



Department of Justice

PATENT AND KNOW-HOW LICENSE AGREEMENTS:
FIELD OF USE, TERRITORIAL, PRICE AND
QUANTITY RESTRICTIONS

Remarks of

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I very much appreciate the opportunity to participate in this fourth annual New England Antitrust Conference. It is dealing with a subject which is especially timely in view of the present congressional interest in patent law reform.

We will discuss the prospects for the patent bill -- including the Scott amendments -- in a few moments. First, however, I'd like to review the present realities of patent law licensing, since this will give us a framework to evaluate where we have been and where we are going.

One of the present realities, it seems, is that whenever a Department of Justice spokesman sets forth the Department's position on the application of the antitrust laws to patent licensing arrangements, a certain amount of criticism ensues.

As a matter of fact, after I had been invited to participate in this program and had agreed to do so, I thought of an episode in the life of Snoopy, that hero of Charles Shultz's comic strip, "Peanuts." The episode begins with Snoopy cringing behind a lectern, shielding himself from an assortment of bricks and other missiles. As he does so, he ponders that he came here

to give a speech and wonders aloud, "Why is everyone yelling? Why is everyone throwing things? What is going on here?" In the next panel, ominous clouds begin to surround Snoopy, and he exclaims, "Smoke! Teargas! Good Grief!" As the episode ends, with Snoopy completely obscured by the clouds, he notes plaintively, "I hate giving speeches."

Fortunately, the verbal brickbats hurled at the Antitrust Division are far milder than the assortment of missiles which bombarded Snoopy. Consider this restrained comment:

The Antitrust Division of the Justice Department may be anti-patents; unquestionably they are anti-patent law. They actively promote anarchy in the area of patent licensing. 1/

I imagine you would be surprised if I did not disagree with that statement. Well, I do. We are not anti-patent, and I think we have made our position rather clear. If we haven't, I will have another go at it today.

1/ Wetzal, Legal Trends and Their Effect on Licensing, Les Nouvelles, Vol. 5, No. 3 (May 1970).

To begin with, what licensing practices does the Department of Justice consider to be clearly unlawful? I believe that I can identify at least nine. Each of them has an effect on competition which extends beyond the metes and bounds of the claims of the patent.

First, it is clear that it is unlawful to require a licensee to purchase unpatented materials from the licensor. The illegality of such tying clauses was established in the International Salt case 2/ and was reaffirmed in 1962. 3/ As a matter of general antitrust law, tying agreements which affect a not insubstantial amount of commerce are unlawful if the selling party enjoys a degree of power over the tying product. 4/ When the tying product is patented -- in the words of the Supreme Court --:

"The requisite economic power is presumed . . . on the theory that the existence of a valid patent on the tying product, without more, establishes a distinctiveness sufficient to conclude that any tying arrangement involving the patented product would have

2/ International Salt Co. v. United States, 332 U.S. 392 (1947).

3/ United States v. Loew's, Inc., 371 U.S. 38 (1962).

4/ Fortner Enterprises, Inc. v. United States Steel Corp., 394 U.S. 495 (1969).

anticompetitive consequences." 5/

Parenthetically, I leave for your speculation whether the decision with respect to monopolization in Walker Process 6/ is consistent with the Court's view of tying.

Second, the Department views it as unlawful for a patentee to require a licensee to assign to the patentee any patent which may be issued to the licensee after the patent licensing arrangement is executed. 7/ Quite clearly, the legitimate desire for a patentee to be able to practice later-developed commercial embodiments of his invention which may be patented by his licensee can be adequately satisfied by requiring the licensee to grant back a non-exclusive license under any subsequent improvement patent. Moreover, the logical result of such an assignment grant-back provision is to stifle innovation on the

5/ United States v. Loew's, Inc., supra note 3, at 45-46.

6/ Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172 (1965).

7/ United States v. Wisconsin Alumni Research Foundation, 1970 CCH Trade Cas. ¶73,015 (consent decree). But see Transparent Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 627 (1949).

part of the licensee. 8/

Third, the Department believes it is unlawful to attempt to restrict a purchaser of a patented product in the resale of that product. This principle goes all the way back to 1873. 9/ The patentee can reasonably be expected to exact his monopoly profit at the time of the first sale. He should not be permitted to control the resale of the patented article by a person who has purchased it from him.

Fourth, a patentee may not restrict his licensee's freedom to deal in products or services not within the scope of the patent. 10/ If he does so, he is

8/ One commentator has characterized a similar statement as a ". . . Freudian conclusion as to what will or will not encourage investment in research." Austern, Surgeons, Morticians, and Patent Lawyers -- The Antitrust Validity of Patent Licensing Restrictions, Lecture before the Practicing Law Institute Program on Current Antitrust Problems, Dec. 5, 1969. However, if a licensee must immediately give away anything he might invent, the corporate executive charged with reviewing expenditures is going to look long and hard before committing substantial resources to research and development. Accordingly, I would characterize this statement as Aristotelian logic rather than Freudian delusion.

9/ Adams v. Burke, 17 Wall. 453 (U.S. 1873); Hobbie v. Jennison, 149 U.S. 355 (1893); Keeler v. Standard Folding Bed Co., 157 U.S. 659 (1895).

10/ McCullough v. Kammerer Corp., 166 F.2d 759 (9th Cir. 1948); National Lockwasher Co. v. George K. Garrett Co., 137 F.2d 255 (3d Cir. 1943); Park-In Theatres v. Paramount Richards Theatres, 90 F. Supp. 727 (D.Del.), aff'd per curiam, 185 F.2d 407 (3d Cir. 1950).

attempting by means other than that of free competition to extend the bounds of his exclusive right to make, use and sell the patented device to the extent where that device might be the only one available to a user of that type of article.

Fifth, the Department believes it to be unlawful for a patentee to agree with his licensee that he will not, without the licensee's consent, grant further licenses to any other person. 11/

Sixth, the Department believes that mandatory package licensing is an unlawful extension of the patent grant. 12/

Seventh, the Department believes that is is unlawful for a patentee to insist, as a condition of the license, that his licensee pay royalties in an amount not reasonably related to the licensee's sales of products covered by the patent 13/ -- for example,

11/ United States v. Krasnov, 143 F. Supp. 184 (E.D. Pa. 1956), aff'd per curiam, 355 U.S. 5 (1957); United States v. Besser Mfg. Co., 96 F. Supp. 304 (E.D. Mich. 1951), aff'd, 343 U.S. 444 (1952).

12/ American Securit Co. v. Shatterproof Glass Corp., 268 F.2d 769 (3d Cir. 1959).

13/ Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100 (1969).

upon total sales of products of the general type covered by the licensed patent. This rule, I should point out, does not apply to percentage of total sales royalties freely negotiated for the convenience of the parties, nor does it apply to minimum or lump-sum royalties.

Eighth, it is pretty clearly unlawful for the owner of a process patent to attempt to place restrictions on his licensee's sales of products made by the use of the patented process. 14/ Many articles, though not themselves patented are produced by the use of patented machinery or processes. "Licensors of the patented machines have no right to interfere with free competition in the sale of unpatented products." 15/

And finally, the Department of Justice considers it unlawful for a patentee to require a licensee to adhere to any specified or minimum price with respect to the licensee's sale of licensed products. Although price restrictions on the licensee were approved in.

14/ Cummer-Graham Co. v. Straight Side Basket Corp., 143 F.2d 646 (5th Cir. 1944).

15/ 143 F.2d at 647.

the General Electric case in 1926, 16/ the rule of this case has been consistently eroded. For example, the Court of Appeals for the Third Circuit has held that the grant of multiple licenses containing price restrictions does not come within the purview of the G.E. doctrine and, without more, violates Section 1 of the Sherman Act. 17/ And twice, the Supreme Court has divided evenly on the question of whether to overrule G.E. 18/

I do not believe that it has been demonstrated that the dangerous power to control the price at which a licensee may sell must be added to the benefits of a patent in order to provide adequate incentive for invention, disclosure or licensing. The patentee obtains the full value of his patent when he exacts all the traffic will bear in the way of royalties or by exercising his privilege to be the sole maker

16/ United States v. General Electric Co., 272 U.S. 476 (1926).

17/ Newburgh Moire Co. v. Superior Moire Co., 237 F.2d 283 (3d Cir. 1961).

18/ United States v. Huck Mfg. Co., 382 U.S. 197 (1965); United States v. Line Material Co., 333 U.S. 287 (1948).

or seller. Royalties, or profits from exclusive exploitation, are the marketplace's impersonal way of evaluating the worth of an invention. To be sure, the patent owner might reap even greater rewards were he able to set the prices charged by his licensees. But those additional rewards would reflect not the value of the invention itself but rather the value of price-fixing. We see not basis for permitting patentees to engage in this practice, which is forbidden to all others.

The practices which I have thus far outlined are, in the Department's view, unlawful in virtually every context.

Most practices other than these, we believe, have a wider scope for justification under the rule of reason -- that is to say, a practice which may be perfectly reasonable if employed in one context may clearly be unreasonable in another. I shall discuss some of these practices in a few moments. But first, let me outline the rule of reason as we see it.

The rule of reason is derived from the ancient doctrine of ancillary restraints, and embraces three principal elements. First, the restriction must be ancillary to carrying out the lawful primary purpose

of the agreement. Second, the scope and duration of the restraint must be no broader than is necessary to support that primary purpose. And third, the restriction must be otherwise reasonable under the circumstances. 19/

This rule can be applied -- and despite some comments to the contrary, I think sensibly applied -- to the myriad of patent licensing arrangements which are not unlawful per se. For purposes of illustration, I would like to discuss three types of arrangements in terms of the rule of reason. These are field-of-use licensing, patent pools and international patent and know-how licensing arrangements.

In the last few years, the Department of Justice has filed a number of cases challenging field-of-use restrictions in various contexts. 20/ In these cases, we have distinguished between a field-of-use restriction applicable to a licensee who purchases a patented

19/ United States v. Bausch & Lomb Optical Co., 45 F. Supp. 387 (S.D.N.Y. 1942), aff'd as modified, 321 U.S. 707 (1944); United States v. Addyston Pipe & Steel Co., 85 Fed. 271 (6th Cir. 1898).

20/ United States v. Karl Ziegler, et al., Civil No. 1255-70; United States v. Bristol-Myers Co., et al., Civil No. 822-70; United States v. Fisons, Ltd., et al., Civil No. 69-C-1530; United States v. Glaxo Group, Ltd. and Imperial Chemical Industries, Ltd., Civil No. 558-68.

product from the patentee and a field-of-use restriction upon a licensee who manufactures the patented product. In the former case -- that of the purchasing licensee -- it is doubtful that any but the most compelling circumstances can justify even minimal restrictions upon the use to which the licensee may put a product which he has purchased. In such cases, the patentee is expected to reap his profits at the time he makes the sale. He cannot expect to control disposition of a product once he has departed with dominion over it.

Field-of-use restrictions upon manufacturing licensees present somewhat more difficult questions. As a general rule, considerable justification can be made for a patentee reserving to himself a well-defined field of use and then offering to license others throughout the remaining fields of use without restrictions on his licensees. If the patentee could not thus protect himself, he might very well decide not to license at all. On the other hand, field-of-use restrictions which divide markets among companies who would otherwise be competitors appear to lack much,

if any, justification at all. 21/ Such divisions are not usually necessary to promote commercialization of the patent through licensing.

Somewhat akin to field-of-use restrictions are the "bulk sales" restrictions which are particularly common in licenses in the pharmaceutical industry. 22/ These restrictions generally prevent a licensee from selling the patented product in other than dosage form. The only justification offered for many of these bulk sales restrictions is that they are designed to prevent the product, in bulk form, from falling into the hands of re-packagers -- re-packagers in this context being synonymous with price cutters. On the other hand, some bulk sales restrictions upon manufacturing licenses might very well be justifiable under the rule of reason. For example, such a restriction might be justified on health and safety grounds if the drug were one which was difficult to handle, requiring critical tolerances to put it in dosage form for administration in a safe manner.

21/ This rule is consistent with such cases as *United States v. Birdsboro Steel Foundry & Mach. Co.*, 139 F. Supp. 244 (W.D. Pa. 1956). In that case, the court made an explicit finding that the companies involved were neither actual nor potential competitors.

22/ E.g., *United States v. Glaxo Group, Ltd.*, supra note 20.

Patent pools provide another example of the application of the rule of reason to a particular licensing practice. A non-exclusive exchange of patent rights can be clearly beneficial to the economy when it is employed to remedy a situation in which two or more companies in an industry hold blocking patents. On the other hand, if the practice were to be extended for an indefinite time to all future patents and if, as a result, competition in research and development in the affected industry were in fact retarded, I think you would rather clearly have an antitrust violation.

Finally, the rule of reason is applicable to international patent and know-how licensing arrangements. The recent Westinghouse-Mitsubishi complaint, 23/ which has attracted so much attention lately, is a good example. It also illustrates the misapprehensions which often surround what are really classically simple cases in the foreign commerce area. One interpretation of the case which I am told is circulating in patent-antitrust circles is that it

23/ United States v. Westinghouse Elec. Corp., Civil No. 70-852-SAW (N.D. Cal., filed April 22, 1970).

is aimed at the licensing of know-how with territorial restrictions, and is designed to obtain new law in this area. Another version is that the case stands for the proposition that if an American company licenses its foreign patents to a foreign company, it must also license any corresponding United States patents to that foreign licensee.

Both of these interpretations are incorrect. What we have in the Westinghouse case is not a simple know-how license with territorial restrictions. Neither does it involve a simple license of a foreign patent accompanied by a refusal to license a corresponding domestic patent. Added to the Westinghouse patent-know-how licenses are these considerations -- all of which are clearly alleged in the complaint:

1. Not only were patented products subject to territorial restrictions, but so also were a great number of products of the same general type covered by the license agreements -- even though such products might not incorporate any of the transferred technology.

2. The agreements -- with their territorial restrictions -- covered products as to which Mitsubishi did not desire to be licensed -- a clear mandatory

package-licensing policy.

3. The agreements had been in existence for over forty years -- hardly a reasonable length of time by anyone's standards -- and yet had years to run.

Thus, this case follows the same general lines as the old ICI 24/ and National Lead 25/ market division cases. Two major manufacturers in different countries -- we allege -- exchanged patents and technology, in broad fields, with the intent and effect of precluding each from exporting the covered products to the other's country. Such agreements in ICI and National Lead, also covering broad fields and not confined to patent rights, were held illegal.

Finally, as to territorial restrictions in domestic patent licenses, you are probably aware that at least one commentator has opined that the legislative history of section 261 of the Patent Code shows that it was not intended to legitimate all divisions of territory, without regard to their effect on competition. 26/

24/ United States v. Imperial Chemical Industries, Ltd., 100 F. Supp. 504 (S.D.N.Y. 1951).

25/ United States v. National Lead Co., 63 F. Supp. 513 (S.D.N.Y. 1945), aff'd, 332 U.S. 319 (1947).

26/ Baxter, Legal Restrictions on Exploitation of the Patent Monopoly, 76 Yale L.J. 276 (1966).

I disagree with this view. I think the statute is clear on its face -- that is, territorial restrictions are permitted -- and, therefore, there is no need to look to the legislative history. This is, I believe, an exception to the general rule of reason.

Much is currently being said of the difficulty -- in terms of uncertainty -- which the rule of reason is alleged to cause in the area of patent licensing. As I noted at the beginning of this talk, some have even termed it "anarchy". In considering these allegations of uncertainty and even anarchy, I think it is important to keep in mind the nature of our antitrust laws. They are not in the form of a European code, designed to provide a ready and concrete answer to every problem arising in the law. On the contrary, they are a broad charter of economic liberty and an expression of Congress that competition should be our basic policy. They are designed to be adapted to changing situations and to changing economic conditions. 27/

27/ Northern Pac. Ry. Co. v. United States, 356 U.S. 1 (1958).

Despite this, I have the lingering feeling that the hue and cry now being raised results not so much from uncertainty as from the fact that we have made our position quite definite and certain. People know very well where the Department of Justice stands -- they just don't like it.

These complaints of uncertainty, however, are now being urged to support the Scott amendments to the bill pending in Congress to revise the patent code. These amendments are based in part upon Recommendation XXII of the President's Commission to study the Patent Laws. The amendments in their present form, I am afraid, would legitimate many of the practices which I discussed earlier as being unlawful per se. Here, we come, I think, to a bit of ancient history. Many lawyers -- and the patent bar in particular -- are echoing the words of a well-known industrialist who said: "In my opinion it is quite uncertain as to just what we have the right to do and what we are forbidden to do by the Sherman Law." 28/ That industrialist happened to be Judge Gary of the United States Steel Corporation testifying before Congress in 1911. So the argument

28/ Senate Committee on Interstate Commerce, Hearings on Control of Corporations, Persons and Firms Engaged in Interstate Commerce, 62d Cong., p. 724.

that the Sherman Act breeds uncertainty is hardly a new one.

About a year ago, in another talk on patents and antitrust law, 29/ I pointed out that one of the jobs of the lawyer in private practice is to keep his client out of antitrust trouble and that one of the ways to accomplish this was to be cautious as to the type of restriction which you write into licensing agreements. I said that I thought that this was one area in which it was wise for the private lawyer to err on the side of caution. Having operated on the basis of this principle in private practice, I thought at the time that it was a fairly sensible approach. However, I was a little bit shaken when a critic found this approach "overbearing" and "more importantly an overture toward importuning the professional independence of the lawyer, offering a compromise to the lawyers obligation to exercise professional judgment solely on behalf of his client." 30/ Seeking some support for my position, I wondered if anyone had had an answer to Judge Gary's complaints of uncertainty in 1911. Going back to the

29/ Patents and Antitrust: The Legitimate Bounds of the Patent Monopoly, an Address before the Pittsburgh Patent Law Association, Nov. 19, 1969.

30/ Wetzel, supra note 1, at 84.

hearings before Congress, I found a witness who testified as follows:

"I have been asked many times in regard to particular practices or agreements as to whether they were legal or illegal under the Sherman law. One gentleman said to me, "We do not know where we can go." To which I replied, "I think your lawyers or anyone else can tell you where a fairly safe course lies. If you are walking along a precipice no human being can tell you how near you can go to that precipice without falling over, because you may stumble on a loose stone, you may slip, and go over; but anyone can tell you where you can walk perfectly safely within convenient distance of that precipice." The difficulty which men have felt generally in regard to the Sherman law has been rather that they have wanted to go the limit than that they have wanted to go safely." 31/

That witness was then a Boston lawyer named Louis D. Brandeis.

31/ Hearings, supra note 26, at 1161.

The supporters of the Scott amendments argue, however, that uncertainty in the area of patent licenses discourages innovation. I know of no empirical evidence whatsoever to support this contention. For example, one commentator suggests that the Justice Department's recent concern with patent licensing arrangements -- which he dubs "The Second Patent Crusade" 32/ -- began in 1965. However, since 1965, non-government expenditures for research and development have increased, in terms of 1968 dollars, from \$8.3 billion to \$9.4 billion. 33/ Moreover, a preliminary report by Professor Oppenheim and Mr. John Scott 34/ indicates that the use of the type of licensing arrangements which the government regards as unlawful is far from widespread. Most of these practices, this preliminary report shows, are never used, or are used only seldom or occasionally.

32/ Hollabaugh, The Scott Amendments v. The Second Patent Crusade, an Address before the Annual Meeting of the ABA Section of Antitrust Law, August 10, 1970.

33/ National Science Foundation, Publication NSF 69-30.

34/ Oppenheim & Scott, Empirical Study of Limitations in Domestic Patent and Know-How Licensing: A Preliminary Report.

I don't think it can be fairly said, therefore, that the Department of Justice is promoting uncertainty in the area of patent law licensing, or that a demonstrative case can be made for the proposition that the antitrust laws in this field are discouraging innovation.

What, then, of future prospects in the area of patent licensing? It certainly does not seem that the present session of Congress will take up the question of patent law reform, including the Scott amendments when it reconvenes in Washington on November 16. Beyond this, I am at the present time unwilling to predict the legislative future of the Scott amendments. Suffice it to say that the amendments, together with the general revision of the patent laws, are receiving much study and thought, both within and without the government.