

## Federal Circuit Issues Decision Regarding “Patent Misuse” Affirmative Defense

### *Introduction*

On April 20, 2009, the United States Court of Appeals for the Federal Circuit issued its opinion in *Princo Corporation, et al. v. International Trade Commission, et al.*, No. 2007-1386 — the latest decision commenting on the intersection between antitrust and intellectual property. At issue in *Princo* was whether the ITC erred in rejecting Princo’s affirmative defense of “patent misuse” to Philips’ claim of infringement. Patent misuse is a defense which requires proof that a patent holder extended its patent monopoly beyond the lawful bounds of the patent with anticompetitive effect.

In this case, Princo asserted that Philips committed patent misuse by “tying” patents essential to the Orange Book standard for compact disc technology to patents that were non-essential to that standard. On this point, the Federal Circuit affirmed the ITC’s decision, concluding that no tying violation existed. Princo also asserted that patent misuse occurred because Philips allegedly agreed with Sony not to license Sony’s Lagadec patent, which allegedly competed with the Orange Book technology. On this score, the Federal Circuit vacated the decision and remanded the case for a determination of whether Philips and Sony had such an agreement and, if so, whether the Lagadec patent was in fact a commercial alternative to the Orange Book technology.

### *Relevant Factual Background*

Philips administered a patent pool that contained recordable compact discs (“CD-Rs”) and rewritable compact discs (“CD-RWs”) patents.<sup>1</sup> The patents in the pool “cover[ed] features of discs necessary to comply with the ‘Orange Book,’ a technical standard jointly developed by Phillips and Sony in the late 1980s and early 1990s.”<sup>2</sup> One of the patents in the pool was Sony’s U.S. Patent No. 4,942,565 (referred to as the “Lagadec patent” or “565 Patent”).<sup>3</sup> Also included in the patent pool were Philip’s U.S. Patent Nos. 4,999,825 and 5,023,856 (collectively referred to as the “Raaymakers patents”).<sup>4</sup> The Raaymakers patents were “undeniably essential to the manufacture of Orange Book compliant discs.”<sup>5</sup>

In the process of Sony and Philips working together to develop the “Orange Book” standard, “Philips proposed an analog solution . . . . In contrast, Sony proposed a digital modulation . . . .”<sup>6</sup> “The analog Philips method, . . . was covered by the Raaymakers patents, while the digital Sony solution was covered by the Lagadec patent.”<sup>7</sup> The parties did not dispute that the two approaches — digital and analog — are “fundamentally incompatible.”<sup>8</sup> Even though Sony and Philips chose to use the analog approach to define the Orange Book standard, the Lagadec patent was nevertheless included in the patent pool.<sup>9</sup> “The joint licenses only allowed use of pool patents, including Lagadec, to produce Orange Book compliant discs. They did not allow use of Lagadec to produce a disc using the digital method for encoding position data taught by Lagadec.”<sup>10</sup>

In 1997, Princo obtained a package license from Philips but later stopped paying royalties.<sup>11</sup> Philips then filed

a complaint with the ITC, alleging patent infringement.<sup>12</sup> Although Princo admitted that it infringed Philips' patents, Princo alleged patent misuse as an affirmative defense.<sup>13</sup>

*Issue #1: Tying.*

The ITC rejected Princo's patent misuse theory based on tying because it found at least one claim of the Lagadec patent to be essential to the Orange Book standard. The Federal Circuit agreed with the ITC on this issue, and accordingly, rejected the tying argument. In its analysis, the Court reasoned that because at least one claim of the Lagadec patent could have been viewed as "reasonably necessary" to practice the Orange Book standard, proof that the patent ultimately was not essential to the standard does not establish unlawful tying between the essential and non-essential patents in the pool. The Court stated: "Prohibiting the inclusion in a package license of a patent that is arguably essential, merely because it ultimately proved not to be essential would undercut, even eliminate, th[e] potential precompetitive efficiency [of package licensing]."<sup>14</sup> "[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."<sup>15</sup>

*Issue #2: Agreements Between Patent Holders Not to License a Patent For a Commercially Viable Competing Technology.*

Princo also argued that patent misuse existed because "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.'"<sup>16</sup> The ITC rejected this argument, concluding that the Lagadec patent was a "blocking" patent and that an agreement not to license a blocking patent could not be anticompetitive.<sup>17</sup> The Federal Circuit disagreed, noting that:

- "The essential nature of the Lagadec patent to the Orange Book standard cannot justify the

refusal to allow it to be licensed for non-Orange Book purposes. 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."<sup>18</sup>

- "In contrast to tying arrangements, there are no benefits to be obtained from an agreement between patent holders to forego separate licensing of competing technologies..."<sup>19</sup>
- "[A]n agreement of the sort alleged by Princo is unlikely to have any efficiencies that could not be achieved equally well through a non-exclusive agreement that would have left open the possibility that the Lagadec technology could have been further developed."<sup>20</sup>

Besides relying on its finding that the Lagadec patent was blocking, the ITC also rejected this theory of patent misuse because the record did not establish that the Lagadec technology would have been used or was a commercially viable alternative to the Orange Book technology. The Federal Circuit rejected the ITC's analysis of the issue, concluding that evidence of commercial viability in the existing market was unnecessary. The Court stated:

On the one hand, evidence that a suppressed technology would have been viable would be sufficient; on the other, proof that a suppressed technology could not have been viable would be sufficient to negate a charge of misuse. We need not determine at this time where on the continuum between 'certainly would have been viable' and 'certainly could not have been viable' the appropriate standard lies. We leave that issue for consideration in the first instance by the Commission, together with the question of whether the evidence . . . satisfies the standard.<sup>21</sup>

The Court also addressed the issue of "whether there was in fact an agreement between Philips and Sony to prevent the licensing of Lagadec as a competitor to the Orange Book."<sup>22</sup> The Court concluded that "[t]here is sufficient evidence supporting Princo's

theory . . . that further Commission proceedings are necessary” and thus remanded the case on this point.<sup>23</sup> The Court noted that “[i]f the Commission determines on remand that the record contains insufficient evidence to justify a finding that Sony and Philips agreed that Lagadec would not be licensed as competitive technology, then there would be no misuse under Princo’s theory.”<sup>24</sup>

### *Conclusion*

The Federal Circuit’s latest decision on the affirmative defense of patents misuse demonstrates that the defense is still alive and well. On the one hand, the Federal Circuit has given deference to patentees who

pool patents reading on an industry standard, finding that the appropriate point of reference for evaluating the issue of essentiality is when the patent is licensed, not in retrospect. Thus, if the patent owner has a reasonable basis for concluding that the patent is essential, the court will provide deference to that decision and not find unlawful tying even if the patent later turns out to be arguably non-essential.

On the other hand, drawing on antitrust law forbidding agreements between competitors not to compete, the Federal Circuit has recognized that patent misuse is a viable defense if patent owners enter into an agreement that restricts the ability to license a commercially viable, competing technology.

1 *Id.* at 3.

2 *Id.*

3 *Id.* at 6.

4 *Id.* at 7.

5 *Id.*

6 *Id.* at 8 (emphasis in the original).

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.* at 4.

12 *Id.*

13 *Id.*

14 *Id.* at 17.

15 *Id.*

16 *Id.* at 21-22 (citations omitted).

17 *Id.* at 22.

18 *Id.* at 25-26.

19 *Id.* at 26.

20 *Id.* at 28.

21 *Id.* at 32.

22 *Id.* at 33.

23 *Id.*

24 *Id.* at 36.

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