

THE PATENT MISUSE DOCTRINE: A BALANCE OF PATENT RIGHTS AND THE PUBLIC INTEREST

The progress of private free enterprise is dependent upon the promotion of technological development and the protection of free competitive markets. Recognizing the importance of these factors and realizing the necessity of their continued existence, the federal government has acted to secure these objectives. To promote technology, the Constitution embodies a theory rewarding inventive genius "by securing for limited Times to . . . Inventors the exclusive Right to their . . . Discoveries."¹ Federal patent statutes have been in effect continuously since 1790.² The continued existence of free competition in open markets has been promoted through the enactment of various antitrust statutes such as the Sherman Act of 1890,³ the Clayton Act,⁴ and the Federal Trade Commission Act⁵ which form the core of present antitrust policy. They prohibit monopolies, monopolization, combinations in restraint of trade, unfair competition, price fixing and other economic abuses designed to restrain trade and suppress competition.

Without constitutional protection, the patent holder's exclusive right to his invention would violate the principle of free competition underlying the antitrust laws. Even with that protection, however, the patentee's conduct has not been allowed to go unchecked, for his patent rights are limited.

Historically, the doctrine of "patent misuse" has been applied to keep the use of the patent within the limits set by the original grant and thus avoid any clash with the antitrust laws. Originally, the doctrine was grounded on a violation of patent policy itself.⁶ Recently, however, certain anticompetitive licensing practices have prompted the Supreme Court to utilize the broader standards of antitrust in applying the doctrine of patent misuse. It has been maintained that such an approach contravenes the basic policy behind the patent grant⁷ and foreshadows a permanent subordination of that policy to the antitrust standards of restraining trade and lessening competition. This comment questions the validity of that observation in light of both the recent decision of *Zenith Radio Corp. v. Hazeltine Research, Inc.*⁸ and the earlier patent-antitrust cases. *Zenith* resolves the basic question whether every finding of patent misuse is a per se violation of the antitrust laws or whether the patent misuse doctrine maintains its

¹ U.S. Const. art. I, § 8.

² As codified in 1952, the patent statutes appear in 35 U.S.C. §§ 1-295 (1964).

³ 15 U.S.C. § 1 et seq. (1964).

⁴ 15 U.S.C. § 13 et seq. (1964).

⁵ 15 U.S.C. § 41 et seq. (1964).

⁶ *Morton Salt Co. v. G. S. Suppiger Co.*, 314 U.S. 488, 491-92 (1942). See also Nicoson, *Misuse of the Misuse Doctrine In Infringement Suits*, 9 U.C.L.A. L. Rev. 76 (1962).

⁷ See Nicoson, *supra* note 6.

⁸ 395 U.S. 100 (1969).

independent status as a check on the patentee's conduct apart from the application of antitrust principles. By upholding the independent status of the patent misuse doctrine *Zenith* achieves the necessary balance between the patentee's legitimate rights under the patent grant and the public interest in safeguarding competitive market opportunities.

I. *Zenith Radio Corp. v. Hazeltine Research, Inc.*⁹

Zenith Radio Corporation (Zenith) had been actively engaged in the acquisition of licenses to use patented devices in the manufacture of its radio and television sets. Many of these patent licenses had been acquired from Hazeltine Research, Inc. (HRI) whose sole business is the ownership and licensing of domestic patents principally in the radio and television industry. HRI is a wholly owned subsidiary of Hazeltine Corporation, a larger and more diversified company.

After Zenith's rejection of HRI's offer to renew a patent license, the latter brought suit against Zenith claiming that Zenith's television sets infringed some of HRI's patents. Zenith answered by alleging the invalidity of the patents involved, non-infringement and patent misuse. More than three years later, Zenith filed a counterclaim seeking treble damages and injunctive relief. The counterclaim alleged violations of the Sherman Act by a misuse of the HRI patents and a conspiracy among HRI, Hazeltine Corporation and certain foreign patent pools. For the purpose of this comment, only the domestic patent misuse issue will be discussed.

HRI's patent licensing policy was to grant a so-called standard package license. This package included all HRI patents and provided that no infringement suit would be instituted during the five year term of the agreement. In addition, this standard package license provided for royalties computed on the basis of the licensee's entire production regardless of whether its products utilized any of HRI's patents.

Prior to the initiation of the infringement suit Zenith had the standard HRI patent package license. Toward the end of the last five-year licensing period, HRI requested that the license be renewed for another five-year period at the prevailing package rate of \$50,000 per year. Zenith declined this initial offer to renew, contending that it did not require a license under any of the patents in the package.

During the period beginning with Zenith's refusal to accept the initial offer and ending with the actual commencement of trial, HRI continuously asserted that Zenith was infringing some of HRI's patents and that the only alternative to Zenith's acceptance of one of several offers made during this period was costly infringement litigation. Two of these offers are of particular importance since they form the basis of the misuse issue.

The first offer provided that any one patent in the package would be licensed at 50 per cent of the royalty rate for the entire package con-

⁹ The following facts appear in *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 388 F.2d 25, 33-35 (7th Cir. 1967).

sisting of more than 500 patents and patent applications. Any two patents would be licensed at 80 per cent of the package rate and any three or more at 100 per cent of the package rate. It was provided that all licenses accepted under the above formula would be subject to the terms and conditions of the standard package form of license including the payment of royalties computed on the basis of all of Zenith's production regardless of whether any patent was employed or not.

The second offer proposed the licensing of nine color patents claimed to be infringed at an annual rate of \$435,000 or, the licensing of all color patents at an annual rate of \$500,000. As an alternative to the latter proposals, HRI again offered its standard package license covering all of its patents, both monochrome (black and white) as well as color, for a maximum annual royalty rate of \$150,000. Zenith rejected both the 50%-80%-100% offer and the \$435,000-\$500,000-\$150,000 offer.

The district court held that both offers constituted a misuse of HRI's patents because by insisting on those offers HRI was (1) attempting to coerce Zenith's acceptance of a five year package and (2) insisting on deriving royalties from unpatented products.¹⁰ Therefore, on the misuse issue, judgment was entered for Zenith and an injunction was issued enjoining HRI from further misuse.

On appeal, the Court of Appeals for the Seventh Circuit affirmed the treble damage award against HRI but modified the district court's injunction.¹¹ Specifically, with respect to the practice of package licensing, the court found that there was substantial evidence in the record to support a finding of misuse inherent in HRI's \$435,000-\$500,000-\$150,000 license offer because by that offer HRI was attempting to unlawfully coerce the acceptance of unwanted patents.¹² The court, however, reversed the lower court's holding that the 50 per cent for one, 80 per cent for two, 100 per cent for three license proposal was a misuse stating that such a formula was not unlawful economic coercion and thus not a patent misuse. The court based its holding on the fact that "[t]here were only three HRI patents in general use in 1959 and therefore the formula appears reasonable in light of commercial realities."¹³ Also, the court reversed the district court's finding

¹⁰ See *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 239 F. Supp. 51 (N.D. Ill. 1965). With respect to the package licensing issue, the court stated:

Plaintiff's offer to license its patents individually but at royalty rates far in excess of the package rate was never an alternative to its controlling policy to grant defendant a license only under all of its patents. . . . Although it may be said that the Hazeltine proposals on the surface were offers to treat of individual patents, the design was quite apparent—to force by unlawful coercion the acceptance of unwanted patents. This constituted an illegal extension of the patent monopolies. 239 F. Supp. at 77.

With respect to the royalty base provision, the court stated that: "a patentee has no right to demand or force the payment of royalties on unpatented products." 239 F. Supp. at 77.

¹¹ 388 F.2d 25 (7th Cir. 1967).

¹² *Id.* at 34.

¹³ *Id.*

that royalties based on a percentage of total sales constituted patent misuse.¹⁴

In view of the fact that the court of appeals affirmed the award of treble damages based on the package licensing practice and that HRI did not challenge that award, the Supreme Court addressed itself solely to the question of the legality of computing royalties on the basis of total sales regardless of the use of the patented item.¹⁵ Mr. Justice White, writing for the majority, held that "conditioning the grant of a patent license upon payment of royalties on products which do not use the teaching of the patent does amount to patent misuse."¹⁶ (Emphasis added.) The opinion turns on the word "conditioning," for the Court made it clear that if the parties for their mutual convenience decide to base their royalties on a percentage of the total sales regardless of use, no misuse exists.¹⁷ The Court recognized the legitimate right of a patentee to profit from his patent but pointed out that there are "established limits which the patentee must not exceed in employing the leverage of his patent to control or limit the operations of the licensee."¹⁸

The broad issue resolved by *Zenith* is whether every finding of patent misuse necessarily involves a violation of the antitrust laws. Prior to *Zenith* it was not firmly settled that a finding of patent misuse does not constitute a per se violation of the antitrust laws. The *Zenith* decision removes any lingering uncertainty on this question since the Court states that

if there was such a patent misuse, it does not necessarily follow that the misuse embodies the ingredients of a violation of either § 1 or § 2 of the Sherman Act, or that *Zenith* was threatened by a violation so as to entitle it to an injunction under § 16 of the Clayton Act.¹⁹

Before analyzing in detail the package licensing and royalty base issues presented by *Zenith*, it is necessary to examine the nature of the patent grant and the judicial evolution of the doctrine of patent misuse. Of particular importance are the issues of whether the patent and antitrust laws are in conflict, and whether the Court correctly decided that every patent misuse is not a per se violation of the antitrust laws.

¹⁴ Id. at 39.

¹⁵ 395 U.S. at 133.

¹⁶ Id. at 135.

¹⁷ The Court states:

The trial court's injunction does not purport to prevent the parties from serving their mutual convenience by basing royalties on the sale of all radios and television sets, irrespective of the use of HRI's inventions. The injunction reaches only situations where the patentee directly or indirectly "conditions" his license upon the payment of royalties on unpatented products. . . .

Id.

¹⁸ Id. at 136.

¹⁹ Id. at 140.

II. PATENT MISUSE: THE INTERRELATIONSHIP OF PATENT AND ANTITRUST POLICY

The owner of a patent is given the exclusive right to make, use and sell the patented invention for a period of seventeen years.²⁰ Viewed from this standpoint, the patent grant is a limited monopoly. The term "monopoly", however, must be used carefully in the antitrust and patent contexts because of its changing connotation. Practically speaking, a patent has a monopolistic aspect, namely, the right to exclude others and sell alone; conceptually, however, it is not the type of monopoly against which the antitrust laws are directed. In fact, the Supreme Court has said:

a patent is not, accurately speaking, a monopoly. . . . The term "monopoly" connotes the giving of an exclusive privilege for buying, selling, working or using a thing which the public freely enjoyed prior to the grant. Thus a monopoly takes something from the people. An inventor deprives the public of nothing which it enjoyed before his discovery, but gives something of value to the community by adding to the sum of human knowledge.²¹

Thus, the Court conceives of monopoly as exclusive control over a pre-existing public market. The patent grant, on the other hand, involves no such control because there is no pre-existing public market in the patented item, and the patentee thus creates rather than restricts commerce. In fact, innovation may be one of the best deterrents to monopoly since it tends to create new industry which may displace monopolistic control. A patent owner, however, as in the *Zenith* case, prior to the expiration of his statutory grant, can create a public market in the patented article by licensing others to make, use and sell the invention. By creating such a market, as opposed to exploiting the invention himself, the patentee's actions may then be subjected to the antitrust laws if those actions tend to restrain trade or lessen competition. Such antitrust involvement, however, results from licensing practices and not from the patent grant itself.

It has long been recognized that the patent grant is intended to promote technological development by providing an incentive and reward for the inventor. Thus, an inherent balance must be maintained between the public interest and the inventor's private reward. The Supreme Court, however, has stated:

Since . . . 1829 this court has consistently held that the *primary purpose* of our patent laws is not the creation of private fortunes for the owners of patents but is "to promote

²⁰ 35 U.S.C. § 154 (1964) provides in part:

Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the right to exclude others from making, using, or selling the invention throughout the United States,

²¹ *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 186 (1933).

the progress of science and useful arts." (Constitution, Art. I, § 8) . . .²² (Emphasis added.)

Thus, the public interest in maintaining a progressive economic system lies at the root of the patent system; reward to the inventor is a secondary means to that end. The exclusive rights granted to the patentee to make, use and sell the patented article are the price the public must pay to encourage and exploit his inventive genius.

The patent system, devoid of licensing abuses, accomplishes its intended purpose.²³ The President's Commission on the Patent System has stated:

Agreeing that the patent system has in the past performed well its Constitutional mandate "to promote the progress of . . . useful arts," the Commission asked itself: What is the basic worth of a patent system in the context of present day conditions? The members of the Commission unanimously agreed that a patent system today is capable of continuing to provide an incentive to research, development, and innovation. They have discovered no practical substitute for the unique service it renders.²⁴

The patent system undoubtedly encourages much research and development that would probably not be undertaken but for the profits derived from patent licenses. Also, to the extent the system promotes disclosure of inventions that would otherwise be kept secret, it speeds further developments by those who gain new and useful insights from what is disclosed and reduces the likelihood of wasteful duplicative research. The system also acts as a stimulus for the investment of risk capital in research. In many instances an investor may be reluctant to invest capital in research because of the uncertainty of the outcome of any research activity. However, by extending the prospect of an exclusive right to the anticipated end product, the patent system provides the investor with an additional incentive to invest.

²² *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 510-11 (1917). See also *Kendall v. Winsor*, 62 U.S. (21 How.) 322, 327-28 (1858) where the Court stated:

It is undeniably true, that the limited and temporary monopoly granted to inventors was never designed for their exclusive profit or advantage; the benefit to the public or community at large was another and doubtless the primary object in granting and securing that monopoly.

²³ Report of the President's Commission on the Patent System (1966) [hereinafter cited as *President's Commission Report*]. For an appraisal of the patent system's net contribution to economic welfare including its adverse effects, see Turner, *Patents, Antitrust And Innovation*, 12 *Antitrust Bull.* 277 (1967) where the author cites three adverse effects produced by the patent system. First, because of the patent monopoly, many new ideas are not as widely utilized or applied as they would be if freely available. Second, the patent system often forces competitors of the patent holders to invest resources in duplicating research to find other ways of obtaining the same or nearly the same result. Finally, the patent system tends to inhibit research in areas heavily hedged in by existing patents. In spite of these effects, it is concluded that, because of the lack of reliable information on the net impact of the patent system on our economy, the present system should be maintained.

²⁴ *President's Commission Report* at 2.

Because the subject matter of the licensing agreement and the manner in which it is obtained effect directly the maintenance of a competitive economy, the existence of licensing abuses has necessitated the application of antitrust principles to patent law. Although the patent misuse doctrine as originally developed was grounded solely on a violation of the patent laws, the existence of anticompetitive licensing practices has caused the courts to expand the doctrine to include antitrust standards where the patentee's conduct tends to restrain trade or lessen competition in a patented or unpatented item. Thus, a patent misuse may be grounded on a violation of the antitrust laws, or, the defense may be invoked where, absent any antitrust violation, the conduct of the patent owner violates the patent laws.

The first enunciation of the misuse doctrine came in *Morton Salt Co. v. G. S. Suppiger Co.*²⁵ where the patentee required, as a condition to his licensing of a patented salt tablet dispensing machine, that the licensee use only salt tablets manufactured by the patentee's subsidiary. The Court held that such a licensing practice constituted a patent misuse and denied the patentee infringement relief. It is unclear whether the Court based its decision on antitrust principles or on the general public policy behind the patent grant. The Court discussed both theories²⁶ but found it unnecessary to determine whether the patent owner had violated the Clayton Act since "in any event the maintenance of the present suit . . . [was] contrary to public policy. . . ."²⁷

This language, although not conclusive on the issue, indicates that the court impliedly recognized that a patent misuse may exist apart from any violation of the antitrust laws. Subsequent decisions, however, did not resolve the question whether every patent misuse necessarily involves an antitrust violation. For example, in the majority opinion in *Mercoird Corp. v. Minneapolis-Honeywell Regulator Co.*,²⁸ Mr. Justice Douglas combined patent misuse with antitrust violation, stating that "[t]he legality of any attempt to bring unpatented goods within the protection of the patent grant is measured by the anti-trust

²⁵ 314 U.S. 488 (1942).

²⁶ With respect to the patent policy considerations, the Court stated:

The grant to the inventor of the special privilege of a patent monopoly carries out a public policy adopted by the Constitution and laws of the United States. . . . But the public policy which includes inventions within the granted monopoly excludes from it all that is not embraced in the invention. It equally forbids the use of a patent to secure an exclusive right or limited monopoly not granted by the Patent Office and which it is contrary to public policy to grant.

Id. at 492.

With reference to antitrust policy, the Court further stated:

It thus appears that respondent is making use of its patent monopoly to restrain competition in the marketing of unpatented articles, salt tablets, for use with patented machines. . . .

Id. at 491.

²⁷ *Id.* at 494.

²⁸ 320 U.S. 680 (1944).

laws not by the patent law."²⁹ In a companion case, however, Mr. Justice Roberts considered patent misuse to be "a pure question of the extent of the right of exclusion conferred by the patent statute. It nowise involves the antitrust acts."³⁰

The fact that patent misuse can be found apart from any antitrust violation was clearly enunciated by Mr. Justice Douglas in *Transparent-Wrap Mach. Corp. v. Stokes & Smith Co.*³¹ where he stated that

[t]he requirement that a licensee under a patent use unpatented material or device [*sic*] with the patent might violate the antitrust laws but for the attempted protection of the patent. . . . The condemnation of the practice, however, does not depend on such a showing. Though control of the unpatented article or device falls short of a prohibited restraint of trade or monopoly, it will not be sanctioned.³²

This approach, although inconsistent with the language in the *Mercoird* case, seems to present the better view by acknowledging the important distinction that a patent misuse can be found in the absence of an antitrust violation. As noted, the same goal is envisioned by both the patent and antitrust laws, namely, the maintenance of a progressive economy. As this common objective is sought through different statutory mechanisms any attempt to combine and thereby confuse them would frustrate their ultimate end.³³ The Report of the Attorney General's Committee to Study the Antitrust Laws (Attorney General's Committee Report) supports the view that every misuse is not a per se violation of the antitrust laws.³⁴ In pointing out the necessity of preventing confusion in these two areas, the Attorney General's Committee Report stated that, while the same conduct may violate both antitrust and patent laws, "[f]rom some abuses of patent policy may flow consequences not drastic enough to meet antitrust prerequisites of effect on competition."³⁵ The *Zenith* case³⁶ is in accord with this conclusion.

²⁹ *Id.* at 684.

³⁰ *Mercoird Corp. v. Mid-Continent Co.*, 320 U.S. 661, 674 (1944).

³¹ 329 U.S. 637 (1947).

³² *Id.* at 641.

³³ Accord, Report of the Attorney General's National Committee to Study the Antitrust Laws (1955) [hereinafter cited as the Attorney General's Committee Report]. The Report states:

Holding every patent law transgression to be at the same time an antitrust violation would, moreover, put the patent owner on a different footing than owners of other property subject to antitrust. For antitrust has its own measure of permissive and wrongful conduct. To say that action beyond the borders of the patent grant is a per se antitrust violation is to ignore the Supreme Court's distinctions between the variant statutory standards of the Sherman, Federal Trade Commission and Clayton Acts. . . .

Id. at 254.

³⁴ *Id.*

³⁵ Attorney General's Committee Report at 254.

³⁶ See p. 49 *supra*.

Although it is now settled that patent misuse may be found in the absence of an antitrust violation, some patent misuse cases have been decided solely within the antitrust framework. In these cases courts have utilized the standards prohibiting restraint of trade and lessening of competition to determine the legality of the patentee's conduct. It has been maintained that the legitimate rights of the patent holder have been abrogated by the court's utilization of these antitrust principles.³⁷ An analysis of the cases prior to *Zenith* indicates that such a conclusion is unwarranted, for in each case the patentee's conduct violated the antitrust laws irrespective of his status as a patent holder. Furthermore, by violating the antitrust laws as a patent holder, he also violated the patent laws by extending his limited grant beyond its statutory limit.

*Morton Salt Co. v. G. S. Suppiger Co.*³⁸ involved a possible violation of such antitrust principles, specifically a tie-in, a license provision requiring the use of a profit making, unpatented article with the patented one. The Supreme Court declared such tying arrangements to be a patent misuse based on both a violation of the patent laws, since the patentee seeks to extend his limited grant beyond its intended statutory limit, and a violation of the antitrust laws, because the patent holder's practices tend to suppress competition and restrain trade in the tied article.³⁹ In 1952, Section 271 was introduced into the Patent Code.⁴⁰ Under this section,⁴¹ as subsequently interpreted,⁴² certain previously prohibited tie-in practices may not constitute patent misuse. However, the section's exemption clause specifically refers to misuse only. Consequently, because misuse is not equivalent to an antitrust violation, it appears that the section does not limit in any way the application of antitrust laws to tying arrangements.⁴³

A Subcommittee Report for the Committee on the Judiciary⁴⁴ (Subcommittee Report), which examined the antitrust problems presented by the exploitation of patents concluded that the Court has been correct in its treatment of tie-in arrangements and should continue to apply the same standards "because only then will the patent system

³⁷ See Nicoson, *supra* note 7.

³⁸ 314 U.S. 488 (1942).

³⁹ *Id.* at 494. See also *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947); *Mercoird Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680, 684 (1944); *Mercoird Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661, 667 (1944); *B.B. Chem. Co. v. Ellis*, 314 U.S. 495, 498 (1942).

⁴⁰ 35 U.S.C. § 271 (1964).

⁴¹ In general the section provides that certain tie-ins of components may be permissible provided the components constitute a material part of the invention, are especially adapted for use in the patented invention, and are not a staple article or commodity of commerce suitable for substantial non-infringing use.

⁴² *Calhoun v. State Chem. Mfg. Co.*, 153 F. Supp. 293 (N.D. Ohio 1957); *Sola Elec. Co. v. General Elec. Co.*, 146 F. Supp. 625 (N.D. Ill. 1956).

⁴³ For a detailed analysis of section 271, see 66 Harv. L. Rev. 909 (1953).

⁴⁴ Staff of Subcomm. No. 5, Comm. on the Judiciary, 84th Cong., 2d Sess., *Antitrust Problems in the Exploitation of Patents* (1951) [hereinafter cited as the Subcommittee Report].

THE PATENT MISUSE DOCTRINE

be preserved in its intended statutory sense."⁴⁵ The subcommittee based its conclusion on the fact that "[o]nce any patentee is permitted to tie in some other product with his lawful patent monopoly the constitutional system of securing to investors a *limited* monopoly for their inventions becomes a delusion."⁴⁶ (Emphasis added.) The Court's opinion in *Zenith* supports the Subcommittee Report's conclusion regarding the prohibition of tie-in practices. In fact, in discussing the "established limits" which a patentee must not exceed in exercising his patent rights, the Court cites the tie-in cases, stating that the patentee "may not condition the right to use his patent on the licensee's agreement to purchase, use, or sell . . . another article of commerce not within the scope of his patent monopoly."⁴⁷ Thus, the patentee who incorporates a tie-in provision in his licensing agreement may be guilty of patent misuse based on either a patent law or antitrust law violation, depending on the consequences which flow from his particular practices.

The confrontation between patent policy and antitrust principles exists also in the situation where the licensing agreement contains a price fixing provision. An early case⁴⁸ approved the actions of a patentee in setting the price at which his licensee could sell the patented product. This holding was sustained in the leading case of *United States v. General Elec. Co.*⁴⁹ where General Electric licensed Westinghouse to manufacture and sell patented lamps at prices fixed by General Electric and based on the latter's own sales. Stressing that profit was one of the valuable elements of a patentee's exclusive grant, the Court held that the price fixing provision was "normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly."⁵⁰

In *United States v. Line Material Co.*,⁵¹ the Supreme Court split four to four on whether the holding in *General Electric* should be overruled; therefore, the latter decision still stands. However, since the *Line Material* decision, courts have repeatedly restricted the use of price fixing provisions, making them illegal in all but a few situations. For example, prices may not be fixed on the basis of process patents,⁵² or patents which cover only a part of the product,⁵³ or on unpatented components of patented combinations.⁵⁴

The majority in the Attorney General's Committee Report supported the *General Electric* holding by stating that,

⁴⁵ Id. at 12.

⁴⁶ Id.

⁴⁷ 395 U.S. at 136.

⁴⁸ *Bement v. National Harrow Co.*, 186 U.S. 70 (1902).

⁴⁹ 272 U.S. 476 (1926).

⁵⁰ Id. at 490.

⁵¹ 333 U.S. 287 (1948).

⁵² *Cummer-Graham Co. v. Straight Side Basket Corp.*, 142 F.2d 646, 647-48 (5th Cir. 1944); *Barber-Colman Co. v. National Tool Co.*, 136 F.2d 339, 344 (6th Cir. 1943). A process patent is one which covers a new method utilized in an unpatented invention.

⁵³ *United States v. General Elec. Co.*, 80 F. Supp. 989 (S.D.N.Y. 1948).

⁵⁴ *United States v. United States Gypsum Co.*, 333 U.S. 364, 400-01 (1948).

*in the absence of horizontal agreement among licensees, or any plan aimed at or resulting in industry-wide price fixing, licenses with price fixing provisions fall within the orbit of the patent and need not run afoul of the antitrust laws.*⁵⁵ (Emphasis added.)

The minority expressed the opinion that price fixing arrangements were outside the scope of the patent grant and should be proscribed by the antitrust laws under any circumstances.⁵⁶ However, in the view of the committee, a patentee commits a misuse based on an antitrust violation only where the particular provision tends to restrain trade or suppress competition.

Thus, it has been shown that, with few exceptions, the so-called patent-antitrust cases involve attempts to use a patent for purposes for which it was not intended. In view of both the cases prior to *Zenith* and the determination that every misuse is not a per se violation of the antitrust laws, it seems clear that the Court's treatment of these cases

afford[s] ample means for preserving the rights of patent owners in the legitimate exploitation of their property, while at the same time correcting patent abuse and safeguarding competitive opportunity.⁵⁷

Since patent misuse may be found without a concurrent violation of the antitrust laws, it becomes important to resolve whether the standards utilized by the Court in *Zenith* to determine the legality of HRI's package licensing and royalty base practices continue to safeguard the patentee's rights under the patent grant.

III. PACKAGE LICENSING AND ROYALTY BASE: THE ZENITH STANDARD OF MISUSE

The Supreme Court in *Zenith*, in holding that patent misuse exists when a patent holder conditions the grant of a patent license upon payment of royalties based on a percentage of the total sales, regardless of whether the licensee uses the patent, distinguished *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*,⁵⁸ which upheld a license provision identical to the one in the *Zenith* case. In reversing the court of appeals, the Supreme Court stated that its decision was not contrary to the holding in *Automatic Radio* since that decision "is not authority for the proposition that patentees have *carte blanche* authority to condition the grant of patent licenses upon the payment of royalties on unpatented articles."⁵⁹ Analysis of the *Automatic Radio* decision confirms that conclusion.

In *Automatic Radio* the licensee was not obligated to use any of the patents but was required to pay royalties based on a percentage of

⁵⁵ Attorney General's Committee Report at 235.

⁵⁶ *Id.*

⁵⁷ Subcommittee Report at 25.

⁵⁸ 339 U.S. 827 (1950).

⁵⁹ 395 U.S. at 137.

total sales. The Court held that "it is not *per se* a misuse of patents to measure the consideration by a percentage of the licensee's sales."⁶⁰ In reaching that conclusion the Court distinguished between the privilege of use and actual use, stating that royalties could be exacted for the former as well as the latter, and that "[s]ound 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."⁶¹

The decision in *Automatic Radio*, therefore, supports the proposition that a royalty based on a percentage of total sales, absent other circumstances, is not illegal. In reaching its decision, the Court observed that the presence of coercion might have produced a different result.⁶² The facts in *Automatic Radio* and *Zenith* are essentially the same with the addition in *Zenith* of the fatal element of coercion. The *Zenith* opinion is not contrary to the holding in *Automatic Radio* but clarifies it by indicating that the latter applies only to the narrow situation where no coercion exists and the parties, bargaining as equals, freely agree that such a royalty base will serve the convenience of both.

In discussing the antitrust effect of the royalty base formula, the Court in *Automatic Radio* distinguished the cases involving tie-in arrangements by noting that such a base does not require the purchase of any goods nor does it restrict the licensee's right to manufacture or sell any other product not covered by the patent.⁶³ The plaintiff conceded that the tie-in cases were not directly on point, but urged that such a royalty provision is "identical in principle" with the tie-in cases and constitutes a misuse because it ties in a payment on unpatented goods.⁶⁴ Reliance was placed on the decision in *United States v. U.S. Gypsum Co.*⁶⁵ where the Court struck down a license provision which measured royalties by a percentage of the value of all gypsum products produced by the licensee, patented or unpatented. There it was held that such conduct constituted a conspiracy to restrict the production of unpatented goods in violation of the Sherman Act.⁶⁶ The Court in *Automatic Radio* distinguished the *Gypsum* case by noting that it was not the method of computing the royalties that was objectionable, but rather that method *plus* evidence of an understanding that only patented goods would be sold.

In enunciating the principle underlying the tie-in cases, the Court in *Automatic Radio* stated: "that which is condemned as against public

⁶⁰ 339 U.S. at 834.

⁶¹ *Id.*

⁶² The Court stated: "there is no conditioning of the license grant upon the acceptance of another and different license." *Id.* at 831. Although coercion was alleged in the district court, it was not pressed in either the court of appeals or the Supreme Court. In noting this point the Court stated "[i]n any event there is nothing available in the record to support the averment [of coercion] . . ." *Id.*

⁶³ *Id.*

⁶⁴ *Id.* at 832.

⁶⁵ 333 U.S. 364 (1948).

⁶⁶ *Id.*

policy by the 'Tie-in' cases is the extension of the monopoly of the patent to create *another* monopoly or restraint of competition. . . .⁶⁷ (Emphasis added.) Providing for a royalty based on a percentage of the licensee's total sales produces neither of these two effects.⁶⁸ Implicit in both the *Zenith* and the *Automatic Radio* holdings is the recognition that the patent owner, who has the right to market the use of his patent at a reasonable return, may achieve such a return utilizing a royalty based on total sales regardless of patent use.

Reasoning that the majority opinion overrules *Automatic Radio*, Mr. Justice Harlan, in his dissent in *Zenith*, stated that the presence or absence of coercion should not be the determinative factor since such a standard "is likely to prove exceedingly difficult to apply. . . ."⁶⁹ In addition, he observed that the Court failed to answer what he considered to be the major question at issue, namely, whether percentage-of-sales royalty provisions should be held to constitute patent misuse in all circumstances regardless of the presence or absence of coercion. Had the Court answered this question in the affirmative, it would have been unnecessary to determine the presence of coercion. The dissent also observed that a royalty based on total sales may have two undesirable consequences.⁷⁰ First, such a provision may reduce the licensee's incentive to "invent around" the patent or otherwise acquire a substitute which costs less, because the licensee realizes that, despite his efforts, he must pay the royalty regardless of use. This failure of the licensee to substitute cheaper "inputs" will cause the price of the product to be higher than would be the case had substitution occurred.⁷¹

Second, under certain conditions, a percentage-of-sales royalty may enable the patent owner to reap profits, above the norm for the industry or economy, which are not properly attributable to the licensee's use of the patent but, rather, to other factors which cause the licensee's situation to differ from one of "perfect competition." Such a situation cannot arise when royalties are based on actual use.⁷²

The *Zenith* decision provides a safeguard against these undesirable results while maintaining the *right* of the parties to bargain freely between themselves in arriving at what they consider to be a reasonable return. The coercion standard utilized by the Court will render illegal any attempt by the patent holder to force upon his licensee any provision which the licensee deems undesirable. This is implicit in the

⁶⁷ 339 U.S. at 832.

⁶⁸ Other courts have reached the same conclusion on similar grounds: *H-P-M Dev. Corp. v. Watson-Stillman Co.*, 71 F. Supp. 906, 912 (D.N.J. 1947); *American Optical Co. v. New Jersey Optical Co.*, 58 F. Supp. 601, 606 (D. Mass. 1944); *Ohio Citizens Trust Co. v. Airway Elec. Appliance Corp.*, 56 F. Supp. 1010, 1012 (N.D. Ohio 1944).

⁶⁹ 395 U.S. at 141.

⁷⁰ Justice Harlan referred to and adopted the reasoning of the following article: Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 *YALE L.J.* 267 (1966).

⁷¹ *Id.* at 299-301, 302-06.

⁷² *Id.* at 300-01, 302-06, 331-32.

Court's statement: "we also think patent misuse inheres in a patentee's insistence on a percentage-of-sales royalty, regardless of use, *and his rejection of licensee proposals to pay only for actual use.*"⁷³ (Emphasis added.) For example, should the licensee realize, after a complete assessment of the situation, that the patent holder's scheme for royalty payments fits the licensee's particular needs, the *Zenith* case would allow the agreement to stand. On the other hand, should the patentee's proposal not meet the licensee's particular needs or have results which the licensee considers undesirable, the *Zenith* holding will protect him. This flexibility would be lacking in Justice Harlan's approach.⁷⁴

Prior to the *Zenith* decision, the law as to package licensing was relatively clear; voluntary package licensing was not a misuse, whereas mandatory package licensing was. However, the exact meaning of the word "mandatory," or the degree of coercion necessary to make a package license mandatory, was not clear. The decision in *Zenith* helps to clarify this uncertainty.

Like the percentage-of-sales royalty base, package licensing is not per se illegal. In fact, such an arrangement may be desirable in that it "avoids troublesome questions of infringement, complex bookkeeping, the difficulty of determining which patents cover the present and future needs of the licensee, cost differences, and similar practical considerations."⁷⁵

However, the practice of package licensing can be misused, for example, by coercing a licensee to accept a license under one patent on condition of acceptance of a license under another patent, or the entire package. By utilizing the leverage of the desired patent in this manner, the patentee forces the licensee to accept unwanted patents. This practice was first condemned by the Supreme Court in *Ethyl Gasoline Corp. v. United States*⁷⁶ where the Court analogized it to the tie-in cases and said "[t]he patent monopoly of one invention may no more be enlarged for the exploitation of a monopoly of another [invention]"⁷⁷

Extending this reasoning to copyrights, the Court in *United States v. Paramount Pictures, Inc.*⁷⁸ held illegal a refusal to license one copyright unless another copyright was accepted. In reaching its decision, the Court relied on the opinion in the *Ethyl Gasoline* case. Although the holding in *Paramount* did not specifically refer to mandatory

⁷³ 395 U.S. at 139.

⁷⁴ The White House Task Force Report on Antitrust Policy concludes:

Our proposed remedy [that of requiring a licensor to license on equivalent terms to all qualified licensees] will not require that the courts or administrative agencies determine what are reasonable royalties; *royalties would continue to be bargained between patent owners and initial licensees.* (Emphasis added.)

BNA Antitrust & Trade Reg. Rep. 1, 11 (May 21, 1969).

⁷⁵ Attorney General's Committee Report at 239.

⁷⁶ 309 U.S. 436 (1940).

⁷⁷ Id. at 459.

⁷⁸ 334 U.S. 131, 157 (1948).

package licensing of patents, its rationale is applicable to the patent area because the decision was based on patent as well as copyright law.

Relying on the *Ethyl Gasoline, Paramount and Automatic Radio*⁷⁹ decisions, the Attorney General's Committee Report condemned the practice of mandatory package licensing. The Committee attempted to formulate guidelines as to when package licensing constitutes a misuse.

Package licensing should be prohibited *only where there is refusal, after a request*, to license less than a complete package. Additionally, the licensor should not be required to justify on any proportional basis the royalty rate for less than the complete package, so long as the rate set is not so disproportionate as to amount to a refusal to license less than the complete package.⁸⁰ (Emphasis added.)

Utilizing the standard set out by the Attorney General's Committee Report, the court in *American Securit Co. v. Shatterproof Glass Corp.*⁸¹ condemned the practice of mandatory package licensing. There the patentee offered the licensee a package license providing that the royalty be calculated according to the amount of the licensee's sales. Unlike *Zenith*, however, the licensee *requested* some but not all of the patents included in the package. The patent owner *refused* to license less than the entire package thus forcing the licensee to take unwanted patents. The court held that this practice constituted unlawful coercion and a misuse of the patent monopoly.⁸²

Contrary to the views expressed by Justice Harlan in his dissenting opinion in *Zenith*, judicial guidelines describing what constitutes coercion are emerging. The *Zenith* case represents a major step in determining these guidelines. For example, according to the *Securit* case and the Attorney General's Committee Report, a refusal after a request to license less than the whole package constitutes sufficient coercion to result in misuse. The case is not as clear, however, where the coercion is less direct, such as when the patentee agrees to a request to license individual patents but charges the same royalty for

⁷⁹ Although the Court in *Automatic Radio* considered only the royalty base issue and expressly left the question of mandatory package licensing undecided, dicta in the decision evidenced a hostile attitude toward the practice. The Court stated: "[t]hese cases have condemned schemes . . . conditioning the granting of a license under one patent upon the acceptance of another and different license." 339 U.S. at 830-31.

⁸⁰ Attorney General's Committee Report at 239-40. The Report also noted that, where a substantial group of patents are offered at a flat royalty rate, the deletion of one or several specified patents need not affect the rate. . . . Moreover, where several "per piece" licenses are requested and offered, the mere fact that the sum of the "per piece" license royalties exceeds the package royalty rate should not of itself be considered a condition that all or no patents be taken, again, so long as the "per piece" rate is not so disproportionate as to amount to a refusal to license less than the complete package.

⁸¹ *Id.* at 240.

⁸² 268 F.2d 769 (3d Cir. 1959), cert. denied, 361 U.S. 902 (1959). For a discussion of the case, see 73 Harv. L. Rev. 1628 (1960).

⁸³ 268 F.2d at 777.

the individual patents as he would have charged for the entire package, or when the royalty for the package is less than that charged for individual patents, such as HRI's \$435,000-\$500,000-\$150,000 offer. In these two situations the decision in *Zenith* provides some direction.

In the first situation, where the royalty for the individual patents is the same as that for the entire package, the Court of Appeals for the Seventh Circuit in *Apex Elec. Mfg. Co. v. Altorfer Bros. Co.*⁸³ noted that where there was no refusal to license less than all of three patents in the package, it was not a misuse for the patent holder to insist that exactly the same royalty be paid whether under one, two or three patents. The decision may be justified on the basis of the Attorney General's Committee standard that the licensor should not be required to justify on any proportional basis the royalty rate for less than the complete package "so long as the rate set is not so disproportionate as to amount to a refusal to license less than the complete package."⁸⁴

The Seventh Circuit in *Zenith* held that the 50%-80%-100% license proposal was not unlawful economic coercion and thus did not constitute a patent misuse. In reaching its decision the court relied on the *Apex* case and the fact that "[t]here were only three HRI patents in general use in 1959 and therefore the formula appears reasonable in light of commercial realities."⁸⁵ The court presumably determined that, under the circumstances, the "per piece" rate was not so disproportionate as to amount to a refusal to license less than the complete package.

With respect to HRI's \$435,000-\$500,000-\$150,000 license proposal, the court held that there was sufficient evidence to support a finding of unlawful coercion. The terms, simply stated, offered the "total" package at a substantially lower rate (\$150,000) than the two color patent packages (\$435,000 and \$500,000). These terms, together with the strong evidence introduced in the district court to the effect that HRI realized the misuse consequences of its license proposals,⁸⁶

⁸³ 238 F.2d 867 (1956).

⁸⁴ See note 82 supra.

⁸⁵ 388 F.2d at 34.

⁸⁶ See Brief for Petitioner at 108-109. The brief quotes the following memorandum prepared by Hazeltine's executive vice president and patent counsel:

The Legal Problem (Patent 'Misuse').

This, simply stated, is that we may not get ourselves in a position where we are forcing a licensee to take a license under all our patents in order to get those he wants. He must be free to make his own selection of those he wants without being blackmailed to recognize others. If we do this, the courts will not enforce our patents until we purge ourselves of this "misuse of patents." That can be a very disastrous penalty if we can not purge ourselves quickly, and it conceivably could take us six years to do so.

This legal problem is by no means new but it has assumed a more threatening nature in view of a recent court decision *American Securit Co. v. Shatterproof Glass Corp.*, wherein a company was held to have misused its patents by telling a licensee he could have all patents or only one but that the rate was the same either way. This decision implies that the rate for one must be proportionately smaller than the rate for all in order to be legal.

This is precisely the situation with HRI. *Zenith* wants a license under only

caused the court to find "little difference between outright refusal to license less than a package and the economic coercion of HRI found, with reason, by the district court here."⁸⁷ Viewed in this light, the court, citing the Attorney General's Committee Report, made the determination that, unlike the 50%, 80%, 100% offer, the 1962 proposal and its surrounding circumstances indicated that the "per piece" rate was so disproportionate as to amount to a refusal to license less than the complete package.

With respect to the package licensing issue, therefore, *Zenith* reaffirms prior case law and, in addition, enunciates further guidelines to determine the legality of such license provisions. It is evident from the decision that voluntary package licensing is still not a misuse of the patents. It is also clear from the court's decision regarding the 50%-80%-100% formula, that it is not per se a misuse to charge the same royalty rate for individual patents as would be charged for the entire package. Equally clear is the warning that the number of patents in general use together with the circumstances surrounding the making of the offer, including the intention of the parties, may render a seemingly innocent provision a misuse of the patent, as was the case with HRI's \$435,000-\$500,000-\$150,000 license offer.

CONCLUSION

The Court in *Zenith* clearly established that every patent misuse is not a per se violation of the antitrust laws. Apart from the application of antitrust principles, patent misuse continues to maintain its independent status as a check on the patent holder who seeks to exploit his grant in contravention of the public policy on which the patent system is based. Seen in this light the doctrine poses no threat to those patent holders who confine themselves to the limited scope of their statutory grant.

Furthermore, it is evident that the so-called "patent-antitrust" cases do not represent a basic conflict between patent and antitrust law but rather define the line beyond which the patent holder no longer enjoys the protection of the patent laws and confronts the antitrust laws. This line drawing is necessary to safeguard the public interest and is best achieved by the application of a rule of reason which requires that "there be full inquiry to determine whether the challenged conduct is in furtherance of the patentee's legitimate exploitation of his

a few important patents of their own choosing. We will have to offer them at less than our present royalty rate for all, or run the risk of running afoul of the law and incurring a severe penalty . . .

Also quoted were the patent counsel's handwritten notes which included the following remark:

So what have we gained for the risk of misuse charge. The whole thing is still apt to be viewed for just what we intended—a transparent attempt to force them into package.

⁸⁷ 388 F.2d at 34.

THE PATENT MISUSE DOCTRINE

invention or whether it is the means to other ends.”⁸⁸ Utilization of this approach achieves a balance between the patentee’s rights and those of the public. The *Zenith* case adopts this “rule of reason” approach and successfully maintains the necessary balance. The majority makes it clear that an inquiry into the total factual situation should determine the legality of a particular course of conduct. This approach provides the proper protection for the rights of the patent holder, the licensee and the public.

THOMAS F. MAFFEI

⁸⁸ Wood, Patents, Antitrust And Prima Facie Attitudes, 50 Va. L. Rev. 571, 593 (1964).