
ARNOLD & PORTER

Unilateral Refusals To License IP

Federal Trade Commission - Department of Justice

Hearings on

“Competition and Intellectual Property

Law and Policy in the Knowledge-Based Economy”

May 1, 2002

Jonathan I. Gleklen
Partner
Arnold & Porter

The opinions expressed are those of the author and do not necessarily represent those of the law firm of Arnold and Porter or its clients, including Xerox Corporation.



The *Xerox* Facts

- Xerox makes, sells, and services copiers and printers
- CSU was an ISO -- it serviced those copiers and printers
- In 1984, Xerox unilaterally decided not to sell parts to ISOs. (Later decided not to license software.)
 - There was no agreement with anyone
 - Customers remained free to -- and did -- buy parts and supply them to ISOs
- In 1994, Xerox settles litigation by agreeing to sell parts
 - Everybody (except the U.S. Navy) pays the same prices and gets the same quantity discounts

The *Xerox* Litigation

- CSU opts out, challenging past refusal and current pricing of parts and software
 - CSU's theory: leveraging from a parts and software monopoly to obtain/maintain a service monopoly
 - Only § 2 claims, no § 1 claims
- Xerox counterclaims for patent and copyright infringement, plus trademark and state law claims
 - CSU used infringing parts
 - CSU obtained and reproduced diagnostic software protected by patents and copyrights

The Xerox Issue

- CSU concedes that Xerox's refusal to sell patented parts and refusal to sell patented and copyrighted software is the but-for cause of its entire injury
 - No harm from refusal to sell unpatented parts
- CSU concedes infringement of patents and copyrights
- Remaining issues are pure questions of law:
 - *Can a unilateral refusal to sell parts and license software covered by patents and copyrights constitute anticompetitive conduct under § 2?*
 - *Can "high" prices for IP be anticompetitive?*
 - *Can a refusal to sell or "high" prices be misuse?*

The *Xerox* Holding

- District Court:
 - Unilateral refusals to license IP are neither anticompetitive under § 2 nor misuse
 - “High” prices for IP are neither anticompetitive under § 2 nor misuse
 - The number of markets affected by a refusal to license is irrelevant
 - The IP holder’s intent is irrelevant
- The CAFC:
 - *Affirmed.*
 - The rest is confusing

The CAFC's Decision

- It lacks citation to helpful precedent
- It focuses on whether IP was used to obtain monopoly power beyond the statutory grant without explaining the scope of the statutory grant
- Its “exceptions” to the right to unilaterally refuse to license make no sense
 - “Tying” -- this isn't unilateral conduct
 - “Fraud on the PTO” -- then there's no IP
 - “Sham litigation” -- no explanation of why the refusal to license should be unlawful, rather than just the sham litigation

The *Xerox* Holding Is Limited

- Chairman Pitofsky's Concerns
 - Selective licensing:
 - Tying is not a unilateral refusal to deal, but picking your licensees is
 - Conditioned licenses:
 - Tying or exclusive dealing is not a unilateral refusal to deal
 - Price fixing:
 - This is not a unilateral refusal to deal
 - Fraud on a standard-setting organization:
 - This is not a unilateral refusal to deal

Why The CAFC Got The Holding Right In Xerox

- Compelled by Supreme Court precedent and consistent with every lower court decision except the 9th Circuit's *ITS v. Kodak* decision
- Compelled by the Patent Act
- What's the alternative?

Supreme Court Precedent

- The Patent Act and Copyright Act confer a right to refuse to deal
 - Exclusion of competitors is “the very essence of the right conferred by the patent.”

Continental Paper Bag (1908)

- The “essence” of the patent grant is the “right to exclude others from profiting by the patented invention.”

Dawson Chem. Co. (1980)

- “A copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work.”

Stewart v. Abend (1990)

Supreme Court Precedent (cont.)

- If conduct is authorized by the IP laws, it doesn't violate the antitrust laws
 - “The patent laws . . . are *in pari materia* with the antitrust laws and modify them *pro tanto*.”

Simpson v. Union Oil (1964)
 - “The Sherman Act was enacted to prevent restraints of commerce but has been interpreted as recognizing that patent grants were an exception.”

Precision Instrument Mfg. Co. (1945)
- A patentee's exercise of its right “to exclude others from the use of the invention is not an offense against the Antitrust Act.”

United Shoe (1918)

Lower Court Precedent

- “Xerox’s refusal to license the [xerography] patents . . . was permissible under the patent laws and, therefore, did not give rise to any liability under § 2.”

SCM v. Xerox (2d Cir. 1981)

- “A patent holder who lawfully acquires a patent cannot be held liable under § 2 for maintaining the monopoly power he lawfully acquired by refusing to license others.”

Miller Insituform (6th Cir. 1987)

- Other ISO cases:

- *Data General* (1st Cir. 1994)

- *Service & Training* (4th Cir. 1992)

The 1988 Patent Act Amendments

No patent owner otherwise entitled to relief for infringement of contributory infringement shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of having done one or more of the following:
... refused to license or use any rights to the patent ...

35 U.S.C. § 271(d)(4)

- Language is repetitive if antitrust claims not covered
- Legislative history
 - DOJ opposed original 1951 legislation because it would “carve out an area in which the antitrust laws would not operate”
 - Sponsor of 1988 amendments cited *SCM* and said the purpose of the bill was “to codify existing law”
- Barring misuse is pointless if the same conduct violates the antitrust laws

What's The Alternative: Leveraging?

- Theory: IP right gives the right to “monopolize” a single market
 - Proponents cite *Kodak* footnote 29
- The problems:
 - Are they serious, or is this a special rule for ISOs?
 - CSU said Xerox could refuse to license Kodak (equipment market), but not ISOs (service market)
 - Reads the right to “use” out of the Patent Act
 - IP is *used* in a different market than where it is made
 - Patent’s claims defines scope of right to refuse to deal
 - Every refusal to deal case becomes a market definition exercise; dispositive motions are hard
 - Footnote 29 is about tying in a case that did not address the rights of IP owners

What's The Alternative: Patents are Property?

- “Intent test” (e.g. *Colgate*, *Lorain Journal*) or pretext (*ITS v. Kodak* (9th Cir.))
 - Intent is meaningless -- purpose of IP is to exclude
 - Inconsistent with precedent
 - “[T]o condition a copyright upon a demonstrated lack of anticompetitive intent would upset the notion of copyright as a ‘limited grant’ of ‘monopoly privileges.’” (*PRE*)
 - Patentee may refuse to license “without question of motive” (*Continental Paper Bag*)
 - High cost of enforcing IP rights
 - Every infringement case is implicitly a refusal to license
 - Hard to win a motion to dismiss; bad documents bar summary judgment

What's The Alternative: Patents are Property? (cont.)

- “Essential Facilities” (*Otter Tail*, *Terminal RR*, *MCI*)
 - ***The horror, the horror***
 - “A doctrine in search of limiting principles”
 - Precedent is ambiguous
 - Rejected as a matter of law in *SCM*, district courts in *Data General* and *Servicetrends*
 - Other district courts have found it inapplicable on the facts presented (*Montgomery County Assoc. of Realtors*, *Rural Tel. Serv. Co.*, *Corsearch*)
- Same practical problems as with intent test
 - Raises cost of enforcing IP rights
 - Hard to get rid of the claim early

What's The Alternative: “Rare Cases” Where “Liability Is Unlikely to Frustrate the Objectives of the Copyright Act”

- CAFC applied this rule to copyrights, but not patents
 - Different rules for different IP don't make sense
- From *Data General* (1st Cir.)
- Example of unlawfully acquired IP
 - From *SCM* (2d Cir.)
 - But why liability for refusal to license, vs. unlawful acquisition?
- Hard to think of other examples

If Refusals To License Are Unlawful, So Are “High” Prices

- CSU’s chairman testified:

We’re prepared to give [Xerox] 200 to 300 percent markup . . . We would ask the court to say that a 200% to 300% markup over an objective standard with respect to cost is a sufficient margin for anybody, including ladies’ dresses.

- Courts must evaluate not only refusals to license, but offers of “unreasonable” licensing terms

What Is an Unlawfully High Price?

- Do we want courts policing whether the intent in setting a high price was to obtain that high price or to exclude competitors?
 - Perfectly rational for IP owner to charge a price equal to its “indifference price”
 - Theoretically rational for licensee to pay any fee less than 100% of its economic profits
- Is either “exclusionary” or evidence of “bad intent”?
 - It is not unlawful to “make demands -- like respondent’s demand for 50% of gross proceeds . . . that are so exorbitant that a negotiated accommodation will be impossible.” *Stewart* (1990)

Corollary: If High Prices Are Lawful, What Benefit From Barring Refusals?

- High prices are not unlawful
 - “A patent empowers the owner to extract royalties as high as he can negotiate with the leverage of his monopoly.” *Brulotte* (1964)
 - High prices were “contemplated by Congress” and are “consistent with the goals of the the Copyright Act” *Stewart* (1990)
- If IP owners must license, and they can charge whatever price they want, how is the world a better place under a rule requiring licensing?

The Bottom Line

- “Decision theoretic approach”
 - How many false positives and how many false negatives, and what’s the cost of each?
 - Rule of *per se* legality suggested by:
 - Agreement that there are at most limited circumstances (and at the least no circumstances) in which a unilateral refusal to license should violate the antitrust laws
 - Cost of false positives or defending true negatives in transaction costs and decreased incentives for innovation
 - Modest benefits from licensing without pricing limitations
- Antitrust laws are a “blunt instrument”
 - Treble damages and costs of litigation
 - If refusals to license are a problem, Congress should solve it with statutory compulsory licenses