

## WHAT *TOOL WORKS* TELLS US ABOUT TAILORING PATENT MISUSE REMEDIES

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No one was surprised when, in *Illinois Tool Works, Inc. v. Independent Ink, Inc.*,<sup>1</sup> the Supreme Court reversed the rule that a patentee accused of tying in violation of Section One of the Sherman Act<sup>2</sup> is presumed to have economic power in the product market to which the patent pertains. That presumption was contrary to both logic and experience.

The Court's reasoning is interesting, however, because it points the way to tailoring remedies for patent misuse. The default remedy for misuse is that courts refuse to enforce the patent against any defendant, not just against the victim of misuse.<sup>3</sup> *Tool Works* reasoned from Section 271(d)(5) of the Patent Act,<sup>4</sup> to reform an antitrust liability rule not mentioned in the statute, but influenced by the policy choices it reflects. Similarly, though Section 271(d)(5) does not mention misuse remedies, the policy choices it reflects undermine the rationale for the default remedy for patent misuse.

### I.

Patent misuse is an affirmative defense to an infringement action. A patentee misuses a patent when the patentee takes some action to broaden the scope of patent rights or lengthen their duration.<sup>5</sup> Misuse allegations are typically aimed at license terms.<sup>6</sup> Most misuse cases involve tying claims, in which an infringement defendant argues that a patentee unlaw-

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<sup>1</sup> 126 S. Ct. 1281 (2006) (link).

<sup>2</sup> One patent may claim exclusive rights to technology sold in several product markets, and several patents may claim exclusive rights in technology sold in a single product market, so the statement in the text is somewhat imprecise, but it served well enough for the relevant cases.

<sup>3</sup> I refer to this rule as the "default misuse remedy." Consistent with this remedy, there is no standing requirement for alleging misuse. Any party—licensee or not—may defend an infringement action by alleging that the patentee engaged in misuse directed at someone else. This rule makes no more sense than the remedy itself, but it is not my target here. If the remedy is reformed along the lines I suggest in the text, there would be little incentive for anyone other than the alleged misuse victim to assert a misuse defense.

<sup>4</sup> 35 U.S.C. § 271(d)(5) (link).

<sup>5</sup> See, e.g., *Va. Panel Corp. v. Mac Panel Co.*, 133 F.3d 860, 868 (Fed. Cir. 1997) (link).

<sup>6</sup> A refusal to license, for example, cannot constitute misuse. 35 U.S.C. § 271(d)(4); *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908) (link).

fully tied the purchase of unpatented goods to the purchase or license of patented ones.<sup>7</sup>

*Tool Works* involved a contract term requiring licensees of Tool Works' patented inkjet heads and ink containers to purchase their (unpatented) ink from Tool Works.<sup>8</sup> An independent ink seller sued Tool Works under Section One of the Sherman Act, alleging that the term amounted to an unlawful tie. The Federal Circuit held that, under Supreme Court precedent,<sup>9</sup> Tool Works' patent created a presumption that it had market power in the tying product market.<sup>10</sup> That presumption eliminated the need for the plaintiff to introduce evidence of such power.<sup>11</sup>

The Supreme Court reversed. It noted that Sherman Act jurisprudence derived the presumption of market power from patent misuse jurisprudence.<sup>12</sup> With regard to misuse claims aimed at tying arrangements, however, Congress eliminated this presumption in 1988, when it added Section 271(d)(5) to the Patent Act.<sup>13</sup> That section provides that certain tying arrangements are not misuse if the patentee does not have power in the tying product market.<sup>14</sup>

The market power exception to the protection from misuse claims created by this section would be pointless if all patents conferred such power. Not surprisingly, the *Tool Works* Court believed that the misuse safe harbor reflected Congress's intention that possession of a patent would not be enough to establish such power. Because the presumption had been elimi-

<sup>7</sup> HERBERT HOVENKAMP, MARK D. JANIS, & MARK A. LEMLEY, IP AND ANTITRUST § 3.3b1 (Supp. 2006).

<sup>8</sup> More precisely, the license specified that neither printer manufacturers nor end users would refill the ink containers with ink of any kind. The effect of the term was to compel end-users to buy ink from Tool Works.

<sup>9</sup> *Int'l Salt Co. v. United States*, 332 U.S. 392 (1947) (link).

<sup>10</sup> *Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 396 F.3d 1342 (Fed. Cir. 2005), *rev'd*, *Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 126 S. Ct. 1281 (2006) (link).

<sup>11</sup> *Id.* at 1342, 1346.

<sup>12</sup> *Tool Works*, 126 S. Ct. at 1288–89.

<sup>13</sup> Section 271(d)(5) provides:

No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following . . . (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.

<sup>14</sup> This is not to say that the patentee *is* guilty of misuse if it has power in the market for the tying product. The only consequence of having market power is that the safe harbor of Section 271(d)(5) no longer protects the patentee from a misuse finding. A patentee with power can still prevail on the merits. See *U.S. Philips Corp. v. ITC*, 424 F.3d 1179, 1186 (2005) (link).

nated from its field of origin, the Court reasoned, it should be eliminated from the Sherman Act jurisprudence that borrowed from that field.<sup>15</sup>

## II.

As the *Tool Works* Court pointed out, the Court adopted the market power presumption for Sherman Act cases in *International Salt Co. v. United States*,<sup>16</sup> which relied on a misuse case, *Morton Salt Co. v. G.S. Suppiger Co.*,<sup>17</sup> for the presumption.<sup>18</sup> *Morton Salt* is also the case in which the Court justified the default misuse remedy. The Suppiger Company held a patent on a machine that deposited salt tablets in cans. It sued Morton Salt for infringing its machine patent by manufacturing salt-depositing machines of its own.<sup>19</sup>

Suppiger licensed its machine subject to the requirement that licensees buy salt tablets from it. That term could have either or both of two effects. First, if salt tablets had to be manufactured to certain specifications for the machine to work properly, the term might ensure that a licensee only used such tablets, thus avoiding the risk that a licensee might blame Suppiger's machine for problems caused by non-conforming tablets. Suppiger offered this defense, but the district court rejected it out of hand.<sup>20</sup>

The tying term's second effect was to meter uses. Heavy users would buy more salt tablets than light users, and thus pay more than light users for the machine-tablet system. Assuming a constant cost of selling the machines to different types of users, the term constituted price discrimination among machine purchasers.

Most analysts today think this sort of metering and price discrimination is either beneficial or, at least, not very worrisome as an economic matter.<sup>21</sup> Courts did not hold such views when *Morton Salt* was decided, however. The District Court held that Section 3 of the Clayton Act condemned even "limited monopolies," and rejected Suppiger's argument that it "ha[d] not obtained and [could not] obtain a complete monopoly on the sale of salt tablets through the restrictions imposed on the use of the patented machines."<sup>22</sup> The Seventh Circuit reversed on the ground that the record did not show that Suppiger's leases substantially lessened competition, but even that

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<sup>15</sup> The Court also noted that the Justice Department's licensing guidelines reject the presumption that patents create market power, as do the vast majority of economists. 126 S. Ct. at 1291 n.4.

<sup>16</sup> 332 U.S. 392 (1947).

<sup>17</sup> 314 U.S. 488 (1942) (link).

<sup>18</sup> *Tool Works*, 126 S. Ct. at 1288–89.

<sup>19</sup> *G.S. Suppiger Co. v. Morton Salt Co.*, 117 F.2d 968 (7th Cir. 1941).

<sup>20</sup> *G.S. Suppiger Co. v. Morton Salt Co.*, 31 F. Supp. 876 (N.D. Ill. 1940).

<sup>21</sup> See HOVENKAMP, JANIS, & LEMLEY, *supra* note 7, at § 3.3b1.

<sup>22</sup> *Morton Salt.*, 31 F. Supp. at 876.

court characterized a patentee's position as "fraught with dangerous monopolistic possibilities."<sup>23</sup>

The Supreme Court, in turn, reversed the Seventh Circuit. The Court's reasoning is a good example of the antipathy toward patents, and toward what we would now call efficiency-based arguments, that characterized the Supreme Court's patent and antitrust cases from the 1930s through the mid-1970s. This antipathy produced relatively formal judicial analysis or—perhaps more precisely—analysis that conclusively presumed adverse economic effects from what the Court saw as violations of statutory boundaries.<sup>24</sup>

The *Morton Salt* Court characterized the question as whether "a court of equity will lend its aid to protect the patent monopoly when respondent is using it as the effective means of restraining competition with its sale of an unpatented article."<sup>25</sup> The Court thought it clear that Suppiger's tie "is aiding in the creation of a limited monopoly in the tablets not within that granted by the patent."<sup>26</sup> This view of the tie explains the Court's comment that "courts of equity[] may appropriately withhold their aid where the plaintiff is using the right asserted contrary to the public interest."<sup>27</sup>

Suppiger had tried to distinguish the cases supporting this line of reasoning. It maintained that those cases involved contributory infringement claims, in which a patentee sued a manufacturer that produced competing (and unpatented) inputs and sold them to licensees, not direct infringement claims such as Suppiger's. Suppiger argued that a party should not be denied equitable relief because of unclean hands unless the wrongful conduct occurred "in the particular act or transaction which raises the equity, enforcement of which is sought."<sup>28</sup>

The Court disagreed:

Where the patent is used as a means of restraining competition with the patentee's sale of an unpatented product, the successful prosecution of an infringement suit even against one who is not a competitor in such sale is a powerful aid to the maintenance of the attempted monopoly of the unpatented article, and is thus a contributing factor in thwarting the public policy underlying the grant of the patent. Maintenance and enlargement of the attempted monopoly of the unpatented article are dependent to some extent upon persuading the public of the validity of the patent, which the infringement suit is intended to establish. Equity may rightly withhold its assistance from such a use of the patent by declining to entertain a suit for infringement, and should

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<sup>23</sup> *Morton Salt*, 117 F.2d at 970–71.

<sup>24</sup> *Cf.* Ill. Tool Works, Inc. v. Indep. Ink, Inc., 126 S. Ct. 1281, 1288 (2006) (noting that *Morton Salt* proclaimed anticompetitive effects without market analysis).

<sup>25</sup> *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 490 (1942).

<sup>26</sup> *Id.* at 491.

<sup>27</sup> *Id.* at 492.

<sup>28</sup> *Id.* at 492–93.

do so at least until it is made to appear that the improper practice has been abandoned and that the consequences of the misuse of the patent have been dissipated. . . .

. . . It is the adverse effect upon the public interest of a successful infringement suit in conjunction with the patentee's course of conduct which disqualifies him to maintain the suit, regardless of whether the particular defendant has suffered from the misuse of the patent.<sup>29</sup>

There are two ways to read this reasoning: as a formal argument<sup>30</sup> or as an argument based on economic effects. Either way, Section 271(d)(5) and the *Tool Works* reasoning compels the conclusion that this argument is no longer sound.

The Court's formal argument may be stated this way: (1) Public policy condemns any tying of unpatented to patented goods, regardless of economic effect; (2) equity denies injunctions to those who undermine public policy, even tangentially; (3) Suppiger uses such a tie; therefore (4) Suppiger's tie undermines public policy; ergo (5) Suppiger cannot obtain injunctive relief against direct infringers even if they are not victims of its tie.<sup>31</sup> As the *Tool Works* Court pointed out, Congressional adoption of Section 271(d) undermines the validity of premise (1);<sup>32</sup> the rest of the argument falls with it.

As a matter of economic effects, the *Morton Salt* Court's argument can be stated this way: (1) Attempts to monopolize harm competition and therefore are against public policy; (2) tying arrangements constitute attempts to monopolize; (3) entertaining infringement actions bolsters such attempts; therefore, (4) Suppiger cannot obtain injunctive relief against even direct infringers who are not victims of its tie. As the *Tool Works* Court later explained, by imposing a market power requirement for a misuse find-

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<sup>29</sup> *Id.* at 493–94. Setting aside my general argument, the reasoning of this passage is poor. If the validity of the patent were an important part of monopolization schemes, one would expect the Court to adopt a rule encouraging challenges to validity. *Cf. Lear, Inc. v. Adkins*, 395 U.S. 653 (1969) (link) (licensees may not be estopped from challenging validity of licensed patent). Its ruling did just the opposite, reinstating the dismissal of an infringement action in which the defendant might contest validity. The Court seemed to think validity rulings go only one way, and that is just wrong.

<sup>30</sup> By this, I mean to include an argument that uses the rhetoric of effects but deduces those effects from statutory boundaries rather than showing them through market analysis.

<sup>31</sup> *Morton Salt*, 314 U.S. at 494. This reading of the argument is consistent with the Court's further holding that it did not matter whether Suppiger had violated the Clayton Act (a holding that eliminated the basis for the Seventh Circuit's decision, and thus eliminated the need for a remand). It is also consistent with the general notion at the time that competition was measured by freedom of choice, and that patents were inherently dangerous monopolistic tools. This reading is inconsistent with the Court's reference to attempted monopolization (any "monopoly" over Suppiger's licensees' consumption would be actual, not attempted), its reference to adverse effects, and its comparison of Suppiger's tie to the use of a trademark to dupe consumers. *Id.* at 493–94.

<sup>32</sup> *Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 126 S. Ct. 1281, 1288–89 (2006).

ing, section 271(d)(5) qualifies premise (2).<sup>33</sup> That qualification undermines the unqualified argument in this reading of the *Morton Salt* argument, and thus undermines the conclusion.

In addition, modern antitrust jurisprudence significantly qualifies premises (1) and (2) in this argument. *Spectrum Sports, Inc. v. McQuillan* holds that a plaintiff alleging attempted monopolization in violation of Section 2 of the Sherman Act must show that there is a dangerous probability that the attempt will succeed.<sup>34</sup> This holding recognizes that not all attempts threaten harm to competition. *Jefferson Parish Hospital District No. 2 v. Hyde*<sup>35</sup> creates a somewhat ill-defined market power requirement for tying claims under Section 1.<sup>36</sup> However one construes this requirement, it too focuses on a subset of tying arrangements that threaten actual harm, rather than presuming harm from the presence of a tie. Though these cases are not misuse decisions, they accurately reflect the economic reality of the practices most commonly alleged to constitute misuse. As misuse doctrines once (mis)informed antitrust jurisprudence, so *Tool Works* provides an opportunity for antitrust doctrines to inform misuse jurisprudence.

Against this argument, one might contend that Congress did not intend the 1988 amendment to Section 271(d) to alter misuse remedies. The language of the amendment speaks only to liability for misuse, not remedies. When the language was introduced in the House (it was a compromise between differing House and Senate approaches),<sup>37</sup> Representative Kastnemeier stated: “the general rules of equity applicable to the enforcement of patents currently hold that a person who is found to be guilty of misuse is not permitted to enforce his or her patent.”<sup>38</sup> Nothing in the relevant history suggests that Congress intended to reverse this rule, and comments from

<sup>33</sup> This effects-based reading is inconsistent with the Court’s holding that it did not matter whether Suppiger violated the Clayton Act. Indeed, the Court reversed the Seventh Circuit opinion, the point of which was to remand for further fact-finding on the economic effects of the tie. *G.S. Suppiger Co. v. Morton Salt Co.*, 117 F.2d 968, 972 (7th Cir. 1941). As this and the preceding note show, either reading has its flaws, but the only place to jump from one reading is to the other—form and effects are the only two options for analyzing the tie. Both arguments are undercut by Section 271(d)(5) and subsequent case law, so it is not particularly important which reading one finds more persuasive. To the extent it matters, I think the Court would have claimed that formal and functional analysis led to the same place; if pushed, it probably would have embraced the formal argument.

<sup>34</sup> 506 U.S. 447 (1993) (link).

<sup>35</sup> 466 U.S. 2, 28–29 (1984) (link).

<sup>36</sup> Dicta in *Jefferson Parish* supported the presumption that patents create market power, *id.* at 16, but, as the *Tool Works* Court noted, the market power requirement of Section 271(d) was added after *Jefferson Parish*. *Tool Works*, 126 S. Ct. at 1290. The dicta, therefore, must be disregarded, leaving the *Jefferson Parish* market power requirement standing alone, without a presumption that a patent satisfies it. That requirement undercuts the *Morton Salt* reasoning.

<sup>37</sup> Interestingly, the initial Senate proposal, which was not adopted, would have limited misuse to cases in which a patentee violated the antitrust laws. 134 CONG. REC. 30,689 (1988).

<sup>38</sup> *Id.* at 32,294.

Senator Leahy suggest that he assumed the remedy would remain unchanged.<sup>39</sup>

On the other hand, the text of Section 271(d)(5) says nothing more about antitrust cases than it does about misuse remedies, but the *Tool Works* Court was willing to extrapolate from the logic and policy of the text to Section One of the Sherman Act. And, though nothing in the legislative history suggests that Congress intended to alter the default misuse remedy, nothing in that history suggests that Congress intended to lock it in place, either.

Indeed, in some respects the legislative history supports my argument here. The history shows that Congress wanted courts to undertake “contextual analysis . . . sensitive to the realities of the marketplace.”<sup>40</sup> The language of the amendment was chosen to give courts flexibility in determining when a patentee has market power and, if so, whether a tie in fact threatens anticompetitive harm.<sup>41</sup> By eschewing the *per se* approach of *Morton Salt*, Senator Leahy said Congress was restoring “the equitable nature of the misuse doctrine.”<sup>42</sup>

As these comments illustrate, the policy of the amendment was to substitute functional analysis for formal analysis. Congress wanted misuse liability to be found only where a practice caused or threatened genuine economic harm. Not every extension of the scope or term of a patent does. As equity is ill-served by inflexible liability rules unconnected to demonstrable economic harm, so it is ill-served by inflexible remedial rules unconnected to such harm.<sup>43</sup> Congress seems not to have considered that its amendment undermined the basis for the default misuse remedy in tying

<sup>39</sup> *Id.* at 32,471. On the other hand, Senator Leahy said that simply because Congress agreed on the narrower House version of misuse reform, rather than the Senate version, *see supra* note 37, did not imply that “Congress . . . believes that the traditional misuse doctrine should be retained intact” in areas other than tying. 134 CONG. REC. 32,471 (1988). He was speaking of liability, but the point appears equally applicable to remedy, which Congress did not consider at all in the amendment.

<sup>40</sup> 134 CONG. REC. 32,295 (1988) (statement of Rep. Kastenmeier).

<sup>41</sup> Representative Kastenmeier specifically noted that a tie might be the only practical way to meter a licensee’s output, a fact that “would be legitimate, unless . . . on balance [it] has a generally anticompetitive effect.” *Id.*

<sup>42</sup> *Id.* at 32,472.

<sup>43</sup> One might argue against relating remedies to harm on the ground that disproportionate remedies deter more effectively than tailored remedies. In this context, I do not agree. In part, this is for conventional worries about deterring efficient conduct close to the line of legality. This worry is especially keen in the misuse context because some acts traditionally condemned as misuse are probably efficient most of the time. Tying arrangements commonly increase output, and other types of misuse, such as demanding royalties beyond the patent term, might be efficient financing devices. Where liability itself might be inefficient, disproportionate remedies compound the error. Disproportionate remedies might also be justified on the ground that they offset imperfect enforcement of the law; treble damages would be the equilibrium remedy if only 1/3 of violations were detected and punished. That argument is more conceptual than practical, however; we do not have the data to measure any underenforcement problem, nor is the default use remedy logically related or relatable to any particular level of underenforcement.

cases, but it did, and the indefinite legislative history does not require that courts ignore that fact.

### III.

What does the argument in the previous section imply? There are related vertical and horizontal aspects to this question. The vertical aspect is whether *Tool Works* provides enough of a basis for circuit courts of appeals to discard the default misuse remedy, or whether they must wait for further action by the Supreme Court or Congress. The horizontal aspect is whether the argument justifies the reversal of the default remedy in cases involving some act other than the type of tying addressed in Section 271(d).

With regard to tying arrangements, especially metering ties, as were at issue in *Morton Salt* and *Tool Works*, Section 271(d) entails the conclusion that no court is obligated to apply the default misuse remedy. The logic of both *Tool Works* and Section 271(d) suggests that public policy favors the tailoring of remedies to the economic effects of acts of misuse. Policy considerations therefore favor rejection of the default misuse remedy in such cases. If a court finds that a tying arrangement amounts to misuse, it should limit remedies to actual victims of the misuse and to the extent of the victims' harm caused by the misuse.<sup>44</sup> Because Section 271(d) so clearly undercuts *Morton Salt* with regard to tying cases, a court of appeals could adopt this position on its own.

The logic of this argument applies as well to other practices as it does to tying arrangements. *Morton Salt* turns either on formalism, which has been rejected in both Sherman Act jurisprudence and in the Federal Circuit's misuse jurisprudence, or on a showing of monopolization (and, to be consistent, on a showing of a relationship between such monopolization and infringement actions against parties other than a defendant who shows misuse).

Because Congress aimed only at ties with its market power requirement in Section 271(d), however, I do not think my argument entails the conclusion that public policy now rejects *Morton Salt* with respect to other practices. My argument shows only that the remedy argument in *Morton Salt*, like the Sherman Act liability argument it spawned, is unsound. In fact, by modern standards, it is awful. It should be discarded but, outside the realm of the ties explicitly mentioned in that Section, it must be up to the Supreme Court to discard it.

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<sup>44</sup> Cf. *eBay Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006) (link) (reversing presumption that courts should enjoin infringing conduct in favor of application of equitable factors listed in the Patent Act); *id.* at 1842 (Kennedy, J., concurring) (suggesting that in some cases remedy for infringement should be a royalty; the Justice's reference to a single infringing component within a larger product may imply that in such cases equity might not only favor damages, but in an amount tailored to the plaintiff's inventive contribution).