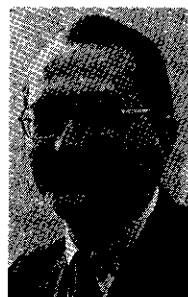


Compulsory Licensing by FTC Decree

Unofficial government views toward pros and cons of compulsory patent licensing and FTC's role

BY OWEN M. JOHNSON JR.*

My purpose is to offer insights into the whys and wherefores of "Compulsory Patent Licensing by FTC Decree." First, let me emphasize that any views I express do not necessarily reflect the views of the Federal Trade Commission, or of any individual commissioner.



O. Johnson

The pros and cons of compulsory patent licensing have been debated since the enactment of our first patent legislation in this country in 1790. Established pursuant to Congress' power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respect Writings and Discoveries,"¹ the Patent Office and the rights inherent in patent ownership are painstakingly spelled out in Title 35 of the United States Code. What may be somewhat less familiar, and surely less understandable, to you is the purpose and function of the Federal Trade Commission, and how these relate to patent licensing. Created in 1914 by act of Congress, the commission was chartered to put an end to "unfair methods of competition . . ."² Today, the FTC serves as an independent law enforcement agency with responsibility for a wide range of statutory authority, including certain antitrust laws. Specifically, the Bureau of Competition not only guards against "unfair methods of competition" under Section 5 of the Federal Trade Commission Act, but also shares jurisdiction with the Antitrust Division of the Department of Justice for enforcement of Sections 2, 3, 7, and 8 of the Clayton Act. Federal antitrust responsibility is somewhat further complicated by the fact that, while only the Antitrust Division polices the Sherman Act, courts have interpreted the broad proscription of FTCA §5 to extend to every Sherman Act violation.³

Infrequent Use.

In any event, the commission's excursions into the realm of compulsory patent licensing to date have been entirely a result of its antitrust efforts. Lest I deceive you at the outset, I should point out that the commission has ordered compulsory patent licensing in only one adjudi-

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cated case and a handful of consent orders where such relief was deemed "necessary to pry open to competition a market that has been closed by illegal restraints."⁴ Despite its relatively infrequent use, compulsory patent licensing remains a valued weapon in the commission's antitrust arsenal. A brief legal review of the government's

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authority to impose compulsory licensing in antitrust contexts should lay the foundation for later analysis of the commission's use of this power.

The Supreme Court first approved the use of compulsory patent licensing in its *Hartford-Empire* decision in 1945.⁵ There the court held that because of respondent's use of patents to preserve its monopoly over glassmaking machines, mandatory licensing at reasonable royalty rates constituted appropriate relief to correct past and prevent future violations of the Sherman Act. While this opinion endorsed court-ordered licensing at reasonable royalties, it condemned the use of royalty-free patent license decrees on the grounds that such relief would "in effect confiscate considerable portions of the [patentee's] property."⁶ Inasmuch as "confiscation" of private property is generally considered to be punitive, rather than remedial, the court impliedly rejected use of royalty-free patent licensing as a remedy for civil antitrust abuses.

With the same single-minded resolution that leads a spurned lover to hear "No! Don't! Stop" as "No, don't stop," the Antitrust Division again sought to establish the use of royalty-free licensing three years later in the *National Lead* case.⁷ Not to be outdone, or for that matter undone, the Supreme Court again refused to require royalty-free licensing, but did so "without reaching the question of whether royalty-free licensing or a perpetual injunction against the enforcement of a patent is permissible as a matter of law."⁸ This caveat represented a significant retreat from the court's implied proscription of royalty-free licensing in its *Hartford* opinion.

Policy Debate

Today, only the policy debate over society's costs of royalty-free versus reasonable royalty licensing remains. The government's legal authority to seek compulsory, royalty-free licensing or patent dedication has been undeniably established.⁹ It is in this context that the commission adopted compulsory patent licensing decrees to remedy violations of Section 5 of the Federal Trade Commission Act and Section 7 of the Clayton Act. Where the key to unlocking competition in a particular industry is the elimination of technological barriers to entry, the commission has not hesitated to order compulsory patent licensing.

For example, the commission first used compulsory licensing provisions in its settlement of *The Vendo Company* case in 1957.¹⁰ There the respondent had been charged with violating Section 7 of the Clayton Act — the antimerger statute¹¹ — for acquiring a direct competitor in the manufacture and sale of coin-operated vending machines. In light of evidence which indicated that the acquired company's success stemmed in part from its infringement on Vendo's patents, the commission concluded "that the only assets that respondent should be required to divest are those relating to the production of non-infringing machines by the [acquired company]."¹² Consequently, rather than order Vendo to divest itself of all the stock and assets of the acquired company, the commission fashioned a consent order which required Vendo to "divest" only non-infringing patents obtained from the acquired company. Under the terms of this settlement Vendo agreed to license all such patents, as well as the acquired company's trademark, on a nonexclusive, reasonable-royalty basis, and not to use such patents (or trademark) itself after one year from the date of the order. The settlement also included procedures for arbitrating the reasonable royalty amount if the parties could not reach an agreement via negotiations. Clearly, this consent order was an attempt to incorporate a new form of relief (for the commission) in terms of a traditional divestiture order.

Notwithstanding the limited precedential value of consent orders, the *Vendo* case furnished the commission a conceptual "stepping stone" for its adjudication of *American Cyanamid*¹³ six years later.

American Cyanamid presented the somewhat unusual situation of two drug companies conspiring to fraudulently induce the Patent Office to grant patents on an unpatentable drug-tetracycline. Once the applicant (Pfizer) received its patent it executed a licensing arrangement with its co-conspirator (American Cyanamid) which simultaneously fixed prices for tetracycline. Upon a review of these facts the commission concluded

"... that under the applicable decisions and considering the nature of [respondents'] misconduct before the Patent Office, this Commission has adequate authority to require a royalty-free license ..."¹⁴

Though the commission's final decree required only that Pfizer license its tetracycline patents along with manufacturing know-how and technical information to all applicants at a royalty determined as a percentage of the licensee's net sales of tetracycline, the *American Cyanamid* case lent judicial recognition to the commission's authority to require compulsory patent licensing.

Consent Orders

Since *American Cyanamid* the commission has entered numerous consent orders which include compulsory patent licensing provisions.¹⁵ Typically, these settlements were negotiated in connection with alleged violations of Section 7 of the Clayton Act where the primary negative effects on competition were, at least in part, a result of accretions in technological market power resulting from the acquisition of patents. Rather than seek a simple divestiture, thereby returning competition to the *status quo ante*, the commission undertook to affirmatively increase competition by making the technology at issue available to all actual or potential competitors via patent licensing.

One of the most recent, and controversial, examples of the commission's use of compulsory licensing involved the Xerox Corporation.¹⁶ As alleged in the complaint there, Xerox had engaged in acts and practices relating to patents which tended to perpetuate its monopoly in the sale and leasing of office copiers generally and plain paper copiers in particular. To open this market to the maximum extent possible, the commission framed a consent order which required, among other things, that Xerox grant to any and all applicants a nonexclusive license for the full, unexpired terms of certain patents. Each license applicant could designate up to three patents for royalty-free licensing. Additional patents were to be licensed at a fixed, nondiscriminatory percentage royalty basis. In addition, Xerox was to provide technical know-how to licensees at reasonable charges. The *Xerox* consent order undoubtedly will serve as a model for future FTC degrees in industries which evidence technological obstructions to competition.

Recently, the Bureau of Competition has sought to extend its use of compulsory licensing to include trademarks. It was a major part of the relief which complaint counsel requested in the *Borden-ReaLemon* matter.¹⁷ As the result of administrative hearings, the law judge concluded that it was appropriate to require Borden to license the "ReaLemon" trade name and label design for 10 years to all applicants in order to remedy Borden's monopolization of the reconstituted lemon juice market. The case is currently on appeal to the commission itself.

In *Borden*, in passing on the use of trademark licenses as relief, the administrative law judge analogized to patent decrees:

"A requirement for compulsory licensing of a trademark, such as ReaLemon, is not essentially different from a requirement of compulsory licensing of a patent. Accordingly, it is clear that the Commission has such authority and . . . compulsory licensing of the ReaLemon trademark is not only reasonably related to the violation here found, but is indispensable to the restoration of competition in the processed lemon juice industry."¹⁸

While there are undoubtedly substantial practical differences between patents and trademarks, the *Borden* decision strongly suggests that the bureau, like the Antitrust Division,¹⁹ does not consider these differences to constitute legal impediments for the purpose of decreeing compulsory licensing. In addition, both the Department of Justice and the commission have indicated a willingness to consider mandating the licensing of all technical know-how associated with patents and trademarks necessary to accomplish the competitive end result.

Our review of the precedents to date clearly indicates that the commission will not hesitate to order compulsory patent licensing in instances where a prime stumbling block to effective competition is restricted technology. The Bureau of Competition believes the same should be true of trademark licensing. In practical terms, trademark licensing is certainly as feasible as patent licensing. It is, indeed, the cornerstone of the franchise industry.

Society's increasing dependence on technological innovation makes it imperative that the competitive benefits resulting from patent "sharing" be balanced against the risks of "uncentives for invention." While the Bureau of Competition views compulsory licensing, either at rea-

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Should we worry more about price of a dramatic antibiotic, or about whether that antibiotic comes into being at all? For without it no one can have it at any price.

"Voluntary" Licenses — In Terrorem of Compulsory Licenses.

Perhaps the most insidious part of the compulsory licensing concept, is that having a compulsory license available by law at precedent-set rates forces the patent owner to yield voluntary licenses *in terrorem*, often at rates below the real investment value of R&D-oriented endeavor.

Consider compulsory licensing as applied to two college professors who start their new high technology company on a shoestring and a prayer and borrowed money. Under compulsory licensing law, when they are offered the "privilege" of granting a license to a billion-dollar corporation with muscle and money or a court fight, they have received an offer which, in the words of Don Corleone, the Godfather, is "an offer they cannot refuse." How can they say "no" if there is any form of compulsory license right?

EPILOGUE

"There are more people to feed with fewer resources. There is need for new things," said the Little Red Hen.

"Who will help me plow the ground?" asked the Little Red Hen.

"Not I," said the pig.

"Who will help me plant the seed of needed new things to come?" asked the Little Red Hen.

"Not I," said the pig.

"Who will help me weed the field, cull the crop, take the remaining goodies to market, and teach the public to use and enjoy what I have grown for them?"

"Not I," said the pig.

"Who will give me a 'reasonable' royalty to use my produce, a royalty low enough to enable him still to profit on what I risked when he would not?"

"I will!" shouted the pig.

A competitor who, but for his confidence (the Constitution and 35 U.S.C. § 154 notwithstanding) that there is no "exclusive right," would likely have planted his own seed and raised his own crop to feed and serve the people.

NOTES

1. U.S. Constitution Art. I, §8.
2. *Id.*
3. 35 U.S.C. §154.
4. 35 U.S.C. §§154, 261.
5. 15 U.S.C. §1 et seq.
6. See, e.g., *Bement v. National Harrow Co.*, 186 U.S. 70 (1902); *Henry v. A. B. Dick*, 224 U.S. 1, 56 L. Ed. 645; *United States v. General Electric Co.*, 272 U.S. 476 (1926); *Standard Oil Company (Indiana) et al v. United States*, 283 U.S. 163, 51 S. Ct. 421 (1931); *General Talking Pictures Corp. v. Western Electric Co.*, 305 U.S. 124 (1938). *Contrast* *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 37 S. Ct. 416 (1917).
7. *United States v. General Electric*, 272 U.S. 476, 490 (1926).
8. *Id.* at 489.
9. 283 U.S. 27 (1931).
10. 272 U.S. at 489.
- 11a. *General Talking Pictures Corp. v. Western Electric*, 305 U.S. 124 (1938).
- 11b. *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 37 S. Ct. 416 (1917) and *Carbice Corp. v. American Patents Development Corp.*, 283 U.S. 27 (1931).
12. 314 U.S. 488 (1942).

13. 314 U.S. 495 (1942).
14. 316 U.S. 265 (1942).
15. 316 U.S. 241 (1942).
16. 316 U.S. at 252.
17. 227 F. Supp. 791 (E.D. Mich. 1964), *aff'd per curiam*, 382 U.S. 197 (1965).
- 17a. The total R&D expenditures of the private sector of our economy, in real noninflationary dollars, has decreased 12% in the last ten years. New high technology companies are not being formed like Xerox, Texas Instruments, Polaroid of the period 10 to 30 years ago. *Business Week*, Feb. 16, 1976, *The Breakdown of U.S. Innovation*.
- 18a. See: cover story, *Business Week*, Feb. 16, 1976, "The Breakdown of U.S. Innovation" the National Science Foundation Study headlined in the March 14, 1976 *Houston Chronicle* "U.S. Is Losing Edge in Technology, Study Says."
- 18b. Interestingly two cases have been brought by the Department of Justice against licensing situations wherein the sin was destruction of incentive to invent. See footnotes 24 and 25 *infra*.
19. 7 U.S.C. §2321 et seq. (1970).
20. 7 U.S.C. §§2404, 2583 (1970).
21. 42 U.S.C. §1857 et. seq. (1970), *as amended* (Supp. 1974).
22. Patent Act Amendment 1969, 17-18 Eliz. II, C. 47, §1 (Can.).
23. *Foster v. American Machine and Foundry Co.*, 492 F.2d 1317 (2d Cir. 1974).
24. Civ. No. 72-1307 (S.D.N.Y. 1972).
25. *United States v. Automobile Manufacturers' Ass'n*, 307 F. Supp. 617 (C.D. Cal. 1969), *aff'd sub nom.*, *City of New York v. United States*, 397 U.S. 248 (1970).
26. Donald I. Baker, "Antitrust and Nonprofit Organizations," delivered Feb. 9, 1973, at the Ninth Annual Conference on Federal Tax and Other Problems of Non-Profit Organizations.
27. Attorney General, Opinion on Antitrust Law, delivered to FDA Bureau of Product Safety (1973).
28. *Milwaukee v. Activated Sludge, Inc.*, 69 F.2d 577 (7th Cir. 1934).

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sonable royalties or royalty-free, as an effective remedy for combating certain antitrust abuses, the bureau is also keenly aware of the danger of "discarding the baby with the bath water." The commission's sparing use of compulsory licensing orders in adjudicated cases seems to show its healthy respect for this extraordinary relief.

Notwithstanding these risks, the bureau also recognizes that, from a competitive viewpoint, few remedies can offer the potential affirmative impact that compulsory licensing affords. In the future, therefore, the bureau will try to achieve the perspective, technical expertise, and flexibility necessary to weigh these competing considerations.²⁰

NOTES

1. U.S. Constitution Part I, §8.
2. Federal Trade Commission Act §5, 15 U.S.C. §45 (1914).
3. See, e.g., *Federal Trade Commission v. Cement Institute*, 333 U.S. 683, 691 (1948).
4. *International Salt Co., Inc. v. United States*, 332 U.S. 392, 401 (1947).
5. *Hartford-Empire Co. v. United States*, 323 U.S. 386 (1945).
6. *Id.* at 414.
7. *United States v. National Lead Co.*, 332 U.S. 319 (1948).
8. *Id.* at 338.
9. See, e.g., *United States v. The Greyhound Corp.*, 1957 Trade Cas. ¶68,756 (S.D. 111, 1957); *United States v. General Electric Co.*, 115 F. Supp. 835 (D.N.J. 1953).
10. *The Vendo Company*, 54 F.T.C. 253 (1957).
11. Section 7 of the Clayton Act (15 U.S.C. §18) reads, in part: "... no corporation engaged in commerce shall acquire ... the stock ... or assets of another corporation ... where ... the effect of such acquisition may be substantially to lessen competition ..."
12. *The Vendo Company*, 54 F.T.C. at 256.
13. *American Cyanamid Co.*, 63 F.T.C. 1747 (1963), *vacated on other grounds*, 363 F.2d 757 (6th Cir. 1966), *on rehearing* 72 F.T.C. 623 (1967), *aff'd on appeal sub nom. Charles Pfizer & Co. v. FTC*, 401 F.2d

574 (6th Cir. 1968) cert. denied, 374 U.S. 920 (1969).

14. *American Cyanamid Co.*, 63 F.T.C. 1747, 1891 (1963).

15. See, e.g., *General Railway Signal Co.*, F.T.C. 882 (1964); *Standard Oil Co. (Indiana)*, 74 F.T.C. 141 (1968); *Swingline, Inc.*, 76 F.T.C. 407 (1969); *Occidental Petroleum Corp.*, 77 F.T.C. 710 (1970); *Koppers Co., Inc.*, 79 F.T.C. 837 (1971); *Rockwell International Corp.*, 84 F.T.C. 79 (1974); *Walter Kidde & Co.*, Docket No. 8957 (consent order accepted June 29, 1976).

16. *Xerox Corporation*, Docket No. 8909 (consent order accepted July 29, 1975).

17. *Borden, Inc.*, FTC Docket No. 8978 (initial decision filed August 8, 1976).

18. *Id.* at 165.

19. See, e.g., *United States v. Wallace & Tiernan Co., Inc.*, 1954 Trade Cas. ¶67,828 (D.R.I. 1954); *United States v. A. B. Dick Co.*, 1948-49 Trade Cas. ¶62,233 (D. Ohio 1948).

20. See Rushefsky, *FTC Section 5 Powers and the Pfizer-Cyanamid Imbroglia: Where Do We Go From Here, or "You Ain't Seen Nothing Yet,"* 18 Cath. U. L.Rev. 335, 347 (1969).

Research to Realization Via the Campus

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building suit, to negotiate with Random U, you and they will begin with two essential factors clearly established. These are:

1. The University Licensor absolutely requires the cooperation of some company to develop and market the product or service.

2. The Licensee will be risking substantial time and money on a relatively unproven invention.

The type and details of the license bridge that ultimately rests on these principles will vary with the other circumstances. You will want the technology to:

1. Be fairly priced.
2. Be exclusive for as long as possible.
3. Be patented or patentable.
4. Have a high return on overall investment.
5. Have cost as little as possible in case at some future point you change your mind.

The licensor will want the licensee:

1. To insure diligence in his development and marketing efforts.
2. To return rights in the invention if the project is not pursued.
3. To accept a limited term of exclusivity so that he can expand the market if the licensee does not.
4. To pay a royalty which recognizes the licensor's willingness to wait for a return until sales can generate it.

At WARF, we believe that the licensee usually should:

1. Have the right to terminate the agreement on notice.
2. Not be expected to make minimum royalty payments until sales begin, and then on a graduated scale.
3. Invest its capital in the development rather than in large front-end payments.

We expect the licensee to prepare a development schedule or PERT chart to be made a part of the agreement, with periodic reporting by means of which his progress can be monitored. We do not grant life-of-the-patent exclusive licenses.

These are the key supporting girders. The rest of the bridge will be built by carefully listening to the needs and fears of each party and placing only sufficient structure to handle the problems.

There is one other major reason why licensing is uniquely suited to the long-term relationship which must be sustained if a new product is to get to market in this day

of intense governmental regulation. That reason is *change*. No one can foresee clearly the outcome of a four-to-eight-year development effort. A license agreement based on a mutual understanding of each party's fundamental importance and desire to maintain the bridge can absorb change and evolve with time to provide a workable relationship between the parties.

SUMMARY

I would summarize the case for acquisition of university research through licensing as follows:

1. By utilizing the university discovery that fits your marketing and production skills, you have conserved your R&D efforts for those more predictable, present product-related goals. You have not had to support the uncertain, long quest for a truly different product, i.e., your costs have been reduced.

2. Through the licensing route, you delay payment for the research until after you have established that the product is both producible and marketable. Your royalty payments will be fixed, known costs, and will be earned for you by your customers.

3. Licensing helps both parties to the arrangement avoid those differences in expectation which could stymie other means of acquisition.

Remember, most universities have established the means to help you locate their technical advances. In many cases, their experienced licensing officers will already understand many of your concerns and questions. You, as licensing executives, are trained in the use of one of the most flexible and useful contract forms to help you obtain that technology on a fair and equitable basis.

When will you begin?

Interface With Technology Transfer

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and commercial development. He must convince corporate management of the viability and desirability of the project and acquire the necessary internal financing to implement the project.

The information system is monitored by management at Searle through a bimonthly status report which is sent to the executive committee and other interested parties. The status report contains a list of those projects in development, in advanced evaluation, in primary evaluation, and termination. Of approximately every 100 projects entered into the system, 90 are dropped after initial evaluation and 10 are evaluated in greater depth. Of those 10, one will make it into the development stage and be financed. The experience at Searle has been very similar to that shown to be the case in other companies, as far as number surveyed versus number developed.

In conclusion, if one takes care in structuring a company interface group, the problems associated with transfer of technology into the company from external sources, such as universities, are minimized and the benefits and efficiencies are maximized.

NOTES

1. Granville W. Hough, *Technology Diffusion*, Lomond Books, 1975, pp. 38-45.
2. "Universities Promote Sale of Technology," *Chemical and Engineering News*, March 12, 1973, p. 29.