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Innovation and Competition Policy, Ch. 9 (2d ed): The Innovation Commons

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This book of CASES AND MATERIALS ON INNOVATION AND COMPETITION POLICY is intended for educational use. The book is free for all to use subject to an open source license agreement. It differs from IP/antitrust casebooks in that it considers numerous sources of competition policy in addition to antitrust, including those that emanate from the intellectual property laws themselves, and also related issues such as the relationship between market structure and innovation, the competitive consequences of regulatory rules governing technology competition such as net neutrality and interconnection, misuse, the first sale doctrine, and the Digital Millennium Copyright Act (DMCA). Chapters will be updated frequently. The author uses this casebook for a three-unit class in *Innovation and Competition Policy* taught at the University of Iowa College of Law and available to first year law students as an elective. The table of contents is as follows (click on chapter title to retrieve it):

INNOVATION AND COMPETITION POLICY:
CASES AND MATERIALS
HERBERT HOVENKAMP

CHAPTER NINE (2d ed)
THE INNOVATION COMMONS

BROOKS V. BYAM
2 Story 525, 4 F.Cas. 261
(C.C.Mas 1843)

Story, Justice[1]

By the agreement between Brown and Brooks (18th of September, 1837), it was agreed by Brown to sell and convey unto Brooks 'a right of manufacturing friction matches according to letters patent, granted to Phillips, & c. in the said town of Ashburnham, to the amount of one right, embracing one person only, so denominated, in as full and ample manner to the extension of the said one right as the original patentee;'…

The question, then, is, whether the license or privilege granted by the patentee to Brown is not an entirety, and incapable of being split up into distinct rights, each of which might be assigned to different persons in severalty…..

…[T]he case of Lord Mountjoy, reported in Godb. 17, Moore, 174, and more fully upon the same points in And. 307, approaches by a very near analogy to the present case. There, Lord Mountjoy granted by indenture a certain mannor to one Browne in fee, and there was a proviso in the indenture, and a covenant by Browne, that Lord Mountjoy, his heirs, and assigns, might dig for ore in the lands parcel of the manor, and dig turf also, for the purpose of making alum. Lord Mountjoy demised his interest for a term of years to one L., and L. assigned over the same to two other persons; and among other questions, one was, whether Lord Mountjoy could assign over this right, and if the subsequent assignment to the two were good. Godbolt says, that it was decided by the judges, that the assignment to the two was good; but that the two assignees could not work severally, but together with one stock, or such workmen as belonged to them both. Lord Coke, who was counsel in the case for Lord Mountjoy, and who reported to the privy council, where the question arose, the opinion of the judges, confirms in Co. Litt. 165a, the report of Godbolt, and says,

[1] Justice Story was an Associate Justice of the Supreme Court at this time, but was sitting as a circuit judge.

that the judges, among other things, resolved, 'That the Lord Mountjoy might assign his whole interest to one, two, or more; but then, if there be two or more, they could make no division of it, but work together with one stock; neither could the Lord Mountjoy, &c. assign his interest in any part of the waste to one or more, for that might work a prejudice and a surcharge to the tenant of the land.' And, therefore, Lord Coke adds, if such an uncertain inheritance descendeth to two partners, it cannot be divided between them…. Now, it seems to me, that, in this aspect, the case of Lord Mountjoy has a very striking application to the present case. The grant was of a mere right to dig ore, &c.; and yet upon the ground of possible or probable prejudice to the grantor (Browne) of this privilege, it was held to be indivisible…..

The general rule of the common law is, that contracts are not apportionable; and this rule seems ordinarily, although not universally, true, where the apportionment is by the act of the party, and not by mere operation of law; or where the contract is only in part performed, and is not in its own nature and terms severable. ….

… [I]f I buy as many bricks from a kiln as two horses can haul in an ordinary wagon, or as one mason can lay on the wall of my house in a day, it is a valid sale of the quantity of bricks when ascertained. Certainly it is; but then it is a valid sale of the bricks as property, not the sale of the mere privilege to manufacture bricks at my kiln. So, it is asked, if the owner of a brick-yard sells to A. the right of making as many bricks on any land, as six men can strike in a day, whether it may not make a valid sale to a third person of all, that one man can strike? Certainly he may; but then he sells the ascertained quantity of bricks; and not the right to make them. So, in the case at bar, Brown might well sell to any person or persons all or any undivided portion of the matches made by him under his license; but that would be a very different thing from a sale of a fraction of the privilege to make them…..

Upon the whole, I retain the opinion that the license in this case was an entirety, and incapable of division, or of being broken up into fragments in the possession of different persons. The right granted is to the grantee and six persons to be employed by him in making matches; and if it be assignable, the assignment must be of the entirety of the license to the assignee, and it cannot be apportioned among different persons in severalty….

NOTES AND QUESTIONS

1. Is Lord Mountjoy's case really a "very near analogy" to the case at bar? The ore and turf in *Mountjoy's* was "rivalrous"; that is, one person could take some of it only by depriving others. In that case dividing it up without an agreement restricting the output of those using it would lead to overproduction.

But the right to make matches under a patent permits the owner to make as many as he or she pleases without limiting the amount that others can make. Should that make a difference? Isn't Justice Story's distinction between the sale of bricks and of the right to make them at a particular kiln also off point? After all, the right to make bricks at the owner's kiln is also rivalrous, given that the kiln has only limited capacity. *See* CHRISTINA BOHANNAN & HERBERT HOVENKAMP, CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION, Ch. 12 (2011).

In any event, IP rights are for the most part readily capable of being divided. See, e.g., *Rembrandt Data Technologies v. AOL, LLC* 641 F.3d 1331 (2011), where a corporation reorganized, and as a part of the reorganization "divested most of its businesses and assets, including its agreements and licenses . . . including its right to sublicense." This was simply a *right* rather than a specific *quantity* of a physical good.

A popular song sold on *iTunes* might be licensed millions of times, with each licensee acquiring a license to listen and without impairing the rights of others. The limit on this proposition is "congestion externalities," which occur when the licensee market becomes overcrowded. For example, if a license to make a product is given to too many firms there may be too many sellers in the market to enable all of them to make a profit.

PATENT POOLS AND THE PRICE FIXING PROBLEM

E. BEMENT & SONS v. NATIONAL HARROW COMPANY
186 U.S. 70 (1902)

Mr. Justice Peckham:

… 'The first two above-named firms conducted their business in separate portions or territory of the United States, under the same United States letters patent, and the other firms began their business in hostility to the same letters patent. The first two firms began a number of patent lawsuits against the other firms and their customers for infringement of patents. These suits were vigorously prosecuted, and the court finally decided the patents valid, and ordered an accounding of profits, against the firm of Chase, Taylor, & Company, and W. S. Lawrence.

'Prior to September, 1890, the last four of the above-named firms settled their disputes over patents with the first two firms, and took licenses under their letters patent. Considerable sums of money were paid in settlement of these disputes and rights; and prior to said date, September, 1890, there was no other relation between the first two firms named and the other parties than that of licensor and licensee under United States letters patent.

'In the year 1890, and just prior thereto, other persons, firms, and corporations began the spring tooth harrow business, and other patent lawsuits followed. Suits were begun against the defendants herein, and against their customers purchasing their spring tooth harrows; and one case had gone to final decree, in which the defendant was ordered to account for profits and damages; and an injunction had been granted in another suit. Proceedings were pending upon an application for rehearing in these cases.

'In September, 1890, the six firms first above named decided to organize a corporation known as the National Harrow Company of New York, with a view to transferring various United States letters patent owned by the six firms respectively to said corporation, and for the purpose of conducting the manufacture of some part or portion of the material which entered into their spring tooth harrow business.

The only Federal question raised in the record is as to the validity of contracts … with regard to the act of Congress on the subject of trusts. 26 Stat. at L. 209, chap. 647. The 1st section of the act provides that 'every contract, combination in the form of trust, or otherwise, or conspiracy, in restraint of trade or commerce among the several states or with foreign nations, is hereby declared to be illegal.' Every person making such a contract is deemed guilty of a misdemeanor, and on conviction is to be punished by fine or by imprisonment, or both. As the statute makes the contract in itself illegal, no recovery can be had upon it when the defense of illegality is shown to the court. The act provides for the prevention of violations thereof, and makes it the duty of the several district attorneys, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain such violations, and it gives to any person injured in his business or property the right to sue; but that does not prevent a private individual when sued upon a contract which is void as in violation of the act from setting it up as a defense, and we think when proved it is a valid defense to any claim made under a contract thus denounced as illegal.

This brings us to a consideration of the terms of the license contracts, for the purpose of determining whether they violate the act of Congress. The first important and most material fact in considering this question is that the agreements concern articles protected by letters patent of the government of the United States. The plaintiff, according to the finding of the referee, was at the time when these licenses were executed the absolute owner of the letters patent relating to the float spring tooth harrow business. It was therefore the owner of a monopoly recognized by the Constitution and by the statutes of Congress. An owner of a patent has the right to sell it or to keep it; to manufacture the article himself or to license others to manufacture it; to sell such article himself or to authorize others to sell it. As stated by Mr. Justice Nelson, in Wilson v. Rousseau, 4 How. 646, 674, in speaking of a patent:

> 'The law has thus impressed upon it all the qualities and characteristics of property for the specified period, and has enabled him to hold and deal with it the same as it case of any other description of property belonging to him, and on his death it passes, with the rest of his personal estate, to his legal representatives, and becomes part of the assets.'

Again, as stated by Mr. Chief Justice Marshall, in Grant v. Raymond, 6 Pet. 218, 241:

> 'To promote the progress of useful arts is the interest and policy of every enlightened government. It entered into the views of the framers of our Constitution, and the power 'to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries,' is among those expressly given to Congress. This subject was among the first which followed the organization of our government. It was taken up by the first Congress at its second session, and an act was passed authorizing a patent to be issued to the inventor of any useful art, etc., on his petition, 'granting to such petitioner, his heirs, administrators, or assigns, for any term not exceeding fourteen years, the sole and exclusive right and liberty of making, using, and vending to others to be used, the said invention or discovery.' The law further declares that the patent 'shall be good and available to the grantee or grantees by force of this act, to all and every intent and purpose herein contained.' The amendatory act of 1793 contains the same language, and it cannot be doubted that the settled purpose of the United States has ever been, and continues to be, to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent. It is the reward stipulated for the advantages derived by the public for the exertions of the individual, and is intended as a stimulus to those exertions. The laws which are passed to give effect to this purpose ought, we think, to be construed in the spirit in which they have been made, and to execute the contract fairly on the part of the United States, where the full benefit has been actually received, if this can be done without transcending the intention of the statute, or countenancing acts which are fraudulent or may prove mischievous. The public yields nothing which it has not agreed to yield; it receives all which it has contracted to receive. The full benefit of the discovery, after its enjoyment by the discoverer for fourteen years, is preserved; and for his exclusive enjoyment of it during that time the public faith is pledged.'

In Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co. 77 Fed. 288, 294, it is stated regarding a patentee:

> ‘If he see fit, he may reserve to himself the exclusive use of his invention or discovery. If he will neither use his device nor permit others to use it, he has but suppressed his own. That the grant is made upon the reasonable expectation that he will either put his invention to practical use or permit others to avail themselves of it upon reasonable terms is doubtless true. This expectation is based alone upon the supposition that the patentee’s interest will induce him to use, or let others use, his invention. The public has retained no other security to enforce such expectations. A suppression can endure but for the life of the patent, and the disclosure he has made will enable all to enjoy the fruit of his genius. His title is exclusive, and so clearly within the constitutional provisions in respect of private property that he is neither bound to use his discovery himself nor permit others to use it. The Dictum found in Hoe v. Knap, 27 Fed. 204, is not supported by reason or authority.

It is true that in certain circumstances the sale of articles manufactured under letters patent may be prevented when the use of such article may be subject, within the several states, to the control which they may respectively impose in the legitimate exercise of their powers over their purely domestic affairs, whether of internal commerce or of police regulation. Thus an improvement for burning oil, protected by letters patent of the United States, was condemned by the state inspector of Kentucky as unsafe for illuminating purposes, under the statute requiring an inspection and imposing a penalty for the violation of the statute; and it was held that the enforcement of the statute was within the proper police powers of the state, and that it interfered with no right conferred by the letters patent.

Notwithstanding these exceptions, the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does not render them illegal….

In these contracts, provision is expressly made, not alone for manufacture, but for the sale of the manufactured product throughout the United States, and at prices which are particularly stated, and which the seller is not at liberty to decrease without the assent of the licensor. These contracts directly affected, not as a mere incident of manufacture, the sale of the implements all over the country, and the question arising is whether the contracts which thus affect such sales are void under the act of Congress.

On looking through these licenses we have been unable to find any conditions contained therein rendering the agreement void because of a violation of that act. There had been, as the referee finds, a large amount of litigation between the many parties claiming to own various patents covering these implements. Suits for infringements and for injunction had been frequent, and it was desirable to prevent them in the future. The execution of these contracts did in fact settle a large amount of litigation regarding the validity of many patents, as found by the referee. This was a legitimate and desirable result in itself. The provision in regard to the price at which the licensee would sell the article manufactured under the license was also an appropriate and reasonable condition. It tended to keep up the price of the implements manufactured and sold, but that was only recognizing the nature of the property dealt in, and providing for its value so far as possible. This the parties were legally entitled to do. The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it, or sell the right to manufacture and sell the article patented, upon the condition that the assignee shall charge a certain amount for such article.

It is also objected that the agreement of the defendant not to manufacture or sell any other float spring tooth harrow, etc., than those which it had made under its patents before assigning them to the plaintiff, or which it was licensed to manufacture and make, under the terms of the license, except such other style and construction as it may be licensed to manufacture and sell by the plaintiff, is void under the act of Congress.

The plain purpose of the provision was to prevent the defendant from infringing upon the rights of others under other patents, and it had no purpose to stifle competition in the harrow business more than the patent provided for, nor was its purpose to prevent the licensee from attempting to make any improvement in harrows. It was a reasonable prohibition for the defendant, who would thus be excluded from making such harrows as were made by others who were engaged in manufacturing and selling other machines under other patents. It would be unreasonable to so construe the provision as to prevent defendant from using any letters patent legally obtained by it and not infringing patents owned by others. This was neither its purpose nor its meaning.

There is nothing which violates the act in the agreement that plaintiff would not license any other person than the defendant to manufacture or sell any harrow of the peculiar style and construction then used or sold by the defendant. It is a proper provision for the protection of the individual who is the licensee, and is nothing more in effect than an assignment or sale of the exclusive right to manufacture and vend the article. In brief, after a careful examination of these contracts, we are unable to find any provision in them, either taken separately or in connection with all the others therein contained, which would render the contracts between these parties void as in violation of the act of Congress.

NOTES AND QUESTIONS

1. Developing technologies are often patent intensive as new innovations are built atop previous innovations or complementary technologies are patented. The result can be a "patent thicket" in which large numbers of essential patents are owned by separate firms. Thickets increase the costs of innovating and in extreme cases can even prevent new innovations from emerging. See, for example, the Wright airplane litigation discussed n the first chapter. *See generally* Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard Setting*, *in* 1 INNOVATION POLICY AND THE ECONOMY 119 (Adam B. Jaffe et al. eds., 2001).

One solution is for firms to create a patent pool. While antitrust is rightfully wary of agreements among competing firms, patent pools can be economically justified. In a patent pool, the owners of related patents create a pool of their patents and license the entire pool, both to members of the pool and perhaps to others in the same or related markets. Rather than being concerned with potential infringement and having to go through the cost of discovering whether a particular technology is patented, and by whom, the innovator can simply purchase a license to the entire pool.

Copyright law can create similar thickets, particularly for digital access for purposes of scientific research. See from Jerome H. Reichman & Ruth L. Okediji, *When Copyright Law and Science Collide: Empowering Digitally Integrated Research Methods on a Global Scale*, 96 MINN. L. REV. 1362 (2012). Could pooling solve that problem as well? One problem may be that copyright has a much larger proportion of "non-practicing entities," and as a result there is a much less even balance of power in the system. Researchers may need access to copyrighted data, which can be highly specific to their particular task, but have nothing to leverage in return. Could antitrust law be brought to bear on the problem?

2. Note that in his discussion of patent licensing agreements Justice Peckham did not distinguish vertical from horizontal agreements. For example, he relied on the *button fastener* case, which is discussed in Chapter one. That was a purely vertical case involving a tying arrangement. Should it make any

difference that horizontal agreements are more competitively threatening? Or is that question irrelevant to patent policy? Today, a price fixing agreement among two or more *competitors*, such as the harrow manufacturers or the light bulb manufacturers in the *GE* case, reprinted *infra*, would generally be regarded as unlawful per se unless there were legitimate joint production or some other form of joint venture. However, resale price agreements among non-competitors are generally treated under the rule of reason and most are lawful. *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007) (applying rule of reason to resale price maintenance between a supplier and retailer). Suppose, for example, that GE owned a patent on light bulb technology and manufactured general use light bulbs. However, it did not wish to manufacture specialty bulbs for kitchen ovens or other hot areas and licensed Westinghouse to manufacture those, requiring Westinghouse to set a specified price. Is the agreement horizontal? What if GE did not manufacture any light bulbs at all, but simply licensed Westinghouse to make them and specified the price?

In addition, note that Justice Peckham did not distinguish between agreements that set fees for licensing the patents from agreements fixing the price of the patented *product*. Firms engaged in cross-licensing necessarily must agree on the price of the license itself, even if the price is zero (as it often is). But why do they need to agree on the product price? Justice Peckham suggests that otherwise they might not be able to earn adequate returns. But isn't this just another way of saying that perhaps there were too many firms making harrows and competition would have thinned out the least efficient ones? Interestingly, Justice Peckham is well known for his rejection of a "ruinous competition" defense in the first price-fixing case to reach the Supreme Court. United States v. Trans-Missouri Freight Assn., 166 U.S. 290 (1897). Further, Justice Peckham wrote there, a reasonable price is the one set by competition. Should it be any different when the price-fix accompanies a patent cross license?

UNITED STATES v. GENERAL ELECTRIC CO.
272 U.S. 476 (1926)

Mr. Chief Justice TAFT delivered the opinion of the Court.

This is a bill in equity, brought by the United States in the District Court for the Northern District of Ohio to enjoin the General Electric Company, the Westinghouse Electric & Manufacturing Company, and the Westinghouse Lamp Company from further violation of the Anti-Trust Act of July 2, 1890. 26 Stat. 209. The bill made two charges, one that the General Electric Company, in its business of making and selling incandescent electric lights, had devised and was carrying out a plan for their distribution throughout out the United States by a number of so called agents, exceeding 21,000, to restrain interstate trade in such lamps and to exercise a monopoly of the sale thereof; and, second, that it was achieving the same illegal purpose through a contract of license with the defendants, the Westinghouse Electric & Manufacturing Company and the Westinghouse house Lamp Company. As the Westinghouse Lamp Company is a corporation all of whose stock is owned by the Westinghouse Electric & Manufacturing Company, and is but its selling agent, we may treat the two as one, and reference hereafter will be only to the defendants the General Electric Company, which we shall call the Electric Company, and the Westinghouse Company.

The government alleged that the system of distribution adopted was merely a device to enable the Electric Company to fix the resale prices of lamps in the hands of purchasers, that the so-called agents were in fact wholesale and retail merchants, and the lamps passed through the ordinary channels of commerce in the ordinary way, and that the restraint was the same and just as unlawful as if the so-called agents were avowed purchasers handling the lamps under resale price agreements. The Electric Company answered that its distributors were bona fide agents, that it had the legal right to market its lamps and pass them directly to the consumer by such agents, and at prices and by a system prescribed by it and agreed upon between it and its agents, there being no limitation sought as to resale prices upon those who purchased from such agents.

The second question in the case involves the validity of a license granted March 1, 1912, by the Electric Company to the Westinghouse Company to make, use, and sell lamps under the patents owned by the former. It was charged that the license in effect provided that the Westinghouse Company would follow prices and terms of sale from time to time fixed by the Electric Company and observed by it, and that the Westinghouse Company would, with regard to lamps manufactured by it under the license, adopt and maintain the same conditions of sale as observed by the Electric Company in the distribution of lamps manufactured by it.

There had been a prior litigation between the United States and the three defendants and 32 other corporations, in which the government sued to dissolve an illegal combination in restraint of interstate commerce in electric lamps, in violation of the Anti-Trust Act, and to enjoin its further violation. A consent decree was entered in that cause, by which the combination was dissolved, the subsidiary corporations surrendered their charters and their properties were taken over by the General Electric Company. The defendants were all enjoined from fixing resale prices for purchasers, except that the owner of the patents were permitted to fix the prices at which a licensee should sell lamps manufactured by it under the patent. After the decree was entered, a new sales plan, which was the one here complained of, was submitted to the Attorney General. The Attorney General declined to express an opinion as to its legality. The plan was adopted and has been in operation since 1912.

The government insists that these circumstances tend to support the government's view that the new plan was a mere evasion of the restrictions of the decree and was intended to carry out the same evil result that had been condemned in the prior litigation. There is really no conflict of testimony in the sense of a variation as to the facts but only a difference as to the inference to be drawn therefrom. The evidence is all included in a stipulation as to certain facts, as to what certain witnesses for the defendants would testify, and as to the written contracts of license and agency made by the General Electric Company and the Westinghouse Company.

The General Electric Company is the owner of three patents-one of 1912 to Just & Hanaman, the basic patent for the use of tungsten filaments in the manufacture of electric lamps; the Coolidge patent of 1913, covering a process of manufacturing tungsten filaments by which their tensile strength and endurance is greatly increased; and, third, the Langmuir patent of 1916, which is for the use of gas in the bulb, by which the intensity of the light is substantially heightened. These three patents cover completely the making of the modern electric lights with the tungsten filaments, and secure to the General Electric Company the monopoly of their making, using, and vending.

The total business in electric lights for the year 1921 was $68,300,000, and the relative percentages of business done by the companies were: General Electric, 69 per cent.; Westinghouse, 16 per cent.; other licensees, 8 per cent.; and manufacturers not licensed, 7 per cent. The plan of distribution by the Electric Company divides the trade into three classes. The first class is that of sales to large consumers readily reached by the General Electric Company, negotiated by its own salaried employees, and the deliveries made from its own factories and warehouses. The second class is of sales to large consumers under contracts with the General Electric Company, negotiated by agents, the deliveries being made from stock in the custody of the agents; and the third is of the sales to general consumers by agents under similar contracts. The agents under the second class are called B agents, and the agents under the third class are called A agents. Each B agent is appointed by the General Electric Company by the execution and delivery of a contract for the appointment, which lasts a year from a stated date, unless sooner terminated. It provides that the company is to maintain on consignment in the custody of the agent a stock of lamps, the sizes, types, classes, and quantity of which and the length of time which they are to remain in stock to be determined by the company. The lamps consigned to the agents are to be kept in their respective places of business, where they may be readily inspected and identified by the company. The consigned stock, or any part of it, is to be returned to the company as it may direct. The agent is to keep account books and records giving the complete information as to his dealings for the inspection of the company. All of the lamps in such consigned stock are to be and remain the property of the company until the lamps are sold, and the proceeds of all lamps are to be held in trust for the benefit and for the account of the company until fully accounted for. The B agent is authorized to deal with the lamps on consignment with him in three ways-first to distribute the lamps to the company's A agents as authorized by the company; second, to sell lamps from the stock to any consumer to the extent of his requirements for immediate delivery at prices specified by the company; third, to deliver lamps from the stock to any purchaser under written contract with the company to whom the B agent may be authorized by the company to deliver lamps at the prices and on the terms stated in the contract. The B agent has no authority to dispose of any of the lamps, except as above provided, and is not to control or attempt to control prices at which any purchaser shall sell any of such lamps. The agent is to pay all expenses in the storage, cartage, transportation, handling, sale, and distribution of lamps, and all expenses incident thereto and to the accounting therefor, and to the collection of accounts created. This transportation does not include the freight for the lamps in the consignment from the company to the agent. The agent guarantees the return to the company of all unsold lamps in the custody of the agent within a certain time after the termination of his agency. The agent is to pay over to the company not later than the 15th of each month an amount equal to the total sales value, less the agent's compensation, of all of the company's lamps sold by him-that is, first, of the collections that have been made; second, of those customers' accounts which are past due. This is to comply with the guaranty of the agent of due and prompt payment for all lamps sold by him from his stock. Third, the agent is to pay to the company the value of all of the company's lamps lost or missing from or damaged in the stock in his custody.

There is a basic rate of commission payable to the agent, and there are certain special supplemental and additional compensations for prompt and efficient service. If the agent becomes insolvent, or fails to make reports and remittances, or fails in any of his obligations, the appointment may be terminated, and, when terminated, either at the end of the year or otherwise, the consigned lamps remaining unsold are to be delivered to the manufacturer. It appears in the evidence that since 1915, although there is no specific agreement to this effect, the company has assumed all risk of fire, flood, absolescence, and price decline, and carries whatever insurance is carried on the stocks of lamps in the hands of its agents and pays whatever taxes are assessed. This is relevant as a circumstances to confirm the view that the so-called relation of agent to the company is the real one. There are 400 of the B agents, the large distributors. They recommend to the company efficient and reliable distributors in the localities with which they are respectively familiar, to act as A agents, whom the company appoints. There are 21,000 or more of the A agents. They are usually retail electrical supply dealers in smaller places. The only sales which the A agent is authorized to make are to consumers for immediate delivery and to purchasers under written contract with the manufacturer, just as in the case of the B agents. The plan was, of course, devised for the purpose of enabling the company to deal directly with consumers and purchasers, and doubtless was intended to avoid selling the lamps owned by the company to jobbers or dealers and prevent sale by these middlemen to consumers at different and competing prices. The question is whether, in view of the arrangements made by the company with those who ordinarily and usually would be merchants buying from the manufacturer and selling to the public, such persons are to be treated as agents or as owners of the lamps, consigned to them under such contracts. If they are to be regarded really as purchasers, then the restriction as to the prices at which the sales are to be made is a restraint of trade and a violation of the Anti-Trust Law.

We find nothing in the form of the contracts and the practice under them which makes the so-called B and A agents anything more than genuine agents of the company, or the delivery of the stock to each agent anything more than a consignment to the agent for his custody and sale as such. He is not obliged to pay over money for the stock held by him until it is sold. As he guarantees the account when made, he must turn over what should have been paid whether he gets it or not. This term occurs in a frequent form of pure agency known as sale by del credere commission. There is no conflict in the agent's obligation to account for all lamps lost, missing, or damaged in the stock. It is only a reasonable provision to secure his careful handling of the goods intrusted to him. We find nothing in his agreement to pay the expense of storage, cartage, transportation (except the freight on the original consignment), handling and the sale and distribution of the lamps, inconsistent with his relation as agent. The expense of this is of course covered in the amount of his fixed commission. The agent has no power to deal with the lamps in any way inconsistent with the retained ownership of the lamps by the company. When they are delivered by him to the purchasers, the title passes directly from the company to those purchasers. There is no evidence that any purchaser from the company or any of its agents is put under any obligation to sell at any price, or to deal with the lamps purchased except as an independent owner. The circumstance that the agents were in their regular business wholesale or retail merchants, and under a prior arrangement had bought the lamps and sold them as their owners, did not prevent a change in their relation to the company. We find no reason in this record to hold that the change in this case was not in good faith and actually maintained.

But it is said that the system of distribution is so complicated and involves such a very large number of agents, distributed throughout the entire country, that the very size and comprehensiveness of the scheme brings it within the Anti-Trust Law. We do not question that in a suit under the Anti-Trust Act the circumstance that the combination effected secures domination of so large a part of the business affected as to control prices is usually most important in proof of a monopoly violating the act. But under the patent law the patentee is given by statute a monopoly of making, using and selling the patented article. The extent of his monopoly in the articles sold and in the territory of the United States where sold is not limited in the grant of his patent, and the comprehensiveness of his control of the business in the sale of the patented article is not necessarily an indication of illegality of his method. As long as he makes no effort to fasten upon ownership of the articles, he sells control of the prices at which his purchaser shall sell, it makes no difference how widespread his monopoly. It is only when he adopts a combination with others, by which he steps out of the scope of his patent rights and seeks to control and restrain those be whom he has sold his patented articles in their subsequent disposition of what is theirs, that he comes within the operation of the Anti-Trust Act. The validity of the Electric Company's scheme of distribution of its electric lamps turns, therefore, on the question whether the sales are by the company through its agents to the consumer, or are in fact by the company to the so-called agents at the time of consignment. The distinction in law and fact between an agency and a sale is clear. For the reasons already stated, we find no ground for inference that the contracts made between the company and its agents are, or were intended, to be other than what their language makes them.

The government relies in its contention for a different conclusion on the case of Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U. S. 373 [1911][2] That case was a bill in equity brought by the Miles Medical Company to enjoin Park & Sons Company from continuing an alleged conspiracy with a number of wholesale and retail dealers in proprietary medicines, to induce the persons who had entered into certain agency contracts, to the number of 21,000 through the country, to break their contracts of agency with the Medical Company, to the great injury of that company. The agency concerned the sale of proprietary medicines prepared by secret methods and formulas and identified by distinctive packages and trade-marks. The company had an extensive trade throughout the United States and certain foreign countries. It had been its practice to sell its medicines to jobbers and wholesale druggists, who in turn sold to retail druggists for sale to the customer. It had fixed not only the price of its own sales to jobbers and wholesale dealers but also the prices of jobbers and small dealers. The defendants had inaugurated a cut-rate or cutprice system, which had caused great damage to the complainants' business, injuriously affected its reputation, and depleted the sales of its remedies. The bill was demurred to, on the ground that the methods set forth in the bill, by which attempt was made to control the sales of prices to consumers was illegal both at common law and under the Anti-

[2] [ed. The *Dr. Miles* rule of per se illegality for resale-price maintenance was upset and replaced with a rule of reason in Leegin Creative Leather Products, Inc. v. PSKS, Inc., 551 U.S. 877 (2007)]

Trust Act, and deprived the bill of any equity. This was the issue considered by the court.

The plan of distribution of the Miles Medical Company resembled in many details the plan of distribution in the present case, except that the subject-matter there was medicine by a secret formula, and not a patented article. But there were certain vital differences. These led the Circuit Court of Appeals (164 F. 803, 90 C. C. A. 579) to declare that the language of the so-called contracts of agency were false in their purport, and were merely used to conceal what were really sales to the so-called agents. This conclusion was sustained by certain allegations in the bill inconsistent with the contracts of agency, to the effect that the Medical Company did sell to these so-called agents the medical packages consigned. This court, however, without reference to these telltale allegations of the bill found in the contracts themselves and their operation plain provision for purchases by the so-called agents which necessarily made the contracts as to an indefinite amount of the consignments to them, contracts of sale rather than of agency. The court therefore held that the showing made was of an attempt by the Miles Medical Company through its plan of distribution to hold its purchasers after the purchase at full price to an obligation to maintain prices on a resale by them. This is the whole effect of the Miles Medical Case. That such it was is made plain in the case of Boston Store v. American Graphophone Co., 246 U. S. 8, 21 in which then Chief Justice White reviewed the various cases on this general subject and spoke of the Miles Medical Case as follows:

'In Dr. Miles Medical Co. v. Park & Sons Co., 220 U. S. 373 it was decided that under the general law the owner of movables (in that case, proprietary medicines compounded by a secret formula) could not sell the movables and lawfully by contract fix a price at which the product should afterwards be sold, because to do so would be at one and the same time to sell and retain, to part with and yet to hold, to project the will of the seller so as to cause it to control the movable parted with when it was not subject to his will because owned by another, and thus to make the will of the seller unwarrantedly take the place of the law of the land as to such movables. It was decided that the power to make the limitation as to price for the future could not be exerted consistently with the prohibitions against restraint of trade and monopoly contained in the Anti-Trust Law.'

Nor does the case of Standard Sanitary Manufacturing Co. v. United States, 226 U. S. 20, sustain the contention of the government on the first question. There a number of manufacturers, one of whom owned a patent for enameled iron ware for plumbing fixtures made a combination to accept licenses to make the patented commodities and to sell them in interstate trade to jobbers and to refuse to sell to jobbers who would not agree to maintain fixed prices in sales to plumbers. This was an attempt just like that in the Miles Medical Co. Case to control the trade in the articles sold and fasten upon purchasers who had bought at full price and were complete owners an obligation to maintain resale prices.

We are of opinion, therefore, that there is nothing as a matter of principle or in the authorities which requires us to hold that genuine contracts of agency like those before us, however comprehensive as a mass or whole in their effect, are violations of the Anti-Trust Act. The owner of an article patented or otherwise is not violating the common law or the Anti-Trust Act by seeking to dispose of his articles directly to the consumer and fixing the price by which his agents transfer the title from him directly to such consumer. The first charge in the bill can not be sustained.

Second. Had the Electric Company as the owner of the patents, entirely controlling the manufacture, use and sale of the tungsten incandescent lamps, in its license to the Westinghouse Company, the right to impose the condition that its sales should be at prices fixed by the licensor and subject to change according to its discretion? The contention is also made that the license required the Westinghouse Company not only to conform in the matter of the prices at which it might vend the patented articles, but also to follow the same plan as that which we have already explained the Electric Company adopted in its distribution. It does not appear that this provision was express in the license, because no such plan was set out therein, but even if the construction urged by the government is correct, we think the result must be the same.

The owner of a patent may assign it to another and convey (1) the exclusive right to make, use, and vend the invention throughout the United States; or (2) an undivided part or share of that exclusive right; or (3) the exclusive right under the patent within and through a specific part of the United States. But any assignment or transfer short of one of these is a license giving the licensee no title in the patent and no right to sue at law in his own name for an infringement. Conveying less than title to the patent or part of it, the patentee may grant a license to make, use, and vend articles under the specifications of his patent for any royalty, or upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure. It is well settled, as already said, that where a patentee makes the patented article, and sells it, he can exercise no future control over what the purchaser may wish to do with the article after his purchase. It has passed beyond the scope of the patentee's rights. Adams v. Burks, 17 Wall. 453; Bloomer v. McQuewan, 14 How. 539.

But the question is a different one which arises when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell. The patentee may make and grant a license to another to make and use the patented articles but withhold his right to sell them. The licensee in such a case acquires an interest in the articles made. He owns the material of them and may use them. But if he sells them he infringes the right of the patentee, and may be held for damages and enjoined. If the patentee goes further and licenses the selling of the articles, may he limit the selling by limiting the method of sale and the price? We think he may do so provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly. One of the valuable elements of the exclusive right of a patentee is to acquire profit by the price at which the article is sold. The higher the price, the greater the profit, unless it is prohibitory. When the patentee licenses another to make and vend and retains the right to continue to make and vend on his own account, the price at which his licensee will sell will necessarily affect the price at which he can sell his own patented goods. It would seem entirely reasonable that he should say to the licensee, 'Yes, you may make and sell articles under my patent but not so as to destroy the profit that I wish to obtain by making them and selling them myself.' He does not thereby sell outright to the licensee the articles the latter may make and sell or vest absolute ownership in them. He restricts the property and interest the licensee has in the goods he makes and proposes to sell.

This question was considered by this court in the case of Bement v. National Harrow Co., 186 U. S. 70. A combination of manufacturers owning a patent to make float spring tool harrows licensed others to make and sell the products under the patent on condition that they would not during the continuance of the license sell the products at a less price or on more favorable terms of payment and delivery to purchasers than were set forth in a schedule made part of the license. That was held to be a valid use of the patent rights of the owners of the patent. It was objected that this made for a monopoly. The court, speaking by Mr. Justice Peckham, said:

> 'The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does nor render them illegal.'

Speaking of the contract, he said:

> 'The provision in regard to the price at which the licensee would sell the article manufactured under the license was also an appropriate and reasonable condition. It tended to keep up the price of the implements manufactured and sold, but that was only recognizing the nature of the property dealt in, and providing for its value so far as possible. This the parties were legally entitled to do. The owner of a patented article can, of

> course, charge such price as he msy choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article.'…

Nor do we think that the decisions of this court holding restrictions as to price of patented articles invalid apply to a contract of license like the one in this case. Those cases are: Boston Store v. American Graphophone Co., 246 U. S. 8; Straus v. Victor Talking Machine Co., 243 U. S. 490; Standard Sanitary Manufacturing Co. v. United States, 226 U. S. 20; Bobbs-Merrill Co. v. Straus, 210 U. S. 339. These cases really are only instances of the application of the principle of Adams v. Burks, 17 Wall. 453, 456, already referred to that a patentee may not attach to the article made by him or with his consent a condition running with the article in the hands of purchasers limiting the price at which one who becomes its owner for full consideration shall part with it. They do not consider or condemn a restriction put by a patentee upon his licensee as to the prices at which the latter shall sell articles which he makes and only can make legally under the license. The authority of Bement v. Harrow Co. has not been shaken by the cases we have reviewed.

For the reasons given, we sustain the validity of the license granted by the Electric Company to the Westinghouse Company. The decree of the District Court dismissing the bill is affirmed.

NOTES AND QUESTIONS

1. The law of patent licensing clearly permits patentees to specify the quantity of goods that the licensee can produce. What is the difference between specifying the quantity and specifying the price? Indeed, many cartels, including OPEC, fix output rather than price. For example, if GE decided that the profit-maximizing output of lighbulbs is 10,000,000 per year and it had the capacity to make 6,000,000 itself, it could license Westinghouse to make 4,000,000 a year, thus yielding the same output and price that a cartel would.

2. While courts favor settlement of infringement disputes over litigation, they sometimes become wary if the settlement is used as an attempt to circumvent antitrust law. In *Asahi Glass Co. v. Pentech Pharmaceuticals, Inc.*, 289 F. Supp. 2d 986 (N.D. Ill., 2003), Judge Posner, sitting by designation, argued that if the *General Electric* case were tried today, the Court would be unlikely to uphold the agreement, at least without determining both the validity of the patents and "the rationale for the licensing agreements." He observed that the initial royalty rate of two percent "suggest[ed] that the right to use the [General Electric] patents was not worth a lot to Westinghouse" and that the minimum-price term in the licensing agreement had the effect of "minimiz[ing] competition." As Judge

Posner observed, the strength of the patent(s) subject to the settlement is highly relevant to the antitrust analysis. A useless patent could be used to facilitate a naked price fixing agreement if one firm licenses others to use it while specifying the sale price or limiting the output.

> If a patent is valuable a licensor would ordinarily want to maximize its own revenue by charging a high *license* fee, not by requiring the licensee to charge a high price. Such a price profits the licensee rather than the patentee. However, if the patent is weak or worthless, then it may simply by an excuse for collusion, suggested by a low license fee and a price maintenance provision. See Louis Kapow, *The Patent-Antitrust Intersection: A Reappraisal*, 97 Harv. L. Rev. 1813, 1856–57 (1984).

EFFICIENT PATENT POOLS

STANDARD OIL CO. (INDIANA) ET. AL. v. UNITED STATES
283 U.S. 163 (1931)

Mr. Justice BRANDEIS delivered the opinion of the Court.

This suit was brought by the United States in June, 1924, in the federal court for northern Illinois, to enjoin further violation of section 1 and section 2 of the Sherman Anti-Trust Trust Act July 2, 1890, c. 647, 26 Stat. 209 (15 USCA §§ 1, 2). The violation charged is an illegal combination to create a monopoly and to restrain interstate commerce by controlling that part of the supply of gasoline which is produced by the process of cracking. Control is alleged to be exerted by means of seventy-nine contracts concerning patents relating to the cracking art. The parties to the several contracts are named as defendants. Four of them own patents covering their respective cracking processes, and are called the primary defendants. Three of these, the Standard Oil Company of Indiana, the Texas Company, and the Standard Oil Company of New Jersey, are themselves large producers of cracked gasoline. The fourth, Gasoline Products Company, is merely a licensing concern. The remaining forty-six defendants manufacture cracked gasoline under licenses from one or more of the primary defendants. They are called secondary defendants….

The violation of the Sherman Act now complained of rests substantially on the making and effect of three contracts entered into by the primary defendants. The history of these agreements may be briefly stated. For about half a century before 1910, gasoline had been manufactured from crude oil exclusively by distillation and condensation at atmospheric pressure. When the demand for gasoline grew rapidly with the widespread use of the automobile, methods for increasing the yield of gasoline from the available crude oil were sought. It had long been known that from a given quantity of crude, additional oils of high volatility could be produced by 'cracking'; that is, by applying heat and pressure to the residum after ordinary distillation. But a commercially profitable cracking method and apparatus for manufacturing additional gasoline had not yet been developed. The first such process was perfected by the Indiana Company in 1913; and for more than seven years this was the only one practiced in America. During that period the Indiana Company not only manufactured cracked gasoline an large scale, but also had licensed fifteen independent concerns to use its process.

Meanwhile, since the phenomenon of cracking was not controlled by any fundamental patent, other concerns had been working independently to develop commercial processes of their own. Most prominent among these were the three other primary defendants, the Texas Company, the New Jersey Company, and the Gasoline Products Company. Each of these secured numerous patents covering its particular cracking process. Beginning in 1920, conflict developed among the four companies concerning the validity, scope, and ownership of issued patents. One infringement suit was begun; cross-notices of infringement, antecedent to other suits, were given; and interferences were declared on pending applications in the Patent Office. The primary defendants assert that it was these difficulties which led to their executing the three principal agreements which the United States attacks; and that their sole object was to avoid litigation and losses incident to conflicting patents.

The first contract was executed by the Indiana Company and the Texas Company on August 26, 1921; the second by the Texas Company and Gasoline Products Company on January 26, 1923; the third by the Indiana Company, the Texas Company, and the New Jersey Company, on September 28, 1923. The three agreements differ from one another only slightly in scope and terms. Each primary defendant was released thereby from liability for any past infringement of patents of the others. Each acquired the right to use these patents thereafter in its own process. Each was empowered to extend to independent concerns, licensed under its process, releases from past, and immunity from future claims of infringement of patents controlled by the other primary defendants. And each was to share in some fixed proportion the fees received under these multiple licenses. The royalties to be charged were definitely fixed in the first contract; and minimum sums per barrel, to be divided between the Taxes and Indiana companies, were specified in the second and third....

The Government contends that the three agreements constitute a pooling by the primary defendants of the royalties from their several patents; that thereby competition between them in the commercial exercise of their respective rights to issue licenses is eliminated; that this tends to maintain or increase the royalty charged secondary defendants and hence to increase the manufacturing cost of cracked gasoline; that thus the primary defendants exclude from interstate commerce gasoline which would, under lower competitive royalty rates, be produced; and that interstate commerce is thereby unlawfully restrained. There is no provision in any of the agreements which restricts the freedom of the primary defendants individually to issue licenses under their own patents alone or under the patents of all the others; and no contract between any of them, and no license agreement with a secondary defendant executed pursuant thereto, now imposes any restriction upon the quantity of gasoline to be produced, or upon the price, terms, or conditions of sale, or upon the territory in which sales may be made. The only restraint thus charged is that necessarily arising out of the making and effect of the provisions for cross-licensing and for division of royalties.

The Government concedes that it is not illegal for the primary defendants to cross-license each other and the respective licensees; and that adequate consideration can legally be demanded for such grants. But it contends that the insertion of certain additional provisions in these agreements renders them illegal. It urges, first, that the mere inclusion of the provisions for the division of royalties, constitutes an unlawful combination under the Sherman Act because it evidences an intent to obtain a monopoly. This contention is unsound. Such provisions for the division of royalties are not in themselves conclusive evidence of illegality. Where there are legitimately conflicting claims or threatened interferences, a settlement by agreement, rather than litigation, is not precluded by the Act. Compare Virtue v. Creamery Package Co., 227 U. S. 8, 33. An interchange of patent rights and a division of royalties according to the value attributed by the parties to their respective patent claims is frequently necessary if technical advancement is not to be blocked by threatened litigation. If the available advantages are upon on reasonable terms to all manufacturers desiring to participate, such interchange may promote rather than restrain competition.

The Government next contends that the agreements to maintain royalties violate the Sherman Law because the fees charged are onerous. The argument is that the competitive advantage which the three primary defendants enjoy of manufacturing cracked gasoline free of royalty, while licensees must pay to them a heavy tribute in fees, enables these primary defendants to exclude from interstate commerce cracked gasoline which would, under lower competitive royalty rates, be produced by possible rivals. This argument ignores the privileges incident to ownership of patents. Unless the industry is dominated, or interstate commerce directly restrained, the Sherman Act does not require cross-licensing patentees to license at reasonable rates others engaged in interstate commerce.... The allegation that the royalties charged are onerous is, standing alone, without legal significance; and, as will be shown, neither the alleged domination, nor restraint of commerce, has been proved.

The main contention of the Government is that even if the exchange of patent rights and division of royalties are not necessarily improper and the royalties are not oppressive, the three contracts are still obnoxious to the Sherman Act because specific clauses enable the primary defendants to maintain existing royalties and thereby to restrain interstate commerce. The provisions which constitute the basis for this charge are these. The first contract specifies that the Texas Company shall get from the Indiana Company one-fourth of all royalties thereafter collected under the latter's existing license agreements; and that all royalties received under licenses thereafter issued by either company shall be equally divided. Licenses granting rights under the patents of both are to be issued at a fixed royalty-approximately that charged by the Indiana Company when its process was alone in the field. By the second contract, the Texas Company is entitled to receive one-half of the royalties thereafter collected by the Gasoline Products Company from its existing licensees, and a minimum sum per barrel for all oil cracked by its future licensees. The third contract gives to the Indiana Company one-half of all royalties thereafter paid by existing licensees of the New Jersey Company, and a similar minimum sum for each barrel treated by its future licensees,-subject in the latter case to reduction if the royalties charged by the Indiana and Texas companies for their processes should be reduced. The alleged effect of these provisions is to enable the primary defendants, because of their monopoly of patented cracking processes, to maintain royalty rates at the level established originally for the Indiana process.

The rate of royalties may, of course be a decisive factor in the cost of production. If combining patent owners effectively dominate an industry, the power to fix and maintain royalties is tantamount to the power to fix prices. Where domination exists, a pooling of competing process patents, or an exchange of licenses for the purpose of curtailing the manufacture and supply of an unpatented product, is beyond the privileges conferred by the patents and constitutes a violation of the Sherman Act. The lawful individual monopolies granted by the patent statutes cannot be unitedly exercised to restrain competition. … But an agreement for cross-licensing and division of royalties violates the Act only when used to effect a monopoly, or to fix prices, or to impose otherwise an unreasonable restraint upon interstate commerce. … In the case at bar, the primary defendants own competing patented processes for manufacturing an unpatented product which is sold in interstate commerce; and agreements concerning such processes are likely to engender the evils to which the Sherman Act was directed. … We must, therefore, examine the evidence to ascertain the operation and effect of the challenged contracts.

No monopoly, or restriction of competition, in the business of licensing patented cracking processes resulted from the execution of these agreements. Up to 1920 all cracking plants in the United States were either owned by the Indiana Company alone, or were operated under licenses from it. In 1924 and

1925, after the cross-licensing arrangements were in effect, the four primary defendants owned or licensed, in the aggregate, only 55 per cent. of the total cracking capacity, and the remainder was distributed among twenty-one independently owned cracking processes. This development and commercial expansion of competing processes is clear evidence that the contracts did not concentrate in the hands of the four primary defendants the licensing of patented processes for the production of cracked gasoline. Moreover, the record does not show that after the execution of the agreements there was a decrease of competition among them in licensing other refiners to use their respective processes.

No monopoly, or restriction of competition, in the production of either ordinary or cracked gasoline has been proved. The output of cracked gasoline in the years in question was about 26 per cent. of the total gasoline production. Ordinary or straight run gasoline is indistinguishable from cracked gasoline and the two are either mixed or sold interchangeably. Under these circumstances the primary defendants could not effectively control the supply or fix the price of cracked gasoline by virtue of their alleged monopoly of the cracking processes, unless they could control, through some means, the remainder of the total gasoline production from all sources. Proof of such control is lacking. Evidence of the total gasoline production by all methods, of each of the primary defendants and their licensees is either missing or unsatisfactory in character. The record does not accurately show even the total amount of cracked gasoline produced, or the production of each of the licensees, or competing refiners. Widely variant estimates of such production figures have been submitted. These were not accepted by the master and there is no evidence which would justify our doing so.

No monopoly, or restriction of competition, in the sale of gasoline has been proved. On the basis of testimony relating to the marketing of both cracked and ordinary gasoline, the master found that the defendants were in active competition among themselves and with other refiners; that both kinds of gasoline were refined and sold in large quantities by other companies; and that the primary defendants and their licensees neither individually or collectively controlled the market price or supply of any gasoline moving in interstate commerce. There is ample evidence to support these findings.

Thus it appears that no monopoly of any kind, or restraint of interstate commerce, has been effected either by means of the contracts or in some other way. In the absence of proof that the primary defendants had such control of the entire industry as would make effective the alleged domination of a part, it is difficult to see how they could by agreeing upon royalty rates control either the price or the supply of gasoline, or otherwise restrain competition. By virtue of their patents they had individually the right to determine who should use their respective processes or inventions and what the royalties for such use should be. To warrant an injunction which would invalidate the contracts here in question, and require either new arrangements or settlement of the conflicting claims by litigation, there must be a definite factual showing of illegality.

In the District Court, the Government undertook to prove the violation charged by showing that the three agreements challenged were made by the primary defendants in bad faith. The bulk of the testimony introduced by it, is directed to this issue and relates to the validity and scope of twenty-three jointly-used patents which were selected by it for attack. This evidence was admitted, over objection, for the purpose of showing that these patents were either invalid or narrow in scope; that there was no substantial foundation for the alleged conflicts and threatened infringement suits; that these were a pretext; and that the patents had been secured, and their infringement was being asserted, merely as a means of lending color of legality to the making of the contracts by which competition would inevitably be suppressed. The master found, after an elaborate review of the entire art, that the presumption of validity attaching to the patents had not been negatived in any way; that they merited a broad interpretation; that they had been acquired in good faith; and that the scope of the several groups of patents overlapped sufficiently to justify the threats and fear of litigation. The District Court stated that the particular claims should be interpreted narrowly, and that the respective inventions might be practiced without infringement of adversely owned patents. But it confirmed the finding of presumptive validity and did not question the finding of good faith. It held that the patents were adequate consideration for the cross-licensing agreements and that the violation charged could not be predicated on patent invalidity. Inasmuch as the Government did not appeal from these findings, we need not consider any of the issues concerning the validity or scope of the cracking patents; and we accept the finding that they were acquired in good faith. Neither the findings nor the evidence on this issue supply any ground for invalidating the contracts.

The remaining issues in the case have become moot. The Government objected to a number of early Indiana Company licenses which contained certain territorial restrictions on the production of cracked gasoline; and also to a provision in the first contract between primary defendants, and in licenses thereunder, by which the Indiana Company secured an option to purchase a portion of the cracked gasoline manufactured in, or shipped into, its sales territory. At the hearing before the District Court it appeared that these provisions had never been enforced. Upon the court's request the objectionable clauses were voluntarily cancelled some months before the entry of the decree. Similarly, the propriety of certain blanket acknowledgments of patent validity in the first contract, and in a number of licenses under later contracts, were questioned by the lower court. At its suggestion, these provisions also were formally cancelled by the parties. As the relief here sought is an injunction, and hence relates only to the future, the alleged validity of such provisions has become moot.

The District Court accepted the Government's estimates of cracked gasoline production; found that the primary defendants were able to control both supply and price by virtue of their control of the cracking patents; held that although these patents were valid consideration for the cross-licenses, the agreement to maintain royalties was in effect a method for fixing the price of cracked gasoline; and concluded that a monopoly existed as a result of such agreements. This appears to be the only basis for the relief granted. But the widely varying estimates, relied upon to establish dominant control of the production of cracked gasoline were insufficient for that purpose. And the court entirely disregarded not only the fact that the manufacture of the cracked is only a part of the total gasoline production, but also the evidence showing active competition among the defendants themselves and with others. Its findings are without adequate support in the evidence. The bill should have been dismissed.

Reversed.

NOTE: PATENT POOLS: BLOCKING RELATIONSHIPS, PRICE FIXING AND BOUNDARY AMBIGUITY

One rationale for patent pools is that they are needed to prevent "blocking" claims, which occur when claims in one patent overlap with claims in a different patent. As a result, the technology in one patent cannot be practiced without infringing the other patent. The *Harrow* case, *supra*, very likely involved blocking claims. The court typically decided these early cases, however, without discussing blocking. *Standard Oil* very likely did not involve blocking claims.

Blocking patent relationships can be both one-way and two-way. If patent B is built atop patent A — for example, if B was a patented improvement on A – the typical result is a one-way block. A firm wishing to practice patent B would also need a license to practice patent A, but not vice-versa. By contrast, a two-way block occurs when the owner of patent A can prevent the practice of patent B, and the owner of patent B can prevent the practice of patent A. *See* Richard J. Gilbert, *Antitrust for Patent Pools: A Century of Policy Evolution*, 2004 STAN. TECH. L. REV. 3 (2004).

Patents in a blocking relationship are formally complementary. That is, they must be used together. By contrast, if alternative patents perform the same economic or mechanical function but do not block one another they are considered *substitutes*. In that case a licensee might need either one of them, but not both. In *Standard Oil* the process patents in question were very likely substitutes rather than complementary blocking patents: the Court indicated that cracking "was not controlled by any fundamental process" and that other firms had come up with cracking technology independently. *Standard Oil* at 167. If Standard had obtained a "fundamental process" which other firms had relied on in their processes, then it would have a one-way blocking patent.

Patent pools are easily justified when the patents in question are complements that block one another. They are more difficult to justify when they bring competing patents together. *See generally* ROBERT C. LIND ET AL., REPORT ON MULTIPARTY LICENSING 10–16 (2003) (discussing the evolution of the various types of patent-pool arrangements).

Firms with complementary products do not typically have an incentive to fix prices. For example, the makers of printers would not profit from an agreement with makers of computers under which the computer makers reduced computer output and raised price. Printer makers are best off if computers are as high quality and cheap as possible, and computer makers are better off if printers are both good and cheap.

Should the story for patents be any different? That is, if patents are blocking the first patentee would benefit if the second patent were sold as cheaply as possible. That would leave more margin for the first patentee. However, the problem is much more complex if we are considering *product* prices rather than patent prices. Two firms that both make printers may have complementary (i.e., blocking) patents. Their agreement to pool (i.e., cross license) one another's patents is almost certainly efficient. But often in the history of patent pools the parties have also agreed either to limit the output of printers or to fix their price. The gains from price fixing could be enormous and are particularly suspicious if one or both of the patents are of dubious quality or the patents represent only a small portion of the value of the overall product. In any event, however, what socially beneficial motive could the poolers have for fixing product prices, given that patents are nonrivalrous goods – that is, each can be used a large number of times without diminishing what is left over? One important difference between a pool or commons for, say, fisheries or cattle grazing is that overuse of the commons is a serious problem and the participants have a justifiable interest in limiting the number of uses (e.g., 10 cows per farmer on a grazing commons). Output limitations for commons do not have a similar justification.

Of course, a large patent pool might bring together hundreds or even thousands of patents, and both blocking (complementary) and substitute relationships will be present. Another reason patent pools are used has less to do with whether the patents in the pool are substitutes or complements than with the ambiguity of patent boundaries, particularly in computer, electronic and other information technologies. As a result those evaluating them cannot readily determine their relationships. When the cost of defining and defending individual boundaries is greater than the cost of sharing, firms may find it profitable to form a "commons" for joint production. In the case of grazing commons the operative facts are (1) cattle, unlike plants, move around; and (2) given that the land and its use are relatively cheap, the relative costs of fencing are high in relation to the costs of establishing a commons together with some access rules. See ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990).

Compare the situation of firms making, say, cellular phones, which could have thousands of patent but determining the precise boundaries of each could be very costly. A litigation fight over the scope of a single patent typically costs more than $1,000,000. Further, this rationale applies equally to complementary and competing patents. This fact very likely explains a great many patent pools today, particularly in information technologies, such as software, electronics and data processing, and perhaps even some business method patents. See CHRISTINA BOHANNAN & HERBERT HOVENKAMP, CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION, Ch. 12 (2011).

PATENT PACKAGE LICENSING

AUTOMATIC RADIO MFG. CO., INC. v. HAZELTINE RESEARCH, INC. 339 U.S. 827 (1950)

Mr. Justice MINTON delivered the opinion of the Court.

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

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

This suit was brought to recover the minimum royalty due for the year ending August 31, 1946, for an accounting of other sums due, and for other relief. The District Court found the case to be one appropriate for summary procedure under Rule 56 of the Federal Rules of Civil Procedure, 28 U.S.C.A., and sustained the motion of respondent for judgment. The validity of the license agreement was upheld against various charges of misuse of the patents, and judgment was entered for the recovery of royalties and an accounting, and for a permanent injunction restraining petitioner from failing to pay royalties, to keep records, and to render reports during the life of the agreement. The Court of Appeals affirmed, one judge dissenting, and we granted certiorari in order to consider important questions concerning patent misuse and estoppel to challenge the validity of licensed patents.

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

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

But petitioner urges that this case 'is identical in principle' with the 'Tie-in' cases. It is contended that the licensing provision requiring royalty payments of a percentage of the sales of the licensee's products constitutes a misuse of patents because it ties in a payment on unpatented goods. Particular reliance is placed on language from United States v. U.S. Gypsum, 333 U.S. 364, 389. That case was a prosecution under the Sherman Act for an alleged conspiracy of Gypsum and its licensees to extend the monopoly of certain patents and to eliminate competition by fixing prices on patented and unpatented gypsum board. The license provisions based royalties on all sales of gypsum board, both patented and unpatented. It was held that the license provisions, together with evidence of an understanding that only patented board would be sold, showed a conspiracy to restrict the production of unpatented products which was an invalid extension of the area of the patent monopoly. There is no indication here of conspiracy to restrict production of unpatented or any goods to effectuate a monopoly, and thus the Gypsum case does not aid petitioner. That which is condemned as against public policy by the 'Tie-in' cases is the extension of the monopoly of the patent to create another monopoly or restraint of competition-a restraint not countenanced by the patent grant…. This royalty provision does not create another monopoly; it creates no restraint of competition beyond the legitimate grant of the patent. The right to a patent includes the right to market the use of the patent at a reasonable return.

The licensing agreement in issue was characterized by the District Court as essentially a grant by Hazeltine to petitioner of a privilege to use any patent or future development of Hazeltine in consideration of the payment of royalties. Payment for the privilege is required regardless of use of the patents. The royalty provision of the licensing agreement was sustained by the District Court and the Court of Appeals on the theory that it was a convenient mode of operation designed by the parties to avoid the necessity of determining whether each type of petitioner's product embodies any of the numerous Hazeltine patents. D.C., 77 F.Supp. at 496. The Court of Appeals reasoned that since it would not be unlawful to agree to pay a fixed sum for the privilege to use patents, it was not unlawful to provide a variable consideration measured by a percentage of the licensee's sales for the same privilege. Numerous District Courts which have had occasion to pass on the question have reached the same result on similar grounds, and we are of like opinion.

The mere accumulation of patents, no matter how many, is not in and of itself illegal. See Transparent-Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 637. And this record simply does not support incendiary, yet vague, charges that respondent uses its accumulation of patents 'for the exaction of tribute' and collects royalties 'by means of the overpowering threat of disastrous litigation.' We cannot say that payment of royalties according to an agreed percentage of the licensee's sales is unreasonable. Sound business judgment could indicate that such payment represents the most convenient method of fixing the business value of the privileges granted by the licensing agreement. We are not unmindful that convenience cannot justify an extension of the monopoly of the patent. But as we have already indicated, there is in this royalty provision no inherent extension of the monopoly of the patent. Petitioner cannot complain because it must pay royalties whether it uses Hazeltine patents or not. What it acquired by the agreement into which it entered was the privilege to use any or all of the patents and developments as it desired to use them. If it chooses to use none of them, it has nevertheless contracted to pay for the privilege of using existing patents plus any developments resulting from respondent's continuous research. We hold that in licensing the use of patents to one engaged in a related enterprise, it is not per se a misuse of patents to measure the consideration by a percentage of the licensee's sales.

It is next contended by petitioner that the license agreement is unenforceable because it contained a provision requiring the following restrictive notice to be attached to apparatus manufactured by petitioner under the agreement: "Licensed by Hazeltine Corporation only for use in homes, for educational purposes, and for private, non-commercial use, under one or more of the following patents and under pending applications:' followed by the word 'Patent' and the numbers of the patents which are, in the opinion of Licensor, involved in apparatus of the types licensed hereunder manufactured by one or more licensees of Licensor.'

Respondent did not seek to have this provision of the agreement enforced, and the decree of the District Court does not enforce it. It may well have been a dead letter from the beginning, as indicated by the fact that, as petitioner averred in its answer, it has never observed this provision of the agreement. Thus it is doubtful that the legality of this provision could be contested, even assuming that the issue was properly raised, which respondent disputes. In any event, it is clear that any issue with respect to this provision of the agreement is moot. An affidavit of the president of respondent corporation advises us of certain letters which were sent by respondent in September 1945, to each of its licensees, including petitioner. These letters authorized the discontinuance of the restrictive notice provision and the substitution of the marking 'This apparatus is licensed under the United States patent rights of Hazeltine Corporation.' It is further averred that this form of notice is all that respondent has required of its licensees since September 1945. Since this provision of the agreement was made for the benefit of respondent, it could voluntarily waive the provision.

Finally, it is contended that notwithstanding the licensing agreement, petitioner-licensee may contest the validity of the patents it is charged with using. The general rule is that the licensee under a patent license agreement may not challenge the validity of the licensed patent in a suit for royalties due under the contract. United States v. Harvey Steel Co., 196 U.S. 310.[3] The general principle of the invalidity of price-fixing agreements may be invoked by the licensee of what purport to be valid patents to show in a suit for royalties that the patents are invalid. Katzinger Co. v. Chicago Metallic Mfg. Co., 329 U.S. 394. There is no showing that the licensing agreement here or the practices under it were a misuse of patents or contrary to public policy. This limited license for 'home' use production contains neither an express nor implied agreement to refrain from production for 'commercial' or any other use as part consideration for the license grant. The Katzinger and MacGregor cases are inapplicable. The general rule applies, and petitioner may not, in this suit, challenge the validity of the licensed patents.

The judgment of the Court of Appeals is affirmed.

Mr. Justice DOUGLAS, with whom Mr. Justice BLACK concurs, dissenting.

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

Mr. Justice Brandeis and Chief Justice Stone did not fashion but they made more secure one important rule designed to curb the use of patents. It is as follows: One who holds a patent on article A may not license the use of the patent on condition that B, an unpatented article, be bought. Such a contract or agreement would be an extension of the grant of the patent contrary to a long line of decisions. See Motion Picture Patents Co. v. Universal Film Co., 243 U.S. 502; Carbice Corp. of America v. American Patents Corp., 283 U.S. 27; Morton Salt v. G.S. Suppiger, 314 U.S. 488, 491-492…. For it would sweep under the patent an article that is unpatented or unpatentable. Each patent owner would become his own patent office and, by reason of the leverage of the patent, obtain a larger monopoly of the market than the Constitution or statutes permit.

That is what is done here. Hazeltine licensed Automatic Radio to use 570 patents and 200 patent applications. Of these Automatic used at most 10. Automatic Radio was obligated, however, to pay as royalty a percentage of its

[3] [ed -- The Supreme Court subsequently overruled this doctrine of licensee estoppel in Lear vs. Adkins, 395 U.S. 653 (1969)]

total sales in certain lines without regard to whether or not the products sold were patented or unpatented. The inevitable result is that the patentee received royalties on unpatented products as part of the price for the use of the patents. The patent owner has therefore used the patents to bludgeon his way into a partnership with this licensee, collecting royalties on unpatented as well as patented articles. A plainer extension of a patent by unlawful means would be hard to imagine.

Chief Justice Stone wrote for the Court in Sola Electric Co. v. Jefferson Electric Co., 317 U.S. 173, holding that a licensee is not estopped to challenge a price-fixing clause by showing the patent is invalid. He also wrote for the Court in Scott Paper Co. v. Marcalus Mfg. Co., 326 U.S. 249, holding the estoppel did not bar the assignor of a patent from defending a suit for infringement of the assigned patent on the ground that the alleged infringing device was that of a prior-art expired patent.

These decisions put the protection of the public interest in free enterprise above reward to the patentee. The limitations which they made on the estoppel doctrine represented an almost complete cycle back to the salutary teaching of Pope Mfg. Co. v. Gormully, 144 U.S. 224, 234, that, 'It is as important to the public that competition should not be repressed by worthless patents, as that the patentee of a really valuable invention should be protected in his monopoly.' To estop the licensee from attacking the validity of patents is to forget that 'It is the public interest which is dominant in the patent system. Mercoid Corp. v. Mid-Continent Investment Co., supra, 320 U.S. at page 665.

It is said that if the purpose was to enlarge the monopoly of the patent-for example, through price fixing-then estoppel would not bar the licensee from challenging the validity of the patents. But what worse enlargement of monopoly is there than the attachment of a patent to an unpatentable article? When we consider the constitutional standard, what greater public harm than that is there in the patent system?

It is only right and just that the licensee be allowed to challenge the validity of the patents. A great pooling of patents is made; and whole industries are knit together in the fashion of the unholy alliances revealed in United States v. Line Material Co., 333 U.S. 287, and United States v. Gypsum Co., 333 U.S. 364. One who wants the use of one patent may have to take hundreds. The whole package may contain many patents that have been foisted on the public. No other person than the licensee will be interested enough to challenge them. He alone will be apt to see and understand the basis of their illegality.

The licensee protects the public interest in exposing invalid or expired patents and freeing the public of their toll. He should be allowed that privilege.

He would be allowed it were the public interest considered the dominant one. Ridding the public of stale or specious patents is one way of serving the end of the progress of science. We depart from a great tradition in this field (and see Graver Tank & Mfg. Co. v. Linde Air Products, 339 U.S. 605), when we affirm this judgment.

NOTES AND QUESTIONS

1. The license agreement at issue did two things. First, it permitted the licensee to use any or all of the several hundred patents in the patentee's portfolio. This is called "package licensing." Second, it required the licensee to pay a royalty calculated as a percentage of the sales of its *product* output, including the sales of at least some radios that apparently did not use any of the patents in the portfolio. Is either of these terms inherently anticompetitive?

Package licensing is particularly valuable when a firm owns many interrelated patents and it is difficult for an outside observer to verify precisely which patents are being practiced in a particular device. This is another problem of boundary ambiguity. Where is the *competitive* harm, however? The licensee might complain that package licensing requires it to take a larger package than it would otherwise wish to purchase. But is that any different from the land owner who insists on selling its 1000 acres as a plot rather than subdividing it? On the other side, package licensing might exclude a rival when the package contains patents for which rival producers have effective competing technologies. Suppose, for example, that the dominant patentee has patent A, B & C, which it packages at a single price. A rival makes an alternative technology C′, which many licensees would prefer, but the package licensing terms offer one price for any combination, which means that the package licensee can use the C patent at a marginal cost of zero. The rival, having only the C′ patent, cannot afford to compete with a price of zero.

And what about basing royalties on sales of the finished product? In most cases this is very likely nothing more than a form of surrogate pricing in which the price is tagged to something readily capable of being measured. How many times a particular patent is used in a complex piece of equipment might be hard to measure, but how many units of the product as made is typically fairly easy to determine. Further, the sale price of the finished product occurs in a market that already exists. By contrast, there may not be a good mechanism for placing a value on a patent that is not sold anywhere else. As a result the product price becomes a useful surrogate for patent value.

NERO AG v. MPEG LA, L.L.C.
2010 WL 4878835 (C.D. Cal. Nov. 24, 2010)

MARIANA R. PFAELZER, District Judge.

Plaintiff Nero AG ("Nero") brings this antitrust lawsuit against Defendant MPEG LA, LLC ("MPEG LA") for anticompetitive conduct in MPEG LA's licensing of patent pools related to industry standards for consumer electronics. Nero contends MPEG LA has violated Section 2 of the Sherman Antitrust Act by unlawfully maintaining, extending, and/or abusing its monopoly power.

The FAC [First Amended Complaint] relies on three basic allegations: (1) Nero has no practical alternative to licensing from the MPEG-2 pool; (2) MPEG LA has impermissibly expanded the temporal scope of its monopoly by adding non-essential patents with later term expiration dates to the MPEG-2 patent pool; and (3) MPEG LA coerced licensees into an Extended MPEG-2 License, which cannot be cancelled until January 31, 2016.

Nero's monopolization claim continues to rely heavily on the economic infeasibility of individual licensing, but Nero has not demonstrated any attempt to license the necessary patents individually. "The burden of proving lack of a realistic opportunity to license directly cannot be met where a plaintiff never makes an inquiry or attempts to negotiate a single individual license." Nero AG, 2010 WL 4366448, at *6 (citing Matsushita Elec. Indus. Co., Ltd. v. Cinram Int'l, Inc., 299 F.Supp.2d 370, 377-78 (D.Del.2004)). As the Court explained in its prior Order, because Nero has not tried to individually license only the patents it needs, its argument that direct licensing is economically infeasible remains a speculative hypothesis.

The FAC includes a new allegation that it would cost Nero $7 million to determine which essential patents Nero must license to comply with the MPEG-2 standard. FAC ¶42. Even if Nero's estimate were accurate, this allegation adds nothing to pleading because the time and effort Nero will have to expend to determine which patents it needs to license to avoid infringement litigation is irrelevant to the feasibility determination. Thus, having already rejected Nero's excuse that it would be cost-prohibitive for Nero to determine which patents it needs to license in order to practice its technology without infringing, the Court concludes again that Nero has failed to plausibly allege that direct licensing is infeasible.

Nero's allegations of predatory conduct continue to be premised on inference. Nero infers that because of the "drastic and unforeseen increase in the number of patents" in the patent pool, MPEG LA must have added hundreds of non-essential patents to the pool for predatory purposes.... [T]he FAC adds six examples of nonessential patents that Nero alleges were added for predatory purposes. Nero includes the following patents and the corresponding parenthetical descriptions in the FAC: U.S. Patent Nos. 5,420,866 (encryption, transmission of multiple program streams, and remote tower transmission and the like); 4,833,543 (hardware-implemented MPEG-2); 4,849,812 (same); 5,457,701 (remote tower transmission and the like); 5,461,420 (telecine processing schemes); 5,453,790 (digital playback in real time). FAC ¶ 40. Nero alleges:

> Those patents and others are not infringed by the products offered by Nero and other similarly-situated (MPEG-2-compliant) companies, and, as a result, these patents are not essential to complying with the MPEG-2 standard. On information and belief, such nonessential patents were added to the MPEG-2 pool only to extend the ultimate expiration date of the pool and/or to make individual licensing impracticable.

However, none of these six patents support Nero's allegations of predatory conduct. Three of these allegedly nonessential patents are part of the initial 27 patents submitted to the Department of Justice ("DOJ") in connection with its request for a Business Review Letter approving the MPEG-2 pool and, thus, were not added later to improperly extend the temporal scope of the pool. See Steinberg Decl., Ex. K FN4 (listing U.S. Patent Nos. 4,849,812; 5,420,866; and 5,457,701 as "MPEG-2 patents to be included in the patent pool."). The other three patents also could not have been added to extend the temporal scope of the pool. The ’543 patent expired in 2006. The ’420 patent and the ’790 patent expire in 2013. See Motion at 17 n. 8. Because at least two patents in the original pool will not expire until 2014, it is impossible that the ’420, ’543 or ’790 patents were added to extend the duration of the MPEG-2 pool because the "new" patents expire before the original patents. Therefore, none of the six patents Nero alleges are nonessential could have been added for the anticompetitive purpose of unlawfully extending the temporal scope of the MPEG-2 pool. In that regard, Nero's allegations of predatory conduct remain entirely implausible.

Nero also alleges that MPEG LA added nonessential patents to the MPEG-2 pool to increase the cost to Nero of determining which patents it needs to practice its technology in compliance with the standard. Nero identifies six nonessential patents but does not include any factual basis or explanation of why the patents are not essential to practice the MPEG-2 standard. Nero explains only that the patents address "peripheral matters" such as encryption, transmission of multiple program streams, and digital playback. See FAC ¶ 40.

Nero contends a patent is not essential if it is possible to practice the MPEG-2 standard without infringing it. In other words, Nero contends an essential patent is a patent which is necessarily infringed in connection with the use or implementation of the MPEG-2 standard. Therefore, according to Nero's tailored theory of patent essentiality, if Nero does not need to license the patent to manufacture its product in compliance with the MPEG-2 standard, the patent is nonessential.FN6 However, this Court has already ruled, "[i]t is not anticompetitive for a patent pool to include numerous potentially blocking patents, patents which may or may not be essential but which are more efficient to license as part of the pool than to risk the expense of future litigation." Nero AG, 2010 WL 4366448, at * 5 (citing U.S. Philips Corp. v. ITC, 424 F.3d 1179, 1187-90 (Fed.Cir.2005)); Princo v. ITC, 563 F.3d 1301, 1310 (Fed.Cir.2009) (finding a patent is essential if it is reasonable for a manufacturer of standard-compliant products to believe that its product infringed any of the claims in the patent), vacated on other grounds by Princo v. ITC, 583 F.3d 1380 (Fed.Cir.2009). Nero is not entitled to a patent pool customized by MPEG LA to Nero's precise needs; direct licensing can accomplish that aim.

Nero's chief complaint is that a licensee wanting to individually license the patents necessary to practice its technology has to conduct its own essentiality review of the unexpired patents. But if there were no patent pool at all, Nero would have to conduct the same inquiry. The fact that there is an option to license from a patent pool is therefore a benefit to Nero. Princo v. ITC, 563 F.3d at 1310 (recognizing patent pools are desirable because they can generate precompetitive efficiencies in the form of reduced transaction costs). Nero has not plausibly alleged that it did not have the option to license the patents individually; it has not plausibly alleged that the package licensing is a restraint of trade. See, e.g., McCullough Tool Co. v. Well Surveys, Inc., 343 F.2d 381, 409-10 (10th Cir.1965) (distinguishing patent misuse cases in which licensees were faced with a take all or none choice from the case where "the package license was purely voluntary and a licensee who did not want the whole package could obtain a license on a reasonable basis covering any particular patent he did want.")

For the reasons set forth above, the Court DISMISSES the case with prejudice….

NOTES AND QUESTIONS

1. How can a firm monopolize anything – or even obtain a higher price for that matter – by including nonessential patents in a pool? Licensees value what they need. In this case they cannot resell what they do not need. As a result the value of a nonessential patent is zero, isn't it? The boundary complexity argument may have more bite. If a patentee and a manufacturer are disputing whether the manufacturer needs a license, it might be fairly easy to get a legal opinion about a single patent stating whether or not the manufacturer's product infringes the patent. But suppose the patentee places 1000 patents into a

package and states that the manufacturer is infringing several of them, but without identifying which ones. Now the transaction costs of determining noninfringement have risen considerably and it may be cheaper simply to obtain a license. Would that practice violate the antitrust laws? Would it violate the Patent Act? Would it constitute misuse?

2. In *Philips*, the Federal Circuit decided that patents within a pool are considered non-essential if there are "commercially feasible alternatives to those patents" and that "[i]f there are no commercially practicable alternatives to the allegedly nonessential patents, packaging those patents together with so-called essential patents can have no anticompetitive effect in the marketplace, because no competition for a viable alternative product is foreclosed." *Philips v. ITC*, 424 F.3d 1179, 1194 (Fed. Cir. 2005) (internal quotation omitted). If there are viable alternatives to the so-called nonessential patents, then the effect of "tying" the essential with the nonessential patents can have an anticompetitive effect. Cv. the Ninth Circuit's decision in Brantley v. NBC, reprinted in Chapter Two, *supra*, where the court rejected a claim that it was unlawful to tie desired and undesired cable television channels but no identified rival was excluded.

PATENT POOLS AND EXCLUSION

UNITED STATES V. SINGER MFG. CO.
374 U.S. 174 (1963)

Mr. Justice CLARK delivered the opinion of the Court.

…. Singer is the sole United States manufacturer of household zigzag sewing machines. In addition to the multicam variety at issue here, it produces replaceable cam machines but not the manually operated zigzag. Singer sells these machines in this country through a wholly owned subsidiary and in various foreign countries through independent distributors. Singer's sales comprised approximately 61.4% of all domestic sales in multicam zigzag machines in the United States in 1959. During the same year some 22.6% were imported from Japan and about 16% from Europe. In 1958 Singer's percentage was 69.6%, Japanese imports 20.7% and European imports 9.7%. Further, Singer's 1959 and 1960 domestic sales of multicam machines amounted to approximately $46 million per year, in each of which years such sales accounted for about 45% of all its domestic sewing machine sales.

It appears that Singer by April 29, 1953, through its experimental department, had completed a design of a multiple cam zigzag mechanism in what it calls the Singer '401' machine. It is disclosed in Singer's Johnson Patent. In 1953 Singer was also developing its Perla Patent as used in its '306' replaceable cam machine and in 1954 its '319' machine-carried multiple cam machine. In September of 1953 Vigorelli, an Italian corporation, introduced in the United States a sewing machine incorporating a stack of cams with a single follower. Singer concluded that Vigorelli had on file applications covering its machine in the various patent offices in the world and that the Singer design would infringe. On June 10, 1955, Singer bought for $8,000 a patent disclosing a plurality of cams with a single cam follower from Carl Harris, a Canadian. It was believed that this patent, filed June 9, 1952, might be reissued with claims covering the Singer 401 as well as its 319 machine, and that the reissued patent would dominate the Vigorelli machine a well as a Japanese one introduced into the United States in September 1954 by Brother International Corporation. Thereafter Singer concluded that litigation would result between it and Vigorelli unless a cross-licensing agreement could be made, and this was effected on November 17, 1955. The license was nonexclusive, world-wide and royalty free.... The agreement also contained provisions by which each of the parties agreed not to bring any infringement action against the other 'in any country' or institute against the other any opposition, nullity or invalidation proceedings in any country. In accordance with this agreement Singer withdrew its opposition to Vigorelli's patent application in Brazil and Vigorelli later (1958) abandoned a United States interference to the Johnson application which cleared the way for the Johnson Patent to issue on December 2 of that year.

While Singer was negotiating the cross-license agreement with Vigorelli it learned that Gegauf, a Swiss corporation, had a patent covering a multiple cam mechanism. This placed an additional cloud over Singer's Harris reissue plan because the Gegauf patent enjoyed an effective priority date in Italy of May 31, 1952. This was nine days earlier than Singer's Harris patent filing date in the United States. In December 1955 Singer learned that Gegauf and Vigorelli had entered a cross-licensing agreement covering their multiple cam patents similar to the Vigorelli-Singer agreement. In January 1956 Singer found that Gegauf had pending an application in the United States Patent Office and assumed that it was based on the same priority date, i.e., May 31, 1952. If this was true Singer could use its Harris reissue patent only to oppose through interference the allowance of broad claims to Gegauf. It therefore made preparation to negotiate with Gegauf, first approaching Vigorelli in order to ascertain how the latter had induced Gegauf to grant him a royalty-free license and drop any claim of infringement. Singer made direct arrangements for a conference with Gegauf for April 12, 1956, and the license agreement was made April 14, 1956.

The setting for this meeting was that Gegauf had a dominant Swiss patent with applications in Germany, Italy, and the United States all prior to Singer. In addition, Singer's counsel had examined Gegauf's Swiss patent and advised that it was valid. Singer opened conversation with indications of coming litigation on the Harris patent, concealing the Johnson and Perla applications.

Gegauf felt secure in his patent claims but insecure with reference to the inroads the Japanese machines were making on the United States market. It was this 'lever' which Singer used to secure the license, pointing out that without an agreement Gegauf and Singer might litigate for a protracted period; that they should not be fighting each other as that would only delay the issue of their respective patents; and, finally, that they should license each other and get their respective patents 'so they could be enforced by whoever would own the particular patent.' Singer in the discussions worked upon these Gegauf fears of Japanese competition 'because one of the strong points' of its argument was that an agreement should be made 'in order to fight against this Japanese competition in their building a machine that in any way reads on the patents of ourselves and of Bernina (Gegauf) which are in conflict. The trial judge found that the only purpose 'disclosed to Gegauf, and in fact the very one used to convince Gegauf of the advisability of entering into an agreement' was to 'obtain protection against the Japanese machines which might be made under the Gegauf patent; this sprang from a fear which Singer had good reason to believe to be well founded.' While he found Singer's 'underlying, dominant and sole purpose * * * was to settle the conflict in priority between the Gegauf and Harris patents and to secure for Singer a license right under the earlier patent,' it is significant that no such overriding purpose was found to have been disclosed to Gegauf.

The license agreement covered (1) the Singer-Harris patent and its reissue application in the United States and nine corresponding foreign ones, and (2) the Gegauf Swiss, Italian and German patents, as well as the United States and German applications covering the same. The parties agreed in the first paragraph of the agreement 'not to do anything, either directly or indirectly and in any country, the result of which might restrict the scope of the claims of the other party relating to the subject matter of the above mentioned patents and patent applications.' In addition 'each undertakes, in accordance with the laws and regulations of the Patent Office concerned, to facilitate the allowance in any country of claims as broad as possible, as regards the subject matter of the patents and patent applications referred to above.' The parties also agreed not to sue one another on the basis of any of the patents or applications. Singer agreed not to make a 'slavish' copy of Gegauf's machine and to give Gegauf 'the amical assistance of its patent attorneys for the defense of any of the above mentioned Gegauf patents or patent applications against an action in cancellation.' The agreement made no mention of Singer's Perla or Johnson aplications, the existence of which Singer did not wish Gegauf to know…..

First it may be helpful to set out what is not involved in this case. There is no claim by the Government that it is illegal for one merely to acquire a patent in order to exclude his competitors; or that the owner of a lawfully acquired patent cannot use the patent laws to exclude all infringers of the patent; or that a licensee cannot lawfully acquire the covering patent in order better to enforce it on his own acccount, even when the patent dominates an industry in which the licensee is the dominant firm. Therefore, we put all these matters aside without discussion.

What is claimed here is that Singer engaged in a series of transactions with Gegauf and Vigorelli for an illegal purpose, i.e., to rid itself and Gegauf, together, perhaps, with Vigorelli, of infringements by their common competitors, the Japanese manufacturers. The Government claims that in this respect there were an identity of purpose among the parties and actions pursuant thereto that in law amount to a combination or conspiracy violative of the Sherman Act. It claims that this can be established under the findings of the District Court.

We note from the findings that the importation of Japanese household multicam zigzag sewing machines first came to notice in the United States in 1954 with the introduction of such a machine by the Brother International Corporation. It incorporated the mechanism of the Vigorelli zigzag and the Singer 401 machines. By 1959 importations of all Japanese household sewing machines reached 1,100,000, while importations of European machines reached only 100,000. Moreover, it appears that all but two domestic manufacturers were put out of business in three to four years after the Japanese machines first appeared. The two remaining domentic manufacturers were Singer and a company not specializing in sewing machines, which manufactured only straight stitch machines on order for a single domestic customer…..

We now come to the assignment of the Gegauf patent to Singer…. Singer proposed to Vigorelli that it could prosecute the Gegauf patent in the United States better than Gegauf and, after Vigorelli agreed, solicited his help in getting Gegauf to agree to assign the patent. … Gegauf replied that he would be happy to meet Singer to discuss 'mutual enforcement' of its United States application and the Harris reissue. Then, in the final conferences in Europe Gegauf told Singer that he had no objection 'to making an agreement with Singer, in order to stop as far as possible Japanese competitors in the United States market.' Further, the trial court found that Singer assured Gegauf that 'Singer was insurance against common competitors' and Gegauf's fears that if Singer stopped the Japanese infringements in the United States they (the Japanese) would go to Europe, where Gegauf was not in as good a position to stop them, were unfounded because a greater risk was run in Europe if Singer were not permitted to first stop infringements in the United States. Finally, the court found that Singer was determined 'to drive home the point' that Gegauf stood to benefit more by enforcement of the patents in the United States because the 'Brother Pacesetter' machine, a big selling and patent infringing Japanese-made machine, was in direct competition with the Gegauf machine in the United States…..

As we have noted with reference to the cross-license agreement, the trial court decided that '(t)he undisputed facts support no conclusion other than that the underlying, dominant and sole purpose of the license agreement was to settle the conflict in priority between the Gegauf and Harris patents * * *.' We have rejected this conclusion on the trial court's own finding in the next paragraph of the opinion that Singer's 'secondary' purpose, the only one disclosed to Gegauf, was its 'desire to obtain protection against the Japanese machines which might be made under the Gegauf patent.'

The trial court held that the fact that Singer had a purpose, which 'Gegauf well knew,' of enforcing the patent upon its acquisition, that the enforcement 'would most certainly include Japanese manufacturers who were the principal infringers,' and 'that Gegauf shared with Singer a common concern over Japanese competition' did not establish a conspiracy. Given the court's own findings and the clear import of the record, it is apparent that its conclusions were predicated upon 'an erroneous interpretation of the standard to be applied. * * * Thus, '(b)ecause of the nature of the District Court's error we are reviewing a question of law, namely, whether the District Court applied the proper standard to essentially undisputed facts.' United States v. Parke, Davis & Co., 362 U.S. 29, 44 (1960). There in a discussion of a like problem we held that 'the inference of an agreement in violation of the Sherman Act' is not 'merely limited to particular fact complexes,' ibid., 'Both cases,' the Court continued, 'teach that judicial inquiry is not to stop with a search of the record for evidence of purely contractual arrangements. * * *' Whether the conspiracy was achieved by agreement, by tacit understanding, or by 'acquiescence * * * coupled with assistance in effectuating its purpose is immaterial.' Here the patent was put in Singer's hands to achieve the common purpose of enforcement 'equally advantageous to both' Singer and Gegauf and to Vigorelli as well. What Singer had refused Vigorelli, i.e., acting 'in concert against others,' was thus achieved by the simple expedient of transferring the patent to Singer.

Thus by entwining itself with Gegauf and Vigorelli in such a program Singer went far beyond its claimed purpose of merely protecting its own 401 machine-it was protecting Gegauf and Vigorelli, the sole licensees under the patent at the time, under the same umbrella. This the Sherman Act will not permit. As the Court held in Frey & Son, Inc. v. Cudahy Packing Co., 256 U.S. 208, 210 (1921), the conspiracy arises implicitly from the course of dealing of the parties.... The fact that the enforcement plan likewise served Singer is of no consequence, the controlling factor being the overall common design, i.e., to destroy the Japanese sale of infringing machines in the United States by placing the patent in Singer's hands the better to achieve this result. It is this concerted action to restrain trade, clearly established by the course of dealings, that condemns the transactions under the Sherman Act....

Moreover this overriding common design to exclude the Japanese machines in the United States is clearly illustrated by Singer's action before the United States Tariff Commission. Less than eight months after the patent was issued it started this effort to bar infringers in one sweep. As an American corporation, it was the sole company of the three that was able to bring such an action…. This maneuver was for the purpose, as the trial court found, of giving Singer "a better chance of prevailing before the Tariff Commission' in its efforts to exclude' infringing machines…..

It is strongly urged upon us that application of the antitrust laws in this case will have a significantly deleterious effect on Singer's position as the sole remaining domestic producer of zigzag sewing machines for household use, the market for which has been increasingly preempted by foreign manufacturers. Whether economic consequences of this character warrant relaxation of the scope of enforcement of the antitrust laws, however, is a policy matter committed to congressional or executive resolution. It is not within the province of the courts, whose function is to apply the existing law. It is well settled that '(b)eyond the limited monopoly which is granted, the arrangements by which the patent is utilized are subject to the general law,' United States v. Masonite Corp., *supra*, 316 U.S. at 277 and it 'is equally well settled that the possession of a valid patent or patents does not give the patentee any exemption from the provisions of the Sherman Act beyond the limits of the patent monopoly. By aggregating patents in one control, the holder of the patents cannot escape the prohibitions of the Sherman Act.'

NOTES AND QUESTIONS

1. One of the most famous patent pools in American industrial history involved the sewing machine in the middle of the nineteenth century, more than a century before the *Singer* decision printed here. *See* Adam Mossoff, *The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s*, 53 ARIZ. L. REV. 165 (2011).

Elias Howe, Jr. was an impoverished apprentice in a machine shop in Boston when he overheard someone saying that a functional sewing machine would be worth a fortune. Howe began experimenting and invented a functioning machine whose patent issued in 1846, but his invention was not commercially successful. A number of other firms entered the race for a commercial machine and I. M. Singer was issued a patent in 1851. While Howe's machine was able to produce 250 stitches per minute, Singer's machine produced 900. However, parts of the Singer machine were covered by Howe's 1846 patent, and the two entered several years of costly patent infringement litigation, Singer finally settled with Howe, and as part of the settlement agreed to pay Howe a license for every machine sold.

Several other machines appeared on the market, and Singer found himself in over twenty different patent-infringement lawsuits spanning at least three different venues. "By the mid-1850s, sewing machine firms were spending all their time, money, and energy in patent litigation." *Id.* at 194. Finally, the firms formed a patent pool in which the patents were cross licensed and each firm paid a license fee for every machine produced. That largely brought an end to the litigation.

2. As the principal case suggests, patent pools may be used for exclusion as well as collusion. The participants in the pool may license to one another freely but use their patents to keep outsiders from entering the market. A patentee acting alone may generally refuse to license without antitrust or patent law liability. But how should the law treat an agreement among two or more firms that they will not license their patents to outsiders? Could a pool attain all the efficiencies that pooling makes possible by agreeing to license their patents to one another but not specifying whether or not the members may also license their own patents to outsiders?

COPYRIGHT BLANKET LICENSING

BROADCAST MUSIC, INC. v. MOOR-LAW, INC.
527 F. Supp. 758 (D. Del. 1981)

STAPLETON, District Judge:

Virtually all licensing of performing rights to musical compositions in the United States is conducted by two large organizations representing thousands of individual copyright owners, Broadcast Music, Inc. ("BMI") and the American Society of Composers, Authors, & Publishers ("ASCAP")…. This lawsuit involves antitrust and copyright misuse challenges to BMI's practices in licensing music rights to small establishments, like nightclubs and bars, that provide live music.

In 1977, BMI and several publisher affiliates initiated a copyright infringement action against Moor-Law, Inc., a Delaware corporation doing business as the Triple Nickel Saloon. In 1979, BMI initiated another infringement action under the amended Copyright Act. The two actions were consolidated. Triple Nickel raised the affirmative defense of copyright misuse, and counterclaimed for violations of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act….

The central issue at trial was the legality of BMI's use of a “blanket license” agreement. This agreement provides users like the Triple Nickel with access to all compositions within the BMI repertory, and bases the fee for that access not on the amount of BMI music used, but on the user's total entertainment expenses.

… BMI licensees fall into two categories: broadcast and non-broadcast (or general). Included among the broadcast licensees are television networks like CBS, television stations, and radio stations. Included among the non-broadcast licensees are hotel and motels, dance studios, skating rinks, colleges, concert halls, and a sub-category called “GLAs.” GLAs are small establishments like bars, nightclubs and restaurants that offer live music and are subject to BMI's General Licensing Agreement (GLA).

The Triple Nickel falls within the GLA category. Owned and operated by Mr. Robert Moor, the Triple Nickel has been doing business in Bear, Delaware, since September 1976. It offers primarily country and western music.

The “blanket license” offered by BMI to establishments like the Triple Nickel provides the licensee with the right to immediate, indemnified access to any and all songs in the BMI repertory. The GLA licensee is charged an annual fee for the license based on its annual entertainment expenses (i.e. the cost of hiring musicians). The Triple Nickel's fee for BMI's license based on its 1979 estimated entertainment expenses of $75,000 would have been $400. Mr. Moor testified that an ASCAP representative informed him that their licensing fee for the Triple Nickel would be approximately $600…..

The events leading up to this litigation are not atypical of the experiences of other GLA licensees who testified at trial. In January 1977, Mr. Moor, the owner of the Triple Nickel, received a form letter from BMI informing him of his obligation under the copyright statute and the necessity for obtaining a BMI license. The Triple Nickel was also visited by a BMI representative; Mr. Moor refused to enter into the BMI blanket license. After a second visit by the BMI representative, during which the performance of live songs at the Triple Nickel were logged, and two more letters, BMI initiated this copyright infringement action against the Triple Nickel in August 1977. In 1978, counsel for BMI and the Triple Nickel engaged in correspondence concerning the form of license. BMI offered a per piece license to Mr. Moor if he could identify the songs he wanted to use; Mr. Moor requested a list of all BMI compositions; BMI explained such a list was not available since BMI had a constantly changing repertory of one million songs (over 40,000 new songs being added annually), but invited Mr. Moor to New York to search the BMI library himself. This was the end of negotiations between the parties.

The relevant market in this case is the licensing of musical performing rights to GLA licensees. An examination of the characteristics of this unique market is essential to an evaluation of the Triple Nickel's antitrust and copyright misuse claims.

Both parties' experts agreed that this market has natural monopoly characteristics. Because there are thousands of individual copyright "sellers" seeking to deal with thousands of GLA buyers, the potential transaction costs are very high. Economies of scale exist as sellers band together to spread transaction costs of identical transactions over a larger group. Thus, some pooling of copyrights by individual copyright holders is a necessity in order to take advantage of the natural monopoly characteristics of the market.

In addition, both parties' experts agree that the goods in this market—the performing rights to the musical compositions—have the characteristics of "public goods". Public goods have two salient characteristics which operate in this market. First, unlike private goods (e.g. apples), one can use a public good without leaving any less for others to consume. Once a musical composition is created, the marginal cost of additional consumption is zero. The second characteristic of public goods is that it is difficult to exclude persons who do not pay from using the good. The owners of private goods can withhold their goods from the market and release them only in return for payment; but, once a composer's song becomes known, he or she finds it difficult to prevent that good from being "stolen" by users. The enforcement problem resulting from this public good characteristic manifests itself in the GLA market through users who don't pay any licensing fee. During the course of this litigation, this has been labeled the "free rider" problem.

Because the high transaction costs derived from natural monopoly characteristics are increased by the public good enforcement problem, very large performing rights organizations, like BMI and ASCAP, in which individual copyright holders pool their rights are necessary to achieve efficiency. The larger the organization, the more efficient it will be in reducing transaction costs; indeed, Triple Nickel's expert, Dr. Cirace, advocated one combined licensing operation as the most efficient means of operating in this market. The necessity for these large licensing organizations makes competition in the sense of many sellers competing against each other in the GLA market unrealistic.

The parties are also in agreement that the nature of the GLA market makes some kind of blanket license a necessity. As the Supreme Court observed in *CBS IV*:

> Individual sales transactions in this industry are quite expensive, as would be individual monitoring and enforcement, especially in light of the

> resources of single composers. Indeed, as both the Court of Appeals and CBS recognize the costs are prohibitive for licenses with individual radio stations, nightclubs, and restaurants, ... and it was in that milieu that the blanket license arose.

CBS IV, 441 U.S. at 20.

Moreover, the Supreme Court's recognition in the CBS case that most users want "unplanned, rapid and indemnified access" to a wide range of compositions, is particularly apt in the GLA market. Testimony at trial made clear that GLA users typically do not know in advance what compositions will be performed nightly in their establishments and yet want the right to perform them instantaneously. The blanket license provides instantaneous access to any composition desired.

A corollary of the conclusion that the blanket license is a necessity in the GLA market is that the alternatives required by BMI's consent decree of direct licensing with individual copyright owners or of per piece licensing are unfeasible in this market. Again, the parties seem to agree on this point. Unlike the situation in CBS where large networks were interested in a relatively small number of compositions known in advance of performance, GLAs like the Triple Nickel are small establishments which lack the resources or the advance notice to contact copyright owners individually on a large scale. Likewise, because GLA owners rarely know in advance of performance the songs a band intends to play and because GLA bands often take audience requests, a prospective per piece license is unrealistic.

Finally, although the parties disagree over appropriate methods of pricing, they seem to agree that the natural market forces of supply and demand do not operate normally on pricing in this market. Because of the public good characteristic that the marginal cost of using a musical composition is zero, normal cost-based pricing is not feasible. The parties seem to agree that some form of pricing based on benefit conferred is appropriate. But, since as a practical matter a GLA needs a license from both ASCAP and BMI, the normal constraint on benefit pricing-alternative supply-does not operate in this market.

Thus, although large performing rights organizations are a necessity in this market, the result in the current market is that BMI can exercise substantial monopoly power over price. This monopoly power of the seller is particularly strong in a negotiating situation where there is no corresponding power on the buyer's side. Unlike the television network market where buyers like CBS exercise some monopsony power of their own, the buyers in the GLA market are weak and diffuse.

While normal competitive forces do not operate in this market, it is not true that BMI's price for its GLA license is unconstrained. Testimony at trial convinced me that the free rider problem does provide a significant constraint on the price BMI charges. The higher the price it charges, the greater the resistance of GLA users is likely to be, and, conversely, the lower the price, the lower the resistance will be. Since the free rider problem tends to make BMI's enforcement costs high and can, indeed, cause increased costs to more than consume increased revenue from a higher price, BMI considers this problem when setting a price.

The Triple Nickel's primary challenge is to the current licensing agreement BMI offers to GLAs. It maintains that the offering of that license without providing a realistic alternative constitutes an illegal tie-in which is a per se violation of Section 1 of the Sherman Act. But regardless of the disposition of the tie-in claim, the Triple Nickel attacks the combination of full repertory blanket license and fee tied to entertainment expense as a general restraint of trade illegal under Section 1. It further argues that BMI's imposition on GLAs of this blanket license involving pooled copyrights priced in such a way that it includes other factors besides the amount of BMI music used constitutes copyright misuse….

The Triple Nickel argues that BMI's current licensing practices coerce it into purchasing music which it does not wish to perform in order to secure access to music which it does wish to perform. Because of this "tie-in", the Triple Nickel maintains that this case is an appropriate one for per se rather than Rule of Reason analysis. As I indicated in my prior opinion, however, this issue was resolved against the Triple Nickel in CBS IV.

As discussed in more detail … *infra*, the Triple Nickel failed to prove that there was only one category of musical compositions, i.e., country-western, for which it desired performing rights. The Triple Nickel also failed to prove that there was a larger category of music-e.g. a "family" of music including country, bluegrass and gospel-that could be adequately defined to meet its needs. It is true, as the Triple Nickel urges, that BMI music may theoretically be categorized as consisting of two kinds of music: music that the Triple Nickel wants to play in its establishment, and music that the Triple Nickel doesn't want to play. But it is not true in any realistic sense that the full repertory license forces the Triple Nickel to take the music it doesn't want along with the music it wants; rather Triple Nickel's method of doing business, which does not permit advance identification of the compositions it will ultimately wish to play, causes it to need the right to perform the full BMI repertory. The Supreme Court recognized this fact when it characterized the blanket license as akin to a single product:

> The blanket license is composed of the individual compositions plus the aggregating service. Here, the whole is truly greater than the sum of its parts; it is, to some extent, a different product.... (T)o the extent the blanket license is a different product, ASCAP is not really a joint sales agency offering the individual goods of many sellers, but is a separate seller offering its blanket license, of which the individual compositions are raw material.

CBS IV, 441 U.S. at 21-22.

In *CBS IV*, the Supreme Court held that ASCAP's blanket license required Rule of Reason analysis and each of the reasons given for that conclusion support the utilization of that approach in this case. Here, as there, the market is sufficiently unusual and the Court's experience with the challenged practice sufficiently sparse that one cannot confidently characterize the defendants' conduct as " 'plainly anticompetitive' and very likely without 'redeeming virtue.' "

Accordingly, I hold that Rule of Reason analysis is appropriate in this case and turn to the evidence in order to assess the actual and potential adverse impacts of BMI's practices on the relevant market, the positive contributions of those practices in that market, and the effects of the alternative practices which Triple Nickel believes would involve less restraint on competition.

The first and most obvious restraint of trade which arises from BMI's current licensing practices is the one focused on in the CBS case, the elimination of price competition among those whose compositions are in its pool of music. There are additional anticompetitive effects, however, of the kind reflected in the leading "block booking" cases upon which the Triple Nickel so heavily relies.

This package selling arrangement results in the sellers selling more "product" than they would in a competitive market. In a competitive market, some sellers would sell more songs than others depending upon the popularity of their compositions. In this market, however, sellers pool their songs and sell them on an all-or-nothing basis. By thus banding together, rather than competing against each other, the sellers are able to lever the selling power of one copyright to the selling power of others and thus enlarge the monopoly of all. As a result, less popular sellers sell more than they otherwise would. As the Supreme Court has observed in a motion picture context:

> Where a high quality film greatly desired is licensed only if an inferior one is taken, the latter borrows quality from the former and strengthens its monopoly by drawing on the other. The practice tends to equalize rather than differentiate the reward for the individual copyrights.

United States v. Paramount Pictures, Inc., 334 U.S. 131, 158 (1948).

In addition to rewarding inferior copyrights, all copyrights will tend to achieve greater sales by package selling than they would without such an arrangement. Even the most popular songs are not wanted by all GLAs. Thus, any songwriter is likely to increase his sales by combining his songs in a package with all other songs, since some buyers who would not otherwise purchase his songs must now do so in order to get the songs that they do desire.

In addition to the anticompetitive effects on individual copyright sellers, there are corresponding effects on the copyright buyers. BMI's current licensing practices deprive GLA purchasers of the control which they would have in a competitive market over the amount of business they conduct with a particular source. In a competitive market, for example, a GLA would have the ability to reduce its purchases from a particular source in response to a price rise. Where the only feasible access to BMI's music is through an all-or-nothing license which bases the price paid on factors other than the quantity of BMI music performed, however, a GLA is unable to reduce its total obligation to BMI through control of the quantity of BMI music performed.

Finally, the all-or-nothing BMI license may erect barriers to entry to potential competition from other musical performing rights organizations. GLA proprietors testified that the combined costs of BMI and ASCAP all-or-nothing licenses were significant for them, and that the arrival of a third licensing organization, SESAC, increased their resistance to licensing proposals further. When the only option the seller offers is all-or-nothing, the buyer presumably wants to deal with as few sellers as possible. In such a situation, because the price the buyer is charged is not related to the quantity used, even if its total quantity of music used remains the same, it may face a higher total price with each additional seller, rather than a reallocation of total price among different sellers. One would expect that the burden of this increased resistance to licensing would not be visited equally on all sellers in the market. The buyers have a greater incentive to resist a new and smaller organization who controls a smaller percentage of the compositions desired and whose willingness and ability to enforce its rights through expensive litigation has not been as forcefully demonstrated in the marketplace. Since the willingness of most GLA's to take a license without litigation is crucial to success in this market, the increased resistance engendered by the absence of a relationship between price and quantity may constitute a barrier to entry. The significance of that barrier is impossible to assess, however, on the basis of the record in this case.

BMI asserts, and the Triple Nickel does not dispute, that BMI's blanket license has redeeming virtues. As earlier noted, the parties agree that performing rights societies and their blanket licenses reduce transaction costs which would otherwise be prohibitive. BMI's blanket license thus has a pro-competitive effect in the sense that there would be no market if individual GLAs were left to negotiate with individual copyright holders.

Moreover, Triple Nickel acknowledges that some form of blanket license is necessary to meet the needs of GLAs. The "unplanned, rapid and indemnified access" which GLAs need can only be afforded by a form of licensing which does not require the identification of particular musical compositions in advance of their performance.

BMI justifies the "full repertory" blanket license both on the ground that it is the best means of meeting the needs of virtually all GLA buyers and on the ground that a less than full repertory license system, if feasible at all, would be significantly more expensive to administer than a full repertory one. Since GLA users tend to use a large number and wide variety of musical compositions, their needs can generally be most completely served with access to as large a repertory as possible. Because the marginal cost of additional consumption is zero, it is no less expensive for BMI to provide access to a more limited repertory of songs than to its full repertory of a million songs. Indeed, as discussed hereafter, a limited repertory license would undoubtedly be more expensive for BMI to provide because, among other things, of the additional cost of monitoring the holders of such licenses to ascertain if their use of BMI compositions exceeds the scope of their licenses.

Finally, BMI justifies pricing based on the GLA user's total entertainment expense as a convenient, inexpensive and reliable way of providing a rough measure of the benefit conferred by the music rights licensed. The only information necessary to administer the present pricing system is a GLA's annual figures for its entertainment expenses. Since these figures must be kept for tax purposes in any event, there is virtually no cost involved in gathering this data and it is likely to be reliable.

Triple Nickel acknowledges that there is no feasible way to create and maintain price competition between copyright holders in the GLA market. It asserts, however, that there are alternative forms of licensing which BMI could offer in addition to its current full repertory license which would involve less restraint on the GLA's freedom of choice and on the entry of additional performing right societies in the market. The Triple Nickel's first suggestion is that BMI offer a less-than-full repertory, or "mini" blanket, license as an alternative to its full repertory license and its per piece license. Second, the Triple Nickel urges that a license be offered that bases cost on a retroactive determination of the quantity of BMI music played each year and a "proxy", per performance price.

The alternative form of license that was the primary focus of Triple Nickel's trial testimony and post-trial briefing was a limited repertory license based on a category of music, like "country and western". It also proposed a limited repertory license based on a family of music, like country, bluegrass, folk and gospel. In either event, the suggestion is that the price would bear the same relationship to the price for a full repertory license which the BMI compositions in the covered categories bears to the compositions in BMI's total repertory. For pricing purposes, BMI would categorize a limited sample of its songs in order to determine what percentage of BMI music fell into each field of music and this category percentage would be periodically adjusted through sampling of the new songs that BMI constantly adds to its repertory.

The first problem with the Triple Nickel's suggestion is that the "mini" blanket licenses which it proposes would not meet its own needs. The music performed at the Triple Nickel includes compositions that have gained popularity in a variety of performance styles. Mr. William Ivey, Director of the Country Music Foundation and an expert in the identification of the styles of musical performance, testified that only about two-thirds of the music performed at the Triple Nickel had a country and western performance history, and, therefore, even if it were possible to categorize music based on the primary style in which such music has historically been performed, approximately one-third of the compositions performed at the Triple Nickel would fall outside the country and western category. Indeed, the Triple Nickel admits that the music it plays includes rock and roll, folk, bluegrass, and gospel, as well as country and western. It has suggested no "mini" blanket license which would authorize it to play all that it is in fact using.

More fundamentally, however, it is simply not feasible to categorize music for licensing purposes into such performance style labels. As Mr. Ivey explained, the method of categorizing musical compositions proffered by the Triple Nickel is in reality a categorization not of the music but the style in which the music is performed. Since there is insufficient information residing in the composition itself (that is, the score and lyrics) to determine the performance style, to categorize a song based on score and lyrics alone would be arbitrary. Moreover, any such categorization based on a study of performance history would be subject to disagreement. Frequently a musician will take a song historically popular in one style and perform it in a different style. And it is also common for a song which has gained popularity in one performance style to subsequently gain popularity in another style. For these reasons, a "mini" blanket licensing system would create intolerable uncertainty in the marketplace.

In addition, even if it were assumed for purposes of argument that there are GLA users whose licensing needs would be satisfied by a limited category license, obviously no one would opt for that form of license if the fee for it equaled or exceeded the fee for the full blanket license. Perhaps in recognition of this fact, Triple Nickel suggests that the Court decree a proportionately reduced price for "mini" blanket licenses. It tenders no persuasive rationale for doing so, however. The benefit derived from the use of BMI music will not vary materially depending upon whether a user is performing twenty different BMI songs from different categories each night or twenty songs from the same category. Moreover, the "mini" blanket license would necessarily cost more to administer than the full repertory license because the "mini" license would involve categorization costs, additional policing costs, and the costs of resolving, and of attempting to avoid, disputes over the scope of the license. For these reasons, there is no basis for an injunction requiring a proportionately reduced fee for a "mini" license. As the experts acknowledged, however, in the absence of such a decree, there is no reason to believe that BMI's charge for a "mini" blanket license would be less than its charge for a full repertory one.

In examining the alternatives that an antitrust claimant has proposed, the Third Circuit has described the comparative standard normally applied under rule of reason analysis as follows:

> (T)he test is not whether the defendant deployed the least restrictive alternative. Rather the issue is whether the restriction actually implemented is 'fairly necessary' in the circumstances of the particular case, or whether the restriction 'exceeds the outer limits of restraint reasonably necessary to protect the defendant.'

American Motor Inns, 521 F.2d at 1248-49. The record in this case convincingly demonstrates that the full repertory blanket license system is "fairly necessary" to serve the relevant market and that "mini" blanket licenses are not a practical alternative.

The primary problem which the Triple Nickel has with the current practices of BMI is not with the form of its licenses but rather with the prices that it charges. It proposes alternative pricing schemes with features that are purportedly designed to overcome several restraints which it attributes to BMI's current pricing arrangement. First, the Triple Nickel objects to the current practice because it is not related to the amount of BMI music actually performed by the licensee. It proposes a use-based pricing approach. Second, the Triple Nickel argues that a price based on total entertainment expense illegally extends BMI's monopoly power because it charges for factors other than the actual benefit the GLA user derives from the blanket license. It proposes a pricing formula which utilizes the number of performances of BMI music, the number of listeners per performance, and a per performance or "per use" price. Finally, the Triple Nickel seeks to solve the problem caused by the absence of competitive restraints on BMI's pricing by requiring it to charge a "proxy", per use price.

In place of the current licensing agreement which fails to account for actual use, the Triple Nickel proposes that the price of a full repertory blanket license be based on the amount of BMI music actually performed, measured after the fact. It concedes that measuring use daily throughout the year would be impractical, so it has suggested a sampling system under which songs used at a GLA establishment would be logged by the licensee over a short period of time. Dr. Lamb, a computer and statistics expert, suggested that a sample of 150 songs would be sufficiently reliable. BMI would then use its computer to determine what percentage of the GLA's total song consumption belongs to BMI. This percentage and an estimate of the GLA's total performances during the year would provide the number of BMI performances for which it would be billed.

The first problem with this proposal for a per use price is a conceptual one. It fails to account for a significant part of the benefit provided by the BMI license. The inability of GLAs to identify in advance the compositions which will be played means that they need the right to perform all BMI music which the musician may ultimately select. Thus, with the full repertory blanket license the GLA purchases more than the right to play the BMI compositions which are actually performed; he also purchases immediate and unlimited access to BMI's entire repertory. As the Supreme Court observed in CBS IV, this makes the blanket license akin to a single product.

The major difficulty with this proposed per use licensing feature, however, is a practical one, the increased costs associated with the sampling. Initially, there would be the expense of educating GLAs with respect to the necessity of taking the sample and the proper method of performing that task. Following up to secure a suitable sample from these GLAs will also involve expense. Finally there would be the expense of determining which compositions listed on the logs are in the BMI repertory.

In addition to the disadvantage of increased costs, I am unable to say on this record that institution of per use pricing would materially effect the restraints which have been identified in the market. Such a system would not provide a constraint on BMI's pricing by giving a GLA control over the quantity of BMI music used and paid for. GLAs do not know which compositions belong to which organization and providing complete lists of BMI's repertory to educate them would require the equivalent of a two thousand page phonebook, with frequent periodic supplements to keep it current. And, even if the GLA owner were motivated enough to purchase and work with such a cumbersome publication, it is the musician, and not the GLA owner, who actually decides which compositions will be performed.

It is, of course, true that under a per use pricing scheme a GLA could reduce its total consumption of music in order to reduce the amount paid during the period covered by the license. But so long as the unit price in each new license is controlled by the performing rights societies, nothing in this record demonstrates that the per use pricing system by itself would serve as a constraint on BMI's power over price.

It is only in the area of the potential barrier to entry that I perceive the possibility of a beneficial effect from a per use pricing approach. Under such a system, if and when a new performing rights society attempts to enter this market, presumably by gaining rights to compositions which would otherwise belong to existing organizations, its licensing fees would be reflected in correspondingly reduced charges by the existing organizations and, as noted above, one would expect this fact to lessen GLA resistance to that entry. As discussed in more detail in Section VII, however, one cannot tell from this record the significance of that barrier or, indeed, whether such an entry would be feasible under either pricing scheme.

Given the additional cost of per use licensing and the fact that the only potential benefit from its adoption is a highly speculative one, I decline to require its adoption by BMI.

In combination with per use pricing, the Triple Nickel asks the Court to impose a "proxy price" to be charged for each performance of a BMI composition. This request brings us to the heart of this matter. The core problem here is, of course, that normal competition does not and cannot operate in this market to establish the price which GLAs will pay for the right to perform music. The Triple Nickel insists that this means the Court must step in to set an appropriate price. I decline to do so for several reasons.

First, the Triple Nickel has not suggested an adequate rationale for adopting any of its suggested means of determining that price. …

There are two other possible remedies for the unique problem which the Triple Nickel here brings to the Court: concentration of market power on the buyer's side of the market of the kind which has occurred in the hotel and motel market, or some form of continuing regulation which will fix and modify prices in light of the present and future conditions in this market. The first remedy I am obviously unable to prescribe. The second is one that this Court is not suited to administer. If Congress sees fit to occupy this field, I am confident it can make a more rational assignment of the task. As Judge Kaufman recently observed in a Section Two context, "(J)udicial oversight of pricing policies would place the courts in a role akin to that of a public regulatory commission. We would be wise to decline that function unless Congress clearly bestows it upon us." Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263, 294 (2d Cir. 1979).

Regardless of whether various aspects of BMI's current pricing system constitute restraints of trade objectionable under the antitrust laws, they are also subject to scrutiny under the copyright misuse doctrine. I conclude, however, that the Triple Nickel's case fares no better under copyright misuse analysis.

The Triple Nickel maintains that BMI's practice of basing its license fee on entertainment expense unlawfully extends the scope of its lawful copyright monopolies. As already noted, it objects to entertainment expense because it contains "add-on" factors; it includes the popularity of the musician and it reflects not only the contribution of the music in BMI's pool, but that of all music performed. In support of its argument it relies primarily upon Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969).

In the *Zenith* case, Zenith asserted a patent misuse defense against an infringement claim. The contested licensing agreement allowed Zenith to use all of Hazeltine's radio and television patents for a fee based on a percentage of Zenith's total sales. The court concluded that such an arrangement might constitute patent misuse, distinguishing a similar earlier case, Automatic Radio Mfg. Co. v. Hazeltine Research, 339 U.S. 827 (1950), in which it had found nothing "inherent" in a patent arrangement based on a percentage of total sales which illegally extended the monopoly conferred by the patent. On remand, the District Court in Zenith was to be guided by the Court's statement that "If convenience of the parties rather than patent power dictates the total sales royalty provision, there is no misuse of the patents and no forbidden conditions attached to the license."

Under the Zenith approach, the relevant issue here is whether the feature of BMI's licensing which bases the fee on a percentage of entertainment expense rather than on a per use price times the number of BMI songs played is a product of the convenience of the parties or of a BMI effort to extend its monopolies beyond their legal boundaries. The evidence on this issue weighs in BMI's favor. The record establishes that the percentage of entertainment expense approach is a simple and convenient one for both parties because it utilizes reliable data collected and maintained for other purposes. It further establishes that a pricing system based on a per use price times the number of BMI songs played would require the gathering of additional information which would be substantially more costly while substantially more susceptible to manipulation. Further, we know that in another market in which BMI customers have substantial bargaining power, the hotel-motel market, the negotiated licenses provide for fees based on entertainment expense. Finally, the record fails to persuade me that as a practical matter BMI's current approach enables it to abuse its monopoly power more easily than would be the case if it determined a per unit price and charged on the basis of BMI plays. Accordingly, I perceive no motive for BMI coercing use of the former in lieu of the latter. Under these circumstances, it is more likely than not that the percentage of entertainment expense approach arose and exists as a matter of the convenience of the parties…..

In defending against a copyright infringement action, the Triple Nickel has contended that a number of licensing practices of BMI in the GLA market-primarily its use of a full repertory blanket license in combination with a price based on total entertainment expenses-are illegal. It has challenged these practices as violations of Sections One and Two of the Sherman Act and as copyright misuse. I have concluded that it has failed to prove any of these claims. Therefore, judgment will be entered in favor of BMI on its copyright infringement claim and against the Triple Nickel on its antitrust counterclaims.

NOTES AND QUESTIONS

1. In Broadcast Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1 (1979), CBS charged BMI and ASCAP claimed that the blanket licenses they used, which gave the licensee the right to play anything in the licensor's library, amounted to price-fixing in violation of the Sherman Act. The court of appeals held that the blanket license was a *per se* violation of the Sherman Act. The Supreme Court reversed, holding that the arrangement should be addressed under the rule of reason. The Court stated:

> … our inquiry must focus on whether the effect and . . . the purpose of the practice are to threaten the proper operation of our predominantly free-market economy -- that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output.
>
> The blanket license, as we see it, is not a "naked restrain[t] of trade with no purpose except stifling of competition," White Motor Co. v. United States, 372 U.S. 253, 263, but rather accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use. … ASCAP and the blanket license developed together out of the practical situation in the marketplace: thousands of users, thousands of copyright owners, and millions of compositions. Most users want unplanned, rapid, and indemnified access to any and all of the repertory of compositions, and the owners want a reliable method of collecting for the use of their copyrights. Individual sales transactions in this industry are quite expensive, as would be individual monitoring and enforcement, especially in light of the resources of single composers. Indeed, as both

the Court of Appeals and CBS recognize, the costs are prohibitive for licenses with individual radio stations, nightclubs, and restaurants, and it was in that milieu that the blanket license arose.

> A middleman with a blanket license was an obvious necessity if the thousands of individual negotiations, a virtual impossibility, were to be avoided. Also, individual fees for the use of individual compositions would presuppose an intricate schedule of fees and uses, as well as a difficult and expensive reporting problem for the user and policing task for the copyright owner. Historically, the market for public-performance rights organized itself largely around the single-fee blanket license, which gave unlimited access to the repertory and reliable protection against infringement. When ASCAP's major and user-created competitor, BMI, came on the scene, it also turned to the blanket license.
>
> The blanket license has certain unique characteristics: It allows the licensee immediate use of covered compositions, without the delay of prior individual negotiations and great flexibility in the choice of musical material. Many consumers clearly prefer the characteristics and cost advantages of this marketable package, and even small-performing rights societies that have occasionally arisen to compete with ASCAP and BMI have offered blanket licenses.
>
> Not all arrangements among actual or potential competitors that have an impact on price are per se violations of the Sherman Act or even unreasonable restraints. Mergers among competitors eliminate competition, including price competition, but they are not per se illegal, and many of them withstand attack under any existing antitrust standard. Joint ventures and other cooperative arrangements are also not usually unlawful, at least not as price-fixing schemes, where the agreement on price is necessary to market the product at all.
>
> Here, the blanket-license fee is not set by competition among individual copyright owners, and it is a fee for the use of any of the compositions covered by the license. But the blanket license cannot be wholly equated with a simple horizontal arrangement among competitors. ASCAP does set the price for its blanket license, but that license is quite different from anything any individual owner could issue. The individual composers and authors have neither agreed not to sell individually in any other market nor use the blanket license to mask price fixing in such

> other markets. . . . The District Court found that there was no legal, practical, or conspiratorial impediment to CBS's obtaining individual licenses; CBS, in short, had a real choice.
>
> [T]he blanket license has provided an acceptable mechanism for at least a large part of the market for the performing rights to copyrighted musical compositions, we cannot agree that it should automatically be declared illegal in all of its many manifestations. Rather, when attacked, it should be subjected to a more discriminating examination under the rule of reason. It may not ultimately survive that attack, but that is not the issue before us today.

2. In BMI v. *CBS, supra,* the Supreme Court also noted that there was no "impediment to CBS's obtaining individual licenses." 441 U.S. at 24. Indeed, as the district court below found, members of ASCAP and BMI are granted "the nonexclusive right to license users to perform the compositions owned by them." *CBS v. ASCAP*, 400 F. Supp. 737, 742 (S.D.N.Y. 1975). Because the agreements granted BMI and ASCAP a nonexclusive right to license, the individual copyright owners were free to license their works individually. By the same token, if a bar such as the Triple Nickel wanted to license only certain songs it could contact each individual owner.

A cartel can keep up its monopoly price only by reducing output. How can it sustain an output reduction if any one of its thousands of members is free to make unlimited "side sales." Couldn't the Supreme Court in *BMI v. CBS* and the court in *Moor-Law* simply have rested on the single observation that nonexclusive agreements made anticompetitive outcomes very unlikely?

PRODUCTION JOINT VENTURES AND INTELLECTUAL PROPERTY RIGHTS

POLYGRAM HOLDING, INC. V. FTC
416 F.3d 29 (D.C.Cir. 2005)

GINSBURG, Chief Judge.

PolyGram Holding, Inc. and several of its affiliates petition for review of an order of the Federal Trade Commission holding PolyGram violated § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. As detailed below, PolyGram entered into an agreement with Warner Communications, Inc. to distribute the recording of a concert to be given by "The Three Tenors" in 1998. The two companies later entered into a separate agreement to suspend, for ten weeks, advertising and discounting of two earlier Three Tenors concert albums, one distributed by PolyGram and the other by Warner. The Commission held the latter agreement unlawful and prohibited PolyGram from entering into any similar agreement in the future. We agree with the Commission that, although not a per se violation of antitrust law, the agreement was presumptively unlawful and PolyGram failed to rebut that presumption. We therefore deny PolyGram's petition for review.

The Three Tenors—José Carreras, Placido Domingo, and Luciano Pavarotti—put on spectacular concerts coinciding with the World Cup soccer finals in 1990, 1994, and 1998. PolyGram distributed the recording of the 1990 concert, which became one of the best-selling classical albums of all time.

In late 1997 PolyGram and Warner agreed jointly to distribute the recording of The Three Tenors' July 1998 concert. Warner, which had the worldwide rights, retained the United States rights but licensed to PolyGram the exclusive right to distribute the 1998 album outside the United States, and the companies agreed to share equally the worldwide profit or loss on the project. The agreement also obligated PolyGram and Warner to consult with one another on all "marketing and promotional activities" for the 1998 concert album, but each company was free ultimately to pursue its own marketing strategy and to continue exploiting its earlier Three Tenors concert album without limitation. The agreement also provided that PolyGram and Warner would collaborate on the distribution of any future Three Tenors album released through August 2002.

Representatives of PolyGram and Warner first met in January 1998 to discuss "marketing and operational issues." One of PolyGram's representatives voiced concern about the effect of marketing the earlier Three Tenors albums upon the prospects for the 1998 concert album and suggested the two companies impose an "advertising moratorium" surrounding the 1998 release, which was scheduled for August 1. According to notes of their next meeting (in March) PolyGram and Warner representatives agreed that "a big push" on the earlier albums "shouldn't take place before November 15." After that meeting, each company instructed its affiliates to cease all promotion of the 1990 and 1994 Three Tenors albums for approximately six weeks, beginning in late July or early August.

Apparently Warner's overseas division did not get the message because in May it announced an aggressive marketing campaign, scheduled to run through December, to discount and to promote the 1994 album throughout Europe. When PolyGram learned of this, it threatened to "retaliate" by cutting the price of its 1990 album. Accusations then flew between the two companies about which had started the imminent price war. Meanwhile, in June the promoter of The Three Tenors concert informed PolyGram and Warner that the repertoire for the 1998 concert would substantially overlap those of the 1990 and

1994 concerts, which in the view of both PolyGram and Warner executives jeopardized the commercial viability of the forthcoming concert album.

By the time The Three Tenors performed in Paris on July 10, PolyGram and Warner had exchanged letters reaffirming their commitment to suspend advertising and discounting the 1990 and 1994 concert albums and agreeing the moratorium would run from August 1 through October 15. About a week later, however, PolyGram's Senior Marketing Director, who had passed on the details of the agreement to PolyGram's General Counsel, sent a memorandum around the company stating, "Contrary to any previous suggestion, there has been no agreement with [Warner] in relation to the pricing and marketing of the previous Three Tenors albums." Warner followed suit on August 10, sending a letter to PolyGram repudiating any pricing or advertising restrictions relative to its 1994 album. At the same time, however,PolyGram and Warner executives privately assured one another their respective companies intended to honor the agreement, and in fact the companies did substantially comply with the agreement through October 15, 1998.

In 2001 the Commission issued complaints against PolyGram and Warner charging that, by entering into the moratorium agreement, the companies had engaged in an unfair method of competition in violation of § 5 of the FTC Act. Warner soon consented to an order barring it from making any similar agreement in the future. PolyGram contested the charge and, after a trial, an Administrative Law Judge ruled that PolyGram had violated § 5 and ordered PolyGram, like Warner, to refrain from making any similar agreement in the future.

The Commission affirmed the order of the ALJ. After first observing (correctly) that the analysis under § 5 of the FTC Act is the same in this case as it would be under § 1 of the Sherman Act, the Commission revived the analytic framework it had first announced In re Massachusetts Board of Optometry, 110 F.T.C. 549 (1988), which begins with the proposition that conduct "inherently suspect" as a restraint of competition—that is, conduct that "appears likely, absent an efficiency justification, to restrict competition and decrease output"—is to be presumed unreasonable. Only if the competitive harm wrought by the restraint is not readily apparent from the nature of the restraint itself, or the charged party offers a plausible competitive justification for the restraint, must the Commission, under this approach, engage in a more searching analysis of the market circumstances surrounding the restraint

Here the Commission determined the agreement between PolyGram and Warner to prohibit discounts and advertising for a time was indeed "inherently suspect" because such restraints by their nature tend to raise prices and to reduce output. The Commission then looked to PolyGram to identify some competitive justification for the restraint. PolyGram objected that the Commission must first offer some evidence the agreement actually harmed competition. In any event, PolyGram argued, the agreement was justified because it prevented PolyGram and Warner, as distributors of the 1990 and 1994 albums, respectively, from free-riding upon—and thereby diminishing—each other's efforts to promote the 1998 album; hence the restraints created an incentive for each company vigorously to promote the 1998 album and thereby increased output. The Commission rejected that purported efficiency justification as legally insufficient. In the Commission's view, the moratorium agreement could not have had any such procompetitive effect but instead simply shielded the 1998 concert album from the competition of the two earlier albums.

Observing that under the analytic framework of Mass. Board it could have stopped there, the Commission nonetheless went on to rule that, even if PolyGram's efficiency justification were cognizable, the facts simply did not support it; indeed, the Commission found the moratorium had no effect upon the degree to which the companies promoted the 1998 album and did not make the joint venturers any more likely to release a future Three Tenors album. Thus, upon closer inspection, the Commission confirmed its initial conclusion that the moratorium agreement was an unreasonable restraint of trade in violation of § 1 of the Sherman Act and, hence, an unfair method of competition in violation of § 5 of the FTC Act.

PolyGram raises four objections to the decision of the Commission: First, the Commission should not have rejected the free-rider justification as legally insufficient because the moratorium agreement had a legitimate, procompetitive purpose reasonably related to the joint venture. Second, the Commission was required to show the restraints actually harmed competition before it could require PolyGram to proffer a competitive justification. Third, the Commission's findings concerning the competitive impact of the restraint were not supported by substantial evidence. Finally, there is no danger the same conduct will recur, so the Commission's prohibitory remedy is unreasonable.

The Commission's findings of fact are conclusive if supported by substantial evidence. See 15 U.S.C. § 45(c). The legal issues are "for the courts to resolve, although even in considering such issues the courts are to give some deference to the Commission's informed judgment that a particular commercial practice is to be condemned as 'unfair.' " FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 454, (1987).

The Supreme Court's approach to evaluating a § 1 claim has gone through a transition over the last twenty-five years, from a dichotomous categorical approach to a more nuanced and case-specific inquiry. In 1978, just before the transition began, the Court summarized its doctrine as follows:

> There are ... two complementary categories of antitrust analysis. In the first category are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are "illegal per se." In the second category are agreements whose competitive effect can only be evaluated by analyzing the facts particular to the business, the history of the restraint, and the reasons why it was imposed.

Nat'l Soc'y of Prof'l Eng'rs v. FTC, 435 U.S. 679, 692 (1978).

Courts and commentators have recognized the trade-offs inherent in each category. Per se analysis, which requires courts to generalize about the utility of a challenged practice, reduces the cost of decision-making but correspondingly raises the total cost of error by making it more likely some practices will be held unlawful in circumstances where they are harmless or even procompetitive. See, e.g., Arizona v. Maricopa County Med. Soc., 457 U.S. 332, 344 (1982) ("For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a full-blown inquiry might have proved to be reasonable"); Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law, ¶ 1509c (2d ed.2003) (observing that per se analysis "dispenses with costly proof requirements, such as proof of market power," but consequently "produces a certain number of false positives"). The converse—increased litigation cost but reduced cost of error—obtains under the rule of reason, which requires an exhaustive inquiry into all the myriad factors "bearing on whether the conduct is on balance anticompetitive or procompetitive." Donald F. Turner, *The Durability, Relevance, and Future of American Antitrust Policy*, 75 CAL. L. REV. 797, 800 (1987); see Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L.Rev. 1, 12-13 (1984) ("When everything is relevant, nothing is dispositive .... Litigation costs are the product of vague rules combined with high stakes, and nowhere is that combination more deadly than in antitrust litigation under the Rule of Reason").

Since *Professional Engineers* the Supreme Court has steadily moved away from the dichotomous approach—under which every restraint of trade is either unlawful per se, and hence not susceptible to a procompetitive justification, or subject to full-blown rule-of-reason analysis—toward one in which the extent of the inquiry is tailored to the suspect conduct in each particular case. For instance, the Court did not hold unlawful per se an agreement limiting the number of football games each participating college could sell to television, which agreement was challenged in *NCAA v. Board of Regents*, 468 U.S. 85, 100 (1984) (recognizing but declining to apply doctrine that "[h]orizontal price-fixing and output limitation are ordinarily condemned as a matter of law under an 'illegal per se ' approach"); or the refusal of an organization of dentists to provide x-rays to dental insurers, which was at issue in *IFD*, 476 U.S. at 458 ("Although this Court has in the past stated that group boycotts are unlawful per se, we decline to resolve this case by forcing the Federation's policy into the 'boycott' pigeonhole and invoking the per se rule") (citations omitted). Compare, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (price-fixing per se unlawful); and *Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959) (group boycott per se unlawful).

At the same time, however, in *NCAA* and *IFD* the Court did not insist upon the elaborate market analysis ordinarily required under the rule of reason to prove the defendant had market power and the restraint it imposed had an anticompetitive effect. See *NCAA*, 468 U.S. at 109-10 (rule of reason analysis unnecessary in light of district court's finding price and output not responsive to demand); *IFD*, 476 U.S. at 459 ("While this is not price fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement"). The Court instead adopted an intermediate inquiry, since dubbed the "quick look," to evaluate horizontal restraints of trade. See, e.g., Areeda & Hovenkamp, Antitrust Law, ¶ 1911a.

It would be somewhat misleading, however, to say the "quick look" is just a new category of analysis intermediate in complexity between " per se " condemnation and full-blown "rule of reason" treatment, for that would suggest the Court has moved from a dichotomy to a trichotomy, when in fact it has backed away from any reliance upon fixed categories and toward a continuum. The Court said as much in *California Dental Association v. FTC*:

> The truth is that our categories of analysis of anticompetitive effect are less fixed than terms like " per se," "quick look," and "rule of reason" tend to make them appear. We have recognized, for example, that there is often no bright line separating per se from Rule of Reason analysis, since considerable inquiry into market conditions may be required before the application of any so-called " per-se " condemnation is justified.

526 U.S. 756, 779 (1999).

Rather than focusing upon the category to which a particular restraint should be assigned, therefore, the Court emphasized the basic point that under § 1 the essential inquiry is "whether ... the challenged restraint enhances competition." In order to make that determination, a court must make "an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint," which in some cases may not require a full-blown market analysis. The Court continued:

> The object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principle tendency of a restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one. And of course what we see may vary over time, if rule-of-reason analyses in case after case reach identical conclusions.

Id.; *cf. United States v. Microsoft*, 253 F.3d 34, 84 (D.C. Cir.2001) (declining to condemn per se tying arrangements involving platform software products because there was "no close parallel in prior antitrust cases" and "simplistic application of per se tying rules carries a serious risk of harm").

In this case, as we have said, the Commission analyzed PolyGram's conduct under the legal framework it had devised in *Mass. Board* (1988), which it maintains is consistent with the Supreme Court's teaching of more than a decade later in *California Dental* (1999). The *Mass. Board* analysis proceeds in several distinct steps: First, the Commission must determine whether it is obvious from the nature of the challenged conduct that it will likely harm consumers. If so, then the restraint is deemed "inherently suspect" and, unless the defendant comes forward with some plausible (and legally cognizable) competitive justification for the restraint, summarily condemned. "Such justifications," the Commission explained, "may consist of plausible reasons why practices that are competitively suspect as a general matter may not be expected to have adverse consequences in the context of the particular market in question, or they may consist of reasons why the practices are likely to have beneficial effects for consumers."

If the defendant does offer such an explanation, then the Commission "must address the justification" in one of two ways. First, the Commission may explain why it can confidently conclude, without adducing evidence, that the restraint very likely harmed consumers. Alternatively, the Commission may provide the tribunal with sufficient evidence to show that anticompetitive effects are in fact likely. If the Commission succeeds in either way, then the evidentiary burden shifts to the defendant to show the restraint in fact does not harm consumers or has "procompetitive virtues" that outweigh its burden upon consumers.

PolyGram argues the Commission's framework conflicts with Supreme Court precedent by condemning a restraint that is not per seillegal without the Commission having to prove the restraint actually harms competition. According to PolyGram, "proof of actual anticompetitive effect (or market power as its surrogate) is required in any Rule of Reason case."

For reasons we have already explained, we reject PolyGram's attempt to locate the appropriate analysis, and the concomitant burden of proof, by reference to the vestigial line separating per se analysis from the rule of reason. See Areeda & Hovenkamp, Antitrust Law, ¶ 1511a ("judges and litigants too often assume erroneously that the classification, per se or rule of reason, necessarily determines what must or may be alleged and proved, made the subject of detailed findings, or submitted to the jury"). At bottom, the Sherman Act requires the court to ascertain whether the challenged restraint hinders competition; the Commission's framework, at least as the Commission applied it in this case, does just that.

We therefore accept the Commission's analytical framework. If, based upon economic learning and the experience of the market, it is obvious that a restraint of trade likely impairs competition, then the restraint is presumed unlawful and, in order to avoid liability, the defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm. That much follows from the caselaw; for instance, in *NCAA* the Court held that a "naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." 468 U.S. at 110. Similarly, in *IFD*, the Supreme Court ruled a horizontal agreement to withhold services could not be sustained because the dentists failed to advance any "credible argument" that "some countervailing procompetitive virtue ... [redeemed] an agreement limiting consumer choice by impeding the 'ordinary give and take of the market place.' " 476 U.S. at 459; see also *California Dental*, 526 U.S. at 771 (remanding for closer look at challenged advertising restrictions after concluding they "might plausibly be thought to have a net procompetitive effect, or possibly no effect at all on competition").

Although the Commission uses the term "inherently suspect" to describe those restraints that judicial experience and economic learning have shown to be likely to harm consumers, we note that, under the Commission's own framework, the rebuttable presumption of illegality arises not necessarily from anything "inherent" in a business practice but from the close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare. The Commission appears to acknowledge, as it must, that as economic learning and market experience evolve, so too will the class of restraints subject to summary adjudication. See *California Dental*, 526 U.S. at 781 (the ability of a court to draw "a confident conclusion about the principal tendency of a restraint ... may vary over time, if rule-of-reason analyses in case after case reach identical conclusions"); see also *Broad. Music, Inc. v. CBS*, 441 U.S. 1, 9 (1979) ("it is only after considerable experience with certain business relationships that courts classify them as per se violations").

That said, we have no difficulty with the Commission's conclusion that PolyGram's agreement with Warner in all likelihood had a deleterious effect upon consumers—unless, that is, PolyGram comes forward with some plausible explanation to the contrary. An agreement between joint venturers to restrain price cutting and advertising with respect to products not part of the joint venture looks suspiciously like a naked price fixing agreement between competitors, which would ordinarily be condemned as per se unlawful. The Supreme Court has recognized time and again that agreements restraining autonomy in pricing and advertising impede the "ordinary give and take of the market place." *IFD*, 476 U.S. at 459; see also *NCAA*, 468 U.S. at 107 ("[r]estrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit")....

PolyGram's fate in this case therefore rests upon the plausibility of the sole competitive justification it proffered for the moratorium agreement, namely, that the restrictions on discounting and advertising enhanced the long-term profitability of all three concert albums and promoted the "Three Tenors" brand. According to PolyGram, each company was concerned the other would "free ride" on the promotional activities of the joint venture by promoting its own earlier concert album; as a result fewer Three Tenors albums would be sold overall and the joint venture would be less likely to create future products, such as a "greatest hits" album or a boxed set. Thus, PolyGram likens the moratorium agreement here to the restraint at issue in *Polk Brothers, Inc. v. Forest City Enterprises*, 776 F.2d 185 (7th Cir.1985), where two potential retail competitors collaborated to build a store offering some of each company's products but agreed not to sell competing products at the new store. Because the restraint arguably promoted productivity and output by controlling each participant's ability to free-ride on the other's promotional efforts, the court, rather than condemning the restraint summarily, went on to evaluate it under the rule of reason.

At first glance PolyGram's contention has some force; the moratorium appears likely to have mitigated the "spillover" effects that could be expected to follow an aggressive launch of the 1998 album. Absent the moratorium, that is, a consumer, after learning of the new album through the joint venture's advertising, might decide that he would be just as happy with an older concert album, especially if the older album were then available at a discount. The "free-riding" to be eliminated by the moratorium agreement, however, was nothing more than the competition of products that were not part of the joint undertaking. Why not an agreement by which PolyGram and Warner would eliminate advertising and price competition on all their records for a time while they focused exclusively upon promoting the new Three Tenors album? The "procompetitive" justification PolyGram offers is "nothing less than a frontal assault on the basic policy of the Sherman Act." *Nat'l Soc'y of Prof'l Engineers*, 435 U.S. at 695.

To take the Commission's example, if General Motors were vigorously to advertise the release of a new model SUV, other SUV manufacturers would no doubt reap some of the benefit of GM's efforts. But that would not mean General Motors and its competitors could lawfully agree to restrict prices and advertising on existing SUV models in return for General Motors giving its rivals a share of its profit on the new model. Nor would an agreement to restrain prices and advertising on existing SUVs be lawful if General Motors were to release the new model SUV as a joint venture with one of its competitors. A restraint cannot be justified solely on the ground that it increases the profitability of the enterprise that introduces the new product, regardless whether that enterprise is a joint venture or a solo undertaking. And it simply does not matter whether the new SUV would have been profitable absent the restraint; if the only way a new product can profitably be introduced is to restrain the legitimate competition of older products, then one must seriously wonder whether consumers are genuinely benefitted by the new product. See also *Law v. NCAA*, 134 F.3d 1010, 1023 (10th Cir.1998) ("While increasing output, creating operating efficiencies, making a new product available, enhancing service or quality, and widening consumer choice have been accepted by courts as justifications for otherwise anticompetitive agreements, mere profitability or cost savings have not qualified as a defense under the antitrust laws").

In sum, because PolyGram has failed to identify any competitive justification for its agreement with Warner to refrain from advertising or discounting their competitive Three Tenors products, we hold it violated § 5 of the FTC Act. Hence, we need not go on to determine whether the Commission's findings of fact concerning actual competitive harm are supported by substantial evidence.

Finally, we hold the remedy ordered by the Commission was reasonable. The Commission found there was a significant risk that, if not prohibited from doing so, PolyGram would enter into similar arrangements in the future. That determination is supported by substantial evidence. The record shows the condition that gave rise to the moratorium agreement-namely, the company "fear [ed] that a new release by one of [its] recording artists may lose sales to the artist's older albums owned by a competitor," FTC Op. at 59-is a recurrent one in the record industry; therefore, PolyGram would have the same incentive in the future to enter into other agreements to restrain advertising and price discounting.

For the foregoing reasons, PolyGram's petition for review is Denied.

NOTES AND QUESTIONS

1. Traditionally the courts have taken a bifurcated approach to the antitrust analysis of multifirm conduct – a rule of "per se" illegality for conduct that seems inherently competitive and does not involve any integration of research and development, production or distribution; and a "rule of reason" for conduct that has plausible competitively benign explanations. In rule of reason cases the plaintiff, including the government, must prove that the defendants collectively have market power and that the practice has an anticompetitive effect. One important issue that often emerges is the so-called problem of characterization – or determining whether the per se rule or the rule of reason applies.

A few decisions, of which *Polygram* is an example, have sought ought middle ground for highly suspicious restraints for which more benign explanations are possible, although perhaps not probable. These require at least a "quick look" at any defenses that may be offered. *See* 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶¶1508, 1511 (3d ed. 2010).

STANDARD SETTING AND FRAND (RAND) LICENSING

GOLDEN BRIDGE TECHNOLOGY, INC. v. MOTOROLA, INC.
547 F.3d 266 (5th Cir. 2007)

EMILIO M. GARZA, Circuit Judge:

The district court granted summary judgment against GBT's claim that the defendants unlawfully conspired not to deal with GBT in violation of the Sherman Antitrust Act. For the following reasons, we affirm.

Golden Bridge Technology ("GBT") develops wireless communications technology for cellular networks. Along with the Appellees, GBT is a member of a non-profit standard setting organization called Third Generation Partnership Project ("3GPP"). 3GPP institutes uniform technology standards for the telecommunications industry to ensure worldwide compatibility of cellular devices and systems. More than 260 companies belong to 3GPP, representing all levels of the cell phone industry. The 3GPP members are responsible for creating and developing the 3GPP standard, which means determining what technologies will be included in the standard as either mandatory or optional features.

GBT owns patents to Common Packet Channel technology ("CPCH"), which allows the transmittal of electronic information packets between cellular phones and base stations. In 1999, 3GPP adopted CPCH as an optional feature. Optional status meant that manufacturers did not have to use CPCH, but if they chose to they had to follow the 3GPP standard to ensure compatibility with other equipment and networks. Since that time, two companies have obtained licenses to use CPCH, but neither company has field tested or implemented the technology….

At the 2004 plenary meeting for the Technical Specification Group to which GBT and the Appellees belonged, individual members wanted to simplify the 3GPP standard by removing old and unused technologies. At a subsequent Working Group meeting in Scottsdale, Arizona, two individual members presented a proposed feature clean-up list that did not include CPCH. No decision was reached….

The next plenary meeting occurred in Tokyo, Japan. Appellees all attended this meeting, but GBT did not. The proposed feature clean-up list was presented, still not including CPCH. However, an Ericsson representative spoke out in front of the entire group, suggesting adding CPCH to the clean-up list. Cingular, a previous friend of CPCH, announced support for removal…. At the following plenary meeting in Quebec, the change requests obtained final unanimous approval and all of the features on the revised clean-up list were removed from the 3GPP standard. GBT also failed to attend this meeting and did not appeal CPCH's removal to the Project Coordination Group.

GBT filed this lawsuit prior to the Quebec meeting, alleging a violation of the Sherman Antitrust Act, 15 U.S.C. § 1. GBT claimed that the defendants conspired with each other to remove CPCH from the 3GPP standard, resulting in the unlawful exclusion of GBT from the market. The district court granted the defendants' motion for summary judgment, finding that GBT had failed to present any evidence of a conspiracy. GBT now appeals.

We review the district court's grant of summary judgment de novo….

The Supreme Court has specified what a plaintiff must show to avoid summary judgment on a Sherman Act § 1 claim:

> To survive a motion for summary judgment ... a plaintiff seeking damages for a violation of § 1 must present evidence "that tends to exclude the possibility" that the alleged conspirators acted independently. Respondents ... must show that the inference of conspiracy is reasonable in light of the competing inferences of independent action or collusive action that could not have harmed respondents.

Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587-88(1986)….

Regarding the conspiracy element, the Supreme Court recently observed that "the crucial question [in a § 1 claim] is whether the challenged anticompetitive conduct stems from independent decision or from an agreement." Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007) (internal quotations omitted). The plaintiff must present evidence that the defendants engaged in concerted action, defined as having "a conscious commitment to a common scheme designed to achieve an unlawful objective." Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984). Concerted action may be shown by either direct or circumstantial evidence. Direct evidence explicitly refers to an understanding between the alleged conspirators, while circumstantial evidence requires additional inferences in order to support a conspiracy claim. See Tunica, 496 F.3d at 409. Independent parallel conduct, or even conduct among competitors that is consciously parallel, does not alone establish the contract, combination, or conspiracy required by § 1.

GBT argues that email communications between the Appellees and others following the Scottsdale meeting show a conspiracy, in the form of a group boycott, to eliminate CPCH from the 3GPP standard. The district court disagreed, granting summary judgment because GBT failed to present any evidence supporting the inference of a conspiracy. We agree.

As a threshold matter, GBT has presented only circumstantial evidence of a conspiracy. None of the emails, or any other evidence GBT presents, show an explicit understanding between the Appellees to collude and unlawfully eliminate CPCH from the standard. Compare *Tunica*, 496 F.3d at 410 (finding that email communications show conspiracy because they contain direct evidence stating that the parties entered into a "gentlemen's agreement" not to deal with another company). Unlike Tunica, here the emails actually reveal disagreement among the Appellees. The Appellees disliked CPCH for different reasons and wanted to remove it at different times. They disagreed about the very action GBT claims constituted the conspiracy-whether to add CPCH to the clean-up list being presented at the Tokyo meeting. Viewing the evidence favorably to GBT, the emails do reveal a common dislike for CPCH among some of the Appellees and other companies. However, common dislike is not the same as an explicit understanding to conspire, so we accordingly review GBT's claim under the stricter standard required for circumstantial evidence.

To show conspiracy, circumstantial evidence must tend to exclude the possibility that the Appellees acted independently. See *Matsushita*, 475 U.S. at 587-88. However, GBT has presented no evidence refuting the possibility that the Appellees found CPCH outdated and independently supported its removal. Viewed most favorably to GBT, the evidence indicates that some of the Appellees communicated their dislike of CPCH to each other, and that each Appellee hoped CPCH would eventually be removed from the standard. However, at least one Appellee (Lucent) only expressed a desire to remove CPCH in internal company emails, and was not part of the group email discussions. This evidence amounts to an exchange of information, followed by parallel conduct when the Appellees (and over 100 other companies) unanimously voted to remove CPCH, and it does not refute the likelihood of independent action. See Consol. Metal Prods., Inc. v. Am. Petroleum Inst., 846 F.2d 284, 294 n. 30 (5th Cir.1988) (noting that the mere exchange of information, or even consciously parallel action, is insufficient to establish a conspiracy under § 1). Moreover, the action that GBT alleges implemented the conspiracy-when the Ericsson representative moved to place CPCH on the clean-up list at the Tokyo meeting-occurred independently before the entire plenary body, and GBT offers no evidence indicating it resulted from any explicit agreement. On the contrary, the evidence indicates that Ericsson's action was in opposition to what some of the other Appellees wanted, due to their concerns about Cingular's allegiance to CPCH.

GBT argues that the Appellees' had economic motives to remove CPCH, demonstrating that they did not act independently. These purported motives include avoiding the payment of royalty fees to use CPCH and promoting their own competing technology. The first motive finds no support in the evidence, because none of the Appellees, and in fact no company at all, had ever paid royalties to GBT for CPCH. Further, CPCH was an optional feature in the 3GPP standard. There was no rational reason for the Appellees to conspire to unlawfully remove CPCH to avoid paying royalties, when they could simply opt not to use it. Regarding the alleged competing-technology motive, such evidence does not exclude the possibility of independent conduct. Appellees could still support CPCH's removal because they disliked it, even if they owned competing technology. In fact, the existence of an independent financial motive to remove CPCH might be an independent reason for each Appellee company to support CPCH's removal. It is not sufficient under Matsushita for GBT to simply propose conceivable motives for conspiratorial conduct; GBT's evidence must tend to show that the possibility of independent conduct is excluded. See Matsushita, 475 U.S. at 587-88. GBT's evidence does not tend to exclude the possibility that the Appellees acted independently, motivated by a desire to improve the 3GPP standard by removing outdated and underused technologies.

Moreover, the Appellees presented evidence showing that these informal communications are an important part of the standard setting process, and that the 3GPP standards are beneficial to the market. We have maintained that "it has long been recognized that the establishment and monitoring of trade standards is a legitimate and beneficial function." Consol. Metal Prods., 846 F.2d at 293-94 (finding that though a trade association naturally involves collective action by competitors, it is not by its nature a "walking conspiracy"). The standards 3GPP sets allow the numerous necessary components of cellular communications to operate compatibly. Potential procompetitive benefits of standards promoting technological compatibility include facilitating economies of scale in the market for complementary goods, reducing consumer search costs, and increasing economic efficiency. We have found it "axiomatic" that a standard setting organization must exclude some products, and such exclusions are not themselves antitrust violations. See Consol. Metal Prods., 846 F.2d at 294. To hold otherwise would stifle the beneficial functions of such organizations, as "fear of treble damages and judicial second-guessing would discourage the establishment of useful industry standards." Accordingly, we decline to infer conspiratorial action on the basis of limited circumstantial evidence, particularly where this evidence is at least as consistent with permissible competition, and with independent action, as with unlawful conspiracy.

As GBT has not met the threshold requirement of demonstrating the existence of an agreement in restraint of trade, we need not review the district court's findings as to the remaining requirements of a § 1 violation.

NOTES AND QUESTIONS

1. A standard setting group for a profitable and very widely used product such as cellular phones cannot possibly incorporate every patented technology that is offered to it; it must choose. So is the issue in *Golden Bridge* whether the members of the SSO "agreed" or "conspired" to exclude someone's technology from their standards, or is the question whether the decision to exclude was "reasonable" in the antitrust sense. Clearly the members of the SSO "agreed" in the sense that they voted to remove CPCH from the standard. Should the court be more concerned about the reasonableness of the agreement rather than its existence? Considering that CPCH was only an optional standard and was never implemented in any product even when it was available probably indicates that its exclusion was not anticompetitive.

2. It is unclear whether any of the other members of the SSO had a technology that competed with CPCH, although the plaintiff alleged that some did. Should that matter? For example, if Motorola owned a competing technology, it would have an incentive to exclude GBT's competing technology. The court addressed this issue in *Moore v. Boating Indus. Ass'n*, 819 F.2d 693 (7th Cir. 1987). The plaintiff manufactured tail lights designed for trailers, and claimed that the defendant boating association engaged in anticompetitive behavior by refusing to certify its lights. The boating association answered that the plaintiff's tail lights had a tendency to short out when the trailer was submerged. Because none of the defendants in the standard setting organization were in competition with the plaintiffs the court found it highly unlikely that the defendants had behaved anticompetitively. Trailer makers are *customers* of tail light manufacturers. Presumably they wanted high quality cost effective lights.

MICROSOFT CORP. v. MOTOROLA, INC.
696 F.3d 872 (9th Cir. 2012)

BERZON, Circuit Judge:

In this interlocutory appeal, Motorola appeals from the district court's preliminary injunction to enjoin Motorola temporarily from enforcing a patent injunction that it obtained against Microsoft in Germany. We review the district court's grant of a foreign anti-suit injunction under the deferential abuse-of-discretion standard, and affirm.

I. BACKGROUND

A. Standard-setting organizations and intellectual property law

The underlying case before the district court concerns how to interpret and enforce patent-holders' commitments to industry standard-setting organizations ("SSOs"), which establish technical specifications to ensure that products from different manufacturers are compatible with each other. *See generally* Mark A. Lemley, *Intellectual Property Rights and Standard–Setting Organizations,* 90 Calif. L.Rev. 1889 (2002). Specifically, the case involves the H.264 video coding standard set by International Telecommunications Union ("ITU"), and the 802.11 wireless local area network standard set by the Institute of Electrical and Electronics Engineers ("IEEE"). This appeal implicates primarily the H.264 standard.

Standards provide many benefits for technology consumers, including not just interoperability but also lower product costs and increased price competition. *See Apple, Inc. v. Motorola Mobility, Inc.,* 2011 WL 7324582, at *1 (W.D. Wis. June 7, 2011). The catch with standards "is that it may be necessary to use patented technology in order to practice them." *Id.* As a result, standards threaten to endow holders of standard-essential patents with disproportionate market power. In theory, once a standard has gained such widespread acceptance that compliance is effectively required to compete in a particular market, anyone holding a standard-essential patent could extract unreasonably high royalties from suppliers of standard-compliant products and services. This problem is a form of "patent holdup." *See generally* Mark A. Lemley, *Ten Things to Do About Patent Holdup of Standards (And One Not To),* 48 B.C. L. Rev. 149 (2007).

Many SSOs try to mitigate the threat of patent holdup by requiring members who hold IP rights in standard-essential patents to agree to license those patents to all comers on terms that are "reasonable and nondiscriminatory," or "RAND." *See* Lemley, *Intellectual Property Rights,* 90 Calif. L.Rev. at 1902, 1906. For example, consider the ITU, whose H.264 standard is implicated in this appeal. The ITU's Common Patent Policy (the "ITU Policy") provides that "a patent embodied fully or partly in a [standard] must be accessible to everybody without undue constraints." Anyone who owns a patent declared essential to an ITU standard must submit a declaration to the ITU stating whether it is willing to "negotiate licenses with other parties on a non-discriminatory basis on reasonable terms and conditions." If a "patent holder is not willing to comply" with the requirement to negotiate licenses with all seekers, then the standard "shall not include provisions depending on the patent."

Pursuant to these procedural requirements, Motorola has submitted numerous declarations to the ITU stating that it will grant licenses on RAND terms for its H.264–essential patents. A typical such declaration provides:

> The Patent Holder will grant a license to an unrestricted number of applicants on a worldwide, non-discriminatory basis and on reasonable terms and conditions to use the patented material necessary in order to manufacture, use, and/or sell implementations of the above ITU–T Recommendation ISOC/IEC International Standard.

The ITU Policy does not specify how to determine RAND terms, or how courts should adjudicate disputes between patent-holders and would-be licensors under a RAND commitment. To the contrary, the ITU Policy includes the following disclaimer:

> [Standards] are drawn up by technical and not patent experts; thus, they may not necessarily be very familiar with the complex international legal situation of intellectual property rights such as patents, etc....
>
> ....
>
> ... The detailed arrangements arising from patents (licensing, royalties, etc.) are left to the parties concerned, as these arrangements might differ from case to case.

The ITU Policy also disclaims any role for the organization in negotiating licenses or in "settling disputes on Patents," stating, "this should be left—as in the past—to the parties concerned." Finally, the ITU form that patent-holders use to submit licensing declarations includes the caveat: "This declaration does not represent an actual grant of a license."

Courts and commentators are divided as to how, if at all, RAND licensing disputes should be settled.... Judge Posner, sitting by designation on the U.S. District Court for the Northern District of Illinois, recently held in a different case involving Motorola-owned standard-essential patents for which Motorola had made a RAND commitment that the court would not

> be justified in enjoining Apple [the plaintiff in that case] from infringing [the patent at issue] unless Apple refuses to pay a royalty that meets the FRAND requirement. By committing to license its patents on FRAND terms, Motorola committed to license the [patent] to anyone willing to pay a FRAND royalty and thus implicitly acknowledged that a royalty is adequate compensation for a license to use that patent.

Apple, Inc. v. Motorola, Inc., 869 F.Supp.2d 901, 913 (N.D.Ill. 2012) (Posner, J.). More generally, Justice Kennedy has suggested that injunctions against patent infringement "may not serve the public interest" in cases where "the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations." *eBay Inc. v. MercExchange, L.L.C.,* 547 U.S. 388, 396–97 (2006) (Kennedy, J., concurring).

B. The U.S. contract litigation

In October 2010, Motorola sent Microsoft two letters offering to license certain of its standard-essential patents. Of relevance to this appeal is the H.264 letter, sent on October 29, 2010. The letter proposed a royalty of "2.25% per unit" for each standard-compliant product, "subject to a grant back license" of Microsoft's standard-essential patents, "based on the price of the end product (e.g., each Xbox 360 product, each PC/laptop, each smartphone, etc.) and not on component software (e.g., Xbox 360 system software, Windows 7 software, Windows Phone 7 software, etc.)." It noted in closing: "Motorola will leave this offer open for 20 days. Please confirm whether Microsoft accepts the offer."

Appended to the letter was a "non-exhaustive list" of the U.S. and international patents that Motorola declares that it owns and that are essential to the H.264 standard, and that would be "included in the license" being offered. The list comprised not just U.S. patents but also numerous patents granted or filed in foreign jurisdictions....

On November 9, 2010, Microsoft filed a breach-of-contract suit against Motorola in the U.S. District Court for the Western District of Washington, under Washington state contract law. Microsoft's theory of liability is that Motorola's proposed royalty terms were unreasonable, and that Motorola's letters therefore breached its contractual RAND obligations to the IEEE and the ITU, to which Microsoft is a third-party beneficiary. The next day, Motorola filed a patent suit against Microsoft in the U.S. District Court for the Western District of Wisconsin, alleging infringement of U.S. patents ' 374, '375, and '376.

In February 2012, the district court granted partial summary judgment for Microsoft on its contract claims, finding that:

> (1) Motorola entered into binding contractual commitments with the IEEE and the ITU, committing to license its declared-essential patents on RAND terms and conditions; and (2) that Microsoft is a third-party beneficiary of Motorola's commitments to the IEEE and the ITU.....

C. The German patent litigation

In July 2011, several months into the above-described domestic litigation, Motorola sued Microsoft in Landgericht Mannheim, or Mannheim Regional Court, alleging infringement of the German '667 and '384 patents. In the German suit, Motorola sought, among other relief, an injunction prohibiting Microsoft from selling allegedly infringing products in Germany, including the Microsoft Xbox gaming system and certain Microsoft Windows software.

On May 2, 2012, the Mannheim Court issued its ruling. First, the court held that Microsoft did not have a license to use Motorola's patents. Second, it rejected the argument that Motorola's RAND commitment to the ITU created a contract enforceable by Microsoft.... Finally, the German court held that Microsoft had infringed the '667 and '384 patents, and enjoined Microsoft from "offering, marketing, using or importing or possessing ... in the territory of the Federal Republic of Germany decoder apparatus (in particular Xbox 360)"; from "offering and/or supplying in the territory of the Federal Republic of Germany computer software (in particular Windows 7 and/or Internet Explorer 9)"; and "from offering and/or supplying in the territory of the Federal Republic of Germany computer software (in particular Windows Media Player 12)." The German court rejected the argument that a RAND commitment operates as a "waiver of claims for injunctive relief."...

On March 28, 2012, Microsoft moved the district court for a temporary restraining order ("TRO") and preliminary injunction to enjoin Motorola from enforcing any German injunctive relief it might obtain....

We clarified our framework for evaluating a foreign anti-suit injunction in [*E. & J. Gallo Winery v. Andina Licores S.A.*, 446 F.3d 984, 989 (9th Cir.2006) and later cases]. Together, these cases establish a three-part inquiry for assessing the propriety of such an injunction. First, we determine "whether or not the parties and the issues are the same" in both the domestic and foreign actions, "and whether or not the first action is dispositive of the action to be enjoined." *Gallo,* 446 F.3d at 991 (citations omitted). Second, we determine whether at least one of the so-called "*Unterweser* factors"[4] applies. Finally, we assess whether the injunction's "impact on comity is tolerable." ...

The full list of *Unterweser* factors is as follows:

> [whether the] foreign litigation ... would (1) frustrate a policy of the forum issuing the injunction; (2) be vexatious or oppressive; (3) threaten the issuing court's *in rem* or *quasi in rem* jurisdiction; or (4) where the proceedings prejudice other equitable considerations.

... In explaining its rationale for the injunction, the district court made findings sufficient to establish at least two of the *Unterweser* factors: that the foreign litigation is "'vexatious or oppressive,'" and that the foreign litigation "'prejudice[s] ... equitable considerations.'"

Motorola contends that the German litigation cannot be described as "vexatious" because the German court ruled in Motorola's favor. But litigation may have some merit and still be "vexatious," which is defined as "without reasonable or probable cause or excuse; harassing; annoying." *Black's Law Dictionary* 1701 (9th ed.2009). In the midst of litigation over Motorola's obligations under Washington state contract law with respect to a portfolio of patents that includes the two German patents, Motorola initiated separate proceedings in Germany to enforce those two patents directly. The district court interpreted this step as a procedural maneuver designed to harass Microsoft with the threat of an injunction removing its products from a significant European market and so to interfere with the court's ability to decide the contractual questions already properly before it. Although the district court's interpretation of Motorola's litigation decisions may not be the only possible interpretation, it is not "illogical, implausible, or without support from inferences that may be drawn from facts in the record." ....

. . . Reviewing that determination for an abuse of discretion, we cannot say that it rested upon an erroneous view of the law or a clearly erroneous view of the facts. "At most, there are competing comity concerns, so it cannot fairly be said" that the district court's preliminary injunction "would have an intolerable impact on comity."

[4] [Referring to *In re Unterweser Reederei GMBH*, 428 F.2d 888, 896 (5th Cir.1970), aff'd on reh'g, 446 F.2d 907 (5th Cir.1971) (en banc) (per curiam), rev'd on other grounds sub nom. *M/S Bremen v. Zapata Off–Shore Co.*, 407 U.S. 1 (1972) -- ed.]

V. CONCLUSION

Under the unique circumstances of this case, the district court's narrowly tailored preliminary injunction was not an abuse of discretion. We **AFFIRM.**

APPLE, INC. v. MOTOROLA, INC.
869 F.Supp.2d 901 (N.D. Ill. 2012)

[Apple and Motorola sued each other for patent infringement. Motorola sued Apple for infringing its '898 and '559 patents, and Apple sued Motorola for infringement of its '002, '263, '647, and '949 patents. Both Apple and Motorola sought damages and injunctive relief. Judge Posner, sitting on the district court by designation, granted Apple's motion for summary judgment as to Motorola's '559 patent. Following a Daubert hearing, Judge Posner first rejected both parties' damages claims and then moved on to their requested injunctive relief—Ed.]

POSNER, Circuit Judge.
...

There is another decisive objection to Motorola's damages claim. The proper method of computing a FRAND royalty starts with what the cost to the licensee would have been of obtaining, just before the patented invention was declared essential to compliance with the industry standard, a license for the function performed by the patent. That cost would be a measure of the value of the patent qua patent. But once a patent becomes essential to a standard, the patentee's bargaining power surges because a prospective licensee has no alternative to licensing the patent; he is at the patentee's mercy. The purpose of the FRAND requirements, the validity of which Motorola doesn't question, is to confine the patentee's royalty demand to the value conferred by the patent itself as distinct from the additional value—the hold-up value—conferred by the patent's being designated as standard-essential. *Broadcom Corp. v. Qualcomm Inc.,* 501 F.3d 297, 313–14 (3d Cir. 2007); Daniel G. Swanson & William J. Baumol, "Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power," 73 *Antitrust L.J.* 1, 7–11 (2005). Motorola has provided no evidence for calculating a reasonable royalty that would be consistent with this point.

So damages are out for both parties. But a patentee can also seek injunctive relief for infringement, and both parties seek such relief, as I have already noted with respect to Apple.

Injunctive Relief. To begin with Motorola's injunctive claim, I don't see how, given FRAND, I would be justified in enjoining Apple from infringing the '898 unless Apple refuses to pay a royalty that meets the FRAND requirement. By committing to license its patents on FRAND terms, Motorola committed to license the '898 to anyone willing to pay a FRAND royalty and thus implicitly acknowledged that a royalty is adequate compensation for a license to use that patent....

The Federal Trade Commission recently issued a policy statement which implies that injunctive relief is indeed unavailable for infringement of a patent governed by FRAND. "Third Party United States Federal Trade Commission's Statement on the Public Interest," filed on June 6, 2012, in *In re Certain Wireless Communication Devices, Portable Music & Data Processing Devices, Computers & Components Thereof,* Inv. No. 337–TA–745, www.ftc.gov/os/2012/06/1206ftcwirelesscom.pdf (visited June 22, 2012). This was said in the context of an exclusion order by the International Trade Commission, but its logic embraces any claim to enjoin the sale of an infringing product. For the FTC says it's "explaining the potential economic and competitive impact of injunctive relief on disputes involving SEPs [standard-essential patents]." *Id.* at 2. It goes on to note that

> a royalty negotiation that occurs under threat of an exclusion order may be weighted heavily in favor of the patentee in a way that is in tension with the RAND commitment. High switching costs combined with the threat of an exclusion order could allow a patentee to obtain unreasonable licensing terms despite its RAND commitment, not because its invention is valuable, but because implementers are locked in to practicing the standard. The resulting imbalance between the value of patented technology and the rewards for innovation may be especially acute where the exclusion order is based on a patent covering a small component of a complex multicomponent product. In these ways, the threat of an exclusion order may allow the holder of a RAND-encumbered SEP to realize royalty rates that reflect patent hold-up, rather than the value of the patent relative to alternatives....

Motorola counters that Apple's refusal to negotiate with it after rejecting its initial offer of a 2.25 percent royalty warrants injunctive relief; by opting not to take a license ex ante, it argues, Apple should lose the FRAND safe harbor. But Apple's refusal to negotiate for a license (if it did refuse—the parties offer competing accounts, unnecessary for me to resolve, of why negotiations broke down) was not a defense to a claim by Motorola for a FRAND royalty. If Apple said no to 2.25 percent, it ran the risk of being ordered by a court to pay an equal or even higher royalty rate, but that is not the same thing as Motorola's being excused from no longer having to comply with its FRAND obligations. Motorola agreed to license its standards-essential patents on FRAND terms as a *quid pro quo* for their being declared essential to the standard. It does not claim to have conditioned agreement on prospective licensees' making counteroffers in license negotiations.

Motorola argues further that deprived of the possibility of injunctive relief, it will not be able to extract a reasonable royalty from Apple. Suppose, hypothetically, that the maximum reasonable FRAND royalty would be $10 million. If Motorola therefore demanded such a royalty, Apple, knowing that litigation is costly, would refuse, and Motorola would accept a lesser amount. Of course litigation would also be costly for Apple, and this might induce it to pay the $10 million rather than fight. But the deeper objection to Motorola's argument is that the "American rule," which with immaterial exceptions makes the winning party in a litigation bear his litigation costs rather than being able to shift them to the loser, does not deem damages an inadequate remedy just because, unless backed by a threat of injunction, it may induce a settlement for less than the damages rightly sought by the plaintiff. You can't obtain an injunction for a simple breach of contract on the ground that you need the injunction to pressure the defendant to settle your damages claim on terms more advantageous to you than if there were no such pressure.

.... The grant of an injunction is not an automatic or even a presumptive consequence of a finding of liability, either generally or in a patent case—in fact the Supreme Court has held that the standard for deciding whether to grant such relief in patent cases is the normal equity standard. *eBay Inc. v. MercExchange, L.L.C., supra,* 547 U.S. at 391–92... And that means, with immaterial exceptions, that the alternative of monetary relief must be inadequate. "[T]he inadequacy of one's damages remedy is normally a prerequisite to injunctive relief." *Hoard v. Reddy,* 175 F.3d 531, 533 (7th Cir. 1999).... A FRAND royalty would provide all the relief to which Motorola would be entitled if it proved infringement of the '898 patent, and thus it is not entitled to an injunction.

In fact neither party is entitled to an injunction. Neither has shown that damages would not be an adequate remedy. True, neither has presented sufficient evidence of damages to withstand summary judgment—but that is not because damages are impossible to calculate with reasonable certainty and are therefore an inadequate remedy; it's because the parties have failed to present enough evidence to create a triable issue. They had an adequate legal remedy but failed to make a prima facie case of how much money, by way of such remedy, they are entitled to. That was a simple failure of proof.....

There is no question of collectability in this case, a common reason why a damages remedy is inadequate. Both parties have deep pockets. And neither has acknowledged that damages for the infringement of its patents could not be estimated with tolerable certainty. On the contrary, each insists not only that damages are calculable but that it has calculated them. The problem is not that damages cannot be calculated, but that on the eve of trial, with the record closed, it became apparent that the parties had failed to make a responsible calculation.

Apple claims that Motorola profited from infringement by incorporating the desirable features of Apple's patented technology into its own devices without either paying a royalty for a license to use the patents or incurring the cost of inventing around them. Apple has never contended that these benefits to Motorola of infringement cannot be quantified. It merely has failed, despite its vast resources and superb legal team, to do so in a minimally acceptable manner—failed whether because of mistakes in trial preparation (which even the best lawyers can make), or because too many cooks spoil the stew (Apple is represented by three law firms in this litigation), or maybe because the infringements did not deprive Apple of any profits (I'll come back to this counterintuitive point).

Apple also contends that it's losing market share (which could happen though its sales were growing—as they have been—because a competitor, namely Motorola, was growing faster) to Motorola, and also losing future customers to Motorola because of infringement, and requests an injunction to limit Motorola's penetration of the market and preserve Apple's own customer base. But it has not laid a foundation for such relief.

To begin with, as far as the record shows, an injunction would not avert such losses, because of the ease of designing around the patent claims at issue. The costs of designing around the '647 patent (structure detection and linking) . . . would just require reprogramming Motorola's smartphones to avoid at least one claim limitation. (A claim is not infringed if at least one "limitation" (element) of the claim is not present in the allegedly infringing device. *Catalina Marketing Int'l, Inc. v. Coolsavings.com, Inc.,* 289 F.3d 801, 812 (Fed. Cir. 2002); *Lemelson v. United States,* 752 F.2d 1538, 1551 (Fed. Cir. 1985).) Given my claims construction of the '647 patent, Motorola could design around simply by creating copies of the code that performs structure detection and linking for each particular program rather than by using a common-code module for all programs; for without a common code there is no "analyzer *server,*" as required by the patent claim. As far as the '263 patent (realtime) is concerned, there is no evidence of the cost of inventing around the surviving claims in it, and for all the records shows the cost may be slight.

If, then, Apple couldn't exclude Motorola from the market with an injunction because of the ease of inventing around, the only thing Apple lost as a result of the alleged infringements was royalties capped at the minimum design-around cost. Its alleged loss of market share because Motorola's smartphones do the same thing (either via license or design-around) would have occurred with or without an injunction, and so doesn't establish the inadequacy of damages.

Thus, while difficulty of quantifying loss of goodwill or of market share might justify injunctive relief in some cases, in this case an injunction would in all likelihood be ineffectual in preventing such loss. (No damages are sought for past such loss.) Unsurprisingly, there's no evidence of loss of market share or customer goodwill by Apple, and no basis for expecting such loss in the future. The price differences between the iPhone, which is Apple's smartphone, and Motorola smartphones suggest that the markets for the two classes of product are not perfectly overlapping, and so a small improvement in a Motorola smartphone attributable to infringement may not take significant sales from Apple. And while the patents themselves (or some of them at least) may well have considerable value, after the claims constructions by Judge Crabb and myself and after my grants of partial summary judgment only a handful of the original patent claims remain in the case; infringement of that handful may not be a source of significant injury past, present, or future. For a variety of reasons patents in the field of information technology often have little if any value except defensively. See Alan Devlin, "Systemic Bias in Patent Law," 61 *De–Paul L. Rev.* 57, 77–80 (2011), and references cited there....

A compulsory license with ongoing royalty is likely to be a superior remedy in a case like this because of the frequent disproportion between harm to the patentee from infringement and harm to the infringer and to the public from an injunction, a factor emphasized in Justice Kennedy's concurring opinion in *eBay Inc. v. MercExchange, L.L.C., supra*, in which he pointed out that "when the patented invention is but a small component of the product the companies seek to produce and the threat of an injunction is employed simply for undue leverage in negotiations, legal damages may well be sufficient to compensate for the infringement and an injunction may not serve the public interest." He could have been describing this case. Three Justices joined his opinion, and no Justice expressed disagreement with it....

NOTES AND QUESTIONS

1. At this writing Judge Posner's decision is under appeal to the Federal Circuit. However, early in 2013 Google agreed to a consent order permitting those who wish to use its FRAND-encumbered patents to enter a request for a royalty determination from an independent arbitrator. Google agreed to refrain from making claims for injunctive relief against qualified firms requesting such

arbitration, provided that they agreed to the arbitrated royalty terms. If a firm refuses to recognize the patents or pay any royalty, Google is free to bring an infringement action and seek an injunction under ordinary equity principles. *Motorola Mobility LLC and Google, Inc*., Decision and Order (FTC, 1-2-2013), available at

http://ftc.gov/os/caselist/1210120/130103googlemotorolado.pdf

2. In *Apple Inc. v. Samsung Elecs. Co.*, 2012 WL 1672493 (N.D. Cal. May 14, 2012), Samsung sought to dismiss Apple's claims that Samsung "defraud[ed] the standards setting organization that set the UMTS standards, inducing the organization to adopt Samsung's Declared–Essential Patents, and later refus[ed] to license its Declared–Essential Patents on fair, reasonable, and non-discriminatory terms.

For its Sherman Act § 2 claim and its unfair competition claim, Apple was required to allege that: "(1) Samsung possessed monopoly power in the relevant market, and (2) that Samsung achieved or is maintaining monopoly power through anticompetitive conduct." The district court held that Apple sufficiently pled a relevant market because it "pled that [t]he relevant markets in which to assess the anticompetitive effects of Samsung's conduct . . . are the various markets for technologies that—before the standard was implemented—were competing to perform each of the various functions covered by each of Samsung's purported essential patents." The court further held that Apple adequately alleged that Samsung's patents provided it with monopoly power. Samsung alleged that Apple "erroneously base[d] its allegation of Samsung's monopoly power on ETSI's incorporation of Samsung technology into the WCDMA standard." In rejecting Samsung's argument, the court agreed with other courts which held that there is

> a legal distinction between a normal patent—to which antitrust market power is generally not conferred on the patent owner, and a patent incorporated into a standard—to which antitrust market power may be conferred on the patent owner. In so doing, these courts have found similar allegations of market power conferred as a result of a patent incorporated into a standard to be sufficient to state a claim upon which relief can be granted.

Id. The court also found that Apple adequately pled that Samsung engaged in anticompetitive conduct based on a False FRAND theory. As the district court stated, to survive a motion to dismiss under this theory, a party must allege that:

> (1) in a consensus-oriented private standard-setting environment, (2) a patent holder's intentionally false promise to license essential proprietary technology on FRAND terms, (3) coupled

> with [a standard setting organization's] reliance on that promise when including the technology in a standard, and (4) the patent holder's subsequent breach of that promise, is actionable anticompetitive conduct.

Does it make sense to potentially hold the owner of a standards-essential patent liable for treble damages for not offering its patent on terms that a court would find reasonable and non-discriminatory? Suppose that a company has been issued a patent that could potentially be adopted by a standards-setting organization as a standards-essential patent. Might the threat of treble damages (pursuant to the Sherman Act) down the line prevent a firm from submitting its patent to a standards-setting organization as a standards-essential patent? Does this harm standard-setting organizations? Would it be better to allow patentees free rein in setting terms it deems "reasonable?"

3. Interpreting FRAND commitments requires courts to fill in the gaps in incomplete contracts. Assessing the base and royalty rate poses one set of problems. Another set relates to "evasion" devices –namely, transfers and injunctions

Should FRAND commitments "run with the land," in the sense that owners of FRAND-encumbered patents should not be able to free them from FRAND commitments simply by assigning the patents to someone else? One fundamental principle of property law is that a property owner cannot transfer away a larger interest than it owns. Of course, that may beg the question if the issue is what does it own. More fundamentally, the entire FRAND commitment process would be worthless if patentees were able to evade it by the simple device of assigning encumbered patents to someone else in order to remove the encumbrance. As a result the proper default rule is that a FRAND commitment "runs with the patent" so to speak. If a firm wants to transfer less, it should be required to state its wishes up front when technologies are being selected. For example, if a firm wants to limit its FRAND commitment to, say, two years it should be free to do so by declaring as much as part of its original commitment. Then the SSO can consider the offer and compare it with alternatives or make a counter-proposal. By contrast, if a patentee stated up front that it intended to make its FRAND commitment last only until it chose to sell the patent to someone else, whenever that might be, it would be tantamount to no FRAND commitment at all. Some companies, such as Microsoft, have policies to this effect,[5] but the legal obligation should be clear in any event.

[5] *See Microsoft's Support for Industry Standards* (Feb. 8, 2012), *available at* http://www.microsoft.com/about/legal/en/us/IntellectualProperty/iplicensing/ip2.aspx (visited Sep. 26, 2012) (commitment to continue acknowledging FRAND commitments).

The question of injunctive relief is only a little more complex. A FRAND commitment is on its face an offer to license to all who employ that patent in their standards-compatible product. True, the precise royalty terms are typically not specified in advance, but that entails that the FRAND royalty will be determined by the body, and by reference to common indicia of royalty rates, such as rates paid for similar technologies in the same or perhaps another situation. Further, as noted earlier, the FRAND commitment effectively turns the royalty issues into a breach of contract claim rather than a litigated royalty claim. Permitting the owner of a FRAND-encumbered patent to have an injunction against someone willing to pay FRAND royalties is tantamount to making the patent holder the dictator of the royalties, which once again is the same thing as no FRAND commitment at all. Permitting an injunction effectively places the patent holder and the potential infringer in the same position that they would be when an innocent infringer invests in a technology and is later taken by surprise by a patent holder, who can then claim royalties whose amount is driven mainly by the infringer's costs of extracting itself from the patented technology.

The Supreme Court's *eBay* decision overruled a line of Federal Circuit decisions that had made injunctions almost a matter of right in patent infringement cases.[6] The fact that the patent in question has already been FRAND encumbered establishes that the patentee's reasonable expection was the right to obtain FRAND royalties, not to exclude. Further, inherent in the FRAND requirement is that the royalties be nondiscriminatory – that is, once they are determined any participant has the right to the technology upon payment of that sum. Beyond that, the fact that the patent in question is standards-essential places a heavy thumb on the scales with respect to *eBay's* public interest requirement. Here, an injunction can potentially hold up an entire network or make it less competitive. In sum, FRAND-encumbered patents should never be enforced by injunction, at least not when the infringement defendant has agreed to pay a FRAND royalty.

In January 2013 the Antitrust Division of the Justice Department and the United States Patent and Trademark Office issued a joint statement indicating that obtaining injunctions on FRAND-encumbered patents is generally inappropriate. Further, the statement concluded, "hold-up may be exacerbated when patents are sold or otherwise transferred by their owners. If F/RAND licensing obligations do not travel with a transferred patent, the potential for hold-up from the network effects of a standard may be substantially increased. For this reason, we believe that F/RAND commitments should bind subsequent patent transferees." United States Department of Justice and United States Patent & Trademark Office, *Policy Statement on Remedies for*

[6] *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388, 391 (2006).

Standards-Essential Patents Subject to Voluntary F/RAND Commitments (Jan. 8, 2013), available at http://www.uspto.gov/about/offices/ogc/Final_DOJ-PTO_Policy_Statement_on_FRAND_SEPs_1-8-13.pdf.

4. *Exclusion Orders and the U.S. International Trade Commission.* The ITC is a regulatory body with quasi-judicial power to exclude certain classes of unlawful imports. Historically the ITC, created in 1916, was concerned with practices like dumping and foreign subsidies deemed to make import of the subsidized goods unlawful. More recently, however, the ITC has had a major role to play in the enforcement of United States intellectual property rights abroad by preventing the import into the United States of goods that infringe United States patents, copyrights, or trademarks.[7] The ordinary remedy granted by the ITC is an "exclusion order," which is not a general injunction prohibiting production but rather a bar from importing the foreign-produced good into the United States.[8] To the extent that domestic companies outsource production to foreign firms or produce in plants located abroad, they may also be subject to exclusion orders. If a large American firm outsources the production of its products for shipment back into the United States, those goods are within the jurisdiction of the ITC. For example, in May, 2012, the ITC issued an exclusion order against Motorola Mobility upon Microsoft's complaint that certain imported Motorola Mobility devices infringed Microsoft's patents.[9] In an extreme case where most of a firm's product is made abroad an exclusive order is tantamount to an injunction.

The difficulty with ITC exclusion orders derives from two things. First, because an exclusion order is not literally an injunction but only a prohibition of import, the Federal Circuit has held that it is not covered by the Supreme Court's *eBay* decision.[10] Second, the ITC has no independent authority to award damages for patent infringement. The fact that damages are unavailable would ordinarily count in favor of injunctive relief. Equally significant, however, is the

[7] *See* Colleen V. Chien & Mark A. Lemley, Patent Holdup, the ITC, and the Public Interest, 98 Cornell L.Rev. 1 (2012); Sapna Kumar, *The Other Patent Agency: Congressional Regulation of the ITC*, 61 Fla. L. Rev. 529 (2009).

[8] 19 U.S.C. § 1337(d)(f). A prominent example involving virtually the entire smart phone industry is Certain Electronic Devices with Communication Capabilities, Components Thereof, and Related Software; Notice of Institution of Investigation; Institution of Investigation Pursuant to 19 U.S.C. 1337, 76 Fed. Reg. 60870-01 (Sept. 30, 2011).

[9] *See, e.g.*, In re Certain Mobile Devices, Associated Software, and Components Thereof, Inv. No. 337-TA-744, 2012 WL 3715791 (USITC, May 18, 2012).

[10] *See Spansion, Inc. v. ITC,* 629 F.3d 1331, 1359 (Fed. Cir. 2010), *cert. denied,* 132 S. Ct. 758 (2011). The FTC has argued the contrary position. *See* FEDERAL TRADE COMM'N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 31-72 (2011).

fact that once an infringing good is sold in the United States the seller is guilty of infringement and facilitators may be guilty of contributory infringement or inducement. As a result, the reason that the challenger has gone to the ITC rather than a district court in the first place may be in order to earn a kind of quasi-injunctive relief that it could not obtain from a federal district court. Given that a significant percentage of devices or their components employing standards essential patents are produced abroad for United States markets, a ITC exclusion order can be an effective end run around a FRAND commitment if the ITC issues an exclusion order because of infringement of a FRAND-encumbered patent.

Once again, the reasonable approach for the ITC in such a case is to deny an exclusion order. Significantly, this does not deny the patent holder a remedy. Rather, it relegates the patentee to a federal district court, which can then decide the injunction or damages question in light of the FRAND commitment, *eBay*, and any other relevant factors. Exclusion orders should be limited to situations representing a manifest unwillingness to pay a FRAND obligation. The Federal Trade Commission has taken that position in an ITC filing. As the Commission observed

> The possibility of patent hold-up derives from changes in the relative costs of once competing technologies as a result of the standard setting process. Prior to adoption of a standard, alternative technologies compete to be included in the standard. SSO members often agree to license SEPs on RAND terms as a quid pro quo for the inclusion of their patents in a standard. Once a standard is adopted, implementers begin to make investments tied to the implementation of the standard. Because it may not be feasible to deviate from the standard unless all or most other participants in the industry agree to do so in compatible ways, and because all of these participants may face substantial switching costs in abandoning initial designs and substituting a different technology, an entire industry may become locked in to a standard, giving a SEP owner the ability to demand and obtain royalty payments based not on the true market value of its patents, but on the costs and delays of switching away from the standardized technology.[11]

Nevertheless, the ITC has indicated that it will not refrain from granting an exclusion order simply because the patents upon which the request is based are FRAND encumbered.[12]

[11] *See in re* Certain Gaming and Entertainment Consoles, Related Software, and Components Thereof, Third Party United States Federal Trade Commission's Statement on the Public Interest, Inv. No. 337-TA-752 (USITC, June 6, 2012), *available at* http://www.ftc.gov/os/2012/06/1206ftcgamingconsole.pdf.

[12] *See In re Certain Gaming and Entertainment Consoles, Related to Software, and*

5. *FRAND commitments and non-practicing entities.* A non-practicing entity, or NPE, is a firm that does not make patent-protected goods itself but earns its revenue by licensing to others or bringing infringement actions. The classical image of the NPE is the firm that developed its own patents internally in its own laboratory or other facility, but then licensed them rather than producing goods that employ them. A more recent phenomenon is the firm that acquires patents from others, often in large numbers, and then re-licenses them or brings infringement actions. One of the most important consequences of *eBay* was for NPEs. Because a nonproducing firm can profit from patents only by licensing them it is very difficult for the NPE to show that damages are an inadequate remedy, as *eBay* requires. As a result, since *eBay* most NPEs have been limited to damages. [13]

NPEs have the potential to destabilize the entire standard setting process because they have a different set of incentives from participating members. Whether they agree to FRAND terms depends on the circumstances. First, at the standards adoption, or "bidding" stage the NPE certainly has an incentive to induce the SSO to adopt its own technology as the standard. Returning to the previous example, if the SSO is selecting among patented standards Alpha, Beta, and Gamma, it will presumably apply the same criteria even though Alpha might not be a producer of any good covered by the standard, but merely a patent holder. In order to attain SEP status, Alpha must make the same FRAND commitment as anyone else. On the other side, however, the NPE does not have to worry about infringing the standard once it is adopted, because it does not make anything. As a result it may decide to avoid the standard setting process altogether, hoping to be in a position to bring an infringement action after the standard is deployed. Its incentive to do this may be stronger if it believes it can conceal its own technology from the SSO – for example, if it has a pending but undisclosed patent application covering one or more of the standards, or if its patents are so numerous and ambiguous that the SSO might overlook one or more of them. In general, the more relevant patents the NPE owns and the more costly it is to interpret them, the greater will be its incentive to avoid making any FRAND commitment and stake its royalty claims later.

The lack of FRAND commitments is only part of the story for the NPE, however. Because the NPE is not a potential infringer itself, it faces an entirely different risk profile from producing entities. When the NPE is enforcing FRAND

Components Thereof, Initial Determination, Inv. No. 337-TA-752, 2012 WL 1704137 at *163 (USITC, Apr. 23, 2012).

[13] *See* Chien & Lemley, Patent Holdup, *supra*; CHRISTINA BOHANNAN & HERBERT HOVENKAMP, CREATION WITHOUT RESTRAINT: PROMOTING LIBERTY AND RIVALRY IN INNOVATION 79 (2012).

encumbered patents there is no less reason for enforcing the FRAND commitment than when the enforcer is a practicing entity.

The bigger problem involving NPEs is those who have never agreed to FRAND commitments and who threaten infringement actions or request licensing only after the technologies claimed to infringe have been put into place. Even though its NPE status is likely to deny it an injunction, it will be in a position to obtain larger damages because it has not made the FRAND commitment. This problem is hardly confined to the context of standard setting. However, it has become particularly serious in networked communications technologies because of the very large numbers of poorly defined patents.

Here, defects in the patent system (whether inherent or not) account for a great deal of the extra leverage that NPEs enjoy. Perhaps the most significant problem is that patent law provides no protection for the independent developer, as copyright law does. You can infringe a patent even if you have developed the relevant technology entirely on your own. Compound this fact with the extraordinarily high cost of interpreting a patent and the large number of patents at issue, and one soon suspects that the principal thing that patents are contributing to these technologies are transactions costs. The NPE or patent aggregator who owns several thousand patents can go to a producer and claim infringement of various unspecified patents in its portfolio and then ask for a license fee that is much smaller than the cost of ascertaining whether any of the patents cover the producer's technology, leaving aside questions of patent validity.[14]

This is much less likely to occur when both of the parties in question have substantial patent portfolios and each is a producer. In that case each one of them is in a position to make the same offer to the other and we often see a phenomenon called "tacit pooling," in which the equilibrium position is for each firm not to bring suit against the other.[15] This explains why many producers or their representatives have attempted to acquire large portfolios for defensive purposes. This phenomenon differs from traditional tacit collusion in that it operates pairwise rather than across the entire industry; that is, each firm will

[14] *See, e.g.*, *Apple, Inc. v. Motorola Mobility*, 2011 WL 7324582 (W.D. Wis. June 7, 2011) (Motorola could have violated §2 by threatening an infringement action on unidentified "essential" patents, which would be identified only after certain standards were adopted). See also Eon-Net LP v. Flagstar Bancorp., 653 F.3d 1314 (Fed. Cir. 2011), *cert. denied*, 132 S. Ct. 2391 (2012) (finding litigation misconduct in filing of baseless patent claims where cost of obtaining legal opinions on patent validity and infringement greatly exceeded the demand license fee).

[15] *See* Erik Hovenkamp, *Tacit Pooling* (2012) (unpublished manuscript on file with author).

decide whether or not to sue the other depending on the size and scope of the other's portfolio. In some cases the best strategy will be to file an infringement suit, particularly if the patent portfolios are uneven in strength, but in others the most profitable strategy will be not to sue.[16]

Tacit pooling is a socially desirable phenomenon in that it permits the firms in question to rely on production of goods rather than litigation for their revenue. Patent aggregators are fashionable today because they are in a stronger position to monetize patents than individual owners. But one must then question the source. Conceivably an aggregation of patents can provide turnkey licensing that eliminates double marginalization problems and provides a manufacturer with all of its technology needs for a certain product. Often, however, the source of additional revenue is nothing more than the increased transaction costs that can be threatened against producers who would rather pay the license fee even though they may not actually be using any of the technology held by the aggregator's valid patents.

One approach is to require that a firm that is in a position to earn supracompetitive returns from a patent be relegated to a nonexclusive license for all patents obtained from outsiders.[17] That is to say, the firm engaged in internal patenting, a presumptively innovative act, is in a much stronger position than the firm that acquires its patents from another. To be sure, a producing dominant firm needs someone else's patent in order to keep its own technology up to date. It has a legitimate interest in acquiring patents to the extent it intends to practice them. But a nonexclusive license will serve that purpose just as well as an exclusive license or assignment.

Why does a patent become more valuable in the hands of an acquirer from its original owner? One possibility is that a monopoly producer will earn more from it than a competitive producer could, but that rationale applies only to the firm that actually practices the patent. Another possibility is that uniting ownership of complementary patents may reduce double marginalization problems. Generally, when two or more firms with market power each licenses its own technology separately the sum of their individual prices will be higher than if one firm owned everyone's technology and licensed it together. This union benefits both licensors and licensees and thus might explain some instances of aggregation by non-practicing entities, although I am unaware of a specific example.[18] But even here the aggregator needs only a nonexclusive

[16] Ibid.

[17] See 3 ANTITRUST LAW ¶707b-g; and BOHANNAN & HOVENKAMP, CREATION WITHOUT RESTRAINT, *supra,* 293-295.

[18] On double marginalization, see ERIK HOVENKAMP & HERBERT HOVENKAMP, *Tying*

license plus the right to sublicense. That is, by uniting two complementary patents into a common licensing agency and permitting them to sublicense the agent will be able to offer a lower price for the two together than others can offer for each patent separately.

In any event, the NPE who knew or reasonably should have known about a standard setting procedure and voluntarily declined to participate should be held to the same remedy as actual participants – namely, FRAND damages. The Patent Act's standard for damages in this context is a "reasonable" royalty, and here the policy preference should be strong for competitively determined royalty rates rather than those based on ex post possibilities for holdup.

5. In Interdigital Communic., LLC v. ITC, ___ F.3d ___ (Fed. Cir. Jan. 10, 2013) (en banc), the Federal Circuit held that a patentee could obtain an exclusion order from the ITC even though it was not practicing the patent itself within the United States. While the ITC provisions in question required a domestic injury, the majority concluded that the business of licensing, rather than producing, met the injury requirement. Judge Newman wrote a lengthy dissent.

NOTE: REFUSAL TO LICENSE AND RELATED PRACTICES INVOLVING STANDARDS-ESSENTIAL PATENTS

One almost omnipresent component in information technologies is standard setting, driven by the need for compatibility across networks that contain numerous participants. Notwithstanding some competitive risks, collaborative standard setting is presumptively a good thing, particularly when one considers the alternative. The monolithic controller of a network, such as AT&T prior to its 1982 breakup,[19] may have little need for standards to the extent that it makes every product and controls every transaction that occurs on the network. In more dominated networks, such as Microsoft's Windows system, standards are essential but many may be imposed from the top down, as when Microsoft instructs independent software developers in the protocols necessary to achieve compatibility. As networks become more competitive, however, more collaborative standard setting is necessary. Today virtually every interactive technology incorporated into a cellular phone, computer, digital camera or similar devices is governed by a standard.

Arrangements, in OXFORD HANDBOOK OF INTERNATIONAL COMPETITION LAW (2012), currently *available at* http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=23858.

[19] United States v. AT&T, 552 F. Supp. 131, 136 (D.D.C. 1982), *aff'd mem. sub nom.*, Maryland v. United States, 460 U.S. 1001 (1983).

Participation in a standard-setting organization (SSO) is usually voluntary, but access to existing standards is often essential if a producer wishes to supply its product or service "on the network." For example, cellular phones must be able to connect into the wireless system and in some cases the internet. Memory devices for computers or video cameras must be compatible if the hardware itself is to be transportable, or if the files or images they read or create are to be shared. In some cases the standard that an SSO adopts is already in the public domain, perhaps because the relevant patents have expired, have been dedicated to the public by their users, or are part of an open source arrangement. In other cases the SSO may believe that the standard it is adopting is in the public domain, but may find out only later that the standard actually infringes someone's patent. This may happen inadvertently, or it may happen if a patentee intentionally withheld information about its technology.[20]

Intentional withholding can also take different forms. First it may occur because a patentee takes advantage of the "gap" between patents, which become public upon issuance, and patent applications, which have priority over later developed technology but are not published for the first eighteen months after the filing date. 35 U.S.C. § 122(b)(1). This problem in turn can be magnified by the patent "continuation" process, by which patent claims can be added or broadened as long as a patent is pending and even after issuance in some cases.[21] A firm actively participating in an SSO might be surreptitiously modifying its patent claims so as to cover a standard that the SSO is in the process of developing. It may then lie in wait until other members have made a significant investment in the standardized technology, announcing its patents at a time when it can extract the largest possible royalty. Finally, intentional withholding may occur because patents are ambiguous and costly to interpret; so a patent owner might simply wait until after the standard has been deployed to announce its belief that its patent has been infringed.

As a result it is critically important from the onset that an SSO insist that its members make a commitment about their own patents as a condition of their participation. The standard setting process is typically not run by lawyers but rather by engineers, product managers, or other people whose technical training is in some area other than law. As a result, the process has sometimes reflected

[20]See 3 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law ¶712 (3d ed. 2007); *and Rambus Inc. v. FTC,* 522 F.3d 456 (D.C. Cir. 2008), *cert. denied*, 555 U.S. 1171 (2009).

[21] Mark A. Lemley & Kimberly A. Moore, *Ending Abuse of Patent Continuations*, 84 B.U. L. Rev. 63, 70 (2004); Michael J. Meurer & Craig Allen Nard, *Invention, Refinement and Patent Claim Scope: A New Perspective on the Doctrine of Equivalents*, 93 Geo. L.J. 1947, 1993 (2005).

considerable naiveté about the strategic possibilities that can arise. This was true, for example, in the *Rambus* case, where JEDEC, the standard setting organization, did not do an adequate job of making such precommitments clear.

At the time such precommitments are called for the participants are typically acting under a great deal of uncertainty about the value of their respective technologies.[22] Alternatively, if they have no technologies to offer themselves, they will not be clear about how much they will be expected to pay. For example, an SSO may begin considering technologies for a particular feature that limits undesirable noise in audio transmissions. The choices may be patented technologies Alpha, Beta, and Gamma, and also technology Delta, whose patent has expired. Delta may not be quite as good as the patented alternatives, but it is free. Until the owners of patented technologies Alpha, Beta and Gamma have made commitments they are all likely to have positive but uncertain costs. To the extent that any questions persist about the validity or scope of Alpha's, Beta's, or Gamma's patents there may be additional uncertainty.

This is where the FRAND royalty comes in. FRAND refers to a firm's commitment to make its technology available at a "fair, reasonable and nondiscriminatory royalty" if it is adopted as the standard.[23] That is, the FRAND commitment is a form of bidding. Typically the FRAND commitment is not a promise to charge any particular price, but only a price that meets the FRAND expectations. For example, the Ninth Circuit quoted this typical FRAND provision:

> The Patent Holder will grant a license to an unrestricted number of applicants on a worldwide, non-discriminatory basis and on reasonable terms and conditions to use the patented material necessary in order to manufacture, use, and/or sell implementations of the above … Standard.[24]

[22] *See* Doug Lichtman, *Understanding the RAND Commitment*, 47 Hous. L. Rev. 1023, 1039–43 (2010); Joseph Scott Miller, *Standard Setting, Patents and Access Lock-In: RAND Licensing and the Theory of the Firm*, 40 Ind. L. Rev. 351, 358 (2007); Daniel G. Swanson & William J. Baumol, *Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power*, 73 Antitrust L.J. 1, 7–11 (2005); Mark A. Lemley, *Intellectual Property Rights and Standard–Setting Organizations*, 90 Cal. L. Rev. 1889 (2002).

[23] The United States literature often speaks of "RAND" royalties, thus explicitly requiring that the royalty be "reasonable" but not necessarily that it be "fair." Today the two terms are generally used interchangeably.

[24] Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 876 (9th Cir. 2012).

This commitment permits the members of the SSO to focus on technical issues and worry about the price later. Of course, if the commitment meant nothing at all, then the concept of FRAND would largely lose its value. Nevertheless, computing FRAND royalties in the first instance after the FRAND commitment has been made is not easy. It may become much easier, however, after the FRAND-encumbered patent has been licensed to others, thus creating a "yardstick" for measuring future royalties. The non-discrimination provision creates at least a strong presumption that the terms given to a first licensee will also apply to subsequent licensees.

FRAND obligations tend to "level" the value of patents in the sense that they apply a uniform royalty measure to patents that are declared essential. Of course, patentees can be expected to claim that their particular patent is unusually valuable because of the features that it covers. Patents have market value, however, not intrinsic value. Their value depends on the cost of the next-best alternative. A patent may cover sixteen different "essential" things in a device, but if one or a set of alternative patents or public domain technologies can do these things as well the value of the patent must be measured against these alternatives. For example, clean drinking water is "essential," but if six different technologies are available to filter water effectively, then the value of any particular patent is the price it would claim in a market in which the six technologies bid against each other.

Of course, once a patent is declared by an SSO to be standards essential and incorporated into technology, the bidding is over. If we ignore the FRAND commitment, the patent's value is largely determined by the costs of extraction from that particular technological element, not from anything inherent in the patent itself. As a result, a patent declared to be essential can acquire significantly more market power than it had previously. Further, firms know all of this in advance, so if they wish to assert later that a particular patent within their standards-adaptable portfolio is unusually valuable, they can always say so and leave the SSO to decide whether or not to adopt it.

"FRAND" typically refers to a rather nonspecific agreement among participants to bargain about technology first, while deferring questions about specific royalties to later. The Patent Act itself specifies that a patentee in an infringement action is entitled to damages that are not less than a "reasonable" royalty,[25] but identification of a reasonable royalty in infringement cases has become an extremely costly and often indeterminate process. Further, royalties developed as damages in a patent infringement action may differ in important respects from royalties negotiated at arms' length in a market. To the extent

[25]35 U.S.C. § 284 ("…damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention….").

that a FRAND commitment is contractual damages should reflect the arms length bargaining setting rather than the litigation setting.

In the FRAND context, the term "nondiscriminatory" means an absence of third degree price discrimination, which occurs when a seller charges two or more different prices to two or more distinctively identified groups of customers. The term certainly does not refer to a promise not to engage in second degree price discrimination, which refers to such things as quantity based pricing. For example, a patentee that charges a royalty of five cents per unit discriminates between the licensee who sells 100 units and the one who sells 1000, because its costs of licensing are the same for both. But such discrimination is inherent in the per unit, per dollar, or other "per click" licensing terms that are common in patent licensing, including FRAND licensing.

The important questions that a FRAND commitment typically leaves open is the base upon which the royalty rate must be computed and the royalty rate. As to the base, a memory chip in a GPS device may be covered by 10 patents, one of which is subject to a FRAND commitment. Should the royalty percentage (whatever it may be) be computed on the chip, the GPS device that contains the chip, or the automobile that contains the GPS device?[26] In general, the royalty must reflect a base that identifies the functionality to which that particular patent is tied.[27] Second, it must include a realistic apportionment of the overall number of patents included in a device. For example, someone who claims that an accused device infringes 10 of its patents and seeks a 3% royalty, but who later establishes infringement of only one patent, should not be heard to say that this one patent deserves the entire 3% royalty.[28] Presumptively, it deserves one tenth of that amount.

The federal courts have increasingly rejected an "entire value" method that identifies the "gross" product as the base for measuring royalties. Instead, they are moving toward a "smallest salable patent practicing unit" measure in ordinary patent infringement actions where damages are based on per unit royalties. As the Federal Circuit recently observed,

[26] *See* Eingestellt von Florian Mueller um, *Newly-Discovered Apple Letter to Wireless Standards Body Proposed Solution to Rampant FRAND Abuse*, FOSS PATENTS (Feb. 8, 2012, 11:41 AM), http://www.fosspatents.com/2012/02/newly-discovered-apple-letter-to.html (visited Sep 26, 2012). *See also* Ove Granstrand & Marcus Holgersson, *The 25% Rule Revisited and a New Investment-Based Method for Determining FRAND Licensing Royalties*, 47 les Nouvelles, No. 3 (2012).

[27] *See, e.g.*, *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292 (Fed. Cir. 2011); *IP Innovation L.L.C. v. Red Hat, Inc.*, 705 F. Supp. 2d 687 (E.D. Tex. 2010).

[28] *Apple, Inc. v. Motorola, Inc.*, 869 F. Supp. 2d 901, 913 (N.D. Ill. 2012).

> damages must be awarded "for the use made of the invention by the infringer." [Citing 35 U.S.C. §284] Where small elements of multi-component products are accused of infringement, calculating a royalty on the entire product carries a considerable risk that the patentee will be improperly compensated for non-infringing components of that product. Thus, it is generally required that royalties be based not on the entire product, but instead on the "smallest salable patent-practicing unit."[29]

The court took the same approach in *Lucent Technologies*, when it rejected an expert report concerning a relatively minor patent for entering information into fields on a computer with a touchscreen without using the physical keyboard, but which based royalties on the value of the entire computer in which the accused method was employed.[30] The court held that a patentee could base damages on the value of the entire product only by showing that "the patent-related feature is the 'basis for customer demand" of the entire good.[31] It relied on nineteenth century decisions holding that when a patent is on an improvement rather than the original machine, damages based on reasonable royalties must be confined to the value of the improvement.[32]

The "basis for customer demand" language is not particularly helpful. A computer may have patents on memory chips, processor chips, storage devices, controllers, all of which are essential to the functioning of the computer. In addition, each of these things forms a "basis for consumer demand" to the extent that consumers do not want to purchase a computer that lacks any one of them. The value of any "essential" component effectively becomes the value of the entire device to the extent that the device is worthless without it. But ten essential components cannot each claim to represent the value of the entire device.

In any event, the size of the base is largely irrelevant if one can freely inflate the royalty rate. The *Lucent* decision addressed an attempt to do that. Forbidden from estimating a reasonable royalty at 1% of the entire computer, the expert revised his opinion to base royalties only on Microsoft *Outlook*, a

[29] *LaserDynamics, Inc. v. Quanta Computer, Inc.,* 694 F.3d 51, 67 (Fed. Cir. 2012), quoting *Cornell Univ. v. Hewlett-Packard Co.,* 609 F.Supp.2d 279, 287-288 (N.D.N.Y. 2009).

[30] *Lucent Technologies, Inc. v. Gateway, Inc.*, 580 F.3d 1301 (Fed.Cir. 2009). The method consisted in using a keyboard displayed on the screen together with a calculator, and touching the screen directly. The patentee did not claim to invent the touchscreen itself.

[31] Id. at 1336.

[32] Garretson v. Clark, 111 U.S. 120 (1884); Seymour v. McCormick, 57 U.S. (16 How.) 480, 491 (1853).

portion of Microsoft's *Office* software thought to be the smallest saleable unit upon which royalties could be based, but then he raised the royalty rate to 8%.[33]

While the use of the smallest saleable unit as a base for estimating royalties is not free from problems, it does have the value that it provides a more-or-less common and objectively measurable currency for assessing the size of the royalty base. At that point the market itself will hopefully provide yardsticks for computing the size of the royalty, using negotiated royalties rather than damage awards as the yardstick. That is, damages measurement in an infringement case involving a FRAND-encumbered patent should be different from damages in patent cases generally.

Using negotiated royalties rather than damages awards based upon a reasonable royalty standard is justified by an important difference in how royalties are computed in arms length as opposed to litigation settings. In the standard-setting process, proffered technology is probabilistic in the dual sense that (1) the patents being offered have typically not been litigated in order to establish validity or scope; and (2) the SSO typically has alternative technologies to choose from in selecting a standard. By contrast, in the litigation context the infringement defendant has already "selected" the standard by virtue of its infringement, and the patent has already been determined or acknowledged to be valid. When we are dealing with *ex ante* FRAND commitments rather than *ex post* infringement, it is the *ex ante* value that should be accorded the weight.[34] For example, in a breach of contract action in which the plaintiff contractor had bid on the job in a competitive market, it would not be proper to look at the price charged in a monopoly transaction to determine damages.

In spite of their many ambiguities, open ended FRAND commitments are a valuable and competitive tool, given the uncertainty that exists at the time the commitments must be made. Standard setting would be a much more costly and indeterminate process without them. FRAND royalties should generally be low and manageable by default, because SSO participants can always "bid" for a higher royalty *ex ante*, and then the SSO can decide which technology to accept on the basis of the proffered price.

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[33] *Lucent*, 580 F.3d at 1301, 1338 ("Being precluded from using the computer as the royalty base, he used the price of the software, but inflated the royalty rate accordingly.").

[34] Cf. Judge Posner's conclusion the the FRAND royalty analysis should start out "with what the cost to the licensee would have been of obtaining, just before the patented invention was declared essential to compliance with the industry standard, a license for the function performed by the patent." Apple, Inc. v. Motorola, Inc., 869 F. Supp. 2d 901, at 913-914.

The non-practicing entity (NPE) that declines to participate in the SSO process should generally be held to the same price as the measure of its damages. That is so say, a "reasonable" royalty is the royalty that the NPE would have obtained in the competitive market in which it might have participated but declined to do so. The case for measuring NPE damages in this way is strongest when the NPE had actual knowledge of the SSO process but declined to participate, or when an objectively reasonable NPE would have known about the process. The case is weakest when the SSO's processes were not well communicated to outsiders or the NPE in question was not permitted to participate.[35]

The FRAND process permits SSOs to select a standard based upon performance characteristics on the assumption that all of the standards will be reasonably priced, without worrying too much about exactly what that price will be. Once the standard is adopted, however, the patents that write on that standard become "essential" to the extent that the standard is a necessary component of the network. The change in the financial positions of those offering the alternative technologies can be dramatic. To return to the previous hypothetical, prior to standard adoption patents Alpha, Beta, and Gamma competed to be selected as the standard. If Alpha's technology is adopted the result will be an immediate and very substantial increase in Alpha's value because it is now a "standards essential patent" (SEP). By contrast, Beta and Gamma were not adopted. In an extreme case those patents might become worthless. This would be true, for example, if the technologies that those patents cover has no market other than inclusion as the standard for this particular SSO.[36] Further, as time goes on the manufacturers participating in this standard will invest in production facilities and begin producing under the standard, typically making a switch very costly.

Alpha's position, of course, is that its patent has become immensely valuable, but might be even more valuable if it could be freed from its FRAND commitment. Alpha is a little like the contractor who submits a winning low bid but later realizes that the seller might have been willing to pay more. Alpha can thus be expected to do what it lawfully can in order to increase the value of its patent which has now become standards essential. First, it might use the negotiation process to try to maximize royalties by getting a high royalty rate or a larger base for computing royalties. Second, it might seek to evade the consequences of its FRAND obligation altogether.

[35] See ¶712.

[36] *See, e.g. Golden Bridge Tech., Inc. v. Motorola, Inc.,* 547 F.3d 266 (5th Cir. 2008) (rejecting antitrust boycott claim by plaintiff whose technology was not accepted as a standard for wireless communication technologies).

Solving problems of patent competition often requires a combination of Hovenkamp, Herbertantitrust and nonantitrust solutions. For example, *eBay* is not an antitrust case at all, but an equity decision concerned with private remedies generally. The Ninth Circuit's decision denying an injunction on FRAND-encumbered patents is similar.[37] If the FRAND commitment exists at all, it is typically enforced under principles of contract law,[38] or in some cases equitable estoppel, another equity doctrine that requires firms to make good on promises once others have acted in reliance.[39] By contrast, anticompetitive patent transfers clearly fall within the heart of traditional antitrust concerns.

[37] *Microsoft Corp. v. Motorola, Inc.*, 696 F.3d 872 (9th Cir. 2012).
[38] See *Apple, Inc. v. Motorola Mobility, Inc.*, 2012 WL 3289835 (W.D. Wis. Aug. 10, 2012) (patentee's FRAND commitments were a contract for state law purposes).
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[39] E.g., *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297, 314 (3d Cir. 2007).