



# US Federal Circuit Narrows Patent Misuse Doctrine as a Defence to Patent Infringement

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*Princo Corp. v ITC*, No. 2007-1386, 2010 US App. LEXIS 18101, US Court of Appeals for the Federal Circuit, 30 August 2010 (en banc) ('*Princo II*')

## Abstract

A patent misuse defence requires more than a mere allegation of anticompetitive conduct.

## Legal context

The patent misuse defence, a judicially created doctrine in US patent law, seeks to prevent a patent owner from enforcing a patent that has been misused. While it is often confused with Antitrust Law, it is a separate, more narrowly tailored defence, as the US Court of Appeals for the Federal Circuit explains. In particular, the *Princo II* majority confirms that a claim for patent misuse requires not only a showing that the conduct under challenge has anticompetitive effects under a rule of reason analysis, but also that the challenged conduct improperly expands the scope of the asserted patent. While decisions relating to the patent misuse defence are not often issued, *Princo II* provides further guidance to entities that seek to use patent pools in connection with standards for new product lines.

## Facts

In the 1980s and 1990s, the recordable compact disc (CD-R) and rewriteable compact disc (CD-RW) standards were developed and published in a publication entitled 'Recordable CD Standard', informally known as the 'Orange Book'. Philips and Sony were two of the principal entities behind the development and publication of the Orange Book standards.

At the time, both Philips and Sony had developed their own way of encoding location codes on CDs. Philips' solution was the subject of two US patents, referred to as 'the Raaymakers patents'. Sony's solution was the subject of its own US patent, referred to as 'the Lagadec patent'. In developing the CD-R and CD-RW standards, Philips and Sony engineers agreed to adopt Philips' solution instead of Sony's solution as part of the standard.

Philips, as the administrator of the CD-R and CD-RW licensing program, offered prospective licensees several different 'package' licences to patents owned by Philips, Sony, and others. Included among the patents deemed potentially necessary to manufacture CDs in accordance with the CD-R and CD-RW standards were both the Raaymakers patents and the Lagadec patent. The licences included a 'field of use' restriction that required licensees to produce CDs in accordance with the Orange Book standards.



In the late 1990s Princo entered into a package licence agreement with Philips to manufacture CDs and import them into the US. However, soon after entering into the agreement, Princo stopped paying the licensing fees. Philips filed a complaint against Princo with the International Trade Commission, alleging that Princo violated 19 USC §1337(a)(1)(B) by importing CD-Rs and CD-RWs that infringed Philips' patents. See *In re Certain Recordable Compact Discs & Rewritable Compact Discs*, Inv. No. 337-TA-474, 67 Fed. Reg. 48,948 (ITC 26 July 2002).

In response to Philips' assertions of patent infringement, Princo raised a patent misuse defence based on the theory that, in order to obtain a licence to the patents that were necessary to manufacture CD-R and CD-RW products, Philips forced Princo and other licensees to obtain licences to other patents that were not necessary to manufacture the CD-R and CD-RW products.

Although the Administrative Law Judge (ALJ) found that various claims of six asserted Philips US patents were infringed by Princo and were not invalid, Philips was nonetheless denied relief because the ALJ also found that that the patents were unenforceable due to patent misuse. In particular, the ALJ found that the Philips package licence was an improper tying arrangement, and that the Philips patents were unenforceable due to price fixing, price discrimination, and acts in restraint of trade.

On Philips' petition for review, the International Trade Commission ('the Commission') affirmed the ALJ's ruling that Philips' package licence constituted patent misuse for unlawfully tying patents that were essential for the Orange Book standards to licences for other patents that were not essential. However, the Commission did not address the ALJ's rulings that the patent pooling arrangements between Philips and its co-licensors, including Sony, constituted price fixing and price discrimination, or the ALJ's ruling that the royalty structure of the patent pools resulted in an unreasonable restraint of trade. See *In re Certain Recordable Compact Discs & Rewritable Compact Discs*, Inv. No. 337-TA-474 (ITC 25 Mar. 2004) ('Princo I'). The Federal Circuit reversed Philips I on appeal, rejecting the ALJ's tying theory on the grounds that Philips merely charged others a fixed licensing fee in exchange for the right to manufacture CDs under the Orange Book standards. See *U.S. Philips Corp. v ITC*, 424 F.3d 1179 (Fed. Cir. 2005) ('Princo II').

In *Princo II*, the Federal Circuit recognized that Philips gave its licensees the option to use any patents in the package, and did not require any of the patents in the package licence to be used. *Princo II* also recognized that charging one licensing fee had the advantages of minimizing transaction costs and ensuring against the risk of post-agreement disputes as to whether additional patents were required to practise the patented technology. *Princo II* also rejected the Commission's rule of reason analysis as being based on legal errors and unsupported factual findings. The case was remanded for further proceedings to address the remaining grounds on which the ALJ based his rulings.

On remand, the Commission rejected Princo's remaining theories of patent misuse based on



allegations of price fixing and alleged agreements to foreclose competition. First, the Commission rejected Princo's price fixing argument because there was no evidence in the record that the patents in the package licences covered technologies that were close substitutes, or that the licensors in the patent pool would have competed in the technology licensing market absent the pooling arrangement. Further, the Commission also rejected, as speculative and unsupported by the evidence, Princo's assertion that Philips included Sony's Lagadec patent in the package licence merely to foreclose competition.

This time, Princo appealed the denial of its defences to the Federal Circuit. On this second appeal, a divided three-judge panel ruled against the Commission and Philips, and remanded the case to proceed on one specific issue. See *Princo Corp. v ITC*, 563 F.3d 1301 (Fed. Cir. 2009) (*'Princo I'*).

*Princo I* unanimously rejected Princo's claim that the Philips package licence improperly tied the Raaymakers patents and the Lagadec patent, on the grounds that the alleged tying arrangement had potentially procompetitive efficiencies, such as clearing possible blocking patents, integrating complementary technologies, and avoiding litigation. According to the unanimous panel, a package licence to enable the practice of a particular technology is not the type of tying arrangement that the doctrine of patent misuse was intended to prevent.

*Princo I* also unanimously rejected Princo's claim that the Philips package licence violated the US Supreme Court decision in *Zenith Radio Corp. v Hazeltine Research, Inc.*, 395 US 100, 135 (1969), which held 'conditioning the grant of a patent license upon payment of royalties on products which do not use the teaching of the patent [is] misuse.' Specifically, the *Princo I* panel unanimously found that, since at the time the package licence was executed it appeared that the Lagadec patent might reasonably be necessary to manufacture Orange Book compact discs, 'it cannot fairly be said on these facts that a royalty is paid on products which do not use the teaching of the Lagadec patent' (560 F.3d at 1312-13).

Finally, the one issue on which the panel was divided was 'whether an agreement that would prevent the development of alternatives [to the licensed technology] would constitute misuse under a theory of elimination of competition or price fixing.' (*Id.* at 1314.) The majority found that despite the inadequate record, this issue should be remanded again to the Commission, 'to determine whether "Philips and Sony agreed not to license Lagadec in a way that would allow a competitor "to develop, use or license the [Lagadec] technology to create a competing product"', ie, a product that would compete with the technology of the Raaymakers patents, and whether, if there was such an agreement, the suppressed technology "could not have been viable," which would "negate a charge of misuse."' [*Princo II*, 2010 US App. LEXIS 18101 at \* 16 (citation omitted)]. Philips and the Commission filed petitions for rehearing en banc which raised numerous issues. The Federal Circuit granted a rehearing en banc which addressed the final disputed issues for which the *Princo I* panel granted a remand. See *Princo Corp. v ITC*, 583 F.3d 1380 (Fed Cir. 2009) (*per curiam order granting rehearing en banc*).



## Analysis

On 30 August 2010 the Federal Circuit issued its en banc decision in *Princo II*. Since there was no dispute regarding the panel's decision to deny Princo's first two theories of patent misuse, that portion of the opinion was reinstated and not substantively addressed in *Princo II*.

Rather, *Princo II* addresses whether Princo's assertion that the agreement between Philips and Sony to include the Lagadec patent in the Orange Book constituted patent misuse as a purported horizontal agreement between two competitors to suppress competing technology.

The majority opinion, authored by Judge Bryson, and joined by Chief Judge Rader and Judges Newman, Lourie, Linn and Moore, rejected this theory and crafted a narrow view of the doctrine of patent misuse. In particular, the majority confirmed that not every antitrust violation gives rise to a patent misuse claim. Rather, patent misuse requires a connection between the allegedly anticompetitive conduct and the patent-in-suit.

Further, the majority confirmed that patent misuse requires proof of anticompetitive effect. Since Princo's claim established neither a sufficient connection between the patent-in-suit and the allegedly anticompetitive conduct nor a reasonable probability of anticompetitive effect, the majority affirmed the dismissal of Princo's claim.

Judge Prost authored a separate concurring opinion, which was joined by Judge Mayer. Judges Prost and Mayer agreed that the facts of this case did not establish any anticompetitive effects, but declined to reach the broader issues.

Judge Dyk authored a dissenting opinion, in which Judge Gajarsa joined, that would have reached the conclusion that the existence of an antitrust violation—in the form of an agreement to suppress an alternative technology designed to protect a patented technology from competition—constitutes patent misuse.

This current intelligence provides a summary of the rationale applied by the majority to find that Princo failed to establish a patent misuse defence.

The *Princo II* majority began its substantive discussion of the doctrine of patent misuse by reviewing the leading US Supreme Court cases on point and the legislative history of 35 U.S.C. §274(d), which limits the availability of the defence. As the majority recognized, the doctrine of patent misuse is a judicially created defence that has its roots in a series of US Supreme Court decisions dating from 1917. See *Princo II*, 2010 US App. LEXIS 18101, at \*17-20 [citing and discussing *Motion Picture Patents Co. v Universal Film Mfg. Corp.*, 243 US 502 (1917); *Carbice Corp. of Am. v American Patents Dev. Corp.*, 283 US 27 (1931); *Morton Salt Co. v G.S. Suppiger Co.*, 314 US 488 (1942)]. *Princo II* summarized the teachings of this line of cases as follows:

“In those cases, and several others in the same line of authority, the Supreme Court established the basic rule of patent misuse: that the patentee may exploit his patent but may not ‘use it to acquire a monopoly not embraced in the patent.’”



[2010 US App. LEXIS 18101, at \*20 (quotation omitted).] The *Princo II* majority summarized the types of arrangements that the US Supreme Court had found to constitute patent misuse as:

1. requiring the purchase of an unpatented product as a condition for obtaining a licence to a patented product; and
2. requiring the payment of licensing fees after the expiration of the licensed patent and thus having the effect of extending the life of the patent beyond the statutory period.

In reviewing the Federal Circuit's prior statements on the doctrine of patent misuse, the *Princo II* majority states, 'we have characterized patent misuse as the patentee's act of "impermissibly broaden[ing] the 'physical or temporal scope' of the patent grant with anticompetitive effect.'" [Id. at \*21-22, citing *Windsurfing Int'l, Inc. v AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986).]

Thus the *Princo II* majority summarized the essence of a patent misuse claim as follows:

"It follows that the key inquiry under the patent misuse doctrine is whether, by imposing the condition in question, the patentee has impermissibly broadened the physical or temporal scope of the patent grant and has done so in a manner that has anticompetitive effects. Where the patentee has not leveraged its patent beyond the scope of rights granted by the Patent Act, misuse has not been found. (Id. at \*23-24 (citation omitted).)"

Significantly, the *Princo II* majority adopted a narrow view of the patent misuse defence:

"Recognizing the narrow scope of the doctrine, we have emphasized that the defence 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. ... While proof of an antitrust violation shows that the patentee has committed wrongful conduct having anticompetitive effects, that does not establish misuse of the patent in suit unless the conduct in question restricts the use of that patent and does so in one of the specific ways that have been held to be outside the otherwise broad scope of the patent grant. (Id. at \*25-26.)"

In other words, to establish a patent misuse defence, not only must the proponent of the defence establish some kind of wrongful conduct that has anticompetitive effects, but he must also establish that the wrongful conduct is tied to the patent sought to be enforced: '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.' [Id. at \*34-35 (citation omitted)]. In the *Princo II* majority's discussion of the narrow application of the patent misuse defence, it also turned to 35 USC §271(d), which it found was enacted by Congress to 'cabin in', not 'broaden', the defence. In



rejecting Princo's claim, the *Princo II* majority explained:

“Philips is not imposing restrictive conditions on the use of the Raaymakers patents to enlarge the physical or temporal scope of those patents. Instead, the alleged act of patent misuse that the panel focused on was 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. Even if such an agreement were shown to exist, and even if it were shown to have anticompetitive effects, a horizontal agreement restricting the availability of Sony's Lagadec patent would not constitute misuse of Philips's Raaymakers patents or any of Philips's other patents in suit. (*Id.* at \*31-32.)”

It is also significant that the *Princo II* majority (and the concurring opinion) found that in any event ‘Princo failed to establish that the alleged agreement to suppress the Lagadec technology had anticompetitive effects’ since:

1. ‘Philips and Sony acted legitimately in choosing not to compete against their own joint venture;’ and
2. ‘the Lagadec technology was not a viable potential competitor to the technology embodied in the Raaymakers patents.’ (*Id.* at \*41.)

To support these conclusions, in addition to relying upon the Commission's findings, the *Princo II* majority cites, *inter alia*, the US Department of Justice & US FTC's Antitrust Guidelines for the Licensing of Intellectual Property for the following proposition:

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.’ (*Id.* at \*45-46.)

In sum, the *Princo II* majority confirmed that a patent misuse defence is a narrow, judicially created defence to be applied where a patentee improperly seeks to broaden the physical or temporal scope of a patent through anticompetitive conduct which is directly connected to broadening the scope of the patent and has an anticompetitive effect. Since Princo failed to establish that the conduct it complained of was directly connected to broadening the scope of the patent (either physically or temporally), and failed to establish an anticompetitive effect, its assertion of a patent misuse defence was rejected.

### **Practical significance**

It has become common in at least the consumer electronics industry for competitors to jointly establish standards for new products, and to create pools of patents that relate to such standards. *Princo II* recognizes the procompetitive effects that such arrangements can



have, and restricts the availability of patent misuse defences to these types of arrangements when they are properly structured. The guidance provided in *Princo II* should help guide participants in structuring such future arrangements.

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