

The Patent Misuse Defense and Antitrust Violations:

The Implications of *Princo Corp. v. International Trade Commission and U.S. Philips Corp.*

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The Federal Circuit, sitting *en banc*, has narrowed the scope of the patent misuse defense. In *Princo Corp. v. International Trade Commission and U.S. Philips Corp.*,¹ the Court was presented with the question of whether an agreement between two collaborators to suppress a competitive technology could constitute patent misuse and thus render their patent unenforceable during the period of misuse. "Recognizing the narrow scope of the [patent misuse] doctrine,"² the Court found that the agreement did not constitute patent misuse – a decision which, in the view of the dissent, "emasculate[d] the doctrine so that it will not provide a meaningful obstacle to patent enforcement."³

Patent misuse is a long-recognized judicially created equitable defense to an action of patent infringement. The controlling inquiry is whether the patentee "impermissibly broadened the 'physical or temporal' scope of the patent grant with anticompetitive effect."⁴ If a patent owner is found to have misused a patent, the patent is unenforceable until such time as the misuse is corrected or "purged."⁵ The Federal Circuit in *Princo* explained that "what patent misuse is about, in short, is patent leverage, *i.e.*, the use

of the patent power to impose over-broad conditions on the use of the patent in suit that are not within the reach of the monopoly granted by the Government."⁶ This "patent leverage" test requires a connection between the patent right and the misconduct in question "such that the patent in suit must itself significantly contribute to the practice under attack. Patent misuse will not be found when there is 'no connection' between the patent right and the misconduct in question... or no 'use' of the patent."⁷

In *Princo*, the Federal Circuit addressed the following question: "When a patentee offers to license a patent, does the patentee misuse that patent by inducing a third party not to license its separate, competitive technology?"⁸ The Court found that there was no patent misuse in the circumstances of this case.

Chief Judge Rader and Judges Newman, Lourie, Linn and Moore, concluded that the required connection was missing between the patents asserted against *Princo* and the alleged misconduct. The majority further concluded that *Princo* failed to carry its burden of demonstrating an "actual adverse effect on competition in the marketplace"⁹ because it did

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not show that the suppressed technology had technical or commercial prospects.¹⁰ Given the Federal Circuit's exclusive appellate jurisdiction over patent infringement cases, the decision will likely serve to limit the availability of misuse as a defense in such cases and have an impact on patent licensing practices going forward.

Background

US Philips Corporation ("Philips") and Sony Corporation ("Sony") collaboratively developed CD-R and CD-RW technology, which allowed the public to create discs readable by CD players or CD-ROM drives. During the course of development, the companies encountered the problem of encoding "position information" in writable discs. The engineers of both companies tackled the problem, resulting in two proposed solutions. Sony's digital solution was set forth in its "Lagadec patent," while Philips' analog solution was set forth in its "Raaymakers patents." The engineers of both companies reviewed the proposed solutions and agreed to use the Raaymakers solution which "was simple and worked well" in comparison to the Lagadec solution which "was prone to error and would have been very difficult to implement."¹¹ Thus, the Raaymakers approach was incorporated in the "Orange Book" which codified the industry standards for recordable CD-R and CD-RW technology.

Philips and Sony, along with several other patent holders, created a patent pool to license patents that were essential to manufacture CD-R/RW discs in accordance with the Orange Book standards, including the Lagadec

patent (which arguably read on part of the Raaymakers patent). The package licenses contained field-of-use limitations limiting the use of all the patents to Orange Book-compliant disc production.

Patent misuse is not a defense to all wrongful commercial conduct, even if there are anticompetitive effects.

Princo Corporation ("Princo"), a licensee, stopped paying licensing fees but continued to try to import the patented CD-Rs and CD-RWs into the US, thus prompting Philips, the patent pool administrator, to file suit with the International Trade Commission ("ITC"). Although the administrative law judge determined that Princo had infringed claims of the six patents Philips asserted, relief was denied because patent misuse rendered the patents unenforceable. The next six years of subsequent proceedings at the ITC and Federal Circuit leading up to the Federal Circuit's *en banc* review centered on Princo's patent misuse defenses, including assertions that Philips foreclosed competition from an alternative standard built around the Lagadec patent by including the Lagadec patent in the patent pool and thus securing Sony's adherence to the Orange Book standard.¹²

Federal Circuit *en banc* Decision

After reviewing the history of patent misuse law, the Court explained that the defense of patent misuse is "not available to a presumptive infringer simply

because a patentee engages in some kind of wrongful commercial conduct, even conduct that may have anticompetitive effects."¹³

Proof of an antitrust violation does not even establish misuse of the patent "unless the conduct in question restricts the use of that patent... outside the otherwise broad scope of the patent grant."¹⁴

The majority stressed that the alleged misuse must be of the patent in suit, and as the patents in suit are the Raaymakers patents, not the allegedly suppressed Lagadec patent, the alleged misuse was not of the patent in suit.¹⁵ Therefore, the alleged patent misuse "is not patent misuse under any court's definition of the term."¹⁶ The Court rejected Princo's argument that Phillips's use of proceeds from the Raaymakers licensing program to fund royalty payments that allegedly induced Sony to enter into the alleged agreement to suppress the Lagadec patent constituted leveraging of the Raaymakers patents.¹⁷ The Court explained that because such use of funds does not place any conditions on the availability of Phillips' patents to any potential licensees, it is not the power of Philips' patent right that is being misused.

The Court further supported its "recogni[tion of] the narrow scope of the doctrine" by arguing that "Congress enacted section 271(d) [of the Patent Act] not to broaden the doctrine of misuse, but to cabin it."¹⁸ Section 271(d) exempted five categories of conduct (none of which were applicable in the case at hand) from the patent misuse doctrine.

The Court went on to discuss that Princo failed to show the requisite actual or prospective

anticompetitive effects of the agreement as *Princo* did not provide evidence of the commercial viability of the Lagadec technology.¹⁹ When examining whether a certain business practice is anticompetitive, courts must evaluate whether the practice is an unreasonable restraint on trade. Some business practices, such as price-fixing, are considered “naked restraints” and so inherently anticompetitive and lacking in any redeeming virtue that they are conclusively presumed to be automatically illegal, or *per se* illegal. However, most business practices can have procompetitive effects and are thus evaluated under a reasonableness standard, referred to as rule of reason, which requires an examination of a restraint’s actual effect on competition. Under a rule of reason analysis, the plaintiff has the burden of showing anticompetitive effects in the relevant market. The burden is shifted if the practice is inherently suspect with questionable procompetitive effects. These practices warrant an abbreviated “quick look” analysis of the business justifications for the restraint, placing the evidentiary burden on the defendant.

The Court highlighted the procompetitive effects of research joint ventures and standard setting in support of its use of the rule of reason analysis rather than a “quick look” analysis which would have presumed competitive harm and thus shifted the burden to Philips to show the justifications for the agreement.²⁰

The dissent sharply criticized the majority’s interpretation of the scope of the misuse

doctrine. Arguing for a vigorous misuse defense that would include antitrust violations, the dissent cited *Illinois Tool Works* for the proposition that “it would be absurd... to provide that the use of a patent that merited punishment as a felony [under antitrust laws] would not constitute misuse.”²¹ According to the dissent, the majority’s holding in effect protects anticompetitive agreements that suppress alternative technologies for the purpose of insulating a technology from competition.²² The dissent disagreed with the majority’s assessment that the agreements to suppress the Lagadec technology were separate or collateral agreements as, in its view, the agreements were part and parcel of the same conduct designed to protect the Raaymakers patents.²³

The dissent’s view on the appropriate evidentiary burden also departed from the majority’s position that required *Princo* to show anticompetitive effects. The dissent argued that as the agreement between Sony and Philips was inherently suspect, it should be subject to a “quick look” analysis which does not require proof of actual competitive effects.²⁴ To support its position, the dissent cited *American Needle*, a recent Supreme Court decision which explains that anticompetitive ancillary restraints of joint ventures are not justified simply because they are part of a joint venture that has some procompetitive effects.²⁵ The dissent also criticized the commercial viability test used by the majority as a test that has no support in case law or antitrust policy.²⁶ In support of

this position, the dissent cited to the FTC’s amicus brief²⁷ that argued that *Princo* did not have to prove commercial viability of the Lagadec technology as “such a showing is not an essential step in establishing that the [defendants’] attempt to thwart its achievement was an unreasonable restraint of trade.” (quoting *FTC v. Ind. Fed’n of Dentists*).²⁸

The dissent argued that the holding protects anticompetitive agreements that suppress alternative technologies.

The dissent and the FTC both appeared to focus more on an analysis of Philips’ and Sony’s conduct under the antitrust laws, while the majority viewed the case as more narrowly implicating the misuse defense strategy apart from the antitrust laws.

Implications of *Princo*

The availability of patent misuse as a defense in patent litigation may be substantially constrained as a result of this decision. Motions to strike the defense may become more common as infringement plaintiffs seek to avoid the diversion and discovery involved in litigating a misuse defense. The required finding that the “patent leveraging” be such that it has an actual adverse effect on competition in the marketplace and of “commercial viability” (of any suppressed competition) may be difficult to prove in cases of nascent or developing technologies where the required evidence may

not yet be present. From a patent licensing perspective, although the decision is obviously helpful in avoiding patent misuse claims, patent owners should still be mindful of potential antitrust claims and be cautious in entering into any agreement that reduces actual or potential competition without careful review of the facts and circumstances.

1 *Princo Corp. v. Int'l Trade Comm'n*, 616 F.3d 1318 (Fed. Cir. Aug. 30, 2010).

2 *Id.* at 1329.

3 *Id.* at 1342.

4 *Princo*, 616 F.3d at 1328 (citing *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986)).

5 *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 493 (1942).

6 *Id.* at 1331.

7 *Id.*

8 *Id.* at 1331.

9 *Id.* at 1338.

10 *Id.* at 1338-1339.

11 *Id.* at 1322.

12 *Princo Corp. v. Int'l Trade Comm'n*, 563 F.3d 1301 (Fed. Cir. 2009) (rejecting patent misuse defenses based on "tying" and improper imposition of royalty on products which do not use the teaching of the patent, but remanding on issue of "whether an agreement that would prevent the development of alternatives would constitute misuse").

13 *Id.* at 1329.

14 *Id.* at 1329.

15 *See id.* at 1329, 1331.

16 *Id.* at 1333.

17 *Id.* at 1332.

18 *Id.* at 1329-1330.

19 *Id.* at 1338-1339.

20 *Id.* at 1335.

21 *Id.* at 1341 (citing *Illinois Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 42 (2006)).

22 *Id.* at 1350.

23 *Id.* at 1348-1349.

24 *Id.* at 1353-1354.

25 130 S. Ct. 2201 (2010).

26 *Id.* at 1353-1354.

27 *Id.* at 1356.

28 En Banc Br. of Amicus Fed. Trade Comm'n at 23.

29 476 U.S. 447, 461 (1986)