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NOTES

ANTITRUST—PATENTS—LICENSES—Regulation of Patent License Royalty Rates Under the Antitrust Laws

Neither the Constitution nor federal legislation defines a patentee's licensing rights;[1] consequently, it has devolved upon the courts to control patent marketing practices.[2] A patentee is entitled to a limited monopoly on his invention, and proper use of this grant is not a violation of any law regulating trade practices. Yet licensing affords an opportunity to enlarge the scope of this monopoly, and courts using various rationales have declared illegal different forms of patent licensing arrangements found to be outside the protective coverage of the patent grant.[3] Until recently, however, the courts have not dealt with the problem of whether unusually *high* royalty rates or *discriminatory* rates may constitute unlawful extensions of the patent monopoly.[4]

Two recent cases suggest that the antitrust laws may limit such patent licensing practices. In *American Photocopy Equip. Co. v. Rovico*,[5] the holder of a patent on a portion of a photocopy machine entered into licensing agreements which called for royalties amounting to six per cent of the net *retail* selling price of the machine.[6] These royalties constituted twenty-four per cent of the *licensees'* selling price on the patented segment of the machine, since the licensee was not a retailer but a manufacturer and since about half of the price of the machine could be ascribed to the non-patented portion. The United States Court for the Northern District of Illinois granted a preliminary injunction against an alleged infringement of the patent rights on the machine, despite a defense of patent misuse

1. U.S. CONST. art. I, § 8(8), 66 Stat. 792 (1952), 35 U.S.C. §§ 1-293 (1964).

2. See 65 COLUM. L. REV. 1256 (1965).

3. See Brulotte v. Thys Co., 379 U.S. 29 (1964); United States v. Masonite Corp., 316 U.S. 265 (1942); International Business Mach. Corp. v. United States, 298 U.S. 131 (1936); Motion Picture Patents Co. v. Universal Film Co., 243 U.S. 502 (1917); American Security Co. v. Shatterproof Glass Corp., 268 F.2d 769 (3d Cir.), *cert. denied*, 361 U.S. 902 (1959). See also Austern, *Umbras and Penumbras: The Patent Grant and Antitrust Policy*, 33 GEO. WASH. L. REV. 1015 (1965); McCarthy, *A Patent Licensing Policy for Minimizing Antitrust and Misuse Risks*, 46 J. PAT. OFF. SOC'Y 547 (1964).

4. See STAFF OF SUBCOMM. NO. 5, HOUSE COMM. ON THE JUDICIARY, 84TH CONG., 2D SESS., ANTITRUST PROBLEMS IN THE EXPLOITATION OF PATENTS (Comm. Print 1957); Gibbons, *Field Restrictions in Patent Transactions: Economic Discrimination and Restraint of Competition*, 66 COLUM. L. REV. 423, 433 (1966).

5. 359 F.2d 745 (7th Cir. 1966), *on remand*, 257 F. Supp. 192 (N.D. Ill. 1966).

6. 359 F.2d 745, 746 (7th Cir. 1966). Basing the royalty rate on the retail price of the final product has been upheld as a convenient method of computation. Automatic Radio Mfg. Co. v. Hazeltine Research, Inc., 339 U.S. 827 (1950); Hazeltine Research Inc. v. Avco Mfg. Corp., 227 F.2d 137 (7th Cir. 1955); American Optical Co. v. New Jersey Optical Co., 58 F. Supp. 601 (D. Mass. 1944).

based primarily on the inordinately high royalties the patentee was charging.[7] On appeal, however, the Seventh Circuit vacated the injunction, declaring that the stated facts[8] if proved would constitute a violation of the antitrust laws sufficient to sustain a misuse defense.[9] The circuit court apparently concluded that when an "exorbitant and oppressive" royalty rate is applied to a product widely used in a given industry, the result may, in effect, amount to price fixing since the licensees are forced to fix a minimum selling price far above the prices which they would otherwise have charged.[10] Thus, the court indicated that a patentee may be limited in the amount he can charge for licensing his patent. Nevertheless, on remand the district court heard the case on its merits and granted the plaintiff-patentee a permanent injunction;[11] the conclusions of the Seventh Circuit appear to have been ignored, as indicated by the following passage from the district court's opinion:

> We cannot assume that there exist restrictions against "unreasonably high royalties," absent any proof of *favoritism* or *conspiracy* to fix prices, neither of which has been inferred, much less proven herein. Where a patentee is certainly free not to license at all, we fail to see how competition is restrained by charging high royalties. Indeed, such licensing, if not beyond the scope of the patent grant, should be *encouraged* under anti-trust principles, as an alternative to monopoly, which would otherwise be present. The free competitive market place has built-in controls such as supply and demand to limit the royalties charged by a prospective licensor. There is no indication that further controls are justified.[12]

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7. This defense was not based on collusive price fixing, but upon the assertion that the high royalty in effect caused higher selling prices.

8. The patentee denied knowledge or information sufficient to form a belief as to the truth of the defense. The Seventh Circuit held that this denial was a sham, and thus the facts alleged in the defense stood admitted. As authority for this proposition the court cited Harvey Aluminum v. NLRB, 335 F.2d 749 (9th Cir. 1964). It is possible, however, that the court was simply punishing the patentee for not answering the defense when such information was within its knowledge.

9. The court did not specify which of the antitrust laws was violated, and, indeed, the basis of its holding is not entirely clear. The language of the opinion would seem to indicate that "exorbitant and oppressive" rates constitute illegal price fixing when the practice involves the bulk of an industry. The court did not indicate, however, whether the price fixing was horizontal or vertical, or conscious parallelism. In addition, although the defendant alleged other antitrust violations such as discrimination and tie-ins, the Seventh Circuit did not deal with these claims.

10. American Photocopy Equip. Co. v. Rovico, 359 F.2d 745, 747 (7th Cir. 1966). The circuit court stated:

> The record before us shows that the license agreements in effect require plaintiff's licensees to fix a minimum selling price far above the price which they would otherwise charge and that the royalty policy of plaintiff is in violation of the antitrust laws of the United States, being exorbitant and oppressive.

Ibid.

11. American Photocopy Equip. Co. v. Rovico, 257 F. Supp. 192 (N.D. Ill. 1966).

12. *Id.* at 199. (Emphasis added.)

A second case, *LaPeyre v. FTC*,[13] involved discriminatory royalty rates. Defendants owned a patent on a shrimp peeling machine which the Federal Trade Commission (FTC) found to be such an important advancement that its use had become essential to successful competition in the shrimp canning industry.[14] Defendants also owned a major shrimp cannery on the Gulf Coast which competed with other canneries in that area and with canneries on the Northwest Coast.[15] Under defendants' patent licensing agreements, the royalty rate charged to all canners on the Northwest Coast was twice that charged to those on the Gulf Coast.[16] The type of shrimp caught on the Northwest Coast cost more to peel by hand than those caught on the Gulf Coast. This cost differential would have been eliminated if all canners had been given access to defendants' mechanical peeling device at equal royalty rates; instead, it was perpetuated by the discriminatory licensing practices.[17] As a result, the Northwest canners lost money and some were forced to go out of business. A three member panel of the FTC held that the discriminatory royalty rates constituted an unfair method of competition under section 5 of the FTC Act.[18] Two members grounded their finding of a violation on the theory that the discriminatory rates were used improperly by defendants to protect their own interests as a shrimp canner against competition from the Northwest canners.[19] The third member, Commissioner Elman, maintained that, even absent a finding that the patentee was using its patent to protect other of its interests against competition, and even conceding that the rates were simply an attempt to maximize profits on the patented machine by charging all that the market would bear,[20] the discrimination in royalty rates among competing canners was itself enough to constitute a violation of section 5, since a lawful monopolist has a duty under that section to conduct his business in such a way as to avoid inflicting competitive injury on a class of customers.[21] On appeal, the Fifth Circuit

13. LaPeyre v. FTC, 366 F.2d 117 (5th Cir. 1966), *affirming* Grand Caillou Packing Corp., [1963-1965 Transfer Binder] TRADE REG. REP. ¶ 16,927, at 21,955, 21,972 (FTC 1964).

14. Grand Caillou Packing Corp., [1963-1965 Transfer Binder] TRADE REG. REP. ¶ 16,927, at 21,955, 21,972 (FTC 1964).

15. *Id.* ¶ 16,927, at 21,958.

16. *Id.* ¶ 16,927, at 21,955.

17. The patentee claimed that it costs twice as much to peel Northwest shrimp by hand as Gulf shrimp, and that the savings resulting from the use of his machine in the Northwest (twice those of the Gulf packers) were merely being reflected in the higher royalty rate. The FTC, however, rejected this argument, saying that it was not clear how large a cost differential actually resulted from hand peeling. *Id.* ¶ 16,927, at 21,976.

18. 38 Stat. 721 (1914), as amended, 15 U.S.C. § 45 (1964).

19. Grand Caillou Packing Corp., [1963-1965 Transfer Binder] TRADE REG. REP. ¶ 16,927, at 21,955, 21,976 (FTC 1964).

20. *Id.* ¶ 16,927, at 21,993.

21. *Ibid.*

affirmed, but instead of expressly adopting either of the rationales separately relied on by the Commissioners,[22] it declared that the same central characteristic—"the utilization of monopoly power in one market resulting in discrimination and curtailment of competition in another"—had been relied upon by all three Commissioners in finding a violation of section 5 and was sufficient to support the FTC's decision.[23]

In both of these cases the appellate courts were concerned with the harm that would befall licensees and consumers in the short run as a result of the patentees' licensing practices.[24] However, neither court thoroughly analyzed the problem before it in terms of the relationship between the patent grant and antitrust law, and consequently the decisions shed little light on the wisdom of the limitations that they imposed on a patentee's licensing rights.[25] The basic purpose of both patent and antitrust law is to promote competition.[26] The antitrust laws seek to remove all artificial market restraints in order to insure the proper working of the free enterprise economic system.[27] The patent laws are intended to promote competition in a different way: they are designed to stimulate inventive initiative by affording some protection to the risk capital used in the development and exploitation of innovations.[28] Thus, the patent grant can be

22. The fact that the three Commissioners did not concur in a single opinion raises a serious question of administrative law since the majority opinion does not represent a majority of the five member commission. On this issue the Ninth Circuit has held that a commission cannot issue a valid order without the concurrence of a majority of its authorized membership. Flotill Prods., Inc. v. FTC, 358 F.2d 224 (9th Cir. 1966). In fact, it was this very issue which caused one circuit judge to dissent in the *LaPeyre* case.

23. LaPeyre v. FTC, 366 F.2d 117, 121 (5th Cir. 1966).

24. See also Laitram Corp. v. King Crab, Inc., 244 F. Supp. 9 (D. Alaska 1965), *supplemented by* 245 F. Supp. 1019 (D. Alaska 1965), which involves the same facts and patent as *LaPeyre*. Relying on the FTC opinion, the court held that the discriminatory royalty rates were a valid defense to an infringement suit. In the first opinion the court ruled such practices violative of the Sherman Act, but in the supplemental opinion it held that the violation was only a misuse of the patent. The case thus illustrates the confusion existing among the courts in the patent misuse-antitrust area. See also Peelers Co. v. Wendt, 151 U.S.P.Q. 378 (W.D. Wash. 1966), which held that the similar facts constituted a violation of § 2 of the Sherman Act.

25. The courts seem to have taken a prima facie attitude in favor of the antitrust considerations when dealing with patent-antitrust conflicts. See Wood, *Patents, Antitrust and Prima Facie Attitudes*, 50 VA. L. REV. 571 (1964).

26. See KAYSEN & TURNER, ANTITRUST POLICY: AN ECONOMIC AND LEGAL ANALYSIS (1965); Frost, *Patents and the Antitrust Laws—Thoughts on Competitive Principle and Application to Certain Topics*, 46 CHI. B. REV. 300 (1965); Stedman, *Invention and Public Policy*, 12 LAW & CONTEMP. PROB. 649 (1947).

27. Antitrust law enforcement seems to be primarily concerned with insuring the existence of price competition. However, the antitrust laws are designed to protect all types of competition including innovation, and thus viewed, the market restraint created by the patent grant is not at odds with the antitrust law. See Frost, *supra* note 26, at 311; Gibbons, *Price Fixing in Patent Licenses and the Antitrust Laws*, 51 VA. L. REV. 273 (1965). *But cf.* Baxter, *Legal Restrictions on Exploitation of the Patent Monopoly: An Economic Analysis*, 76 YALE L.J. 267 (1966).

28. See, *e.g.*, United States v. Masonite Corp., 316 U.S. 265 (1942). See generally

viewed as a lawful market restraint deemed necessary to promote competition in the long run at the expense of some short-run market displacements. Given this framework, it is clear that patent law and antitrust law are not in inherent conflict.[29]

Furthermore, the exclusive privilege given to an inventor under the patent laws is not the type of monopoly against which the antitrust laws are directed. As the Supreme Court has stated:

> [T]he term "monopoly" connotes the giving of an exclusive privilege for buying, selling, working, or using a thing which the public freely enjoyed prior to the grant. Thus a monopoly takes something from the people. An inventor deprives the public of nothing which it enjoyed before his discovery, but gives something of value to the community by adding to the sum of human knowledge.[30]

If one assumes the existence of a product already invented, it is easy to say that protection of that product under a patent grant will limit competition. However, the rationale underlying the patent law is that patent protection is a stimulus to the invention of the product in the first place. And the value of innovation to our society should not be underestimated. Indeed, it has been suggested that innovation is one of the best deterrents to monopoly, since it helps to create new industry which may displace monopolistic power.[31] In short, if the antitrust laws are allowed to frustrate the benefits accruing from patent grants, competition may suffer in the long run.[32]

Courts readily accept the foregoing argument when a patentee is exploiting his invention himself. However, the idea persists that different rules should apply when the patentee licenses his invention, since by licensing the patentee may be able to impose additional market restraints as conditions on the license, and thus may be able to enlarge his limited monopoly.[33] Although this approach has

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HOUSE COMMITTEE ON THE JUDICIARY, *op. cit. supra* note 4; Abramson, *The Economic Bases of Patent Reform*, 13 LAW & CONTEMP. PROB. 339 (1948); Folk, *The Relation of Patents to the Antitrust Laws*, 13 LAW & CONTEMP. PROB. 278 (1948).

29. See Precision Instrument Mfg. Co. v. Automotive Mach. Co., 324 U.S. 806 (1945).

30. United States v. Dubilier Condenser Corp., 289 U.S. 178, 186 (1933) (footnote omitted).

31. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY (4th ed. 1965).

32. It is clear that the mechanism which we have elected to use to stimulate innovation is the patent system. However, it is possible that if this device is carried too far, it will result in over-stimulation, thus causing a misallocation of resources. Consequently, it may be desirable to limit the amount of stimulation by curbing the rewards associated with a patent. See generally Baxter, *supra* note 27.

33. It has long been recognized that extension of the limited monopoly by contract is not protected by the patent law. See, *e.g.*, Motion Picture Patents Co. v. Universal Film Mfg. Co., 234 U.S. 502 (1917). For general discussions on the problem of licensing, see Baxter, *supra* note 27; Gibbons, *Field Restrictions in Patent Transactions: Economic Discrimination and Restraint in Competition*, 66 COLUM. L. REV. 423 (1966); Gibbons, *Price Fixing in Patent Licensing and the Antitrust Laws*, 51 VA. L. REV. 273 (1965).

resulted in the elimination of many undesirable practices, the courts should not extend this reasoning to limit licensing arrangements which do not create greater market restraints than those possible when the patentee does not license out but instead exploits the invention by himself. In the principal cases, the licensing practices may have served to restrain competition, but the alternatives to licensing—exclusive exploitation by the patentee and the withholding of the invention[34]—are even less desirable.[35] At least, under licensing arrangements, licensees will compete with each other during the term of the patent. Moreover, more competitive conditions will be assured at the time the patent expires, since there will already be a number of established firms with expertise in the industry engaged in active competition. Thus, it is desirable to create a legal atmosphere which does not discourage licensing.

It is clear that a patentee may maximize the profits on his invention by being the sole marketer or user of that invention instead of permitting exploitation by licensees. In that situation the market forces of supply and demand automatically set the limits on the patentee's monopoly. To set further limits in the case of licensing arrangements would clearly discourage the practice of licensing, and there is no apparent reason for making the profit attainable through licensing any less than that possible if the patentee fully exploits the patent himself.[36] Moreover, the use of self-exploitation as the standard would insure that the practice of licensing will be no more detrimental to competition vis-à-vis antitrust policy than what is already universally deemed permissible under patent law.[37]

This approach would seemingly provide the courts with a standard that could be applied to the problems encountered in the principal cases, and at the same time would not put courts in the position of having to discourage licensing. However, it is also desirable to make sure that patent licensing arrangements are free from inequitable conduct and are kept within their legitimate scope.[38] The self-

34. See American Security Co. v. Shatterproof Glass Corp., 268 F.2d 769 (3d Cir.), *cert. denied*, 361 U.S. 902 (1959).

35. See KAYSEN & TURNER, *op. cit. supra* note 26, at 168; Furth, *Price-Restrictive Patent Licenses Under the Sherman Act*, 71 HARV. L. REV. 815 (1958); 8 IDEA 107 (1964-1965).

36. See Furth, *supra* note 35, at 838: "Every undesirable licensing arrangement is characterized by the fact that the patentee and his licenses acquire a margin of profit or a degree of control over their industry which is unrelated to the competitive superiority of the patent." Thus, assuming exploitation to the fullest extent possible under existing market conditions, any profits a patentee could *legally* obtain through exploitation of his invention should *also* be obtainable through licensing.

37. See SUBCOMMITTEE ON PATENTS, TRADEMARKS & COPYRIGHTS, SENATE COMMITTEE ON THE JUDICIARY, 86TH CONG., 2D SESS., THE PATENT SYSTEM: ITS ECONOMIC AND SOCIAL BASIS, STUDY NO. 26 7, 24 (1960).

38. Precision Instrument Mfg. Co. v. Automotive Mach. Co., 324 U.S. 806, 816 (1945).

exploitation standard alone would not be sufficient to provide adequate protection for the competitive interests that are the concern of the antitrust laws. An additional inquiry must be made to determine whether the challenged conduct is in furtherance of the patentee's legitimate exploitation of his invention or whether it is the means to other ends.[39] Specifically, the inquiry should be directed toward whether the market restraint created in the licensing agreement is confined to the market for the invention itself or whether it directly introduces alien market factors into other markets,[40] as is the case with tying arrangements. While a patentee may not, in the short run, reap greater profits from a tying arrangement than from marketing the patented tying product alone, such an arrangement still has anticompetitive effects: licensees are forced to purchase tied products and competition in the market for these products is foreclosed.[41] Such practices are, of course, prohibited.[42] Significantly, their elimination does not discourage licensing of the patented tying product, since the patentee, even without the use of a tying arrangement, could obtain the same profits through licensing as he could through exclusive exploitation. Furthermore, it should be remembered that if the patentee could through a tying arrangement increase his profits beyond the amount available through self-exploi-

39. See Wood, *supra* note 25, at 593.

40. See Jerrold Electronics Corp. v. Wescoast Broadcasting Co., 341 F.2d 653 (9th Cir. 1965); Steiner Sales Co. v. Schwartz Sales Co., 98 F.2d 999 (10th Cir. 1938).

41. Supply and demand limit what a buyer is willing to pay for the tied products to the same total amount he would be willing to pay for the items if sold individually. For example, if the buyer is willing to pay only $10 for the tying product and $2 for the tied product, then he will be willing only to pay $12 for the package. Thus, the only way to charge more for the tied product is to decrease the price of the tying product by the same amount and vice versa. However, this may not be true in the long run because the elimination of competitors in the tied product may also create market power in the tied product market. Nevertheless, the reason for the tie-in is usually to increase the total profits on the tied products through indirect price discrimination. Even if this discrimination is legal, other adverse effects on the market require a prohibition of the tie-in. And if the discrimination is illegal, there is additional reason for disallowing the tie-in. However, in either event, elimination of the tie-in should not effect the licensing policy of a patentee. If the discrimination is legal, it may be directly applied to the licensees, and if it is illegal, the patentee would not be able to obtain the additional profits even without the benefit of licensing. Thus, elimination of tie-ins promotes competition and does not discourage patent licensing.

International Business Mach. Corp. v. United States, 298 U.S. 131 (1936), is a classic example of a tying arrangement. The lessees of a patented tabulating machine were required to use the lessor's nonpatented machine cards. This condition violated both the Sherman and Clayton Acts since it created a restraint of trade in a product line other than that of the patent grant. For cases in which similar practices have been held illegal, see note 3 *supra*. See also Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957); Iandiorio, *Patent Pools and the Antitrust Laws*, 46 J. PAT. OFF. SOC'Y 712 (1964); 75 HARV. L. REV. 602 (1962).

42. See, *e.g.*, International Business Mach. Corp. v. United States, 298 U.S. 131 (1936).

tation, such behavior also would be prescribed under the self-exploitation standard discussed above.

Thus, licensing practices which are used to maximize profits on a patent to the same extent as is possible under self-exploitation and which do not introduce alien market restraints should not be proscribed. In *Rovico*, it appears that the licensing practices fell within the permissible range. Logically, it is difficult to see how simply charging a high royalty rate to licensees could result in a greater profit to the patentee than he could obtain by marketing his invention himself; in either case profits are limited only by the law of supply and demand. Furthermore, it cannot by claimed that charging high royalty rates introduces an alien restraint into markets other than that of the patented invention. Admittedly, a higher royalty rate results in a higher price being charged by the licensee in the secondary market for the product. However, this is true regardless of the reason for setting the high rate.[43] For example, if a patentee who manufactures his invention responds to an increase in labor costs by raising the royalty rates charged to licensees, the consumer price will increase unless the licensee absorbs the royalty increment. Thus, legal exploitation in the primary market (the market for the patented invention) should not be condemned because of its indirect effects in a secondary market, since such effects must have been contemplated in permitting patenting and licensing in the first place.[44] Under this analysis, the district court in *Rovico* appears to have reached the proper result in holding that there are no restrictions against the amount which a patentee may charge a licensee absent favoritism or conspiracy.

A contrary decision would have several adverse effects. The benefits from lower royalty rates would at best be short-lived, since patentees would seek to avoid the consequences of such a decision by resorting exclusively to self-exploitation of the patent.[45] The result would be the loss of the promotional effect that licensing has on competition. In addition, for those types of inventions which cannot practicably by exploited exclusively by the patentee,[46] the

43. If a patent is significant, the patentee may well be able to drive all competitors in a secondary market out of business simply by exclusively exploiting his patent. Thus, the crucial question is whether the initial market restraint is legal.

44. It has been argued that patent royalty rates should be regulated so as to minimize the indirect effect which such rates have on secondary markets and resource allocation. See Baxter, *supra* note 27.

45. This may not be true in the particular case if the patentee has already committed himself to licensing.

By providing an incentive to innovate, patent law recognizes the need to allow short-run market restraints in order to foster long-run competition. These short-run restraints may be minimized through licensing; but if royalty rates are restricted, patentees will undoubtedly cease to license whenever possible, thus reducing this potential for minimizing the short-run restraints.

46. Many inventions can be commercially utilized only through licensing. See 8 IDEA 107 (1964-1965).

courts would have to determine some sort of workable standard—a "reasonable" royalty rate. This would involve the courts in increased litigation and would force the judges to play the role of economic analysts. These considerations, although not articulated by the court in *Rovico*, probably played an important role in its decisions not to limit patent royalty rates.[47]

The *discriminatory* royalty rates in *LaPeyre* pose a much more difficult problem. It is submitted that the court, in finding illegal discrimination under section 5 of the FTC Act,[48] did not give proper weight to the purposes of the patent grant. It is helpful to view the problem of discrimination in terms of the self-exploitation standard discussed above. Discrimination in patent royalty rates may not result in an increase in profits, or in additional market restraints, over what would have resulted from exclusive exploitation by the patentee, especially when the discrimination is used only as a means to maximize profits accruing from the making, using, or selling of the patented invention; under the self-exploitation standard, such discrimination should not be held illegal. On the other hand, application of this standard would prohibit a patentee from discriminating in royalty rates charged to manufacturing licensees, if he could not legally manufacture the product himself and sell it at discriminatory prices. In *LaPeyre*, the patentee had another legal avenue available by which he could have extracted profits equivalent to the amount earned from discriminatory licenses. The invention revolutionized the shrimp canning industry, and the patentee could have used it to drive all his canning competitors out of that industry. In this way, he could take full advantage of the cost savings of his invention. Thus, since he could have legally extracted these profits anyway, he should be permitted to obtain them through discriminatory patent royalty rates.[49] Nevertheless, Commissioner Elman argued that a

47. The decisions in two other cases appear to be grounded on similar considerations. Brulotte v. Thys Co., 379 U.S. 29, 33 (1964) (dictum) ("A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly."); United States v. Huck Mfg. Co., 227 F. Supp. 791 (E.D. Mich.), *affirmed*, 382 U.S. 197 (1965) (per curiam) (dictum).

48. 38 Stat. 721 (1914), as amended, 15 U.S.C. § 45 (1964). Section 5 of the act states that "unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." This act was designed to supplement and bolster both the Sherman and Clayton Acts, not only by condemning existing violations of the acts, but also by stopping, in their incipiency, practices which when full blown would constitute violations of these acts. FTC v. Motion Picture Advertising Service Co., 344 U.S. 392, 394 (1953); Fashion Originators' Guild, Inc. v. FTC, 312 U.S. 457 (1941). The FTC may also have the power under § 5 to attack practices that are not specifically made illegal under either the Sherman or Clayton Acts but which are violative of their spirit. American News Co. v. FTC, 300 F.2d 104 (2d Cir. 1962); Grand Union Co. v. FTC, 300 F.2d 92 (2d Cir. 1962).

49. It should be noted that under this analysis most royalty-rate discrimination will be proscribed since it would be illegal for the patentee to discriminate in the selling of his invention. Such proscription, however, probably will not significantly discourage licensing since it does not limit the profits legally obtainable from other means. But when an invention is so critical that exclusive exploitation would result

lawful monopolist has no right to discriminate in the royalty rates he charges, if such discrimination inflicts competitive injury on a large segment of the industry.[50] However, it is questionable whether the disparity in royalty rates actually constituted discrimination; arguably, the rate differential merely took into account the dissimilar market positions occupied by the licensees.[51] Without patent licenses, the Northwest canners would not have been able to compete in the industry at all, and the patentee's right to refuse to license them is undeniable.[52] Moreover, uniform royalty rates could cause injury to the Gulf Coast canners, since aside from peeling costs the processing costs are lower on the Northwest Coast.[53] Thus, it appears that the rationale expounded by Commissioner Elman is too superficial to strike a proper balance between the various patent and antitrust policies that are involved. Furthermore, under the self-exploitation standard, if profit maximization was the *sole motive* behind the discrimination in *LaPeyre*, then the case was incorrectly decided.[54]

If, however, the reason for the discrimination in *LaPeyre* was that the patentee was protecting its own canning interests on the Gulf Coast from competition from the Northwest canners, the problem

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in the taking over of an entire industry, as in *LaPeyre*, royalty discrimination ought not be proscribed since the patentee could legally obtain these profits through exclusive exploitation, and from the public point of view it is desirable to encourage licensing as an alternative to exclusive exploitation.

One might argue that all patent royalty discrimination should be legal since the patent contemplates rewards based upon the value of the invention to users rather than upon cost to the patentee, and that the patentee should be free to charge whatever the traffic will bear. See Baxter, *supra* note 27 at 287. On the other hand, it has recently been suggested that no discriminatory royalty rates should be allowed because of their detrimental effect on resource allocation. See Baxter, *supra* note 27.

50. See text accompanying note 21 *supra*.

51. See EDWARDS, THE PRICE DISCRIMINATION LAW (1959). "Equality of treatment is taken to mean equal treatment for persons similarly situated. Where there are substantial differences of condition, inequality is thought to be appropriate; but the differences in treatment are expected to be appropriately related to the underlying differences in condition." *Id.* at 4.

52. The LaPeyre machine was patented in 1949, but the Northwest canners did not enter the field until 1956. Without the licenses they certainly would have been in a worse competitive position and may never have entered the industry at all. Grand Caillou Packing Corp., [1963-1965 Transfer Binder] TRADE REG. REP. ¶ 16,927 (FTC 1964).

53. It is cheaper to catch shrimp on the Northwest Coast but more expensive to peel them. Thus, if the royalty rates were equal, the Gulf Coast canners would be "harmed." This may be desirable in terms of resource allocation, but this is not the rationale used by Commissioner Elman. Moreover, such an explanation disregards the patent grant. For an argument that discriminatory patent royalty rates should be proscribed because of their effects on resource allocation, see Baxter, *supra* note 27.

54. In any event, it is clear that a *per se* rule against royalty rate discrimination would be undesirable. For instance, different licensees may use the invention for completely different purposes. Thus, if a patentee had to charge uniform rates to all licensees, this could eliminate commercial use in a field in which the invention is of a lesser value. For another example of justifiable differentiation, see Hanks v. Ross, 200 F. Supp. 605 (D. Md. 1961).

is quite different: the leverage exercised through the use of the patent would not be limited by the natural market forces which act on the patent monopoly; rather, it would constitute an attempt to restrict competition in a *different market*.[55] Although the patentee's profits on the patented invention might not be increased by this discrimination, his competitive position vis-à-vis the other canners will be enhanced. Assuming that the Northwest canners were charged the maximum that the market in that region would bear, if the Gulf canners were charged less than what their market would bear (in order to protect them from competition from the Northwest), the result would be an artificial market restraint and a competitive advantage not contemplated by the patent grant. If this were not the case, and if all canners were charged the amount that their particular market would bear,[56] then, although a differential in royalty rates between the two areas might still exist, the competitive position of the Northwest canners would only be subject to restraints contemplated by the patent legislation—the patentee's limited monopoly power in the market for the patented invention.

The competitive harm resulting from the limited monopoly of a patent grant is the price of our patent policy. However, the patent laws were intended to protect only the competitive superiority of the *invention*, and not the overall *market power* of the patentee. Thus, efforts to obtain competitive advantages in other than the manufacture, use, or sale of the patented invention should not be immunized by the patent laws from attack under the antitrust laws.[57] Nevertheless, discrimination which results from charging what the market will bear is distinguishable from such efforts, since it furthers the aims of the patent policy and does not cause *additional* harm to competition over that contemplated by the patent laws. Hence, if the discrimination in *LaPeyre* represented an attempt by

55. Acts which are in themselves legal forfeit their protection when they become elements of an unlawful scheme. Jerrold Electronics Corp. v. Wescoast Broadcasting Co., 341 F.2d 653 (9th Cir. 1965).

56. It is possible that the royalty rate charged to the Northwest canners is above what the market could bear and that a lower rate would bring more canners into the industry, thus increasing profits from the licensing of the peeling machine. This would mean that the present Northwest canners overestimated what they could profitably pay for the machine. In any event, royalty rates which discriminate in order to protect interests other than the patented product result in a competitive disadvantage that would not otherwise exist.

57. Our general policies against price discrimination are to be found in the following federal statutes: Sherman Act, 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-5 (1964); Robinson-Patman Act, 49 Stat. 1526 (1936), 15 U.S.C. §§ 13, 13(b), 21(a) (1964); Federal Trade Commission Act, 38 Stat. 717 (1914), as amended, 15 U.S.C. § 46 (1964). It is significant that the Robinson-Patman Act applies only to sales, not leasing. However, patent royalty rates involving favoritism or collusion may still be illegal under the Sherman and FTC Acts. It has been suggested that Robinson-Patman standards should be applied to the *LaPeyre* situation. Baxter, *supra* note 27, at 310.

the patentee to protect its canning interests, the case was correctly decided;[58] otherwise it was not.

Admittedly, as evidenced by *LaPeyre*, it will be difficult to determine the reasons motivating discrimination in any given case. This problem will have to be resolved by the trier of fact on a case-by-case basis. The inquiry should focus upon such factors as the nature of the patent, the manner in which the discrimination arose, the conduct of the patentee in relation both to its licensees and its prospective licensees, the additional interests of the patentee, and the bargaining position of the licensees.[59] Such an analysis will facilitate the determination of the reason for the discrimination, which in turn should determine its legality.

It is not claimed that this type of analysis will give a clear answer to all questions involving patent royalty rates; rather, it is claimed that by examining the problem within the context of the purposes of the patent grant, the courts will reach better and more consistent results.[60] Focusing on the wrong issues can only complicate an already confused problem and frustrate present patent policy. Any arguments that question the soundness of prevailing patent policy[61] should be directed at Congress and not the courts.

58. Frost, *supra* note 26, at 309 suggests that this was the reason for the discrimination in *LaPeyre*, and that the case only stands for the proposition that this type of discrimination is illegal. See note 24 *supra*.

59. See generally Wood, *supra* note 25.

60. The number of different grounds available for attacking the legality of royalty rates increases the necessity for a uniform framework of analysis. The problem may come up in the context of the Clayton Act, the Sherman Act, the FTC Act or even as a defense of patent misuse in a patent infringement suit. See Austern, *Umbras and Penumbras: The Patent Grant and Antitrust Policy*, 33 GEO. WASH. L. REV. 1015 (1965); Nicoson, *Misuse of the Misuse Doctrine in Infringement Suits*, 9 U.C.L.A.L. REV. 76 (1962); 75 HARV. L. REV. 602 (1962).

61. See SENATE COMM. ON THE JUDICIARY, *supra* note 37; Abramson, *supra* note 28; Hamilton & Till, *What Is a Patent?*, 13 LAW & CONTEMP. PROB. 245 (1948).