Department of Justice

DETAILED ANALYSIS OF ANTITRUST LEGISLATIVE REFORMS PROPOSED BY THE DEPARTMENT OF JUSTICE

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Research Joint Ventures and Other Potentially Procompetitive Activities--Eliminating Treble Damage Disincentives

The Need for Legislation

Treble Damage Awards

A unique feature of antitrust law enforcement is the private treble damage action. Under Section 4 of the Clayton Act, anyone injured by an antitrust violation and possessing adequate standing may recover damages, which are automatically trebled. 1/ While the precise rationale for adoption of the mandatory trebling provision cannot be identified authoritatively from legislative history, several rationales have since been provided. Mandatory trebling provides an incentive for "private attorneys general" to challenge anticompetitive conduct, thus supplementing the enforcement resources of the government agencies. Mandatory trebling also serves both general and specific deterrence goals. However,

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1/ Section 4 of the Clayton Act provides in pertinent part:

> Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . . and shall recover threefold the damages by him sustained and the cost of suit, including a reasonable attorney's fee.

Section 4C of the Clayton Act, permitting state attorney general suits on behalf of natural persons within the state, also provides for treble damage awards.

long experience with the private treble damage action has shown that mandatory trebling may be having other, less desirable effects. 2/ These effects point to a need for legislation that would reform antitrust damage remedies to provide treble damages in *per se* cases and compensatory damages in rule of reason cases.

The earliest antitrust rulings by the courts differentiated between business conduct that was so likely to injure competition that it could be deemed illegal without inquiry into competitive effect in every specific case (the *per se* violation), and conduct that had sufficient procompetitive potential that it could be condemned only after consideration of its overall purposes and effects in the particular circumstances presented. Thus, minimum price-fixing among direct competitors is *per se* illegal, while joint ventures are not unlawful unless shown to be anticompetitive in the situations in which they are challenged.

This distinction between *per se* and other offenses has been reinforced by subsequent judicial interpretation, and by the policies of the Department of Justice. With rare exception, the

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2/ The mandatory treble damage rule has often been the subject of study and concern. For example, there have been proposals to allow single damages only in event of "inadvertent" violation (*see*, *e.g.*, H.R. 4597, 83d Cong., 1st Sess. (1953)), or to make trebling discretionary in the trial court (*see*, *e.g.*, U.S. Attorney General's National Committee to Study the Antitrust Laws, Report at 379 (1955); 2 P. Areeda & D. Turner, Antitrust Law, ¶ 331b, at 150 (1978)).

criminal sanction has been invoked only to condemn *per se* violations. Both the case-by-case evolution of the category of *per se* offenses and this long-standing criminal enforcement policy have been guided by perceived differences in the basic nature of the conduct falling into these categories. *Per se* offenses, because they are thought so rarely to have any effect beyond the suppression of competition, have come to be regarded as serious offenses against the public. The use of the criminal sanction to punish such offenses has emerged from and has in turn reinforced this perception. On the other hand, it is recognized that business behavior judged under the rule of reason can benefit consumers by reducing prices and by increasing product output, quality and variety. Such behavior cannot be regarded as inherently reprehensible or properly the subject of punitive sanctions, criminal or civil. Again, the near-universal tendency of public prosecutors to avoid use of the criminal sanction in the rule of reason category both follows from and contributes to this view of culpability.

Regardless of the culpability of the defendant, however, the consequence of a judgment of civil liability is the imposition of treble damages. This inflexibility is objectionable for several reasons. First, mandatory imposition of treble damages in all cases violates notions of fundamental fairness. Where a generally worded law such as the Sherman Act proscribes conduct that is clearly illegal, *e.g.*, bid rigging by competitors, and seeks to punish as well as to deter such conduct by imposing what amount to civil fines or punitive damages, then that law ought clearly to distinguish such conduct from business behavior whose legality can be determined only after close analysis of its actual competitive effects. To punish businesses to the same degree and in the same fashion for both per se and rule of reason violations, as the damage law does now, is offensive to basic notions of fair play. 3/

Second, mandatory treble damages probably overdeter desirable, procompetitive conduct. The rationale for the existence of a "rule of reason" category is that some business behavior has ambiguous competitive effects. Yet such behavior is subjected to damages of the same severity as the most pernicious cartel violation. Behavior that has no redeeming features cannot, of course, be overdeterred. But behavior that can improve productivity and benefit consumers will be overdeterred if there is substantial risk that the severe sanction of treble damages will be imposed. The enforcement agencies have no control of

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3/ Generally speaking, per se cases involve conduct that is concealed, collusive activity, while rule of reason cases involve conduct that is open and notorious, e.g., distribution agreements. Some commentators have viewed, as one of the justifications for the treble-damages awarded in per se cases, the fact that the wrongdoer's conduct may not be discovered and adequately punished. In this sense, the treble-damage award provides a kind of rough justice for the violator. See, e.g., R. Posner, Antitrust Law, 223-227 (1976).

this sanction. Accordingly, it is very likely that socially beneficial conduct is deterred by the mandatory nature of the treble damage remedy.

Joint research efforts, for example, may produce important advances in technology, lower costs, and higher employment and growth. They can enable smaller businesses to stay competitive in new or technologically-evolving marketplaces, and they may stimulate productivity growth that will enable the United States to maintain leadership in world trade. Antitrust should encourage, rather than retard, such efforts.

A related problem created by mandatory trebling involves the evolution of both the substantive standards of liability under the antitrust laws, and equally important procedural and jurisdictional attributes of antitrust enforcement. Upon being sued, an antitrust defendant is forced into a cost-benefit analysis of whether and how to defend itself. The potential cost of a treble-damage award may often far exceed the benefits that might be derived from successfully defending the case. In that situation, sound business judgment may force the abandonment of desirable, procompetitive business practices, and acceptance of a settlement of the case without judicial examination of the competitive aspects of the challenged practices. If damages were merely compensatory, businesses might be more willing to seek vindication of such practices under the rule of reason. Better law, an open judicial process, and more rational business decision-making may therefore result from elimination of the mandatory trebling requirement in rule of reason cases. 4/

Compensatory Prejudgment Interest

As its name suggests, prejudgment interest is interest on the damages awarded a successful plaintiff that would accrue before entry of the judgment--normally, the period from the date on which the litigation was commenced to the date on which judgment was entered. Until 1980, neither statute nor case law provided clear authority for awards of prejudgment interest in antitrust cases. Prejudgment interest is now available to a very limited extent in antitrust cases, under conditions which, with one exception, 5/ take no account of the need to assure that plaintiffs are fully compensated for their injuries, but instead require demonstrations of bad faith, dilatory behavior, or delaying tactics by the defendant.

The merits of these limitations may be debated under the present statutory scheme, which requires the trebling of damages in all antitrust cases. However, if, as suggested above, legislation is passed to limit recoveries to actual damages in "rule of reason" cases, it will be necessary to award prejudgment

4/ *See, generally*, W. Schwartz, An Overview of the Economics of Antitrust Enforcement, 68 Georgetown L.J. 1075 (1980).

5/ The one exception occurs in suits by the United States, where compensation is to be a factor in prejudgment interest awards.

interest as a matter of course in such cases if the plaintiff is to be made whole. 6/ Moreover, if the compensatory and deterrent goals of private damage actions are to be more clearly differentiated and pursued through legislation that would require the trebling of damages in a discrete, identifiable category of cases, there is no reason why prejudgment interest should not be awarded in such cases as well. Of course, in such cases, prejudgment interest should be awarded only on actual damages, in keeping with its compensatory purposes.

Finally, since plaintiff's damage theory and conduct during litigation can influence the amount of prejudgment interest that should be awarded, courts should be empowered to adjust such awards if circumstances indicate that normal assumptions as to the need for compensatory prejudgment interest would lead to unjust results.

Proposed Legislation-Amendments to Clayton Act §§ 4, 4A, and 4C

Section 4 of the Clayton Act, 15 U.S.C. § 15, should be amended to read as follows (material to be deleted is bracketed, material to be added is underlined):

6/ Prejudgment interest is awarded in admiralty cases, for example. In Sea-Land Service, Inc. v. Eagle Terminal Tankers, Inc., 443 F. Supp. 532 (W.D. Wash. 1977), the court expressly recognized that the policies behind awarding prejudgment interest are based upon the desire that the injured party be fully and fairly compensated for his loss.

"Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover [threefold the] actual damages by him sustained, simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee; provided, that damages attributable to agreements or practices the nature or necessary effect of which is so plainly anticompetitve that they are deemed unreasonable and therefore illegal without elaborate study in each individual case as to the precise harm they have caused or the business justification for their use shall be trebled.

[The court may award under this section, pursuant to a motion by such person promptly made, simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only--

(1) whether such person or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay, or otherwise acted in bad faith;

(2) whether, in the course of the action involved, such person or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(3) whether such person or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.]"

Section 4A of the Clayton Act, 15 U.S.C. § 15a, should be amended to read as follows (material to be deleted is bracketed, material to be added is underlined):

"Whenever the United States is hereafter injured in its business or property by reason of anything forbidden in the antitrust laws it may sue therefor in the United States district court for the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover actual damages by it sustained, simple interest on actual damages for the period beginning on the date of service of the pleading of the United States setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit. [The court may award under this section, pursuant to a motion by the United States promptly made, simple interest on actual damages for the period beginning on the date of service of the pleading of the United States setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only--

(1) whether the United States or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay or otherwise acted in bad faith;

(2) whether, in the course of the action involved, the United States or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings;

(3) whether the United States or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof; and

(4) whether the award of such interest is necessary to compensate the United States adequately for the injury sustained by the United States.]"

Subsection (a)(2) of Section 4C of the Clayton Act, 15 U.S.C. § 15c(a)(2), should be amended to read as follows (material to be deleted is bracketed, material to be added is underlined):

"(2) The court shall award the State as monetary relief [threefold] the total damage sustained as described in paragraph (1) of this subsection, <u>simple</u>

interest on the total damage for the period beginning on the date of service of such state's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances, and the cost of suit, including a reasonable attorney's fee; provided, that damages attributable to agreements or practices the nature or necessary effect of which is so plainly anticompetitive that they are deemed unreasonable and therefore illegal without elaborate study in each individual case as to the precise harm they have caused or the business justification for their use shall be trebled. [The court may award under this paragraph, pursuant to a motion by such State promptly made, simple interest on the total damage for the period beginning on the date of service of such State's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this paragraph for any period is just in the circumstances, the court shall consider only--

(A) whether such State or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay or otherwise acted in bad faith;

(B) whether in the course of the action involved, such State or the opposing party, or either party's representative, violated any applicable rule, statute, or court order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(C) whether such State or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.]"

Explanation of Proposed Amendments to Clayton Act §§ 4, 4A, and 4C--Trebling of Damages and Prejudgment Interest

The proposed amendments to Section 4 of the Clayton Act would delete the requirement that plaintiffs' damages be trebled in all actions brought under that section. Rather than trebling in all cases, the amendments would require trebling of damages attributable to "agreements or practices the nature or necessary effect of which is so plainly anticompetitive that they are deemed unreasonable and therefore illegal without elaborate study in each individual case as to the precise harm they have caused or the business justification for their use." These agreements or practices are the so-called "per se" antitrust violations. They include, for example, price fixing and bid rigging among competitors. These are classic cartel activities that serve no purpose other than to suppress competition and adversely affect consumers. Their deterrence is unambiguously beneficial.

The proposed statutory standard for trebling is derived from the Supreme Court's descriptions of per se offenses in National Society of Professional Engineers v. United States, 435 U.S. 679, 692 (1978), and Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5 (1958). The phraseology of the standard is familiar to and well understood by the legal community, and the practices it describes are universally recognized as antitrust violations by the business community. It is an appropriate "bright line" to draw between clear violations that warrant multiple damage remedies and violations that are found on the basis of competitively ambiguous behavior that warrants the payment of compensatory damages only. Importantly, it is a "living" standard that will follow the evolution of antitrust law with respect to per se rules.

The proposed amendments to Section 4 of the Clayton Act also would allow a person injured by an antitrust violation to recover "simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, such interest to be adjusted by the court if it finds that the award of all or part of such interest is unjust in the circumstances." Provisions of present law, which allow an injured person to recover prejudgment interest only upon a showing of conduct by the defendant during litigation that demonstrates intentional delay, bad faith, or dilatory tactics, would be deleted.

The award of prejudgment interest is necessary to fully compensate the victim of an antitrust violation for his loss in any case in which damages are not to be trebled. Under this proposal, such interest would be awarded as a matter of course unless the court finds that all or part of it is unjust in the circumstances, e.g., where the plaintiff's damage theory is inconsistent with the award of prejudgment interest or where the plaintiff has engaged in dilatory or delaying tactics during the litigation.

Prejudgment interest on actual damages also would be available in cases in which the per se nature of the violation leads to trebled damages. Opponents of prejudgment interest in treble damage cases in recent years have urged that the trebling of damages more than makes up for the unavailability of prejudgment interest. This may be so if one's focus is limited to compensating the plaintiff for his loss, but the proposed amendments are intended to draw clear distinctions between cases in which damages are designed primarily to make injured parties whole, and cases in which damages are designed both to compensate injured parties and to encourage private enforcement and deter clear violations. The trebling of damages under the proposed scheme serves distinct purposes other than compensation and there is no reason why defendants who commit *per se* antitrust violations should be excused from the compensatory remedy of prejudgment interest.

Comparable amendments are proposed to Sections 4A and 4C of the Clayton Act. Section 4A, which provides a single damage remedy for the United States whenever it is injured by an antitrust violation, would be amended to track Section 4 with respect to awards of prejudgment interest for compensatory purposes. Section 4C, which allows state attorneys general to bring treble damage actions as parens patriae on behalf of citizens injured by antitrust violations, would be amended to track Section 4 with respect to both compensatory prejudgment interest and the trebling of damages.

Intellectual Property Licensing and the Antitrust Laws

The Need for Legislation

There is no disagreement concerning the urgent need to increase the ability of U.S. industries to develop and adopt new technology. Innovation plays a key role in our economic system, producing growth, employment, new products and processes, and more efficient means of producing and distributing existing products. Innovation is also the key to effective American competition in the evolving worldwide markets for technologically-advanced products. In this context, it is crucial that this country's laws not unnecessarily interfere with the innovation process. However, current court interpretations of the antitrust laws in the area of exploitation of intellectual property unnecessarily deter innovation.

The protection of intellectual property is vital to maintaining an atmosphere conducive to innovation. The willingness to invest heavily in research and development aimed at producing new technology depends upon the perceived rewards from the investment. If protection of proprietary technology is weak, the private sector cannot be expected to devote capital to R&D. The recognition of proprietary rights in intellectual property is directed at this problem. For example, the patent grant permits the patent owner to exclude all competitors from practicing the patented invention. By so doing, the patent grant increases the rewards for R&D and thereby encourages invention.

The ability to license proprietary technology is another important component of a legal system conducive to innovation. Licensing permits the patentee to match its own knowledge and other advantages with those of its licensees, who may possess superior production, distribution, or marketing facilities or skills. Licensing can result in products getting to the marketplace more quickly or at lower cost than would be possible through reliance only upon the patentee's own resources. Licensing can therefore be important in allowing domestic patent owners to compete more effectively with foreign and domestic firms that sell competing goods. Equally important, by allowing the patentee to utilize its patent in the way it deems most effective, licensing increases the value of the patent grant, and hence increases the perceived rewards and the incentive to innovate.

The same benefits that result from granting exclusive licensable rights in patents also result from granting or allowing licensable proprietary rights in other forms of intellectual property, including copyrights, trademarks, and trade secrets. In each of these areas there are analogous "free rider" problems that would undermine the creation of the intellectual property if proprietary rights did not exist, and in each area there are analogous potential efficiencies from licensing of these rights.

Despite these efficiencies, and despite the critical role of intellectual property, courts have sometimes condemned licensing practices under the antitrust laws without sufficient sensitivity to their basic procompetitive nature and purpose. This precedent impairs efficient exploitation of intellectual property and impedes innovation. Legislation should be enacted to rectify this situation.

The need for such legislation can be illustrated by looking at the antitrust treatment of patent licensing. In evaluating the conduct of patentees under the antitrust laws, the courts have relied upon Supreme Court decisions which depict the patent system as inherently in conflict with antitrust goals. The Supreme Court has depicted the patent grant as a "monopoly" 1/ the limits of which are to be "narrowly and strictly confined," 2/ so as to avoid the "evils of an expansion of the patent monopoly by private engagements." 3/ This view of the patent grant has been adopted by the lower courts. One court stated in a recent decision: 4/

> [The patent] grant is in inevitable tension with the general hostility against monopoly expressed in the antitrust laws, 15 U.S.C. § 1 *et seq*. Therefore, courts normally construe patent rights narrowly in deference to the public interest in competition.

1/ United States v. Line Material, Inc., 333 U.S. 287 (1948); Mercoid Corp. v. Mid-Continent Co., 320 U.S. 661 (1944); Ethyl Corp. v. United States, 309 U.S. 436 (1940); Carbice Corp. v. American Patent Development Co., 283 U.S. 27 (1931); Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502 (1917).

2/ Mercoid Corp. v. Mid-Continent Co., *supra*, at 665.

3/ *Id*. at 666.

4/ United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122, 1127 (D.C. Cir. 1981).

This approach is undermined by the observation that the patent owner's monopoly encourages competition between and among different technologies. Rather than being inherently at odds with a competitive economic system, the patent system is an important part of that system.

Based in part upon the misleading view of an inherent patent/antitrust conflict, courts have occasionally condemned as per se unlawful certain patent license practices under the antitrust laws. 5/ Even application of the rule of reason approach has been clouded in the patent context by the more fundamental judicial animosity towards the patent grant.

A per se approach is potentially very damaging to the innovation process. Under a per se approach courts condemn licensing conduct without considering its economic justifications or its actual economic effects. Thus, the per se doctrine undermines the ability of owners of proprietary technology to exploit their rights in the most efficient way possible. The doctrine thereby undermines the procompetitive objectives of the patent grant.

5/ See, e.g., International Salt Co. v. United States, 332 U.S. 392 (1947); United States v. Studiengesellschaft Kohle, m.b.H., 426 F. Supp. 143, 149 (D.D.C. 1976), 1978-2 Trade Cas. ¶ 62,291 (D.D.C. 1978), rev'd, 670 F.2d 1122 (D.C. Cir. 1981); United States v. Glaxo Group Ltd, 302 F. Supp. 1 (D.D.C. 1969), rev'd on other grounds, 410 U.S. 552 (1973); cf. United States v. Loew's, 332 U.S. 392 (1947) [copyright licensing]; United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948) [copyright licensing].

The rationale of the Supreme Court decision in Continental-TV, 6/ which abandoned the per se approach to vertical arrangements, is equally applicable to licensing. However, Continental-TV did not explicitly involve patents, and the risk therefore continues to exist that courts will use a per se approach in certain cases involving patent exploitation. Removing this risk legislatively would encourage innovation by assuring inventors that licensing practices cannot be declared unlawful under the antitrust laws without consideration of their procompetitive effects. Accordingly, it is appropriate to amend the antitrust laws to assure that a per se approach is not employed in the patents or intellectual property context.

Proposed Legislation--Amendment of the Clayton Act

The Clayton Act should be amended by adding the following new section:

> Agreements to develop, or to convey rights to use, practice or sublicense, patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property, shall not be deemed unlawful per se in actions under the antitrust laws.

6/ Continental TV, Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

Explanation of Proposed Legislation-- Amendment of the Clayton Act

The proposed new section of the Clayton Act would prevent courts from treating intellectual property license arrangements as per se illegal under the antitrust laws. By so doing, it would force courts to assess the lawfulness of these arrangements under the antitrust laws through use of a rule of reason analysis. It is also intended to signal courts that the rule of reason analysis should not be given mere lip service when intellectual property licensing is involved, and that under such analysis, the efficiencies and other procompetitive benefits involved in the particular licensing arrangement, as well as the procompetitive benefits of intellectual property protection and licensing in general, must be weighed against any argued anticompetitive effects.

It should be stressed that the proposed amendment will not result in anticompetitive behavior being found lawful under the antitrust laws. Proscription of a per se approach merely obliges the courts to hear evidence on the actual economic effects of the licensing arrangement. Anticompetitive conduct, be it in a vertical or horizontal context, will remain illegal and should be so found under a rule of reason analysis.

Patent and Copyright Misuse--Standards for Finding Competitive Harm

The Need for Legislation

Economic reward is the motive for most investment in the development of new technology. The patent laws are intended to ensure that inventors earn that reward by granting them exclusive rights to make, use, and sell their inventions. Patent owners then secure their reward through infringement actions brought against those who make, use, or sell the inventions without permission, or by enforcing bargains made with those to whom they have given such permission. In circumstances where a patentee's behavior is said to be a "misuse" of the patent right, courts have refused to enforce the inventor's exclusive rights, thus allowing free use of the invention and destroying the value of the patent.

There are two types of cases defining the circumstances in which misuse may be said to occur. The first involves patent licenses that affect commerce outside the scope of the patent claims. The courts have held that it is patent misuse for the patent owner to require a licensee to: (1) purchase unpatented products from a particular source (tie-in); 1/ (2) refrain from dealing in products that compete with the patented product (tie-out

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1/ See, e.g., Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488 (1942).

or exclusive dealing); 2/ (3) license additional patents in order to obtain a license of a particular patent (compulsory package licensing); 3/ or (4) pay royalties under the patent based in whole or part on the sales of an unpatented product (total sales royalties). 4/

The second major line of patent misuse cases involves decisions of the patent owner as to whether to license a particular party and, if so, at what royalty. The courts have found misuse where the patent owner licensed one licensee at a rate that differed from the rate charged other licensees, 5/ refused to license a patent that it licensed to others, 6/ and even where the patent owner charged rates that were deemed exorbitant and oppressive. 7/

Both lines of cases are based on assumptions that the practices classified as misuse are necessarily anticompetitive, and

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2/ National Lockwasher Co. v. George K. Garrett Co., 137 F.2d 255 (3d Cir. 1943); McCullough v. Kammerer Corp., 166 F.2d 759 (9th Cir.), *cert. denied*, 335 U.S. 813 (1948).

3/ Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, *on remand*, 418 F.2d 21 (7th Cir. 1969), *rev'd*, 401 U.S. 321 (1971).

4/ *Id.*

5/ Laitram Corp. v. King Crab Inc., 244 F. Supp. 9, *modification denied*, 245 F. Supp. 1019 (D. Alaska 1965).

6/ Allied Research Products, Inc. v. Heatbath Corp., 300 F. Supp. 656 (N.D. Ill. 1969).

7/ American Photocopy Equipment Co. v. Rovico, Inc., 359 F.2d 745 (7th Cir. 1966).

beyond the rights afforded patentees by the patent system. These assumptions are incorrect. Some existing patent misuse precedent is unsound because it condemns certain conduct as economically contrary to public policy without going through the analysis necessary to determine whether such conduct is in fact anticompetitive.

One example will illustrate the way in which misuse doctrine has given rise to an unnecessary tension between patent protection and competitive policy. A "tie-in" is a practice by which the owner of a patent requires purchasers or licensees of the invention to also purchase their requirements of some other item from the patentee. When courts first confronted this practice, its anticompetitive effects seemed so self-evident, and its possible procompetitive justifications so remote, that the practice was condemned, both as an antitrust violation and as a patent misuse.

However, years of experience, observation, and analysis by economic and legal commentators have shown that this practice may have important procompetitive benefits for the innovative process. If, for example, the potential purchasers of a new invention are uncertain as to the use to which it might be put, they might be unwilling to pay a high initial price for that invention. If, on the other hand, the patentee could sell the invention at a low price, and charge a higher-than-market price for some item used in conjunction with the invention, then the patentee and the purchaser could, in effect, share the risk that the purchaser might not use the invention intensively. If, for example, the invention is a punch-card reader, a tie of the reader to the punch cards used in the reader could serve this procompetitive purpose. If the purchaser uses the reader intensively, a large number of cards will be purchased, and the patentee will receive a greater reward for the invention. If, on the other hand, the purchaser finds no use for the machine, no cards will be purchased and only the low initial price of the reader is paid.

There are numerous other examples of similar practices which may have important beneficial effects for competition and the innovative process, but which have been the subject of condemnation under the misuse doctrine.

Overly inclusive misuse doctrines can have serious anticompetitive effects, and can retard innovation. Innovation is an important part of the competitive process, since it results in new products and more efficient means of producing and distributing existing products. Innovation is also a key factor in the ability of American firms to keep pace with their foreign competitors in technologically-evolving worldwide industries. The patent grant is intended to foster innovation by granting the patentee exclusive rights in his invention. To the extent that patent misuse doctrine unnecessarily and unreasonably interferes with the manner in which patentees choose to license it decreases the perceived value of patents and thus retards innovation.

Congress should pass legislation to bring patent misuse doctrine within appropriate boundaries. Patent licensing practices that have alleged anticompetitive effects should not be condemned out of hand. Such practices should be scrutinized in the circumstances in which they occur, in full recognition of the exclusive rights granted to patentees under patent law, in order to determine whether they are substantially likely to reduce competition. Only after such a finding should a patentee be found to have misused his patent. Such legislation would not prohibit courts from exercising their equitable jurisdiction and refusing to enforce valid patents in circumstances involving fraud or other inequitable conduct. However, it would force courts to use sound economic analysis before condemning on competitive grounds patent licensing practices previously classified as misuse.

The copyright laws should be amended in a similar manner. The doctrine of misuse has been developing in copyright infringement actions, although not nearly as extensively as in the patent area. 8/ While some courts have refused to apply the defense of copyright misuse, 9/ it has been applied in a number of cases. 10/ As in the area of patent misuse the courts have sometimes found

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8/ See generally 3 Nimmer on Copyright, § 13.09(A) (1982).

9/ Id. at 13-112.2 n.3, 6. See also Foreign Car Parts, Inc. of New England v. Auto World, Inc., 366 F. Supp. 977 (M.D. Pa. 1973); Harms, Inc. v. Sansom House Enterprises, Inc., 162 F. Supp. 129 (E.D. Pa. 1958).

10/ Id. at 13-112.3 n.5. See also F.E.L. Publications, Ltd. v. Catholic Bishop of Chicago, 1982-1 Trade Cas. ¶ 64,632 (7th Cir. 1982), petition for cert. filed, July 1982.

copyright misuse on competitive grounds without sound economic analysis. Consequently, amendment of the patent laws to address the misuse problem should be accompanied by corresponding amendment of the copyright laws.

Proposed Legislation--Amendments to
35 U.S.C. § 271 and 17 U.S.C. § 501

Subsections (c) and (d) of 35 U.S.C. § 271 should be redesignated as subsections (c)(1) and (c)(2), respectively, and the following should be added as new section 271(d):

> (d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following, unless such conduct, in view of the commercial circumstances in which it is employed, is likely substantially to lessen competition: (1) licensed the patent under terms that affect commerce outside the scope of the patent's claims, (2) restricted a licensee of the patent in the sale of the patented product or in the sale of a product made under a patented process, (3) obligated a licensee of the patent to pay royalties that differ from those paid by another licensee or are allegedly excessive, (4) obligated a licensee of the patent to pay royalties in amounts not related to the licensee's sales of

the patented product or the product made by the patented process, (5) refused to license the patent to any person, or (6) otherwise used the patent allegedly to suppress competition.

The present law on copyright infringement, 17 U.S.C. § 501(a), should be amended to read as follows (material to be added is underlined):

Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 108, or who imports phonorecords into the United States in violation of section 602, is an infringer of the copyright. No copyright owner otherwise entitled to relief for infringement of a copyright under this title shall be denied relief or deemed guilty of misuse or illegal extension of the copyright by reason of his having done one or more of the following, unless such conduct, in view of the circumstances in which it is employed, is likely substantially to lessen competition: (1) licensed the copyright under terms that affect commerce outside the scope of the copyright, (2) restricted a licensee of the copyright in the sale of the copyrighted work, (3) obligated a licensee of the copyright to pay royalties that differ from those paid by another licensee or are allegedly excessive, (4) obligated a licensee of the copyright to pay royalties in amounts not related to the licensee's sales or use of the copyrighted work, (5) refused to license the copyright to any person, or (6) otherwise used the copyright allegedly to suppress competition.

Explanation of Proposed Legislation--Amendments to 35 U.S.C. § 271 and 17 U.S.C. § 501

The proposed amendment to § 271 of Title 35 would redesignate subsections (c) and (d) as new subsections (c)(1) and (c)(2), respectively. Subsection (c) defines contributory infringement; subsection (d) lists three activities that patentees may engage in, primarily to combat contributory infringement, without being found guilty of patent misuse or illegal extension of a patent. 11/ Redesignation will leave these provisions intact, and thus leave unchanged existing law regarding the extent to which and manner in which a patentee may prohibit the sale by others of commodities that have no substantial use other than use that would infringe his patent. 12/

The proposed amendment also would replace redesignated subsection (d) with a new subsection (d), which would list several patent licensing practices that could not provide the basis for a

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11/ These activities are (1) deriving revenue from acts which if performed by another without his consent would constitute contributory infringement, (2) licensing or authorizing another to perform such acts, and (3) seeking to enforce his patent rights against infringement or contributory infringement.

12/ See generally Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176 (1980).

finding of misuse or illegal extension of a patent unless such practices were found, in view of the circumstances in which they were employed, likely to substantially lessen competition. These practices include the following:

(1) licensing the patent under terms that affect commerce outside the scope of the patent's claims (e.g., requiring a licensee to purchase unpatented materials from the licensor, requiring a licensee to assign to the patentee a patent that may be issued to the licensee after the licensing arrangement is executed, restricting a licensee's freedom to deal in products or services outside the scope of the patent, requiring the licensee to become a licensee of a second patent);

(2) restricting a licensee of the patent in the sale of the patented product or in the sale of an unpatented product made under the patented process;

(3) obligating a licensee of the patent to pay royalties that differ from those paid by another licensee or are allegedly excessive;

(4) obligating a licensee of the patent to pay royalties in amounts that are not related to the licensee's sales of the patented product or unpatented product made by the patented process;

(5) refusing to license the patent to any person; or

(6) otherwise using the patent in a manner that allegedly suppresses competition.

Proposed new subsection 271(d) would carefully limit the patent misuse doctrine but not eliminate it. Courts would still have the discretion to refuse to enforce a valid, infringed patent on grounds not related to competition (e.g., fraud on the Patent Office) and on competitive grounds whenever any of the practices specified in the amendment are likely to substantially lessen competition. Thus, courts could classify conduct as misuse on economic grounds only when an accurate economic analysis, done in full recognition of a patentee's exclusive rights, demonstrates that the patentee's conduct is truly anti-competitive. This will give patentees greater flexibility in realizing the full benefits of their patents, thereby further encouraging firms to invest in research and development aimed at discovery of new products and new processes. Competition in the marketplace and the ability of American firms to keep pace with their overseas counterparts will be benefitted.

The proposed amendment to 17 U.S.C. § 501(a) will do for copyright law what proposed new subsection 271(d) of Title 35 will do for patent law. Thus, under proposed section 501(a) copyright owners will have greater flexibility in licensing their copyrights, and further development of literary and artistic works will be encouraged.

Protecting Patent Owners From Importation Into the United States of Unpatented Goods Made Overseas by Use of Patented Processes

The Need For Legislation

The United States patent laws do not adequately protect the legitimate interests of owners of process patents. Under existing law, a patent is infringed only if the patented invention is made, used, or sold in the United States. 35 U.S.C. § 271. Where a product patent is involved, a firm cannot avoid infringement by manufacturing the product overseas and then importing it into the United States because the use or sale of the product in the United States would infringe the patent. In the case of a process patent, however, there is no patent law that a patentee can use to stop a firm from practicing the process patent overseas and then selling the product made by that process in the United States. In such a case, technically, no one has made, used, or sold the patented process in the United States.

A patentee has two options to protect its patented process from such use overseas. First, it can seek to obtain a patent in as many overseas countries as possible and then sue for infringement of its foreign patents in foreign courts when the process is carried out in those countries. This option is inadequate because it is expensive and it is impossible to obtain adequate protection in all of the countries in which the process might be used.

The other option available to a patentee is to seek relief from the International Trade Commission for violation of 19 U.S.C. § 1337. 1/ Damages are not available to a patentee in a § 1337 proceeding. The patentee can seek a cease and desist order against a particular firm, which may issue if the Commission finds that the firm is violating or believed to be violating § 1337. He also can seek an exclusion order that would bar the importation of products made by his patented process if the Commission finds that § 1337 has been violated. However, these options do not always adequately protect process patentees. In order to obtain a cease and desist order or an exclusion order, a patentee must show not only the importation of a product made by his patented process, but also that the effect or tendency of such importation is to destroy or substantially injure a U.S. industry, or restrain or monopolize U.S. trade and commerce.

1/ Section 1337 provides that unfair methods of competition and unfair acts in the importation of articles into the United States, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and commerce in the United States, are unlawful. Section 1337a provides that the importation of a product made under a patented process shall have the same status under § 1337 as the importation of a patented product. Since the case law has established the importation of patented products as unfair acts under § 1337, § 1337a in effect means that the importation of an unpatented product made by a patented process also may be unfair under § 1337. See Herrington, U.S. International Trade Commission: Imported Articles Made By Patented Processes, 14 J. World Trade L. 549 (1980); Kaye, Developments In Unfair Trade Practices In International Trade: A Review Of The Third And Fourth Years Under Section 1337 As Amended By The Trade Act Of 1974, 61 J.P.O.S. 115 (1979).

Moreover, cease and desist orders against particular firms may not be effective where importation of offending products can easily find alternative channels. And enforcement of exclusion orders by customs officials can be difficult because of the difficulty of differentiating products made by patented processes from those that were not. 2/ Thus, it is quite difficult for a process patentee to obtain effective protection under § 1337 where his patented invention is practiced overseas and the resulting product sold in the United States.

Relevant patent law should be amended to allow holders of U.S. process patents to realize the full benefits of their inventions in the United States. Creating new and more efficient ways to produce the needs of society is becoming increasingly important; such innovation depends on adequate protection of the required investment. Importation and sale in the United States of products produced by patented processes severely undercuts the value of such patents, and should be effectively countered by changes in the patent laws to protect the legitimate interests of U.S. inventors.

2/ In one proceeding, the exclusion order applied to the product regardless of the method used to make it but allowed an importer to institute new proceedings to show that the product it wished to import was made by an unpatented method. Certain Multicellular Plastic Film, Inv. No. 337-TA-54, USITC Pub. No. 987 (June 1979). The utility of this procedure across-the-board is an open question.

Proposed Legislation

1. 35 U.S.C. § 154 should be amended to read as follows (material to be added is underlined):

Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, subject to the payment of issue fees as provided for in this title, of the right to exclude others from making, using, or selling the invention, <u>and if the invention is a process of the right to exclude others from using or selling products produced thereby,</u> throughout the United States, referring to the specification for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof.

2. 35 U.S.C. § 271 should be amended by redesignating existing subsection (a) as (a)(1), and by inserting the following as new subsection (a)(2):

<u>(a)(2) If the patented invention is a process, whoever without authority uses or sells in the United States during the term of the patent therefor a product produced by such process infringes the patent.</u>

3. Title 35, United States Code, should be amended by adding the following new § 294:

§ 294. <u>Presumption: Product Produced by Patented Process. In actions alleging infringement of a process patent based on use or sale of a product produced by the patented</u>

process, if the court finds (1) that a substantial likelihood exists that the product was produced by the patented process and (2) that the claimant has exhausted all reasonably available means through discovery or otherwise to determine the process actually used in the production of the product and was unable so to determine, the product shall be presumed to have been so produced, and the burden of establishing that the product was not produced by the process shall be on the party asserting that it was not so produced.

Explanation Of Proposed Legislation

The proposed amendments to 35 U.S.C. §§ 154 and 271 in effect extend the exclusive rights of the holder of a process patent to products made by the patented process. The amendment to § 154 would grant to process patentees the right to exclude others from using or selling such products; the complementary amendment to § 271 would make the use or sale of such products infringement. This general approach to the scope of process patents has been adopted in many foreign countries.

Under the amendments, use or sale of products made by patented processes would constitute infringement regardless of where such products were made. However, their primary effect would be on foreign manufacturing, since a process patentee can prevent the use of his patented process by domestic manufacturers directly. The amendment would not prevent foreign manufacturers from using patented processes abroad, so long as the products they made thereby were sold and used abroad. But the amendments would prevent circumvention of a U.S. process patentee's legitimate domestic rights through manufacture abroad and subsequent importation into the United States of products made by his patented process.

Providing process patentees with infringement remedies against users or sellers of products made by their patented processes may not, however, be sufficient to protect their rights against the threat of foreign manufacture and importation. Proof of infringement would require proof that the patented process was actually used in the manufacture of the product in question, and a patentee may be unable to provide such proof where the foreign manufacturer is not subject to service of process in the United States. To remedy this problem, new § 294 would be added to Title 35, to establish, in carefully defined circumstances, a rebuttable presumption that a product that could have been made by use of a patented process was in fact so made. The burden of overcoming this presumption would be on the defendant in an infringement suit, regardless of whether it is a foreign manufacturer, an importer, or a subsequent purchaser. While the defendant may not necessarily have in its possession the means necessary to rebut the presumption, it is likely to be in a far better position than the patentee to obtain it. Importers, for example, because of their relationships with foreign manufacturers, may be able to exert pressure on such manufacturers to produce the necessary information. Purchasers from importers may in turn be able to exert similar pressure on those importers, which would be transmitted to foreign manufacturers.

Presumptions of manufacture by a patented process, however, should not be casually established. Importers and subsequent purchasers may be unable to obtain the information needed to overcome such presumptions, even where the products in question were in fact not made by the patented process. At a minimum, the presumption would subject any party who uses or sells any product that might have been made by a patented process to increased litigation risks. Indeed, there is some risk that such a presumption could induce frivolous litigation intended to discourage firms from carrying products that compete with the patentee's product. To minimize these possibilities, the proposed legislation requires two conditions to be satisfied before a product will be presumed to have been made by a patented process.

First, the patentee must demonstrate on the basis of the evidence that is available that a "substantial likelihood" exists that the product was made by the patented process. Such evidence could include indications or "marks" on the product itself, as well as expert testimony regarding known methods of production at costs that would justify sale of the product at the prices being charged. Exactly how much evidence will be needed in particular situations to satisfy the "substantial likelihood" condition would develop in case law. A patentee's burden obviously should be somewhat less than that of proving successfully at trial that a product in question was in fact made by the patented process. On the other hand, a patentee would have to establish more than a slight, even if reasonable, possibility that the product was so made. Second, the patentee must show that he has exhausted all reasonably available means through discovery and otherwise to determine what process was used in the manufacture of the product in question and was unable to do so. Thus, patentees must make initial, good faith efforts to prove this key element in their infringement cases. Patentees will have to use normal discovery channels, as well as other good faith methods, as courts deem appropriate. This burden should help eliminate frivolous or unsound suits.