DOJ, FTC Redefine Antitrust Rules on Patent Pools

By: Mark E. Miller and David S. Almeling
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Elias Howe patented a better sewing machine in 1846, and several other inventors followed quickly with related patents. Sewing machines soon incorporated technology from these overlapping patents. The sewing industry could have stagnated under the burden of protracted patent litigation. But rather than relying on litigation and demanding separate licenses, Howe and the other patentees licensed their patents collectively. And so was born the first “patent pool,” which resulted in two decades of prosperity for the sewing-machine industry.

A patent pool is broadly defined as an agreement between two or more patent owners to aggregate and license their patents. Antitrust treatment of patent pools has varied widely. In the 1960s, the U.S. Department of Justice (DOJ) followed a policy known as the “Nine No-No’s”: nine licensing practices DOJ considered per se antitrust violations. The “Nine No-No’s” never took hold in the courts, and DOJ retreated from this policy.

This past April, DOJ and the Federal Trade Commission (FTC) jointly published a report entitled “Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition.”

The 2007 report provides neither per se prohibitions nor safe harbors. Instead, it lists six elements—or “maybes”—that agencies and courts consider in determining whether a pool passes antitrust muster. This article examines these six elements, as well as six additional common elements of pools, and describes how they redefine antitrust laws governing pools. The history of authority governing patent pools roughly divides into three periods, beginning with deference, shifting to suspicion and per se prohibitions, and reaching a cautious endorsement today.

In the early 1900s, courts sanctioned patent pools based on the doctrine of freedom of contract. The classic case was *E. Bement & Sons v. National Harrow Co.*, 186 U.S. 70 (1902), which addressed a pool that fixed prices and prohibited licensees from making unlicensed products. The U.S. Supreme Court approved this pool with little analysis, proclaiming an “absolute freedom in the use or sale of rights under the patent laws.”
The Supreme Court’s deference ended 10 years later. In *Standard Sanitary Manufacturing Co. v. U.S.*, 226 U.S. 20 (1912), the Supreme Court held that patent pools were no longer immune from antitrust scrutiny. Over the following half-century, the Supreme Court addressed several pools, approving some while dissolving others based on the competitive effects of each pool.

By the 1960s, DOJ interpreted antitrust and patent-misuse law as being hostile to a host of licensing practices. DOJ considered nine of these practices to be per se antitrust violations, including grantback provisions and some forms of package licensing. Beginning in the 1980s, DOJ backed away from the “Nine No-Nos,” and in 1995 DOJ and the FTC jointly published the “Federal Antitrust Guidelines for the Licensing of Intellectual Property.” With a few exceptions, the 1995 guidelines used a rule-of-reason framework to evaluate patent pools by comparing their pro-competitive and anti-competitive effects.

The 1995 guidelines were a cautious endorsement of patent pools that revived the practice. Since then, DOJ has reviewed and approved four pools in formal business review letters, and federal courts have rejected several antitrust challenges to pools. DOJ and the FTC continued this trend with the 2007 report, reaffirming their support for the 1995 guidelines and DOJ’s letters.

**The Report’s Six Maybes**

In addition to reaffirming the rule-of-reason framework for evaluating patent pools, the 2007 report provides guidance on six common elements of patents pools.

First, the 2007 report states that a key antitrust issue is whether the pooled patents cover technologies that compete against each other. Pools with complementary patents are generally pro-competitive because they combine patents that a licensee would otherwise need to license individually. Pools with competing patents, on the other hand, may be anti-competitive because including such patents may inhibit the development of alternative technologies.

If pooled patents relate to a defined technical standard, one way to view complementariness is to determine whether each patent is “essential,” or necessary, to practice that standard. Essential patents are generally complementary because if an element of a standard is compulsory, then patents covering that element do not compete. Optional implementations of a standard, in contrast, are generally not essential.

Nevertheless, there is no strict prohibition against including nonessential, or even competing, patents in pools. For example, in *U.S. Philips Corp. v. International Trade Commission*, 424 F.3d 1179 (Fed. Cir. 2005), the U.S. Court of Appeals for the Federal Circuit reversed a decision finding that including nonessential patents in a pool
constituted illegal tying. The Federal Circuit cited several pro-competitive reasons to include nonessential patents, such as reducing transaction costs with one-stop shopping and avoiding the difficulty and cost of determining essentiality.

Second, the 2007 report encourages pools to permit pool members to individually license their patents outside of the pool to spur development of alternative technologies and because not all licensees need all patents in the pool. Several cases reflect this principle. In Matsushita Electrical Industrial Co. v. Cinram International Inc., 299 F. Supp. 2d 370 (D. Del. 2004), the U.S. District Court for the District of Delaware held that a patent pool did not restrain trade if “the antitrust plaintiff has the opportunity to license independently.” And in In re Summit Technology Inc., 127 F.T.C. 208 (1999), the FTC dissolved a two-member pool in part because the pool members granted each other the right to veto licenses.

The 2007 report was quick to add, however, that favoring individual licensing does not mean that a patent owner must actually license its patents outside a pool, as the right to refuse a license is a core part of the patent right to exclude. Nor does it limit the royalty that a licensor may request.

Third, any grantback—a provision requiring the licensee to give the licensor the right to use the licensee’s improvements—should be nonexclusive and narrow. DOJ and the FTC reason that grantbacks narrowly limited to the subject matter of the pool are pro-competitive because they prevent a patentee from charging too much for its improvement patent and holding up the pool. This form of narrow grantback received favorable treatment in Wuxi Multimedia Ltd. v. Koninklijke Philips Electronics N.V., No. 04cv1136, 2006 U.S. Dist. Lexis 9160 (S.D. Calif. Jan. 6, 2006). But as grantbacks broaden their reach, they can deter innovation because a company is unlikely to innovate if the fruits of its labors are broadly granted back to the pool.

Fourth, the 2007 report suggests that pool members should not exchange sensitive information about downstream products. To be clear, pool members are entitled to meet and share information in order to participate in the pool. The concern, therefore, is not all confidential information, but information about cost data, output level and prices that pool members could use to collude about downstream products.

One way to avoid this problem is to use a pool administrator to coordinate the pool and act as an intermediary between members. Another is to have antitrust counsel attend pool meetings to monitor communications.

Fifth, royalty rates must be both reasonable and nondiscriminatory. As to “reasonable,” the 2007 report has allayed anxieties of pool members and administrators: “The Agencies generally do not assess the reasonableness of royalties set by patent pools.” The reasoning for this hands-off policy appears to be that the marketplace—not agencies or courts—is a better judge of whether a price is too high.
As to “nondiscriminatory,” the 2007 report states that pools should not discriminate between licensees. Nondiscrimination means treating similarly situated licensees the same, but it does not require identical treatment. For example, the 2007 report confirms that different royalty rates faced by different licensees are not necessarily anti-competitive.

Sixth, the 2007 report does not require a patent pool to provide the option of licenses under only some of the pool’s patents. DOJ and the FTC added a caveat that the “refusal to license less than all of a pool’s intellectual property will not raise competitive concerns, provided that the licensors retain the ability to license their patents individually.”

**Six Additional Maybes**

Because the 2007 report uses the rule of reason to examine the competitive effect of patent pools, the six elements enumerated by DOJ and the FTC are only a sample of all potential elements of an antitrust review of a pool. The following six elements, derived from the 2007 report itself, case law, and previous DOJ and FTC statements, result in 12 “maybes” that, while not exhaustive, comprise the elements that antitrust authorities frequently consider when evaluating patent pools. 

The seventh element is whether the pool excludes additional licensors. Though the 2007 report is silent on this practice, the 1995 guidelines approved of excluding additional licensors unless the pool members collectively possess market power and the excluded company is unable to compete. The 2007 report’s silence should not be read as overruling the 1995 guidelines because excluding licensors may have pro-competitive results, such as being an efficient way to develop and exploit the pool technologies.

The eighth element is the use of an independent entity to administer the pool. Such independence easing concerns the pool is a sham cartel. Administrators can also take the laboring oar in collecting and distributing pool revenue as well as finding additional licensors and licensees. But as DOJ demonstrated in a letter approving a pool in which one of the licensors acted as an administrator, using an independent company is not necessary.

The ninth element is the existence of a patent evaluator. This person, who is usually independent of licensors and the administrator, evaluates patents for inclusion in the pool by determining whether a patent is essential or complementary. This independence avoids collusion, and the determination of essentiality or complementariness addresses the 2007 report’s focus on the relationship between patents, which is the first element discussed above.

The 10th element is the inclusion of invalid or expired patents in the pool. The 2007 report describes this element in terms of complementariness, reasoning that invalid or
expired patents are not complementary. Nevertheless, to exclude invalid or expired patents is not to compel pools to conduct an invalidity inquisition. Patents are presumed valid, 35 U.S.C. 282, and pools are entitled to rely on this presumption. If this presumption is overcome, say through a judicial finding of invalidity, a pool should have a mechanism to purge the patent.

The 11th element is that pools should disclose exactly which patents are in the pool. Disclosure is generally pro-competitive because it permits licensees to make an informed decision about whether to take a license, and it lets competitors know what is required to design around the patents.

The 12th element is that licensees should have the freedom to develop alternative technologies. Many early patent pools ran afoul of antitrust law with “tie out” provisions in which a license prohibited the use of nonlicensed technologies. While modern pools rarely contain such provisions, it is important to identify them and limit their use.

In conclusion, the 2007 report provides significant guidance on how to structure patent pools, including a specific analysis of six elements. Yet even the best laid plans for a pro-competitive pool may mean nothing if the pool is not administered in accordance with those plans. The 2007 report recognizes this reality and warns that unless the plans are followed, additional review may be necessary.

The 2007 report is good news for patent pools. As industry trends of product interoperability, uniform technical standards and joint developments combine with the ever-increasing number of patents, there is likely to be an increase in overlapping patents that can be pooled together pro-competitively. The 2007 report’s cautious endorsement of patent pools signals that such pools, when carefully formed and properly administered, should face less scrutiny from the government and fewer threats of private litigation.

Mark E. Miller is a partner, and David S. Almeling is an associate, in O’Melveny & Myers’ San Francisco office. They represent, among other clients, patent pools and companies that participate in such pools.