

## Patent/Antitrust Litigation Alert

### Federal Circuit Limits Patent Misuse in *Princo*

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A sharply divided *en banc* U.S. Court of Appeals for the Federal Circuit significantly narrowed the scope of the patent misuse defense this week. In *Princo Corp. v. International Trade Commission*, a five judge majority drew a sharp line between general antitrust violations in which patents might be involved and a few well-delineated practices which can now constitute patent misuse rendering a patent unenforceable. Two judges concurred on a limited basis, and two judges strongly dissented.

The majority decision emphasized the “narrow scope of the doctrine,” stating that a presumptive infringer cannot escape liability “simply because a patentee engages in some kind of wrongful commercial conduct, even conduct that may have anticompetitive effects.” Slip Op. at 19. Rather, patent misuse must consist of improper “leveraging” of the particular patent asserted against the defendant to broaden the scope of the patent monopoly, typically by tying or requiring payment outside the term of the patent. Anticompetitive practices with only loose connection to the asserted patent—such as suppressing a potentially competitive technology—must find a remedy in antitrust, not patent, law.

#### Facts and Background

The dispute in *Princo* centered on industry standards for recordable CD-R and CD-RW technology, codified in a publication known as the “Orange Book.” The standards in question included a method of encoding location information in the CDs, enabling CD drives to maintain proper positioning while reading and writing to the discs. In developing the technology, Philips and Sony each arrived at a separate solution to the positioning problem. Philips’ method was patented in the Raaymakers patents, while Sony’s was in the Lagadec patent. The companies agreed that the Raaymakers approach was superior and

incorporated it in the Orange Book standards. Philips and Sony, along with several other patent holders, created a pool of patents related to the Orange Book. The Lagadec patent was included in the pool on the ground that it arguably read on part of the Raaymakers patent. Philips offered package licenses to the pool, all of which included field-of-use limitations limiting the use of the patents (including the Lagadec patent) to Orange Book-compliant disc production.

*Princo* Corporation initially licensed the Orange Book patents, but ceased paying royalties, prompting Philips to initiate an investigation in the International Trade Commission to block importation of *Princo*’s allegedly infringing CDs. *Princo* raised patent misuse as a defense, arguing that the pool licenses improperly tied patents necessary to the Orange Book standards to licenses of other, unnecessary patents; that the pooling constituted price fixing and price discrimination; and that inclusion of the Lagadec patent in the pool along with Sony’s agreement not to license it outside the pool foreclosed competition between it and the Raaymakers technology. In an earlier appeal, the Federal Circuit disposed of the tying argument, finding that Philips’ licenses simply charged a flat fee regardless of the licensee’s use, and that the package licenses minimized transaction costs and reduced the risk of post-agreement disputes as to which patents were actually necessary to the standard. Additionally, grouping patents together in package licenses “has potential to create substantial precompetitive efficiencies such as clearing possible blocking patents, integrating complementary technology, and avoiding litigation.” Slip Op. at 11 (quotation omitted).

## The Decision

The en banc *Princo* decision addressed Princo's remaining argument that Philips and Sony colluded to suppress the Lagadec technology by licensing it only in the Orange Book pool with the Raaymakers technology, foreclosing the possibility of the Lagadec patent providing the basis for the creation of a competing standard for CDs. On remand, the ITC had ruled that there was no misuse, and Princo appealed. The Federal Circuit rejected its argument on two grounds, one legal and one factual.

### Patent Misuse is Limited and Distinct from General Antitrust Violations

As a legal matter, the majority laid down the clear rule that patent misuse must constitute "leveraging" the specific asserted patent to improperly enlarge the patent monopoly. The Court relied primarily on early Supreme Court cases in which patent holders conditioned licenses for patented equipment to the purchase of unpatented commodities:

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. What that requires, at minimum, is 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.

Slip Op. at 24 (internal quotations and citations omitted). The "claimed horizontal agreement between Philips and Sony to restrict the availability of the Lagadec patent—an entirely different patent that was never asserted in the infringement action against Princo" lacked the required "link" between

the patent in suit and the alleged misconduct. "At bottom," the Court held, "Princo's complaint is not that its license to the Raaymakers patents is unreasonably conditioned, but that the Lagadec patent has not been made available for non-Orange-Book uses. And that is not patent misuse under any court's definition of the term." Slip Op. at 27.

### Standards-setting and Ancillary Restraints Analyzed through the Rule of Reason

Although the Court could have stopped there, it also addressed the factual deficiencies in Princo's defense. While this portion of the opinion is technically *dicta*, it is likely to have continuing importance. The Court held that patent misuse requires a showing that the patentee's conduct had anticompetitive effects: "What Princo had to demonstrate was that there was a 'reasonable probability' that the Lagadec technology, if available for licensing, would have matured into a competitive force in the storage technology market." Slip Op. at 38. The Court agreed with the ITC's determination that Princo failed to show that the Lagadec technology could have been a viable competitor to Raaymakers apart from the challenged agreements. The ITC found the Lagadec method lacking in both technical feasibility and commercial potential.

In addition to its deference to the ITC's factual findings, the Court apparently was influenced by a desire not to discourage research joint ventures and standards-setting:

Collaboration for the purpose of developing and commercializing new technology can result in economies of scale and integrations of complementary capacities that reduce costs, facilitate innovation, eliminate duplication of effort and assets, and share risks that no individual member would be willing to undertake alone, thereby "promot[ing] rather than hinder[ing] competition."

Slip Op. at 31 (quoting Dep't of Justice & FTC, *Antitrust Guidelines for the Licensing of Intellectual Property* §§ 5.1, at 24; 5.5, at 28 (Apr. 6, 1995)). Following the path chartered in the earlier *Princo* appeal, the Court stressed the procompetitive benefits of industry standardization, which increases competition among interoperable products and spurs innovation. Accordingly, courts must use the rule of reason to assess not only joint ventures and standard setting activities, but also the 'ancillary restraints' that enable them, such as agreements between collaborators not to compete against their joint venture. Such agreements are not naked restraints meriting "quick look" analysis, because they legitimately ensure that the resources invested by one joint venturer will not be undermined or exploited by the other.

### The Dissent

In a sharply-written dissent, the two judges who constituted the majority in the panel opinion issued a passionate warning of the dangers of collusion and the difficulty of policing this type of conduct without a vigorous patent misuse defense:

The majority's strict standard fails to provide adequate protection against the suppression of nascent technology, and allows patent holders free rein to prevent the development of potentially competitive technologies except in the most extreme and unlikely circumstances.

Dissent at 32. Framing the antitrust issue as Philips' agreement to protect Raaymakers from competition by suppressing Lagadec, the dissent reads the Supreme Court precedent to mean that "license agreements that suppress alternative technologies can constitute misuse of the patents for the protected technology." Because Philips would never need to assert the patent it allegedly suppressed, it would never be vulnerable to a misuse defense grounded solely in the Lagadec patent, and barriers to private antitrust suits are high, insulating this sort of collusive agreement

from judicial scrutiny. The dissent also criticizes the majority's holding that the accused infringer must show that the technology was, or would have become, commercially successful, given that agreements between competitors not to compete are "classic antitrust violations" subject to the so-called "quick look" analysis. Dissent at 23.

Because of the sharp division between the majority and the dissenters on the legal question of what conduct can constitute patent misuse, *Princo* is likely to seek review by the Supreme Court. The strong findings of fact by the ITC are likely to make the secondary ruling on competitive effect less attractive for further review. In any event, *Princo* is a major decision on an important issue in many patent infringement cases.

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