ANTITRUST LIABILITY FOR UNILATERAL REFUSALS TO LICENSE
INTELLECTUAL PROPERTY: XEROX AND ITS CRITICS

by

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In *In re Independent Service Organizations Antitrust Litigation (CSU, L.L.C. v. Xerox Corp.)*,[2] the Federal Circuit affirmed a district court decision rejecting the imposition of antitrust liability premised on a unilateral refusal to sell patented parts and license patented and copyrighted software. This decision was controversial enough; however, the Federal Circuit compounded the controversy by using exceptionally broad language to immunize refusals to license – language addressing fact patterns that were not before the court.

There appears to be relatively broad consensus that unilateral refusals to license intellectual property should generally not trigger antitrust liability. Even former FTC Chairman Robert Pitofsky, perhaps the most prominent critic of the Federal Circuit's decision, has said that he has "no quarrel with the fundamental rule that a patent holder has no obligation to license or sell in the first instance."[3]

In addition to the "exceptions" set out in the Federal Circuit's decision in *Xerox*, various limitations on the right to refuse to license have been by the plaintiff in Xerox, by Chairman Pitofsky, and others (including Mark Patterson writing in this issue and elsewhere). In this short paper I attempt to evaluate both the Federal Circuit's exceptions to its general rule and the limitations proposed by the critics of the decision, both in the context of the facts of the *Xerox* case and general antitrust principles. With the exception of the criticisms leveled by CSU, the plaintiff in *Xerox*, the critiques of the decision are not applicable given the actual facts of the case. In other words, the Federal Circuit's *holding* seems to stand up to criticism, even if its language does not.

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[2] 203 F.3d 1322 (Fed. Cir. 2000), *cert. denied* 121 S. Ct. 1077 (2001).

[3] Robert Pitofsky, *Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property* (June 15, 2000), <http://www.ftc.gov/speeches/ pitofsky/ 000615speech.htm>.

THE *XEROX* FACTS

Xerox is in the business of designing, manufacturing, selling, and servicing photocopiers and laser printers. CSU (formerly Copier Services Unlimited) is one of a number of independent service organizations ("ISOs") that compete with Xerox to service these copiers and printers after the initial warranty period.

In 1984 Xerox decided that it would sell parts used to service its copiers and printers to authorized resellers and service providers and to end users of its equipment, but that it would not sell parts directly to its competitors. This refusal to deal was purely unilateral. End users remained free to supply the parts they purchased to any service provider, including ISOs, and to use any service provider they desired to install the parts. Xerox thus never *agreed* with parts purchasers that they would not use ISO service, and indeed some parts purchasers utilized CSU's service. Although Xerox unilaterally limited the quantity of parts it would sell to any one end user to the quantity reasonably necessary to repair the user's equipment, end users were free to resell the parts they purchased to ISOs.

In 1994, as part of a settlement of a class action brought by end users and ISOs, Xerox changed its parts policy. Xerox agreed to sell parts directly to ISOs (including providing them with quantity discounts) and to license diagnostic software to copier and printer end users, who could utilize ISOs as their agents to order and use the software. Since 1994, Xerox has not refused to sell parts or license diagnostic software. Although CSU has claimed that Xerox discriminated against ISOs *vis a vis* end users in sale and licensing terms (a claim that has been picked up by some critics of the *Xerox* decision), CSU introduced no evidence of such discrimination. Rather, all ISOs and all end users pay the same prices (and receive the same quantity discounts).[4]

CSU opted out of the settled 1994 class action and filed its own antitrust claims against Xerox, challenging as antitrust violations Xerox's past refusal to sell parts and license software, as well as its post-1994 pricing of parts and software. All of CSU's claims were under § 2 of the Sherman Act; CSU did not allege any tying arrangement or that Xerox had conspired with any other party to deny CSU parts or software. Although CSU's refusal to deal claims were based on both patented and unpatented parts; CSU and its experts eventually conceded that CSU's alleged injury was attributable solely to Xerox refusal to sell patented parts and to license Xerox's diagnostic software, which was protected by both patents and copyrights.

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[4] The sole exception to this rule was the U.S. Navy, which receives some parts at a somewhat larger discount as part of a unique cooperative servicing agreement, pursuant to which Xerox technicians service shipboard copiers while the ships are in port and Xerox-trained Navy technicians service the copiers while the ships are at sea. CSU did not claim that it competed with the Navy's own technicians either to service the Navy's copiers or to service the copiers of others.

Xerox responded to CSU's antitrust claims by arguing that its prior unilateral refusal to sell patented parts and to license patented and copyrighted diagnostic software (and its post-settlement pricing of such items) were a lawful unilateral exercise of its intellectual property rights and hence could not violate § 2. Xerox did *not* claim that its refusal to deal was in fact motivated by its intellectual property rights, but asserted that the existence of such IP rights immunized its conduct. Xerox did not assert an "IP Defense" with regard to unpatented parts, but argued that CSU could not show it was actually injured by Xerox's refusal to sell such parts. Xerox also asserted patent and copyright infringement counterclaims against CSU based on CSU's use of unlicensed diagnostic software and infringing parts purchased from third party parts vendors. CSU did not contest either the validity of Xerox's patents or its infringement; rather, it defended the infringement with a patent and copyright misuse defense based on the same conduct that underlay its antitrust claims – Xerox's prior refusal to sell or license and its current pricing of parts and software.

THE *XEROX* DECISIONS

Although the district court initially denied Xerox's motion for summary judgment,[5] two weeks later it reconsidered its decision and granted summary judgment to Xerox,[6] and CSU's motion for reconsideration of that decision was denied.[7] The district court rejected CSU's arguments (discussed below) that Xerox's refusal to license was an unlawful attempt to leverage a "parts monopoly" into a "service monopoly" and that Xerox's subjective intent underlying its refusal to deal was relevant to a determination of the legality of Xerox's conduct. Instead, the district court adopted a rule of *per se* legality for unilateral refusals to license.[8]

On appeal, the Federal Circuit affirmed. But it purported to recognize several exceptions to the right of an intellectual property owner to refuse to license, holding that "[i]n the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude

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[5] *In re Independent Service Orgs. Antitrust Litig.*, 964 F. Supp. 1454 (D. Kan. 1997).

[6] *In re Independent Service Orgs. Antitrust Litig.*, 964 F. Supp. 1479 (D. Kan. 1997).

[7] *In re Independent Service Orgs. Antitrust Litig.*, 989 F. Supp. 1131 (D. Kan. 1997).

[8] *In re Independent Service Orgs. Antitrust Litig.*, 964 F. Supp. at 1490 (unilateral refusal to license patents); 989 F. Supp. at 1144 (unilateral refusal to license copyrights).

others from making, using, or selling the claimed invention free from liability under the antitrust laws."[9]

THE "GENERAL RULE" OF LEGALITY FOR UNILATERAL REFUSALS TO LICENSE

Although the 1995 DOJ/FTC *Antitrust Guidelines for the Licensing of Intellectual Property* state that "[t]he Agencies apply the same general principles to conduct involving intellectual property that they apply to conduct involving any other form of tangible or intangible property" and that intellectual property is not "particularly free from scrutiny under the antitrust laws,"[10] every case to address the question has held that a unilateral refusal to license intellectual property should be treated differently from other unilateral refusals to deal, and most commentators appear to agree.

A monopolist whose monopoly is based on tangible property may, in some circumstances, be compelled to share that property with others. For example, in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*[11] the Supreme Court upheld a finding that a defendant with monopoly power in a market for "downhill skiing services in Aspen" had unlawfully maintained that monopoly by refusing to permit a competitor to sell tickets (*i.e.* grant access to) the monopolist's mountains. In so doing, the Court held that "[t]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified."[12]

In contrast, the Supreme Court has held the "[t]he patent laws which give a 17-year monopoly on 'making, using, or selling the invention' are in pari materia with the antitrust laws and modify them pro tanto."[13] Accordingly, courts have consistently rejected the proposition that a patentee acts improperly by refusing to license competitors to make, use or sell its inventions or that the owner of a copyright can be compelled to

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[9] 203 F.3d at 1327. Similarly, with regard to copyrights, the Federal Circuit "reject[ed] CSU's invitation to examine Xerox's subjective motivation in asserting its right to exclude under the copyright laws for pretext, in the absence of any evidence that the copyrights were obtained by unlawful means or were used to gain monopoly power beyond the statutory copyright granted by Congress." 203 F.3d at 1329.

[10] *Guidelines*, § 2.1.

[11] 472 U.S. 585 (1985).

[12] *Id*. at 601.

[13] *Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964)

license others to reproduce, distribute, or perform its work.[14] As the Second Circuit held in *SCM Corp. v. Xerox Corp.*, "[s]imply stated, a patent holder is permitted to maintain his patent monopoly through conduct permissible under the patent laws."[15]

PROPOSED EXCEPTIONS TO THE GENERAL RULE OF LEGALITY

1. CSU and the Ninth Circuit: Leveraging and Bad Intent

CSU (the plaintiff in *Xerox*), following the Ninth Circuit's decision in *Image Technical Servs. v. Eastman Kodak Co.*[16], argued that the general rule of legality is inapplicable when an intellectual property owner's refusal to license permits it to obtain or maintain a monopoly in a market other than the market for the patented product. In other words, while Xerox's patents on parts may give Xerox a right to monopolize a "parts market," they do not give Xerox the right to monopolize a "service market." Unlike general leveraging caselaw, however, the Ninth Circuit's rule affords a "rebuttable presumption" that the refusal to license is lawful – even when more than one

[14] With regard to patents, *see generally Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 215 (1980) (the "essence" of the patent grant is the "right to exclude others from profiting by the patented invention"); *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 135 (1969) (the "heart of [the patentee's] legal monopoly" is the "right to invoke the State's power to prevent others from utilizing his discovery without his consent"); *Hartford-Empire Co. v. United States*, 323 U.S. 386, 432 (1945) ("A patent owner is not in the position of a quasi-trustee for the public or under any obligation to see that the public acquires the free right to use the invention. He has no obligation either to use it or to grant its use to others."); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 457 (1940) (holding that a patent owner has a legal "right to refuse to sell . . . [its] patented products"); *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405, 429 (1908) (holding that exclusion of competitors is "the very essence of the right conferred by the patent"). With regard to copyrights, *see generally Stewart v. Abend*, 495 U.S. 207, 228-29 (1990) (noting that "nothing in the copyright statutes would prevent an author from hoarding all of his works during the term of the copyright" and that "a copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work"); *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932) ("The owner of a copyright, if he pleases, may refrain from vending or licensing and content himself with simply exercising the right to exclude others from using his property.").

[15] 645 F.2d 1195, 1204 (2nd Cir. 1981).

[16] 125 F.3d 1195 (9th Cir. 1997), *cert. denied*, 118 S. Ct. 1560 (1998).

market is affected.[17] This presumption will be rebut, however, where the intellectual property owner is "not actually motivated by protecting its intellectual property rights."[18]

Notwithstanding the Solicitor General's uncompelling argument that there is no actual conflict between the decisions of the Federal Circuit and the Ninth Circuit[19], if CSU and the Ninth Circuit are right, the Federal Circuit's decision is wrong. Although the Federal Circuit's decision does a weak job of making the argument; the better view is that the Ninth Circuit's standard is simply wrong.

CSU and the Ninth Circuit based their "leveraging" exception to the right to refuse to license on footnote 29 in the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, in which the Court stated that "power gained through some natural and legal advantage such as a patent, copyright, or business acumen can give rise to liability if a seller exploits his dominant position in one market to expand his empire into the next."[20] But footnote 29 is not a discussion of unilateral refusals to deal. It appears in the Court's discussion of tying claims, and the footnote characterizes its discussion as one of Kodak's "tying policy" and "tying in derivative aftermarkets." Read in this context, footnote 29 does nothing more than restate the well-established rule that tying – including tying involving intellectual property – is unlawful. Additionally, footnote 29 can be characterized as *dicta* because the *Kodak* case did not involve the rights of intellectual property owners – the only evidence before the Court was that none of Kodak's parts were patented.[21] Accordingly, even the Ninth Circuit recognized that the Supreme Court had not "specifically address[ed] the question of antitrust liability based upon a unilateral refusal to deal in a patented or copyrighted product,"[22] that it could "find no reported case in which a court has imposed antitrust liability for a unilateral refusal to sell or license a patent or copyright,"[23] and that "[c]ourts do not

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[17] *Id* at 1216.

[18] *Id*. at 1219.

[19] *See* Brief of the Solicitor General as *Amicus Curiae* at 15, *available online* at <http://www.usdoj.gov/osg/briefs/2000/2pet/6invit/2000-0062.pet.ami.inv.pdf>

[20] 504 U.S. 451, 480 n.29 (1992).

[21] *See* Respondent's Brief, 1991 WL 530838 at *45 ("Kodak has produced no evidence of exclusive patent rights over OEM-made parts for Kodak equipment (even though such information was sought by interrogatory)."). The rights of intellectual property owners were not discussed in the briefs or mentioned at oral argument in the Supreme Court's *Kodak* case. *See ISO Litig.*, 203 F.3d at 1327; *see generally* 1991 WL 636270 (*Kodak* oral argument); 1991 WL 530837 (Petitioner's Brief in *Kodak*); 1991 WL 530838 (Respondent's Brief in *Kodak*); 1991 WL 530839 (Petitioner's Reply Brief in *Kodak*).

[22] 125 F.3d at 1216.

[23] *Id*. at 1216.

generally view a monopolist's unilateral refusal to license a patent as 'exclusionary conduct.'"[24]

Notwithstanding footnote 29, this focus on the identity of the "markets" affected by a refusal to deal is unsupported in the caselaw. A patent provides its owner with the right to exclude others from *using* its inventions, not just making and selling them.[25] Just as Xerox's patented parts are used in a "service market," most inventions are used in markets other than the "market for the invention" – a patented drug is used in the market for treatment of a disease, and a patented fuel injection system may be used in a market for automobiles. Accordingly, as the *Xerox* district court noted, "a single 'patent monopoly' can be used to secure multiple 'economic monopolies,' *i.e.*, monopolies in more than one relevant antitrust market."[26] Because Xerox has the right to prevent others from making, selling, *and* using its inventions, a patent on a photocopier part could in theory convey an economic monopoly not only in a market for that part, but in markets for servicing copiers or manufacturing copiers where the part is used. Of course, if the part faces competition from noninfringing substitutes, the patent "monopoly" may not afford any economic monopoly at all.

If the exclusive right to use depends on the patentee's market share in the market in which the invention is used, the exclusive right to use is read out of the Patent Act. This is not the law; "the boundary of a patent monopoly is to be limited by the literal scope of the patent claims."[27] As long as a patentee does nothing more than exercise the rights granted by its patent – here the exclusive right to use the claimed inventions – it has not impermissibly expanded the scope of the patent. Indeed, as the Supreme Court has recognized, the "heart of [the patentee's] legal monopoly" is the "right to invoke the State's power to prevent others from utilizing his discovery without his consent."[28] Under this precedent, a court's inquiry is limited to whether the patentee has done anything more than unilaterally refuse to permit others to use the claimed inventions. Where the patentee's conduct is limited to unilaterally excluding others from making, using, or selling the claimed invention, it is irrelevant whether exercise of the patent rights conveys power in an economic market – regardless of whether the market is "for the invention" or some other market.

The Ninth Circuit held that where a patent was being used to obtain or maintain a monopoly in a separate market, it was appropriate to review the intellectual property owner's motives underlying its refusal to deal for evidence of "pretext." This focus on

[24] *Id.*

[25] 35 U.S.C. §§ 154, 271(a).

[26] 964 F. Supp. at 1488.

[27] *Dawson Chemical Co. v. Rohm and Haas Co.*, 448 U.S. 176, 221 (1980).

[28] *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 135 (1969).

subjective intent directly conflicts with the Supreme Court's holding in *Professional Real Estate Investors* that "to condition a copyright upon a demonstrated lack of anticompetitive intent would upset the notion of copyright as a 'limited grant' of 'monopoly privileges.'"[29]. Indeed, in *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, one of its earliest discussions of the right to refuse to license, the Supreme Court held that it is the privilege of an intellectual property owner to refuse to license "without question of motive."[30]

If an inquiry into subjective intent is permissible, no IP owner can refuse to license without facing discovery in an antitrust suit – and maybe a trial. Anyone can allege "pretext" to survive a motion to dismiss, and can likely develop enough evidence to survive summary judgment. As the *Xerox* district court noted:

> Under the *Kodak* standard, a self-serving memorandum in the files of a corporate executive, which states that the company is refusing to license its products because they are patented, apparently could be sufficient to protect the company's refusal to deal from antitrust scrutiny. On the other hand, a company would be subject to antitrust liability for having a corporate memorandum which states that the company plans to use its intellectual property rights to exclude competitors and achieve a competitive advantage in the marketplace. The monopolist's conduct, as well as the anticompetitive effect on the relevant markets, is identical in both circumstances.[31]

2. The Federal Circuit: Tying, Fraud on the PTO, and Sham Litigation

The Federal Circuit identified three exceptions to the right of an intellectual property owner to unilaterally refuse to deal: tying, fraud on the PTO, and sham litigation. The first two are superfluous; the third is probably wrong.

It has long been recognized that a patentee has no right to tie the sale or license of its patented invention to the purchase of an unpatented item.[32] But a tie is not a unilateral refusal to deal – it is an "agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that

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[29] 508 U.S. 49, 64 (1993).

[30] 210 U.S. 405, 429 (1908).

[31] 989 F. Supp. at 1141.

[32] *See, e.g.*, *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 492-94 (1941). There are exceptions – not relevant here – for tying the license of a patented process to the purchase of nonstaple articles of commerce. *See Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176 (1980).

he will not purchase that product from any other supplier."[33] Perhaps the Federal Circuit was referring to a failed tie – where the "victim" refuses to purchase the tied product. In that case there is no actual agreement, but a tying claim will still lie.[34] Regardless, although the Federal Circuit was correct to hold that a tying arrangement involving intellectual property is not immune from antitrust review, its discussion of the issue in the context of unilateral refusals to license is simply confusing.

The Federal Circuit's creation of an exception for fraud on the PTO is even more confusing. Where a patent was issued as a result of such fraud it is invalid; in such a case there is no refusal to license intellectual property, only a refusal to deal in unpatented goods.

Finally, although there is no antitrust immunity for sham litigation,[35] the Federal Circuit provides no reason why the presence of sham litigation should result in the loss of antitrust immunity for a refusal to license. To use a hypothetical, pretend that an owner of a valid patent refuses to license a competitor. Fearing an antitrust suit, and desirous of Federal Circuit appellate jurisdiction, the patentee files a frivolous lawsuit against the party it has refused to license – frivolous because the patentee knows that the defendant has not made, used, or sold the patented invention. Here we have a clear case of sham litigation that may constitute an antitrust violation if the other requirements under *Professional Real Estate Investors* are established. But this is quite different – and the damages may be quite different – from saying that the underlying refusal to license is now unlawful. Just as misuse does not serve to retroactively invalidate a patent for the period prior to misuse,[36] there is no reason why sham litigation should make unlawful prior conduct that was an otherwise lawful exercise of the patentee's rights. In the same way that an antitrust defendant's other unlawful conduct will not transform legitimate petitioning into an unlawful sham,[37] unlawful sham litigation should not deprive a patentee of its rights under the Patent Act.

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[33] *Kodak*, 504 U.S. at 461.

[34] *See, e.g.*, *Thompson v. Metropolitan Multi-List, Inc.*, 934 F.2d 1566, 1572 (11th Cir. 1991).

[35] *See Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49, 56-60 (1993).

[36] This can be seen in the fact that a finding of misuse does not relieve a licensee of the obligation to pay royalties for the period prior to the misuse. *See, e.g.*, *Transitron Electronic Corp. v. Hughes Aircraft Co.*, 487 F. Supp. 885, 893 (D. Mass. 1980).

[37] *See, e.g. City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365 (1991).

3. Former FTC Chairman Robert Pitofsky: Selective Licensing, Conditioned Licenses, Price Fixing, Patent Pools, and Fraud on Standard-Setting Organizations.

Chairman Pitofsky criticized the Xerox decision as "leap[ing] from the undeniable premise that an intellectual property holder does not have to license anyone in the first instance to the unjustifiable conclusions that it can select among licensees to achieve an anti-competitive purpose or can condition a license (for example, you receive a license only if you agree not to do business with my competitor) to achieve an anti-competitive effect."[38] The extent to which Chairman Pitofsky was actually criticizing the holding of *Xerox*, as opposed to cautioning against its extension beyond pure unilateral refusals to license, is not entirely clear.

Xerox *did* selectively license – it sold parts to end users, but not to ISOs. If Chairman Pitofsky believes this is unlawful, it would be an attack on the holding in *Xerox* rather than simply the *dicta*. But it would be a critique without any support in the caselaw; even the Ninth Circuit in *Image Technical* recognized that the distinction between "a selective refusal to sell" and "an absolute refusal to license . . . makes no difference."[39] As the Supreme Court held in *United States v. United Shoe Machinery Co.*, an owner of intellectual property "necessarily has the power of granting [a license] to some and withholding it from others."[40] Indeed, if selective refusals to license were unlawful, exclusive licenses designed to maximize the licensor's profits – the grant of a license to only a single licensee to obtain "an anti-competitive purpose" – would be unlawful. But that position has been rejected in the caselaw, including one case rejecting a challenge by the federal enforcement authorities.[41]

With regard to Chairman Pitofsky's second criticism, however, and as noted above, Xerox did *not* condition its licenses in any way – end users were free to do whatever they wished with parts they purchased from Xerox. The Federal Circuit thus

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[38] Robert Pitofsky, *Antitrust and Intellectual Property: Unresolved Issues at the Heart of the New Economy* (March 2, 2001) <http://www.ftc.gov/speeches/pitofsky/ipf301.htm>.

[39] 125 F.3d at 1216. Two other ISO cases have reached the same result. *See Service Training, Inc. v. Data General Corp.*, 963 F.2d 680, 690 (4th Cir. 1992); *Advanced Computer Services of Michigan v. MAI Systems Corp.*, 845 F. Supp. 356 (E.D. Va. 1994).

[40] 247 U.S. 32 (1918). *See also, e.g.*, *E. Bement & Sons v. National Harrow Co.*, 186 U.S. 70, 94 (1902) (lawful for patentee to grant license but agree to refuse to license others); *Extractol Process Ltd. v. Hiram Walker & Sons Inc.*, 153 F.2d 264, 268 (7th Cir. 1946) ("No legitimate attack can be made on the patent or patent grant because the patentee chooses A and B as its licensees and refuses a license to X, Y, or Z.").

[41] *See U.S. v. Studiengesellschaft Kohle, m.b.H.*, 670 F.2d 1122, 1137 (D.C. Cir. 1981). *Accord, e.g*, *Genentech, Inc. v. Eli Lilly & Co.*, 998 F.2d 931, 949 (Fed. Cir. 1993).

did not address the legality of conditioned licenses; it certainly did not "leap . . . to the unjustifiable conclusion" that such conditioned licenses were lawful.

In an earlier speech,[42] Chairman Pitofsky suggested four additional exceptions (or potential exceptions) to the Xerox rule:

- "Suppose a patent holder refuses to sell except on condition that the purchaser not buy from a potential competitor. Assuming monopoly power, that could be a violation under *Lorain Journal*.[43] Would a patent be an absolute defense because the product incorporates a patented element?"

  As noted above, this fact pattern is not present in the case because Xerox's parts customers could – and did – buy service from Xerox's service competitors. On the merits of the proposed exception, if there is a true conditioned sale – a tie-in or tie-out – this would not be a unilateral refusal to deal, would not be captured by the *Xerox* rule, and would not be immune from antitrust scrutiny.

  A somewhat more difficult issue is raised by the *Lorain Journal* fact pattern – a true unilateral refusal to deal with potential licensees simply because they choose to do business with a competitor. Although the result may be troubling, I believe the answer compelled by the caselaw is that the unilateral refusal to deal is lawful, for an IP owner may refuse to deal "without question of motive."[44] From a policy perspective, the result can be justified by the chilling effect of any inquiry into motive upon the exercise of the lawful patent grant. Moreover, as a practical matter, the line between *Colgate*-protected unilateral conduct and an agreement is difficult to maintain, and policies of the type described in the hypothetical will frequently be subject to antitrust scrutiny because they are *not*, in fact, unilateral.

- "Suppose an inventor licensed an important process patent to five firms in a traditional manufacturing sector. One of the firms is a price-cutter. If the inventor terminates the license, would *Xerox* preclude any investigation into motive, or into the possibility that termination, though unilateral, resulted from anticipation of what the other licensees wanted?"

  The Federal Circuit did not, of course, address anything like this issue. But there would be no basis for treating termination of an intellectual property license differently from termination of any other distributorship. A unilateral termination

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[42] Robert Pitofsky, *Challenges of the New Economy: Issues at the Intersection of Antitrust and Intellectual Property* (June 15, 2000), <http://www.ftc.gov/ speeches/pitofsky/ 000615speech.htm>

[43] *Lorain Journal Co. v. United States*, 342 U.S. 143, l55 (1951).

[44] *Continental Paper Bag*, 210 U.S. at 429.

would be lawful; an agreement with the price-cutter's competitors to terminate the price-cutter would be unlawful.[45] Nothing in *Xerox* should be read to prohibit an investigation of the facts of the case to determine whether the termination was in fact unilateral.

Where, however, the termination is *in fact* unilateral, the fact that the termination "resulted from anticipation of what other licensees wanted" would be irrelevant under well-established caselaw regardless of whether intellectual property or tangible property were involved.

- "Suppose two firms have entered into a patent pooling agreement in which each firm retains veto power over the selection of its partner's licensees. Would a unilateral refusal to license, designed to reduce competition below levels that would exist in the absence of the pooling agreement, be protected activity, even if the pooling agreement led to the refusal?"

  This hypothetical – which has nothing to do with the *Xerox* facts – describes not a unilateral refusal to license, but a concerted refusal to license in which one IP owner controls the IP licensing decisions of another by requiring all licensing to be done through the pool. The cases recognize that such concerted refusals to license are unlawful.[46]

- "Suppose a patent holder knowingly misinformed a standard setting organization that it had no patents in a particular area, and as a result the organization developed a standard that required use of the patent holder's patent. If the patent holder refused to license, or would license only at exorbitant rates, would that be protected activity?"

  This hypothetical, based on the FTC's *Dell* consent decree,[47] again has nothing to do with the correctness of the *Xerox* holding. Indeed, the legality of the refusal to license would be irrelevant in this hypothetical, for the misconduct before the standard-setting body could be a violation of § 2 regardless of the legality of the subsequent refusal to license. The key point here is that it is the misrepresentation – not the patent – that created the market power. Absent the misrepresentation, the patentee's intellectual property would have been competitively irrelevant, because the standard would not have implicated the patent.

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[45] *Compare United States v. Colgate & Co.*, 250 U.S. 300 (1919), *with Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984).

[46] *See, e.g.*, *Primetime 24 Joint Venture v. National Broadcasting Co.*, 219 F.3d 92, 99 (2d Cir. 2000).

[47] *In re Dell Computer Corp*., 121 F.T.C. 616 (1996).

> However, even though the legality of the refusal to license should be irrelevant, this case could be analogized to the case of an unlawfully acquired patent – where it is the unlawful acquisition, not the patent, that has resulted in the ability to exercise market power. In such a circumstance, the cases recognize that "the subsequent exercise of the ordinarily lawful exclusionary power inherent in the patent would be a continuing wrong, a continuing unlawful exclusion of potential competitors."[48]

In sum, although Chairman Pitofsky is troubled by the Federal Circuit's language, his critiques do not appear to go to the *holding* of the case. His proposed exceptions to the Federal Circuit's rule are not really "exceptions" – because they do not involve unilateral refusals to license – or would in fact go beyond the antitrust rules that apply to refusals to deal in tangible property.

4. Mark Patterson: Exploitation of the Patent Other Than In Markets Where The Patent Is "Useful."

Mark Patterson has argued that the right to refuse to license should be limited to markets where the patent is "useful."[49] To the extent that this is a critique of the holding in *Xerox*, it represents a misunderstanding of Xerox's patents and the facts of the case. To the extent that Mr. Patterson is suggesting a rule of decision, it is a rule that is both unworkable and inconsistent with precedent.

Patterson suggests that Xerox's conduct should not be immune from antitrust condemnation because Xerox's economic power was not attributable to its patents. Antitrust liability should attach to Xerox's refusal to sell patented parts, he argues, because "it was the equipment owners, not the service organizations, that benefited from any inventions embodied in those parts."[50] This is simply wrong. Xerox's patents claim inventions that make *servicing* copiers and printers easier and more effective.[51] The claims in the patents simply support the common-sense conclusion that it is service

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[48] *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1206 (2d Cir. 1981).

[49] Mark R. Patterson, *When Is Property Intellectual? The Leveraging Problem*, 73 S. Cal. L. Rev. 1133 (2000).

[50] *Id*. at 1135.

[51] For example, as noted in Xerox's brief in the Federal Circuit, Xerox's '797 pressure roll patent notes that invention provides the advantage of "less down-time required for replacing pressure rolls," *i.e.*, the need for less frequent copier and printer service. Xerox's '256 fuser roll patent states that the object of this invention is to provide a new fuser roll with a longer lasting coating, a goal that is desirable because it "is expensive to . . . install fuser rolls." Xerox's '006 document handler belt patent disclosed a belt with "good document handling performance without requiring the intermittent or periodic adjustment required" by servicemen for proper operation of the prior art belt.

providers who benefit from Xerox's improvements to its parts; if a part lasts twice as long, only half as many hours of service technician time are required.

Regardless of the propriety of applying Patterson's proposed exception to the specific facts in *Xerox*, I would submit that Patterson's rule should be rejected because it is both impractical and inconsistent with the Patent Act and the caselaw. It is unworkable because it creates a disputed issue of fact in every case – is it the patent that has afforded market power, or something else? As the example of the Xerox parts patents demonstrates, the source of market power may be far from obvious. Any rule that creates this type of uncertainty regarding the legality of a refusal to license – just as with any rule that depends on market definition – substantially reduces the benefit of the right to refuse to license.

Patterson's real concern seems to be with worthless IP tacked on to a monopoly product simply to create a justification for a refusal to deal – imagine a part monopolist who inscribed a short original poem on it its parts and justified the refusal to deal by asserting a refusal to sell a copyrighted work. But the antitrust laws already have a way of dealing with this problem – the law of tying as applied to product improvements. Although courts will generally not second-guess product improvements,[52] where there is no real improvement (as in the poetry on the part case), an unlawful tie will be found, resulting in the possibility of antitrust liability. To follow the logic of the technological tying cases, where the patent represents a real improvement, courts should hesitate to condemn the refusal to license based on the possibility that the "wrong" market is being foreclosed as a result of the improvement.

Patterson also proposes an exception to the general rule of antitrust immunity for refusals to license that represents a far more substantial departure from established law – a ban on discrimination among licensees. "[I]ntellectual property also should not allow owners of the property to discriminate among potential buyers or licensees if those buyers or licensees do not differ in their uses of the intellectual element of the property."[53] This is bad law and bad policy for the reasons described above.[54]

Lest there was any doubt, the 1988 Amendments to the Patent Act, Pub. L. 100-703, codified at 35 U.S.C. § 271(d), explicitly provide:

> (d) No patent owner otherwise entitled to relief for infringement of contributory infringement shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of having done

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[52] *See, e.g.*, *United States v. Microsoft Corp.*, 147 F.3d 935 (D.C. Cir. 1998); *Response of Carolina, Inc. v. Leasco Response, Inc.*, 537 F.2d 1307, 1330 (5th Cir. 1976).

[53] 73 S. Cal. L. Rev. at 1135.

[54] *See* p. 6 and nn. 39-41.

> one or more of the following: . . . (4) refused to license or use any rights to the patent . . .

Patterson argues that § 271(d)(4) is inapplicable because it applies only to "complete refusals to license patents, not conditional or selective licensing."[55] This is a misreading of the plain language of the statute. "Any rights to the patent" includes "some rights" to the patent; it is not limited to "all rights to the patent."[56] Notwithstanding Patterson's claims to the contrary,[57] the legislative history supports this reading. In *SCM v. Xerox*[58], one of the two cases that Representative Kastenmeier stated was being codified by § 271(d)(4)[59], the Second Circuit refused to impose antitrust liability upon Xerox based on a refusal to license its patents to competing manufacturers of plain paper copiers even though the patents had been licensed to companies that made coated paper copiers.[60]

CONCLUSION

Criticism of the *Xerox* case has generally been based on the language of the opinion, rather than the holding. Those who have criticized the holding rely on misunderstood facts, bad law, or both. Although there is room in rare factual circumstances for antitrust liability where a defendant has refused to license intellectual property, liability should not attach in the case of the "pure" unilateral refusal to deal at issue in *Xerox*.

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[55] 73 S. Cal. L. Rev. at 1151 n.81.

[56] *See United States v. Gonzales*, 520 U.S. 1, 4 (1997) ("Read naturally, the word 'any' has an expansive meaning, that is, 'one or some indiscriminately of whatever kind.'") (internal citation omitted).

[57] *See* 73 S. Cal. L. Rev. at 1151 n.81.

[58] 645 F.2d 1195 (2d Cir. 1981).

[59] *See* 134 Cong. Rec. H10646, H10648 (Oct. 20, 1988).

[60] 645 F.2d at 1197.