

## FEDERAL CIRCUIT DECISION PROVIDES GUIDANCE FOR JOINT LICENSING OF POOLED PATENTS

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To Our Clients and Friends:

Last month, in *Princo Corporation v. International Trade Commission*, No. 2007-1386, 2009 WL 1035222 (Apr. 20, 2009), the United States Court of Appeals for the Federal Circuit issued an opinion of potential significance for any patent-owner participating or considering participation in a patent pool. The decision provides guidance on the criteria for “essential patents” that will be reassuring to many patent pool participants. At the same time, the opinion is a cautionary reminder of the risks in refusing to license pooled patents outside the package license provided by the pool.

The Federal Circuit’s decision arises from a challenge to the licensing of patents for re-writable and write-once compact discs (“CD-Rs” and “CD-RWs”). The technology relevant to the production of CD-Rs and CD-RWs had been developed by a number of companies, including Sony and Phillips. In the late 1980’s and early 1990’s, Sony and Phillips jointly developed a technical standard for CD discs and players called the Orange Book, which ensured compatibility and inter-operability for discs, players and ROM drives manufactured in accordance with the standard.

In the early 1990’s, Sony, Phillips and two other patent-holders agreed to make their Orange Book-related CD-R and CD-RW patents available on a pooled basis through a package license administered by Phillips. Disc manufacturers licensing the pooled patents were charged a flat per-disc royalty for each CD produced using at least one licensed patent, regardless of how many patents the licensee actually required.

Princo, an importer of CDs, initially took a package license to the pooled patents, but soon ceased to pay royalties. Phillips filed a complaint with the International Trade Commission (“ITC”) under 19 U.S.C. Section 1337, which authorizes the ITC to prevent importation of products infringing U.S. patents. The ITC instituted an investigation in response to Phillips’ complaint, which alleged that Princo and others had imported discs that infringed Phillips’ patents.

Princo conceded that its products were within the scope of Phillips’ patents, but asserted patent misuse (through unlawful tying) as a defense, claiming that Phillips had improperly expanded the scope of its patent rights through the package licensing program by requiring Princo to take licenses to, and pay for, non-essential patents in order to obtain licenses to the

patents it desired. After the administrative law judge ruled in Princo's favor and the ITC affirmed, the Federal Circuit reversed and remanded. *See* 424 F.3d 1179 (2005). On that occasion, the Federal Circuit held that, in light of the efficiencies of package patent licenses, allegations that pooled patent licenses constituted unlawful tying should be assessed under the rule of reason, weighing their pro-competitive and anti-competitive effects, rather than a *per se* standard. Applying the rule of reason, the Federal Circuit concluded that the four patents at issue were essential because the patents covered features necessary for compliance with the Orange Book standard and there was no evidence in the record that "any commercially viable alternative actually existed" to the patents, and, hence, there was "no practical or realistic alternative" to using the challenged patents. The Federal Circuit remanded for further proceedings concerning other misuse theories that the ITC had not considered.

On remand, Princo focused on two arguments relating to a Sony patent (the "Lagadec patent"): that the Lagadec patent was non-essential and that Sony's purported refusal to license the Lagadec patent outside the package license constituted misuse. Following an ITC decision that rejected both arguments, the case returned to the Federal Circuit. It also rejected the first argument, but found the second theory potentially actionable and remanded for further factual determinations.

Princo argued that the Lagadec patent was not essential because the specification disclosed a digital encoding scheme that was (Princo claimed) rejected in the Orange Book. Phillips contended that one of the Lagadec patent's claims was sufficiently broadly written to cover the analog method of encoding described in the Orange Book. The Federal Circuit concluded it need not resolve this dispute or decide if the Lagadec patent was *actually* essential to the Orange Book standard. Instead, it determined that a patent was "essential" for purposes of rule of reason analysis if an "objective manufacturer" at the time the pooled license was being offered would have concluded that a license to the Lagadec patent "reasonably might be necessary" to manufacture Orange Book-complaint discs.

The Court stated that this "reasonably necessary" standard was required to avoid the uncertainty and litigation exposure that would result if it were necessary to determine if a patent was *actually* essential to the standard. The Court also emphasized that the "reasonableness" of the necessity of a patent should be assessed from the perspective of the time that the license was offered, including the law of claims construction at the time.

The Federal Circuit was more sympathetic to Princo's second argument. Princo claimed that the Lagadec patent could have led to development of a standard competing with the Orange Book specifications, but that Sony and Phillips allegedly agreed to forestall that possibility by refusing to license the Lagadec patent except for Orange Book-compliant applications. The

Court concluded that even if the Lagadec patent was a blocking patent for Orange Book purposes, it could still constitute patent misuse for the parties to the pool to agree to refuse to license it to develop competing technologies. The Court found that, in contrast to joint licensing of blocking patents, “there are no benefits to be obtained from an agreement between patent holders to forego separate licensing of competing technologies.” The Court did not find that Sony and Phillips had actually entered into an agreement not to license the Lagadec patent; it left determination of that issue for the ITC on remand.

The Court also recognized that, to establish patent misuse under the rule of reason, there must be some showing that the allegedly suppressed competing technology was commercially viable. The Court did not specify the showing that must be made regarding the commercial prospects of a potentially competitive technology to support a claim of patent misuse, although it offered some guidance. The Court said that it was not necessary to demonstrate that a competing technology was commercially viable at the time that the pooled licenses were granted or to provide “stringent proof of the destruction of future competition.” On the other hand, the Court stated that “proof that a suppressed technology could not have been viable would be sufficient to negate a charge of misuse.” It left the ITC to determine, on remand, the appropriate standard and whether it was implicated in this case.

The Federal Circuit’s decision has significant consequences for any company considering participating in a patent pool licensing program. The decision provides comfort that the inclusion of patents reasonably seen as essential at the time should not be second-guessed, and that such licenses should not be subject to tying claims if a reasonably necessary patent is some day held to be non-essential. At the same time, the decision dictates caution for any patent-holder inclined to license exclusively through pools or to place limitations on the availability of its patents outside the pool – at least where there is a colorable argument that its patents could some day support a commercially viable competitive technology.

Please contact us if you have any questions.

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