

Recent Developments in the Law Relating to Licensing

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UNDER THE 1988 PATENT MISUSE REFORM ACT, BOTH TIE-OUTS AND TIE-INS ARE PERMISSIBLE UNLESS THE PATENT OWNER HAS MARKET POWER IN THE RELEVANT MARKET

In the past, courts automatically found patents misused and unenforceable when the patent holders used "tying arrangements" to condition a licensee's right to use the patent on the licensee's agreeing to purchase use or sell, or not purchase use or sell, another article of commerce not within the scope of the patent.

Subsequently, Congress enacted the 1988 Patent Misuse Reform Act to prohibit courts from automatically holding that a patent was misused when they found a tying arrangement to exist, and to require courts to consider the extent of the patent holder's market power in the relevant market for the patent on which the license is conditioned.

The language of the Act makes it unclear, however, whether the Act applies only to tying arrangements conditioning the license upon the licensee's purchase or use of another product ("tie-in"), or whether it similarly applies to arrangements where the patent holder conditioned the license upon the licensee's promise not to purchase or use another product ("tie-out"). This issue was resolved in *In re Recombinant DNA Technology Patent & Contract Litig.*, 850 F. Supp. 769 (S.D. Ind. 1994).

The underlying dispute arose out of several license agreements and research arrangements among the Regents of the University of California, Genetech, and Lilly which included a provision allowing Genetech to terminate Lilly's rights under the agreements if Lilly sold Recombinant Insulin derived from any product other than one sold to it by Genetech. Thus, if Lilly used material or services of others or developed its own materials for the production of insulin, Genetech could terminate the agreement. Lilly contended that this tie-out provision automatically constituted patent misuse, while Genetech urged that the 1988 Patent Misuse Reform Act applied, requiring the court to consider Genetech's market power in determining whether Genetech misused its patents.

Per Se Illegal

The court found that the tie-out provision would have been per se illegal prior to the

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Act because the agreement foreclosed Lilly from using products and technology of competitors. The fact that the agreement contained a right to terminate rather than an outright prohibition on the use of others' materials and technology created no barrier to a per se finding.

However, the Act changed the law of patent misuse and the court needed to interpret the language of the Act, which declares illegal an agreement that conditions the license of any rights to the patent on the purchase of a separate product where the patentee has market power in the relevant market.

Lilly argued that the new requirement of market power was applicable only to tie-ins. The court, however, considered this language ambiguous and turned to the legislative history for guidance.

Certain legislative history supported Lilly's position that the revised requirements of the Act did not apply to tie-outs. An earlier House version of the Act contained explicit language that covered tie-outs. The House, in the final version of the bill, omitted this language, suggesting Congressional intent not to cover tie-outs under the Act.

However, the court focused on other legislative history which suggested Congressional intent to cover all forms of tying. Certain bill sponsors testified in broad terms that the Act was intended to address tying arrangements and truly anti-competitive conduct. Despite Lilly's assertions, the court felt that, historically, courts had drawn no distinction between the two forms of tying and thus reasoned that Congress would not have intended the Act to apply to only one form of tying. Therefore, the court concluded that it was precluded from automatically finding the patent misused and unenforceable without first considering Genetech's market power and could not summarily resolve the dispute over patent misuse before doing so.

PATENTED ARTICLES MANUFACTURED OR SOLD BY AN IMPLIED LICENSEE OR THE PATENT OWNER MUST BE MARKED TO NOTIFY THE PUBLIC THAT THE ARTICLE IS PATENTED AND PERMIT RECOVERY OF DAMAGES ACCRUING BEFORE ACTUAL NOTICE IS GIVEN TO AN INFRINGER

In the past, courts have held that patented articles manufactured or sold by an express licensee must be marked to notify the public that the article is patented and permit recovery of damages accruing

before actual notice is given to an infringer. Until recently, however, it was not clear whether it was necessary to mark patented articles manufactured or sold by an implied licensee of the patent owner. The Federal Circuit settled this issue in *Amsted Industries, Inc. v. Buckeye Steel Castings Co.*, 24 F.3d 178, 30 U.S.P.Q.2d 1462 (Fed. Cir. 1994).

In *Amsted*, the patent claimed a center plate that was used in combination with several other components to form a railroad car underframe structure. The center plate was just one component of the patented assembly. Amsted, the patent owner, made and sold this center plate to railroad car builders for use in the patented assembly. Buckeye, a competitor of Amsted, had tried unsuccessfully to design around the patent and then to license the center plate component. Frustrated in its failures, Buckeye copied the patented design, hoping that the patent was invalid.

When Amsted learned of Buckeye's infringement of its patent, it sent a cease and desist letter to Buckeye, and then sued for infringement. At a jury trial, the jury returned a verdict that Buckeye infringed Amsted's patent, that the infringement was willful, and that the patent was not invalid. However, the jury limited the damages for which Buckeye was liable to the period after Amsted sent the cease and desist letter. The jury placed this limitation on damages because the component was not marked with the patent number. Amsted appealed this ruling.

Before the Federal Circuit, Amsted argued that the damages should not be limited because it never made the entire patented assembly, and that its customers, who assembled the complete assembly, were not required by law to mark the component. Therefore, Amsted argued, recovery of damages should not have been limited by the patent marking statute.

The patent marking statute, 35 U.S.C. § 287, requires that "persons making or selling any patented article for or under" the patent owner must give notice in order for the patent owner to recover damages. Amsted argued that its "customers" did not sell the patented article "for or under" the patent owner and therefore were not required to mark the component.

'For or Under'

The Federal Circuit, in interpreting the meaning of "for or under" language of the statute, first held that a licensee that makes or sells a patented article does so "for or

under" the patent owner. This doctrine had been applied to express licensees previously, but not to implied licensees, which Amsted's customers were. But in looking at the policy behind section 287, the court held that the purpose of the notice statute was to encourage the patent owner to notify the public of the patent, and there was no reason to distinguish between express and implied licensees.

Amsted also argued that marking an unpatented component of a larger patented assembly would have violated the portion of the patent statute prohibiting the marking of an unpatented article.

The Federal Circuit rejected this argument as well, and stated that Amsted could have indicated on the component that it was "for use under U.S. Patent No. X,XXX,XXX," or required that its purchaser-licensees mark the product "licensed under U.S. Patent No. X,XXX,XXX."

Therefore, the damages were limited to the period after receipt of actual notice of infringement.

AN IMPLIED LICENSE TO USE AN UNPATENTED ELEMENT OBTAINED FROM A THIRD PARTY MAY BE CREATED WHEN A MANUFACTURER SELLS A PATENTED COMBINATION AND IS SILENT AS TO ANY RESTRICTIONS ON THE USE OF THE PATENTED COMBINATION

When a manufacturer sells a patented system, such as a television which can be operated by a remote control, it grants the buyer a license to use the manufacturer's patented method to operate the system. But when the buyer wants to replace a component of that system, such as the remote control transmitter, with a component manufactured by another, the manufacturer of the original system may object, arguing that such replacement may constitute infringement by the buyer if the use of a replacement component to carry out the patented method is not authorized by the system manufacturer.

However, if there is evidence of an implied license between the buyer and seller permitting the use of such replacements, this use will not constitute infringement. One recent case addressed this scenario and, after examining the circumstances surrounding the sale of the original system, concluded that an such implied license existed. *Universal Electronics, Inc. v. Zenith Electronics Corp.*, 846 F. Supp. 641, 30 U.S.P.Q.2d 1853 (1994).

Zenith, an electronics manufacturer, owned a patent claiming a system and a method of remote control of electrical devices such as TVs and VCRs. Zenith's invention comprised a transmitter, i.e. a remote control unit, that forms a code and transmits that code to a receiver, such as

a TV or VCR, that acts in accordance with the coded functions, for example, changing channels. However, the claims of Zenith's patent required both the transmitter and the receiver. No claims covered the remote control by itself.

Universal manufactured multiple-function remote control transmitters that could operate TVs and VCRs sold by Zenith and other manufacturers. Owners of TVs and VCRs purchased Universal's remote control devices for a variety of reasons. Often these owners broke or lost the original remote control which came with the TV or VCR. Other times the owners wanted to "reduce clutter" by operating both their TV and VCR with the one Universal remote control. Zenith was not pleased that owners of Zenith electronic equipment were purchasing Universal's remote control as a replacement instead of purchasing one sold by Zenith. Zenith sued to stop Universal's remote control sales, claiming that Universal was helping Zenith's customers infringe Zenith's patented method, and arguing that because Zenith did not authorize the use of non-Zenith remote controls, the Universal customers were infringing Zenith's patent by using the Universal remote control.

Implied License

Universal contended that its customers' use of Universal's remote control was not prohibited and, therefore, Universal could not have induced them to infringe or be a contributory infringer. Specifically, Universal claimed that Zenith had granted its customers an implied license to practice its patented method by making an unrestricted sale of its non-patented remote control transmitter together with the remote control device in its television. Such an implied license, Universal argued, would allow owners of Zenith electronics to use Universal's remote control.

In order to establish the existence of an implied license between Zenith and its customers, Universal had to establish two elements. First, Universal had to prove that Zenith's receivers in its TVs and VCRs had no noninfringing use. Zenith did not dispute this fact. However, Universal was also legally required to establish that the circumstances surrounding Zenith's sale of its electronics plainly indicate that the grant of a license should be inferred.

The court had to decide whether, as urged by Universal, it should create a bright line rule to determine the existence of an implied license. Universal asked the court to hold, based on an earlier Federal Circuit opinion, that a manufacturer's silence when it sells one or more elements of patented combination is sufficient to demonstrate a prima facie case for an implied license to use the patent with an otherwise unauthor-

ized part. In contrast, Zenith urged that the court limit the earlier opinion to cases where the manufacturer sold an incomplete element of a patented combination, requiring the purchaser to obtain other elements of the combination from other sources. For example, Zenith's proposed rule would apply only if Zenith sold a TV without a remote control. The court rejected both proposals and held that it should consider all of the facts and circumstances surrounding the sale of the patented system to determine whether Zenith granted an implied license to its customers.

Using this analysis, the court considered Zenith's silence to be crucial. Zenith first sold its receivers and transmitters employing the patented method before multiple function remote controls like Universal's were on the market. Once such technology became available, Zenith failed to inform its customers that they were not authorized to use such remote controls.

The court noted the competitive disadvantage Zenith would have suffered if it had prohibited its customers from using multiple function remote controls since other electronics manufacturers allowed the use of these remote controls. The court found that, due to Zenith's silence, its sales were unrestricted.

Therefore, Zenith's customers were not infringing Zenith's patent by using Universal's remote control. Although this holding disposed of the issue of Universal's infringement, the court considered another defense raised by Universal.

Universal also contended that the customers' use of Universal's remote control constituted a permissible repair of the entire remote control system. Under the permissible repair doctrine, a customer may replace or repair worn or broken unpatented parts of a patented combination.

Zenith argued that the customers' use instead constituted impermissible replacement, which does not fall under this doctrine. To decide whether the doctrine applied, the court considered each of different situations in which Zenith TV and VCR owners purchased Universal transmitters.

The court held that where customers broke their original Zenith remote control, the replacement with a Universal remote control merely constituted a permissible repair. It reached this conclusion by determining that the replacement of broken remote controls does not involve a "second creation" of the patented combination or method.

With respect to those customers that purchased Universal's remote control to reduce clutter, the court reached a contrary conclusion. It rejected Universal's argument that permissible repair includes improving on unpatented component parts. Therefore, had the court not found an implied license between Zenith and its

customers, those customers that purchased the Universal remote control solely to reduce clutter would have been infringing Zenith's patented method.

Finally, the court noted that while the per-

missible repair doctrine did not extend to situations where customers lost their original Zenith remote control, customers had an implied license with Zenith to replace lost Zenith remote controls.

In this case, Universal was not liable for inducing its customers to infringe, or contributing to their infringement, because the customers' use was authorized and not infringing.