

Federal Circuit Limits Patent Misuse Defense In Standard-Setting Context

On August 30, 2010, the United States Court of Appeals for the Federal Circuit, sitting *en banc*, issued its long-awaited decision in *Princo Corp. v. International Trade Commission*. *Princo* involved, among other things, a patent misuse challenge to certain licensing arrangements associated with the patent pools underlying recordable and rewriteable compact discs. The majority, in an opinion by Judge Bryson, joined by Chief Judge Rader and Judges Newman, Lourie, Linn and Moore, held that the doctrine of patent misuse did not prevent U.S. Philips Corporation from enforcing patent rights against a licensee (*Princo*) despite an alleged horizontal agreement between two patent owners (Philips and Sony Corporation) of a multi-member patent pool to impede competing technology. That alleged horizontal agreement, the majority held, did not constitute the “leveraging” conduct that concerns misuse. The majority held misuse inapplicable for the separate, independent reason that *Princo* did not carry its burden under antitrust laws’ rule of reason to demonstrate anticompetitive effects. *Princo* thus appears to confine patent misuse in the licensing context to “leveraging” practices, giving patent holders greater freedom to enter into ancillary restraints in standard setting that concern nascent technologies.

The technology at issue, developed primarily by Philips and Sony, involved recordable compact discs (“CD-Rs”) and rewritable compact discs (“CD-RWs”). The patents covering the technology were pooled together into a standard comprised in part of essential and non-essential patents. This standard was defined in a publication known as the “*Orange Book*.” In developing the standard, Sony and Philips encountered the problem of properly positioning the CD writer while writing data to the disc. Philips proposed an analog solution that was later set forth in the two patents at issue in this case (the “Raaymakers patents”), while Sony’s digital approach was set forth in one of its own patents (the “Lagadec patent”). Working as part of a joint venture, Philips and Sony engineers elected to use the Raaymakers approach in lieu of the Lagadec approach, and incorporated the Raaymakers approach as the standard in the *Orange Book*.

Philips managed the patent pool and included both the Raaymakers and Lagadec patents as part of the package of patents it sold, regarding both as necessary to make *Orange-Book*-complaint CD-R or CD-RW discs. Philips did not offer a version of the package that omitted the Lagadec patent, which *Princo* argued was non-essential to the *Orange Book* standard. Moreover, the sale of the patent package contained a “field of use” restriction, limiting licensees to producing only *Orange Book* compliant discs. The original Federal Circuit panel indicated that Philips’s and Sony’s agreement not to license Lagadec for other purposes, if part of an agreement to suppress competing technologies, possibly constituted patent misuse. The Federal Circuit, sitting *en banc*, disagreed.

Reviewing the history of the doctrine of patent misuse and relevant legislation, the majority confined patent misuse to patentees’ “leveraging” of their patent rights to broaden the physical or temporal scope of their patents. Giving leveraging a narrow purview, the Federal Circuit held that the alleged Sony/Philips collusion involved none. The asserted exclusion of rival technology would have been exactly the same, the Court reasoned, if a third party (not part of the patent pool) had owned the Lagadec patent, that patent had not been included in the package license, and that third party had (allegedly) agreed with Philips not to license

that patent to others. But such circumstances would not involve any leveraging of the patents in suit in a sense that implicated patent misuse. In other words, the agreement between Philips and Sony was “collateral” to the patent licenses and did not constitute “leveraging” of the patents. Thus, even if the Sony/Philips agreement violated the antitrust laws, the Federal Circuit held, the alleged collusive agreement did not implicate the narrow bounds of the patent misuse doctrine.

The Federal Circuit held patent misuse inapplicable for the separate, additional reason that Princo failed to prove that Philips’s alleged agreement with Sony to suppress the Lagadec technology had anticompetitive effects. The Court held that the Sony/Philips agreement with respect to the Lagadec technology comprised a restraint ancillary to the pro-competitive formation of a patent pool. Accordingly, Princo bore the burden of demonstrating the restraint’s illegality under the rule of reason. Princo did not carry its burden. Princo failed to show a “reasonable probability” that, but for the alleged agreement to suppress, the Lagadec technology would have been a competitive force in the storage technology market. In so holding, the majority rejected the dissent’s “quick look” approach that would have placed a burden of proving the absence of an anticompetitive effect on Philips.

Judge Dyk, joined by Judge Gajarsa, writing in dissent, contended that the majority’s opinion “emasculate[s]” the patent misuse doctrine by limiting patent misuse to “unlawful tying arrangements and agreements extending the patent term.” The alleged Sony/Philips agreement, according to the dissent, was “part and parcel” of Philips’s licensing agreements and the agreements combined to insulate the joint venture from competition from the development and alternative use of the Lagadec technology. Additionally, the dissent argued that antitrust laws inadequately policed the suppression of competition because private antitrust enforcement is “virtually impossible” in light of the federal bar on suits by indirectly-injured customers and because a competitor’s suit may not secure needed injunctive relief. Finally, as noted, the dissent would have placed the burden of proving the absence of competitive harm on Philips.

Although disagreeing with the dissent’s contention that a finding of patent misuse was compelled by precedent, Judge Prost, joined by Judge Mayer, concurring with the majority opinion, agreed that antitrust considerations are not “separate and apart” from the patent misuse issue.

Princo narrows the patent misuse doctrine, and signals that anticompetitive behavior by a patentee, even if subject to antitrust challenge, does not necessarily amount to patent misuse. Going forward, infringement defendants will face a number of challenges in succeeding on patent misuse claims. In addition to showing impermissible leveraging, infringement defendants have the burden of proving an anticompetitive effect that broadens the physical or temporal scope of the patents in suit. In rapidly-developing technologies, it may prove particularly difficult to show such anticompetitive effects when alternatives have not been given an opportunity to develop.

To find out how the Federal Circuit’s *en banc* decision in *Princo Corp.* affects your interests, please contact your usual Ropes & Gray attorney or a member of our Antitrust or Intellectual Property groups.