Three years ago, Mark Ostrau proposed a four-part test for any finding of IP misuse that we would endorse as consistent with our perspectives as outlined above. Under his test, a finding of misuse would require all of the following (in his words):

1. *Undue Extension of Intellectual Property Rights*: The intellectual property owner has engaged in a practice—normally one restricting a licensee’s activity—that “extended the scope” of its intellectual property.
2. *Conditioning*: The owner has conditioned the intellectual property license on a licensee’s acceptance of the restriction.
3. *Coercion*: Using market power, the owner has coerced the unwilling licensee into accepting the restriction.
4. *Affirmative Justification*: The owner has failed to demonstrate a business justification for having insisted on the restrictive practice despite an opportunity to do so.²⁹

With reform of that sort—promoted by the agencies in their hearings report and thereafter by Congress as well—misuse and antitrust law would be in sync in their protection against IP licensing practices genuinely adverse to consumer welfare. At the same time, neither regime would

²⁹ INTELLECTUAL PROPERTY MISUSE, *supra* note 22, at 221–22.

unduly inhibit licensing flexibility or arrangements that can enhance opportunities for technology dissemination and the growth of new markets that genuinely contribute to consumer welfare. In short, misuse and antitrust law would be on the same page and in the same choir, promoting innovation in a consistent manner. ●