

**ANTITRUST PITFALLS IN INTELLECTUAL
PROPERTY LICENSING**

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I. OVERVIEW

A. LICENSING PROVISIONS RAISING ANTITRUST ISSUES

Provisions in intellectual property licensing agreements raising antitrust issues will generally be analyzed under the “rule of reason.” The basic inquiry under a “rule of reason” analysis is whether a restraint is likely to have anticompetitive effects, and whether the restraint is reasonably necessary to achieve procompetitive benefits that outweigh those anticompetitive effects. See DOJ/FTC *Antitrust Guidelines for the Licensing of Intellectual Property* (“*IP Guidelines*”) § 3.4.

This article will discuss the following licensing provisions which may raise antitrust concerns:

1. “Field of use” and customer restrictions;
2. Territorial restrictions;
3. Exclusive licenses and exclusive dealing arrangements;
4. Grantbacks;
5. Tying and package licensing;
6. Total sales royalties;
7. Post-expiration royalties;
8. Discrimination royalties; and
9. Resale price maintenance issues.

B. KEY COMPETITIVE ISSUES IN ANALYZING VERTICAL LICENSING ARRANGEMENTS

The key competitive issues in analyzing vertical licensing arrangements are:

1. Will the license foreclose access to competitive technologies?
2. Will the license prevent licensees from developing their own competing technologies or using other competitors' technologies?
3. Will the licensing arrangement facilitate market allocation or price fixing?
4. Will the licensing arrangement increase competitors' costs of obtaining important inputs?
5. Will the licensor and licensee be able to demonstrate a legitimate business purpose for the licensing arrangement?
6. Are the royalties structured to impose *de facto* exclusive dealing arrangements (particularly where the licensor is the dominant firm or has market power)? See *IP Guidelines* §§ 3.3 and 3.4.

C. KEY COMPETITIVE ISSUES IN ANALYZING HORIZONTAL LICENSING ARRANGEMENTS

With respect to licensing arrangements involving parties in a horizontal relationship, the key competitive concerns are:

1. Does the licensing provision increase the risk of coordinated pricing?
2. Does the licensing arrangement increase the risk of output restrictions?
3. Does the licensing arrangement increase the risk of the acquisition or maintenance of market power?

4. Does the licensing arrangement pose a significant risk of retarding or restricting the development of new or improved goods or processes?
5. Does the licensing arrangement involve a true "efficiency-enhancing integration of economic activity"? See *IP Guidelines* §§ 3.3 and 3.4.

II. "FIELD OF USE" AND CUSTOMER RESTRICTIONS

"Field of use" restrictions limit the licensee to the manufacture and sale of the licensed product (or technology) to a specified product market or type of use. For example, one licensee to a glass patent might be restricted to automotive uses (windshields, etc.), while another might be restricted to optical uses (eyeglasses).

Customer restrictions limit the licensee to doing business with particular types of customers or particular customers (e.g., wholesalers).

The *IP Guidelines* specifically recognize that "field of use" and customer restrictions in intellectual property licenses frequently serve procompetitive purposes by giving the licensee an incentive to invest in the commercialization and distribution of the licensed product. *IP Guidelines* § 2.3.

A. ANTITRUST CONCERNS WHERE LICENSOR OR LICENSEE ARE COMPETITORS

Antitrust concerns may arise with respect to "field of use" or customer restrictions where the licensor and licensee(s) are actual or potential competitors. The concern is whether the license restrictions are being used to mask an illegal market division of products ("field of use" restrictions) or customers. See *IP Guidelines*, Examples 5 and 6; see also Complaint and Consent Decree, *United States v. Pilkington PLC*, Civ. no. 94-345 (D. Ariz., May 25, 1994).

A key issues in such situation is whether the licensed technology is a genuine advance over the licensee's technology and whether the licensee will actually use the technology. If not, a strong inference arises that the license is a pretext for a horizontal division of market in violation of the antitrust laws. *IP Guidelines*, Examples 5, 6, and 7.

B. LICENSE RESTRICTIONS ON COMPETING PRODUCTS

Antitrust issues also arise where license provisions restrict the licensee's ability to deal in technologies that compete with the licensor's technology. Especially where the licensor has market power, restrictions beyond the scope of the licensed technology can raise serious antitrust concerns. See *Yamaha Motor Co. v. FTC*, 657 F.2d 971, 981 (8th Cir. 1981).

III. TERRITORIAL RESTRICTIONS

Territorial restrictions in a license restrict the licensee to a particular geographical area (e.g., the United States or Latin America).

A. SPECIAL RULE FOR TERRITORIAL RESTRICTIONS IN A U.S. PATENT LICENSE

Section 261 of the Patent Code, 35 U.S.C. § 261, specifically exempts territorial restrictions in a patent license within the U.S. from the antitrust laws. Case law also supports the right of patent holders to limit the grant of a license to a particular country or countries. *U.S. v. Westinghouse Electric Corp.*, 648 F.2d 642, 647-49 (9th Cir. 1981)

However § 261 does not apply outside the U.S. or beyond the first sale of a patented product.

B. GENERAL ADVICE REGARDING TERRITORIAL, CUSTOMER, AND "FIELD OF USE" RESTRICTIONS

As a general matter, territorial, customer and "field of use" restrictions are commonly used in intellectual property licensing arrangements and are usually upheld if challenged.

However, where the licensees are competitors or potential competitors of the licensor, counsel should take special care to make sure that a licensing arrangement has a legitimate business purpose. Clients should be counseled to avoid internal written communications which may be misinterpreted in litigation, and the procompetitive business reasons for the arrangement should be documented.

IV. EXCLUSIVE LICENSES AND EXCLUSIVE DEALING ARRANGEMENTS

A. EXCLUSIVE LICENSES

An exclusive license gives the licensee exclusive rights to the intellectual property subject to the license. Since such a license does not restrict competition any more than a decision by the licensor to exploit the intellectual property itself, an exclusive license generally does not raise serious antitrust concerns.

However, where the licensor and licensee(s) are actual or potential competitors, antitrust issues may arise. For example, in a situation where the licensor and licensee(s) are among the few competitors or potential competitors with respect to particular intellectual property, an exclusive license may be challenged where it eliminates or reduces the ability or incentives of the companies to compete. Second, if the license includes ancillary restrictions that reduce competition between the licensor and licensee with respect to issues beyond the particular subject of the intellectual

property license, the arrangement may be viewed by antitrust enforcers as a pretext for unlawful market allocation. See *IP Guidelines*, Example 7.

In *Abbott Laboratories v. Baxter International, Inc.*, 2000 U.S. Dist. LEXIS 5475 (N.D. Ill.) *aff'd*, 315 F.3d 829 (7th Cir. 2003), the Court addressed the antitrust implications of an exclusive license for an anesthetic called Sevoflurane. Baxter had patented Sevoflurane in the mid-1960s, but did not commercialize it because it was too difficult and costly to produce until the early-1980s, when Baxter obtained process patents on an efficient process for its manufacture. At that time, Baxter decided to license its rights to market Sevoflurane rather than market it directly. It entered into an exclusive license with a Japanese company (Maruishi) which provided:

Baxter hereby grants to Maruishi an exclusive license even as to Baxter under the Licensed Patents and any improvements . . . to make, use, have made, sell and have sold Sevoflurane . . . throughout the Territory with rights to sublicense.

Maruishi manufactured Sevoflurane and sublicensed its marketing rights to Abbott, which produced and sold Sevoflurane in the U.S. with great commercial success. In the late-1990s, another company (Ohmeda) developed a generic version of Sevoflurane, which it planned to introduce commercially. Baxter purchased Ohmeda and decided to proceed with Ohmeda's plans to compete with the Sevoflurane made by Maruishi and sold in the U.S. by Abbott.

Abbott challenged Baxter's right to sell the Ohmeda-process-produced Sevoflurane as a violation of the exclusivity provisions of the Baxter/Maruishi license agreement. In response, Baxter agreed that the exclusive license did not explicitly forbid Baxter itself from competing with Maruishi (in other words, that exclusivity meant only that Baxter could

not issue any other licenses) and second, that if the license did forbid Baxter from competing, then it violated Section 1 of the Sherman Act. The dispute went to arbitration, and the arbitrators ruled against Baxter, holding that the license is exclusive in the strong sense (prohibiting Baxter itself from competing during the term of the license) and that there was no violation of Section 1 of the Sherman Act, since any reduction in competition was attributable to Baxter's decision to purchase the competing Ohmeda process while bound by a specific agreement not to compete with its licensee.

The District Court affirmed the arbitration award, rejecting Baxter's effort to characterize the original exclusive licensing agreement as a "market allocation agreement." The District Court ruled that the licensing arrangements were justified under a "rule of reason" analysis and were procompetitive. The District Court noted that, "Baxter cannot artificially create antitrust claims by narrowly defining the relevant market to be only Abbott and Baxter." Further, the District Court noted that Baxter could not create an antitrust claim by arguing that it was prevented from competing with its exclusive licensee (or the sub-licensee) when it granted the exclusive license in the first place, and other competitors were free to enter the market. The judgment of the arbitration panel was affirmed on appeal by the Seventh Circuit, which ruled that the antitrust issue was properly decided by the arbitration panel. The Seventh Circuit did note that the exclusivity provision in the Baxter/Maruishi license agreement was a "lawful ancillary agreement designed to induce Maruishi and its sub-licensees to make the investments needed to bring the new drug to market." 315 F.3d at 833.

B. EXCLUSIVE DEALING ARRANGEMENTS

An exclusive dealing arrangement arises when a license prevents or restrains a licensee from licensing, selling,

distributing or using competing technologies. See *IP Guidelines*, § 5.4. The antitrust enforcement agencies will look beyond the question of whether the license is denominated as “exclusive” or “non-exclusive,” and look at the actual effect of the licensing arrangement. A non-exclusive license may have the effect of an exclusive dealing arrangement if it is structured to increase significantly a licensee’s cost when it uses competing technologies. *IP Guidelines*, §§ 4.1.2 and 5.4.

In assessing exclusive dealing arrangements, antitrust enforcers and courts examine the duration of the licensing restriction, the market share of the licensor and licensee, and the percentage of the market foreclosed by the exclusive dealing arrangement. As a general matter, unless an exclusive dealing arrangement forecloses from competitors from at least 40-50% of a properly-defined relevant antitrust market, such an arrangement will usually be upheld. *U.S. v. Microsoft Corp.*, 87 F. Supp. 2d, 30, 52 (D.D.C. 2000), *rev’d in part, aff’d in part*, *U.S. v. Microsoft Corp.*, 253 F.3d 34, 70 (D.C. Cir. 2001). Courts will also look at the bargaining power of the licensee and the business justifications for the exclusive dealing arrangement. See *Ticketmaster Corp. v. Tickets.com, Inc.*, 2003 U.S. Dist. LEXIS 6484 (C.D. Cal. March 7, 2003).

As a general matter, exclusive dealing arrangements of a short duration (less than one year) or which are terminable within a year are generally upheld. See *Thompson Everett, Inc. v. National Cable Advertising, L.P.*, 57 F.3d 1317, 1326 (4th Cir. 1995) (granting summary judgment for defendants, noting that exclusive contracts at issue are typically of short duration, usually terminable after a year).

However, the Third Circuit recently upheld a jury verdict of antitrust liability under § 2 of the Sherman Act based upon *de facto* exclusive dealing arrangements resulting from bundled rebates which had the effect of requiring retailers to purchase

the defendant's (3M's) products exclusively. *Lepage's Incorporated v. 3M* (Minnesota Mining and Manufacturing Company), 2003 U.S. App. LEXIS 5757 (3rd Cir. en banc March 25, 2003)

V. GRANTBACKS

A grantback provision in an intellectual property license agreement is an agreement by a licensee to grant back to the licensor any intellectual property rights that the licensee may later develop or acquire with respect to improvements to the technology which is subject to the license. Such clauses are generally deemed procompetitive, but are subject to "rule of reason" analysis because they "could be employed with the purpose or effect of violating the antitrust laws." *Transparent-Wrap Machine Corp. v. Stokes & Smith, Co.*, 329 U.S. 636 (1947).

Grantbacks vary in content and in scope. They vary also in the rights that are granted to the licensor. Grantback provisions can include exclusive grantback rights or non-exclusive rights.

As a general matter, non-exclusive grantbacks—grantbacks where the licensee retains the right to use or license the new technology—generally will not present significant antitrust issues. On the other hand, exclusive grantbacks may present more significant antitrust issues, particularly where the licensor has market power.

Competitive issues with respect to grantbacks may arise if:

1. The licensor is the dominant firm;
2. The licensor tries to obtain any grantbacks for free;
3. The licensor tries to obtain rights extending beyond the expiration of the base license;
4. The licensor tries to obtain rights beyond those related to the technology subject to the base license;

5. The grantback is exclusive; or
6. The grantback extends to firms in addition to the licensor; e.g., all other licensees of the licensor.

The *IP Guidelines* specifically note that grantbacks may raise competitive concerns “if they substantially reduce the licensee’s incentives to engage in research and development and thereby limit rivalry in innovation markets.” *IP Guidelines* § 5.6.

In a Business Review Letter approving the joint licensing of patents essential for making DVD-Video and DVD-ROM discs and players, the Antitrust Division specifically addressed the grantback provisions of the proposed licenses, finding that they were “so narrow that they are unlikely to raise significant issues.” DVD Business Review Letter (from Joel I. Klein to Garrard Beeney), dated December 16, 1998, 1998 DOJBR LEXIS 15 (December 16, 1998). In this letter, the DOJ noted that the grantback provision in the proposed licenses was limited to “essential” patents, thereby limiting the ability of a potential licensee to exact a supra-competitive toll from Portfolio licensees and further lowering licensees’ costs in assembling the patent rights essential to their compliance with the DVD Standard Specifications.

VI. TYING AND PACKAGE LICENSING

A. TYING

Tying occurs when a licensor seeks to condition the license of some intellectual property on the licensee’s agreement to license a second unwanted good, service or item of intellectual property from the licensor. For there to be violation of the antitrust laws, the licensee must be “coerced” to license or purchase the separate unwanted item (the tied item).

The antitrust enforcement agencies analyze tying arrangements in intellectual property licenses under a "rule of reason" analysis. See *IP Guidelines* § 5.3. The government would be likely to challenge a tying arrangement if: 1) the seller has market power in the tying product; 2) the arrangement has an adverse effect on competition in the relevant market for the tied product; and 3) efficiency justifications for the arrangement does not outweigh the anticompetitive effects. *IP Guidelines* § 5.3.

Contrary to some older case law, the *IP Guidelines* make clear that the government will not presume that a patent, copyright, or trade secret necessarily confers market power with respect to the tying product. *IP Guidelines*, § 5.3.

A threshold inquiry with respect tying is whether the tying and tied goods are two separate products. In cases involving technology, this determination may be difficult. In *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756, 761 (7th Cir. 1996), the Court held that the inclusion of an operating system in a Digital Equipment Corporation ("DEC") computer was not an illegal tying arrangement. As Judge Easterbrook stated:

We doubt that it is useful to call DEC's practice a tying arrangement. An operating system is essential to make a bunch of silicon chips a "computer." No OS, no computation. One might as well complain that General Motors includes an electrical system with every car. Some firms sell central processing units, others sell memory chips or logic boards, other sell disk drives, and still others sell operating systems and application software. It is possible to buy parts and software to assemble a computer. But competition is more vital, and consumers are better off, when it is possible to sell entire functioning units in boxes.

In *U.S. v. Microsoft Corp.*, 253 F.3d 34, 84-97 (D.C. Cir. 2001), the Court reversed the trial court determination that Microsoft had violated Section 1 of the Sherman Act by

tying Internet Explorer to the Windows operating system. The Court ruled that the trial judge had erroneously applied a *per se* tying analysis. The Court remanded this issue for further proceedings under “rule of reason” analysis. The Court ruled that such a “rule of reason” would permit the defendant to offer procompetitive justifications for its integration of additional functionality into the operating system.

B. PACKAGE LICENSING

“Package licensing” is similar to tying in that the licensor offers a license to multiple items of intellectual property in a single license.

The *IP Guidelines* recognize that package licensing can be efficiency-enhancing in some circumstances. *IP Guidelines*, § 5.3. See *BMI v. CBS*, 441 U.S. 1 (1977) (blanket license for musical performances upheld).

The critical issue in determining the validity of package licensing is whether or not the licensee is “coerced” to license the entire group of rights. Package licenses will withstand scrutiny if the licensor can demonstrate a legitimate business purpose for the package and licensee voluntarily accept the package.

On the other hand, in older cases, the “packaging” of groups of movies was found to be an antitrust violation because the Court found that the movie studios were trying to leverage the licensing of their “hit” movies in order to make exhibitors also license the less popular movies. *U.S. v. Paramount Pictures*, 334 U.S. 131 (1948), *remanded*, 85 F. Supp. 881 (S.D.N.Y. 1949), *aff’d*, 339 U.S. 974 (1950).

Thus, to lessen antitrust concerns, a licensor would be well-served to offer several different types of “package licenses” and avoid a fee structure which strongly discourages a

license of less than the complete package. See *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969).

C. TOTAL SALES ROYALTIES

Royalties based on the licensee's total sales (regardless of the actual use of the patented product or process) may be illegal if the arrangement arises from coercion by the licensor. *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969); *United States v. Microsoft Corp.*, 56 F.3d 1448 (D.D.C. 1995).

On the other hand, a voluntary agreement, based on the convenience of the licensee, to pay royalties based on sales of all products of a particular type (which may include a patented part) will be upheld. *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 339 U.S. 827 (1950).

Key factors in determining whether a total sales royalty will be upheld if challenged are 1) whether the licensee is given the option of paying royalties only on products that incorporate the licensed part or technology; and 2) the business and efficiency justifications for the total sales royalty arrangement.

D. POST-EXPIRATION ROYALTIES

As a general rule, a licensor is free to negotiate any royalty that a licensee will pay. Some royalty arrangements, however, have been found to be inherently unreasonably or anticompetitive.

One such illegal arrangement is a requirement that a licensee pay royalties for a time period after the expiration of the patent or other intellectual property right.

In *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), the Supreme Court held that a provision that a licensee pay royalties after the expiration of the patent was illegal as a form of patent

misuse, without regard to issues of market power or competitive impact.

However, when Congress amended § 271(d) of the Patent Code to require market power for a finding of misuse, Congress expressly applied this requirement only to tying and package licensing. As a result, courts generally have continued to treat post-expiration patent royalties as misuse.

For example, in *Scheiber v. Dolby Laboratories, Inc.*, 293 F.3d 1014 (7th Cir. 2002), the Court ruled that a licensee was not required to pay royalties after the expiration of a U.S. Patent in May 1993, even though it was the licensee (Dolby) which had proposed the licensing arrangement in the first place. Even though the Court (Judge Posner) criticized the rationale of *Brulotte*, it ruled that the licensee was not required to pay royalties after the expiration of the patent.

Although the prohibition on post-expiration royalties applies to patents, this rule may not apply to trade secrets. Royalties on trade secrets that continue after the trade secrets enter the public domain have been upheld so long as they are legitimate secrets at the time the license was executed.

VII. DISCRIMINATORY ROYALTIES

Licensors of intellectual property do not face the constraints on discriminatory pricing imposed by the Robinson-Patman Act, which applies only to the sale of goods. Thus, there is no general prohibition on discriminatory royalties.

There are some cases, which arose out of the shrimp industry, holding that discriminatory royalties which harm competition between licensees may be an antitrust violation or constitute patent misuse. See *Laitram Corp. v. King Crab, Inc.*, 245 F. Supp. 1019 (D. Alaska 1965); *LaPeyre v. FTC*, 366 F.2d 117 (5th Cir. 1966). However, more recent cases have tended to reject this approach and to uphold discriminatory royalties so long as there was a rational basis for the distinction or there

is no showing of anticompetitive effects on the market. See *Akzo NV v. ITC*, 808 F.2d 1471 (Fed. Cir. 1986); *Hennessy Indus., Inc. v. FMC Corp.*, 779 F.2d 402 (7th Cir. 1985).

Discriminatory royalties may be challenged as a mechanism to coerce an unwilling licensee to accept a package license or to “coerce” a licensee to accept a total sales royalty.

VIII. RESALE PRICE MAINTENANCE ISSUES

Efforts by sellers to fix the minimum price at which a buyer may resell a product—known as resale price maintenance or vertical price-fixing—is *per se* illegal under the antitrust laws. (Setting a maximum resale price is now judged under the “rule of reason,” *State Oil v. Khan*, 522 U.S. 3 (1997)).

The *IP Guidelines* consider vertical price restrictions to be *per se* illegal. *IP Guidelines*, § 5.2. See also *United States v. Univis Lens Co.*, 316 U.S. 241, 243-45 (1942).

On the other hand, it is lawful for a licensor (or other seller) to provide suggested resale prices to a licensee (or distributor) and to urge that licensee (or distributor) to charge the Manufacturer’s Suggest Resale Price (“MSRP”), and even to terminate a licensee for non-compliance.

A licensor (or other seller) may also generally condition the payment of cooperative advertising monies on the licensee not advertising prices other than MSRP in advertisements paid for by the licensor.

Although the Supreme Court held in 1926 that a patentee may condition its license to manufacture a patented product on the fixing of the price of the patented product for resale in *U.S. v. General Electric Co.*, 272 U.S. 476 (1926), this case should not be relied on today to justify resale price maintenance of patented products.