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Case Study: Princo Corp. V. ITC

Law360, New York (April 23, 2010) -- On March 3, 2010, the U.S. Court of Appeals for the Federal Circuit heard oral arguments in the en banc rehearing of Princo Corp. v. Int'l Trade Comm'n, 563 F.3d 1301 (Fed. Cir. 2009), which addressed whether certain patent-pool licensing practices constitute patent misuse. The Federal Circuit's decision has potentially significant implications for patent holders that want to license their patents through pools for use in industry standards, or to engage in other joint conduct concerning related patent rights.

Overview

Princo involves a patent pool administered by U.S. Philips Corporation relating to the "Orange Book" standard for recordable and rewritable compact disc ("CD-R" and "CD-RW") technology that was developed by Philips, Sony and other companies. Philips sued Princo Corp. for infringement at the International Trade Commission. The Commission held that Princo infringed six Philips patents and rejected Princo's misuse defense.

Princo alleged that Philips committed patent misuse based on two theories: (1) that Philips included a Sony patent (the "Lagadec patent") that was not essential to the standard in the Orange Book patent pool along with Philips patents that were essential to the standard (the "tying theory"); and (2) that Philips agreed with Sony not to license the Sony patent for use in technologies that compete with the Orange Book standard (the "price-fixing theory").

The Federal Circuit panel decision, now being reviewed en banc, held that Philips did not commit patent misuse based on the tying theory because the Sony patent could have been viewed as reasonably necessary to practice the standard at the time the licenses were executed and thus was "essential" to the standard. Regarding the price-fixing theory, however, the panel majority remanded to the Commission to determine whether Philips committed misuse.

The majority found that an agreement between competitors not to license patents for use outside the pool could constitute misuse if it potentially foreclosed competition. The court directed the Commission to determine (1) whether the Lagadec patent could have contributed to a viable alternative to the Orange Book standard and (2) whether there was an agreement between Philips and Sony not to license the Lagadec patent for uses that competed with the standard. Circuit Judge Bryson would have rejected Princo's price-fixing theory because Princo did not prove any actual harm to competition.

The Federal Circuit granted the petitions for rehearing en banc filed by Philips and the Commission and asked for briefing from the parties addressing the price-fixing theory. The Federal Circuit denied Princo's petition, which was directed primarily to its tying theory.

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The New York Intellectual Property Law Association ("NYIPLA") and the Intellectual Property Owners Association ("IPO") filed briefs amici curiae supporting Philips. The American Antitrust Institute ("AAI") filed a brief amicus curiae supporting Princo. The American Intellectual Property Law Association ("AIPLA") and the U.S. Federal Trade Commission filed briefs amici curiae in support of neither party.

During oral argument, the en banc court addressed issues raised in the briefs amici curiae, including: (1) whether the panel decision would have a chilling effect on standard-setting activities, given that companies involved in standard setting almost always choose between different technologies; (2) whether Princo needed to prove that it actually wanted to license the Sony patent for a use that competed with the Orange Book; (3) whether an agreement of the type alleged should be considered "inherently suspect;" and (4) whether the panel decision, if adopted, would be an extension of Federal Circuit law relating to patent misuse.

Possible Implications of the Forthcoming Decision

The Federal Circuit's en banc decision could have significant implications for patent holders that want to license their patents through patent pools or to participate in other forms of collaboration.

If the full court upholds the tying portion of the decision, Princo could make it harder for an infringer to assert a successful misuse defense based on a tying theory. The panel decision enunciated a fairly low standard for determining if a patent is "essential" to a standard. A patent qualifies as essential if an objective manufacturer would have believed the patent (or at least one of its claims) was reasonably necessary to practice the pool technology at the time of the license.

That standard for essentiality also could have implications for patent holders outside of the patent-pool context. For example, the anti-competitive effects of patent settlements can hinge on whether the patents at issue are blocking (i.e., "essential") patents for the settling parties. By providing a low standard, the decision could make it harder for challengers to prove that a license or cross-license entered into as part of a settlement agreement is anti-competitive.

If the full court upholds the price-fixing portion of the decision, Princo likely would increase the risks for patentees who license their patents for exclusive use, including as part of a patent pool.

The panel majority stated that, "[i]n contrast to tying arrangements, there are no benefits to be obtained from an agreement between patent holders to forego separate licensing of competing technologies." Id. at 1315. This statement raises the question of whether and how parties to such an agreement can rely on the logic of antitrust precedents that allow joint venturers to agree not to compete against the venture to avoid having one venturer "free ride" on the efforts of the others.

Unless and until the full court decides otherwise, patent holders that want to collaborate in licensing patents should proceed with caution before agreeing to any restrictions. The panel decision arguably exposes any exclusive patent licensing arrangement, or other agreement not to compete against a patent pool or other joint venture, to attack for patent misuse.

The panel decision also highlights the potentially harsh consequences for patent misuse. The panel opinion could be read to hold that a patent holder may be guilty of misuse for agreeing not to license its patent outside the pool, even if there is no evidence that anyone wanted such a non-pool license.

Further, the panel opinion can be understood to say that an agreement not to license one essential patent in the pool for a competing use could make the entire pool unenforceable against all potential infringers until the misuse is purged.

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Background

During the late 1980s and early 1990s, Philips and Sony jointly developed the Orange Book standard for CD-R and CD-RW technology. In establishing the standard, Philips and Sony agreed to pool their patents relating to the standard and allow Philips to administer the pool. Philips sued Princo before the Commission after Princo ceased paying royalties under a pool license. Princo admitted that its products were within the scope of Philips' patents, but asserted patent misuse as a defense.

The panel decision addressed Princo's misuse arguments regarding Sony's Lagadec patent. The Lagadec patent and two Philips patents relate to mechanisms for guiding a laser that writes data to an unrecorded CD-R or CD-RW. Philips developed an analog solution, while Sony developed a digital solution.

Philips and Sony defined the standard to use the analog approach, but also included a license to the Lagadec patent in the Orange Book patent pool. The pool licenses allowed the patents to be used only to produce Orange Book compliant discs and thus did not grant the right to use the Lagadec patent to produce a disc using the digital method.

Patent Misuse Based On Princo's Tying Theory

The unanimous panel decision held that inclusion of the Lagadec patent in the pool was not misuse because one broad claim of the Lagadec patent could have been seen as blocking the Orange Book standard.

The court noted that many procompetitive efficiencies can be generated by patent pools, including reduced transaction costs, reduced litigation expenses, and reduced uncertainty associated with investment decisions. The court explained that prohibiting the inclusion of an arguably essential patent because it might ultimately prove not to be essential would undercut or eliminate those efficiencies.

The court clarified the standard for determining whether a pool administrator can include a patent in a package license without committing misuse: "[P]erfect certainty is not required to avoid a charge of misuse through unlawful tying. Rather, in this context a blocking patent is one that at the time of the license an objective manufacturer would believe reasonably might be necessary to practice the technology at issue." Id. at 1310.

Patent Misuse Based On Princo's Price-Fixing Theory

The panel majority held that Princo's price-fixing theory could have merit. Princo alleged (1) that the Lagadec patent could have represented an alternative technological solution to the Philips analog patents and (2) that Philips and Sony agreed not to license the Lagadec patent for use in a competing technology. The majority found that Philips' alleged behavior could constitute misuse under the rule of reason.

The majority explained that the Lagadec patent's status as a blocking patent, which immunized its inclusion in the pool, could not immunize an agreement not to compete: "It is one thing to offer a pooled license to competing technologies; it is quite another to refuse to license the competing technologies on any other basis." Id. at 1315.

The majority found that, in contrast to other conduct that can produce efficiencies (including patent pools and mergers), the alleged agreement was "unlikely to have any efficiencies that could not be achieved equally well through a non-exclusive agreement." Id. at 1315-16.

The majority also held that the Lagadec patent did not have to be developed to the point of commercial viability before misuse could be found, explaining that horizontal competitors cannot insulate themselves from misuse liability simply by agreeing to suppress competing technologies before they become commercially viable.

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The majority did not make a final determination, however, of what showing of viability must be made to invoke a misuse defense. Instead, the majority remanded for the Commission to decide where on the continuum between "certainly would have been viable" and "certainly could not have been viable" the appropriate standard lies and whether the evidence presented by Princo satisfies that standard. Id. at 1319.

The majority also remanded to the Commission to determine if there was an agreement between Philips and Sony not to license the Lagadec patent as a competing technology. If not, there would be no misuse under Princo's price-fixing theory.

Arguments Presented by Amici Curiae

The price-fixing portion of the decision was addressed by numerous amici curiae, who all acknowledged that collaborative standard-setting activities can generate efficiencies and be procompetitive. However, the amici curiae differed widely on the legal standard for evaluating such activities.

At one end of the spectrum, the NYIPLA argued that the agreement in issue is vertical, procompetitive, and presumptively lawful. At the other end of the spectrum, the AAI argued that such an agreement is horizontal, "inherently suspect" and presumptively unreasonable.

Perhaps most interesting is the FTC position, which criticized the majority for failing to recognize that agreements like the one at issue could create efficiencies. The FTC explained that an agreement not to license patents for use outside of the pool could be justified if it was reasonably necessary to achieve an efficient collaboration.

The FTC's approach, which relies heavily on the D.C. Circuit's 2005 decision in Polygram Holding Inc. v. FTC, 416 F.3d 29 (D.C. Cir. 2005), is very fact-specific and depends in large part on the timing of the agreements (1) to collaborate and (2) to restrict competition. If the latter agreement was necessary ex ante to facilitate the former, then it might be justified. In contrast, if the agreement to restrict was entered ex post, after the agreement to collaborate, then it is inherently suspect.

The FTC also disagreed with the dissent's standard for finding competitive harm. The FTC explained that an agreement between competitors to suppress a nascent alternative technology could be condemned without proof that such technology necessarily could have been commercialized. The FTC position is that the agreement is inherently suspect and the burden is on the patent holder to prove that the agreement was reasonably necessary to achieve the procompetitive efficiencies of the pool collaboration.

--By Eugene L. Chang (pictured), David K. Park and Heather Schneider, Willkie Farr & Gallagher LLP

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