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RAMON A. KLITZKE**

Refusal to License: Monopolization Problems For Patent Owners*

> If he sees fit, he may reserve to himself the exclusive use of his invention or discovery. If he will neither use his device nor permit others to use it, he has but suppressed his own.[1]

A competitor engaging in private business enterprise has independent discretion as to the parties with whom he will deal.[2] However, if the competitor's purpose is to create or maintain a monopoly, the antitrust laws of the United States limit that discretion. Patent licensing[3] is an integral part of competitive business enterprise in this country. The owner of a United States patent grant has a "lawful monopoly"[4] but does not have complete discretion in deciding whether to license a patent to another competitor. If a license is granted, the licensor with monopoly power in a relevant market treads a fine line when deciding whether to terminate the license. If the licensor cannot offer a good business justification and the termination has an anticompetitive effect in that part of the market not controlled by the patent, antitrust laws may be violated.

This Article analyzes patent license refusals and terminations and suggests the market conditions under which they may encoun-

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[1] Bement v. National Harrow Co., 186 U.S. 70, 90 (1902) (quoting Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co., 77 F. 288, 294 (6th Cir. 1896)).

[2] United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[3] A patent license is a contract whereby the patent owner agrees that the exclusive rights in the invention will not be asserted against the licensee. The courts hold that the owner may issue one or more licenses. *See* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 135-36 (1969).

[4] United States v. Aluminum Co. of Am., 148 F.2d 416, 425 (2nd Cir. 1945).

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ter antitrust laws.[5] The monopolization violations proscribed by section 2 of the Sherman Act will be of primary interest.[6] Also, a recent United States Supreme Court case offers considerable guidance, even though it does not involve patent licensing.[7]

I

THE ANTITRUST OFFENSE OF MONOPOLIZATION

Section 2 of the Sherman Act encompasses three distinct offenses: monopolization, attempts to monopolize, and combining or conspiring to monopolize.[8] This Article will focus on monopolization, which has two principal elements: (1) the possession of monopoly power in a relevant product market and in a relevant geographic market, and (2) the willful acquisition or maintenance of that power.[9] If the requisite monopoly power exists, refusal to license a patent may constitute the offense of monopolization, the offense of attempted monopolization, or, if there is more than one competitor involved in the refusal, the offense of combining or conspiring to monopolize. Owners of patent pools are guilty of conspiring to monopolize if they have an exclusionary purpose when refusing to license others. Such conduct may violate section 1 of the Sherman Act as well as section 2.[10]

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[5] This article will not address possible violations of section 1 of the Sherman Act, compulsory package licensing, the conditions for offering patent licenses, and the refusal or termination of a patent license. On patent licensing problems that violate section 1, see generally 9 AMER. PAT. L.Q. No. 4 (1981).

[6] "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . ." 15 U.S.C. § 2 (1982). *See* Klitzke, *Patents and Monopolization: The Role of Patents Under Section Two of the Sherman Act*, 68 MARQ. L. REV. 557 (1985).

[7] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

[8] 15 U.S.C. § 2 (1982). The courts have not clearly defined an attempt to monopolize, in addition to certain other areas of antitrust law. For a discussion of this problem, see Blecher, *Attempt to Monopolize under Section 2 of the Sherman Act: "Dangerous Probability" of Monopolization Within the "Relevant Market,"* 38 GEO. WASH. L. REV. 215 (1969); Hawk, *Attempts to Monopolize—Specific Intent as Antitrust's Ghost in the Machine*, 58 CORNELL L. REV. 1121 (1973); Note, *Attempt to Monopolize: Its Elements and Their Definition*, 27 GEO. WASH. L. REV. 227 (1958).

[9] United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

[10] 15 U.S.C. § 1 (1982).

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A. Monopoly Power

Monopoly power is defined as the power, in a relevant market, to control market prices or exclude competition,[11] whether or not the power is exercised.[12] The patent grant clearly bestows this power to its owner. It is "the right to exclude others from making, using, or selling the invention throughout the United States . . . ."[13] Although this right differs significantly from the historical notion of "monopoly,"[14] ownership of a patent can convey monopoly power for antitrust purposes.[15] The patent grant is not, however, inherently a monopoly.[16] The Supreme Court has ob-

[11] United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956). *See also* United States v. Paramount Pictures, Inc., 334 U.S. 131, 174 (1948); United States v. Griffith, 334 U.S. 100, 105 (1948), *overruled on other grounds*, Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984).

[12] "[T]he material consideration in determining whether a monopoly exists is not that prices are raised and that competition actually is excluded but that power exists to raise prices or to exclude competition when it is desired to do so." American Tobacco Co. v. United States, 328 U.S. 781, 811 (1946); *see also E.I. du Pont de Nemours*, 351 U.S. 377; Standard Oil Co. v. United States, 221 U.S. 1 (1911). For a discussion of the early split among courts on the extent to which a plaintiff must plead and prove a defendant's power in a relevant market in order to take a case to the jury, see Note, *Attempt to Monopolize Under the Sherman Act: Defendant's Market Power as a Requisite to a Prima Facie Case*, 73 COLUM. L. REV. 1451 (1973).

[13] 35 U.S.C. § 154 (1982).

[14] The traditional meaning of "monopoly" is the engrossment of goods by the monopolist that were previously available to the public. The patented invention must be novel, unique, and *not* previously available to the public.

[15] *See* United States v. Line Material Co., 333 U.S. 287, 308-10 (1948); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 456 (1940); Carbice Corp. of Am. v. American Patents Dev. Co., 283 U.S. 27, 31 (1931); Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 510 (1917). *See also* United States v. Aluminum Co. of Am., 148 F.2d 416, 425 (2d Cir. 1945).

[16] *See* Carl Schenck, A.G.A. v. Nortron Corp., 713 F.2d 782, 786 n.3 (Fed. Cir. 1983):

> A patent, under the statute, is property. 35 U.S.C. § 261. Nowhere in any statute is a patent described as a monopoly. The patent right is but the right to exclude others, the very definition of "property." . . . The antitrust laws, enacted long after the original patent laws, deal with appropriation of what should belong to others. A valid patent gives the public what it did not earlier have. . . . It is but an obfuscation to refer to a patent as "the patent monopoly" or to describe a patent as an "exception to the general rule against monopolies."

Contra Crown Co. v. NYE Tool Works, 261 U.S. 24, 37 (1923) ("A patent confers a monopoly."). *See also* Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, 491 (1942) ("[b]ut a patent affords no immunity for a monopoly not within the grant").

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served that the market power of a patent can be acquired legitimately.[17]

Every patent grant does not have full monopoly power in a relevant market. The amount of market power controlled by the patent owner depends entirely upon the market strength of the patented invention and the scope of the relevant market. It is impossible to ascertain the monopoly power without first defining the relevant market and measuring the proportion of that market controlled by the patent. Monopoly power exists within the limited relevant market when the owner of the patent controls prices or lessens competition. If the relevant market has numerous substitutable products and the patented invention is only one of them, there is no monopoly power. If a patent has no significant impact on the marketplace, no antitrust significance will arise with its use.[18]

B. The Relevant Market

The relevant market has two dimensions. It must be defined in terms of the product or service and in terms of the geographical area of competition.[19] Although the patent grant usually extends throughout the geographical limits of the United States, a relevant market for antitrust purposes may be more limited. The usual antitrust market analysis applies in defining the relevant geographical market for a patented product.[20] No extraordinary antitrust analysis is needed in dividing geographical territories into markets and submarkets. However, the relevant product market[21] of the patented invention is not as easily delineated.

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[17] Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 35 (1984) (Brennan, J., concurring).

[18] Brunswick Corp. v. Riegel Textile Corp., 752 F.2d 261, 265 (7th Cir. 1984).

[19] Indiana Farmer's Guide Publication Co. v. Prairie Farmer Publication Co., 293 U.S. 268, 279 (1934); Mullis v. Arco Petroleum Corp., 502 F.2d 290, 295 (7th Cir. 1974).

[20] For a discussion of three purposes for which "relevant market" might be used in an attempt-to-monopolize case, see Note, *Prosecutions for Attempts to Monopolize: The Relevance of the Relevant Market*, 42 N.Y.U. L. REV. 110 (1967). In antitrust market analysis the relevant geographical market is the area where sellers of the product or service operate and where buyers usually purchase the product or service. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961); Standard Oil Co. v. United States, 337 U.S. 293, 299-300 n.5 (1949).

[21] For the purpose of antitrust law, there may be monopolization of either a product or a service. References in this Article will be confined to product mar-

A relevant product market includes all products that are so similar in character or use that buyers will substitute one for another as prices change.[22] This substitutability is measured by the cross-elasticity of demand, which is the degree of change in demand as the price changes. The substitutability of a patented product depends upon its distinctive physical and functional characteristics and those, in turn, are defined by the patent claims[23] at the end of the issued patent. The United States Patent and Trademark Office will issue a patent only if the invention is new,[24] useful,[25] and unobvious to one skilled in the art of the invention.[26] Whether the patented product should be included within a broader product market or constitute its own separate relevant market depends upon the degree to which it differs physically and functionally from other substitutable products.

C. The Maintenance of Monopoly Power

The acquisition or exercise of monopoly power does not by itself violate section 2 of the Sherman Act.[27] However, a willful acquisition or anticompetitive or exclusionary use of that power can rise to a section 2 violation.[28] That is, the patent owner must use its monopoly power to maintain and direct the impairment of the competitors' ability to compete in the relevant market. If a patent owner uses its monopoly power only as an adjunct to fair and open competition in the relevant market, and not as a lever to extract extra-patent concessions from customers or competitors, there is no violation of the antitrust laws.

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kets. It must be noted, however, that patents are issued for products, processes, methods, or machines. The relevant market for a process or method may be that market in which it is used or licensed, or, alternatively, that market in which a product of the process or method is sold or used.

[22] In the 1984 Merger Guidelines, the Justice Department generally includes all products in a relevant market that buyers would substitute if the price of a defendant's product was increased by five percent for one year. Merger Guidelines of Department of Justice—1984, 2 Trade Reg. Rep. (CCH) ¶ 4492 [.101] (June 14, 1984).

[23] 35 U.S.C. § 112 (1982).

[24] *Id.* §§ 101, 102.

[25] *Id.* § 101.

[26] *Id.* § 103 (1982 & Supp. III 1985).

[27] United States v. Grinnell Corp., 384 U.S. 563, 571 (1966); United States v. Aluminum Co. of Am., 148 F.2d 416, 429 (2d Cir. 1945).

[28] *Grinnell*, 384 U.S. at 570-71. *See also* Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291, 1309 (9th Cir.), *cert. denied*, 459 U.S. 1009 (1982).

However, the element of illegal use and maintenance of monopoly power is not easily defined. It consists of a general "purpose or intent to exercise that power."[29] When a patent owner excludes others from making, using, or selling the invention, the monopoly power is utilized as it was intended in the Patent Act. In this situation, there is no inherent purpose or intent to exercise illegal monopoly power. Yet, when a patent owner exercises monopoly power to exclude a competitor from a relevant market or to deter a rival from entering or expanding its share of the market, he monopolizes or attempts to monopolize.[30] If the relevant market is comprised of the patented product alone, exclusionary conduct within the limits of the patent grant is not an illegal use or maintenance of monopoly power.[31]

II

Refusal of License Generally

A patent owner has the option to grant no license,[32] an exclusive license,[33] or a non-exclusive license.[34] A patent license may contain restrictions that otherwise would be unlawful without the patent, such as a minimum price at which the licensee may sell the patented product.[35] Moreover, a patent owner has the right to suppress the invention and prevent all others from using it.[36] In-

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[29] United States v. Griffith, 334 U.S. 100, 107 (1948); American Tobacco Co. v. United States, 328 U.S. 781, 809 (1946).

[30] *See, e.g.*, Kearney & Trecker Corp. v. Giddings & Lewis, Inc., 452 F.2d 579, 599 (7th Cir. 1971), *cert. denied*, 405 U.S. 1066 (1972).

[31] SCM Corp. v. Xerox Corp., 645 F.2d 1195, 1204 (2nd Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982); International Wood Processors v. Power Dry, Inc., 593 F. Supp. 710, 722 n.6 (D.S.C. 1984).

[32] Bement v. National Harrow Co., 186 U.S. 70, 88-91 (1902).

[33] United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122, 1127 (D.C. Cir. 1981).

[34] United States v. Westinghouse Elec. Corp., 648 F.2d 642, 647-48 (9th Cir. 1981).

[35] United States v. General Elec. Co., 272 U.S. 476, 488-90 (1926). *See also* Kaplow, *The Patent-Antitrust Intersection: A Reappraisal*, 97 HARV. L. REV. 1813, 1855-67 (1984).

Patent owners may also refuse to license patents except in conjunction with the purchase of an unpatented staple product that is a material component of the patentee's patented process. Rohm & Haas Co. v. Dawson Chem. Co., 557 F. Supp. 739, 834 (S.D. Tex.), *rev'd on other grounds*, 722 F.2d 1556 (Fed. Cir. 1983), *cert. denied*, 469 U.S. 851 (1984).

[36] Hartford-Empire Co. v. United States, 323 U.S. 386, 432 (1945); Carbice Corp. v. American Patents Corp., 283 U.S. 27, 31 (1931); Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 424-25 (1908).

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deed, even a monopolist cannot be compelled to license a patent[37] without some showing that withholding the license is illegal exclusionary conduct.[38] Exclusionary conduct is anticompetitive conduct in which the patent is used to unreasonably restrain trade in a manner not permitted by the Patent Act.

If a patent owner unilaterally refuses to license or terminates a license, the conduct is not illegally exclusionary,[39] unless the decision is coupled with other market practices in which the power of the patent is used to impede a competitor's ability to compete with the patent owner. Such a refusal may violate section 2 of the Sherman Act. Absent any purpose or intent to maintain illegal monopoly power, the patent owner has the right to withhold licenses arbitrarily.[40] However, the termination of a patent license, motivated by an intent to impair the licensee's fair opportunity to compete in the sale of nonpatented products, is anticompetitive conduct.[41]

A simple unilateral refusal to license a patent is not by itself a violation of the antitrust laws. In *SCM Corp. v. Xerox Corp.*,[42] Xerox enjoyed absolute monopoly power for ten years in the plain-paper copying submarket of the photocopy machine industry by reason of its control over Xerographic pioneer and improvement patents. Xerox refused to license its plain-paper copier patents to SCM, and SCM averred that because of Xerox's monopolistic position in the industry, this refusal was a violation of section 2 of the Sherman Act. Xerox had acquired the key patent rights before plain-paper copiers were sold at a time when the relevant market had not yet been defined. The court held that Xerox's refusal to license the desired patents did not give rise to any liability

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[37] *See* Adelman, *Property Rights Theory and Patent-Antitrust: The Role of Compulsory Licensing*, 52 N.Y.U. L. REV. 977 (1977).

[38] SCM Corp. v. Xerox Corp., 645 F.2d 1195, 1204-05 (2d Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

[39] Bement v. National Harrow Co., 186 U.S. 70, 90 (1902).

[40] *Continental Paper Bag Co.*, 210 U.S. 405.

[41] A patent owner may not condition a license upon the licensee's agreement not to produce products that compete with the invention. National Lockwasher Co. v. George K. Garret Co., 137 F.2d 255 (3d Cir. 1943). To terminate a license for the same reason would also be anticompetitive.

[42] 645 F.2d 1195. *See* Note, *Patent and Antitrust Law: The Second Circuit Strives Toward Accommodation*, 48 BROOKLYN L. REV. 767 (1982). For analysis of the district court opinion, see Comment, *Accommodating Patent and Antitrust Law: Monopolists' Lawful Patenting Conduct and* SCM Corp. v. Xerox Corp., 60 B.U.L. REV. 78 (1980).

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under section 2 of the Sherman Act.[43] Additionally, the court found that Xerox was not engaged in unlawful conduct at the time the patents were acquired, despite the fact that Xerox had acquired a monopolistic position in the relevant market. This relevant market was defined as the plain-paper copying submarket that Xerox itself had created. The court observed that: "No court has ever held that the antitrust laws require a patent holder to forfeit the exclusionary power inherent in his patent the instant his patent monopoly affords him monopoly power over a relevant product market."[44]

SCM Corp. indicates that a patent owner will not violate section 2 when there is a naked refusal to license key patents to a horizontal competitor, even if the patent owner enjoys a secure monopolistic position in the relevant market of the patented product. To prove a section 2 violation the competitor must show that the refusal to license is anticompetitive conduct that excludes the competitor from a fair opportunity to compete in the relevant market in which the patent owner has monopoly power.

Xerox did grant SCM selected limited licenses under its patents to manufacture Xerographic coated-paper copiers. This license allowed SCM to compete with Xerox in a "low income" copier submarket.[45] If Xerox instead had initially licensed its plain-paper copier patents to SCM, SCM would have controlled part of the plain-paper market and competed directly with Xerox. Had Xerox then arbitrarily terminated the license, the court could have found antitrust exclusionary conduct sufficient to violate section 2. This determination would depend upon whether Xerox could supply a legitimate business reason for the termination.

Section 2 relates to market structure violations and the defendant's market power must be shown by the plaintiff. In *Hennessy Industries Inc. v. FMC Corp.*,[46] Hennessy claimed that the defendant conspired to drive it out of the tire changer market by denying it licenses under certain key patents. Plaintiff alleged section 1 and section 2 violations. The court dismissed the section 2 action because there was no allegation as to the defendant's market power.[47] Without market power that amounts to monopoly

[43] *SMC Corp.*, 645 F.2d at 1209.
[44] *Id.* at 1204.
[45] *Id.* at 1200.
[46] 779 F.2d 402 (7th Cir. 1985).
[47] *Id.* at 404-05. The court also dismissed the claim under section 1 because the restraint was vertical, not horizontal. A similar result occurred in a case in-

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power, there can be no monopolization. Even if attempted monopolization is alleged, plaintiffs must prove the defendant has sufficient market power so that a dangerous probability of monopolization exists.[48]

A unilateral termination is markedly distinct from a termination that is part of concerted action.[49] Concerted refusals to deal are per se violations of section 1 of the Sherman Act[50] and may also be illegal under section 2. In *Mannington Mills, Inc. v. Congoleum Industries, Inc.*,[51] Congoleum, the patent owner, terminated Mannington's licenses in response to pressure from Mannington's competitors, whom Congoleum had also licensed. The competitors had complained to Congoleum about Mannington's excessive competition. Congoleum feared they would undertake sales in areas for which they were not licensed if Mannington's infringements were not halted. The court held that Mannington's complaint stated a claim of conspiracy under section 1 of the Sherman Act.[52] Had Mannington also shown that Congoleum had monopoly power in the relevant market of the licenses, an additional claim under Section 2 would have been cognizable. Moreover, if Congoleum and Mannington's competitors had collectively obtained an oligopolistic market position, there would have been a section 2 violation.

Similarly, in *International Wood Processors v. Power Dry, Inc.*,[53] the terminated licensee successfully proved that the termination was part of a conspiracy to preclude the plaintiff as a competitor. The court held that elimination of the only competitor in

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volving an alleged conspiracy to eliminate plaintiffs from medical emergency room practice where the plaintiffs failed to show the defendants' share of the subject relevant market. Smith v. Burns Clinic Medical Center, P.C., 779 F.2d 1173 (6th Cir. 1985).

[48] Swift & Co. v. United States, 196 U.S. 375, 396 (1905). *See also supra* text accompanying notes 27-31.

[49] *See generally* Bauer, *Per Se Illegality of Concerted Refusals to Deal: A Rule Ripe for Reexamination*, 79 COLUM. L. REV. 685 (1979).

[50] Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 293 (1985).

[51] 610 F.2d 1059 (3rd Cir. 1979).

[52] *Id.* at 1070. *See also* United States v. General Motors Corp., 384 U.S. 127, 140 (1966) where the court found a "classic conspiracy" in restraint of trade. Chevrolet dealers had persuaded General Motors to undertake measures to terminate business dealings between dealers and "discount houses" selling new cars at bargain prices.

[53] 593 F. Supp. 710 (D.S.C. 1984).

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the relevant market was, under the rule of reason test,[54] an unreasonable restraint of trade, and therefore a violation of section 1 of the Sherman Act. These cases illustrate that a conspiracy to terminate a competitor's patent license violates the Sherman Act. It is not as clear whether a termination also violates section 2 if no conspiracy is involved. A recent United States Supreme Court case is quite instructive in this regard.

III

ILLEGAL TERMINATION UNDER THE *Aspen Skiing* CASE

In *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,[55] the Supreme Court faced a section 2 issue involving the refusal to continue to deal with a horizontal competitor. For fifteen years the defendant, Aspen Skiing Company, had cooperated with its geographically adjacent competitor, plaintiff Aspen Highlands, in offering a ski lift ticket that was good in both of the parties' ski areas in Aspen, Colorado. After becoming dissatisfied with the allocation of revenues from the combined area ski tickets, Aspen Skiing refused to continue dealing with the plaintiff and proceeded to advertise and sell its own separate ski-area tickets. Skiers were upset with this arrangement because they had to make two separate purchases if they wanted to ski at both areas. The size and popularity of the defendant Aspen Skiing Company's ski areas caused Highland's share of the area ski market to decrease from twenty and one-half percent to eleven percent in only three seasons. The Supreme Court held that the question of whether Aspen Skiing Company's conduct could properly be characterized as exclusionary could not be answered by considering only its effect on Highlands. Additional relevant considerations were its "impact on consumers" and whether it had "impaired competition in an unnecessarily restrictive way."[56] The Supreme Court found a section 2 violation because the refusal was "the willful acquisi-

[54] *Id.* at 722. Under the rule of reason standard of analysis, the fact finder weighs the anticompetitive and procompetitive effects of a restrictive practice to determine whether it imposes an unreasonable restraint on competition. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36, 49 (1977). For a discussion of the application of per se illegality or the rule of reason analysis in a different context, see Lazaroff, *The Antitrust Implications of Franchise Relocation Restrictions in Professional Sports*, 53 FORDHAM L. REV. 157 (1984).

[55] 472 U.S. 585 (1985).

[56] *Id.* at 605.

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tion, maintenance, or use of that [monopoly] power by anticompetitive or exclusionary means or for anticompetitive or exclusionary purposes."[57] Aspen Skiing Company "was not motivated by efficiency concerns and . . . was willing to sacrifice short run benefits and consumer good will in exchange for a perceived long-run impact on its smaller rival."[58]

Aspen Skiing Co. has serious ramifications for the patent owner who terminates key patent licenses granted to a horizontal competitor. The question of whether a termination may be characterized as exclusionary conduct cannot be answered simply by considering the effect on the licensee. A court will consider the impact of the refusal on the ultimate consumer of the product or the service. Most importantly, a court must determine if the termination furthers competition on the merits of competing products or impairs competition in an unnecessarily restrictive way. The Court pointed out that "[i]f a firm has been 'attempting to exclude rivals on some basis other than efficiency,' it is fair to characterize its behavior as predatory."[59]

In *Aspen Skiing Co.*, four factors are discernible that determine whether a section 2 violation exists when a cooperative arrangement between horizontal competitors is terminated: (1) the cross-elasticity of demand between the monopolist's product and that of its competitor; (2) the ability of the terminated competitor to compete without the cooperative arrangement; (3) the asserted business justification for the termination; and (4) the effect on the ultimate consumer of the product or service.[60] While the relative weight given to each factor will vary from case to case, all of the factors should be considered when applying the antitrust laws.

IV

Patent License Refusals and Terminations

A. *Cross-elasticity of Demand for the Patented Product*

The United States government has granted over four and one-half million patents.[61] Although the Patent and Trademark Office

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[57] *Id.* at 596.

[58] *Id.* at 610-11.

[59] *Id.* at 605.

[60] *Id.* at 605-08.

[61] Patent No. 4,644,587, for an Optical Data Connection System, was issued on Feb. 17, 1987. 1075 Official Gazette of U.S. Patent & Trademark Office 1640 (1987).

(PTO) examiners are diligent in rejecting applications for inventions that are not novel or are obvious in light of the prior art, persistent patent attorneys nevertheless prosecute the applications and frequently prevail. The result is that the PTO grants many patents for inventions that do not represent an outstanding advance in technology.

When applying for a patent grant, the patent attorney must persuade the PTO examiner that the applicant's invention is not obvious in light of existing prior art.[62] As the application progresses towards final patentability, the scope of the claims may be narrowed until the patent examiner agrees that the claims do not cover or include products or methods already in the public domain. Thus, patents vary greatly in scope of coverage, depending upon the density and the sophistication of the prior art and the degree to which an invention is a significant advance in that art. Narrow claims are allowed for an invention that comprises only a slight improvement over the prior art.[63] Broad claims are allowed for a pioneer invention that comprises a major advance in technology.

When a patent is issued, its strength (i.e., its degree of monopoly power) depends upon the breadth of the patent claims and its similarity to prior art. Therefore, the monopoly power of a patent cannot be ascertained from the face of the printed document. As the patent proceeds through its seventeen-year term, the patent's monopoly power may actually diminish. Many improved products in a relevant market may be developed after the issuance of the patent, without infringing any of its claims. If consumers readily switch to these improved substitutes in response to an increase in price of the patented product, monopoly power is at a minimum and may even be nonexistent. The patented invention may be only one product in a market with many possible substitutes or the invention alone may engulf the entire relevant market because of its superiority, leaving no practical substitutes available.

The cross-elasticity of demand between the invention and its substitutes is very low when pioneer inventions, such as the telephone, the light bulb, the ballpoint pen, the Polaroid camera, and

[62] 35 U.S.C. § 103 (1982 & Supp. III 1985).

[63] "Slight improvement" may be a misnomer. An improvement of a process, machine, manufacture, or composition of matter may be patentable. 35 U.S.C. § 101 (1982). The improvement must be sufficient so that it is unobvious under 35 U.S.C. § 103 (1982).

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the first plain-paper copying machine, are first introduced. When first patented, these rare inventions enjoyed strong patents with broad claims. A pioneer invention creates its own individual market when it first appears and the patent owner enjoys complete monopoly power. The quality of a product can often result in a low cross-elasticity of demand and consequently a limited relevant market.[64] For example, in *International Wood Processors v. Power Dry, Inc.*, a patented wood-drying kiln comprised its own relevant market, distinct from other wood-drying kilns.[65] Its high drying speed and low energy costs made it far superior to other wood kilns.[66]

For most inventions, however, the patent owner must share a broader market with other substitutable products.[67] The vast majority of issued patents are for improvements over existing products and processes. The owner of an improvement patent does not have full control over market prices, and sales may be lost if the invention is priced too high. The owner of such a patent may have little market power and no monopoly power at all. Such patents should be relegated to minor roles in antitrust prosecutions.

A product with major market power was the key factor in *Aspen Skiing Co.* There, the cross-elasticity of demand between the all-area ski ticket and separate area tickets was very low. Even if skiers could not save money by buying an all-area ticket, convenience and flexibility dictated the all-area choice. This was a determinant fact in the Court's decision.[68] The low cross-elasticity of demand indicated substantial monopoly power in the all-area ticket.

The cross-elasticity of demand for a patented product is found by comparing consumer preferences. If there is evidence that a slight increase in the price of the patented product will produce an immediate switch to a competing product, monopoly power, if any, is minimal. If consumers continue to buy the patented prod-

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[64] International Wood Processors v. Power Dry, Inc., 593 F. Supp. 710, 722 (D.S.C. 1984).

[65] *Id.* at 716.

[66] For example, in Syufy Enter. v. American Multicinema, Inc., 783 F.2d 878, 883 (9th Cir. 1986), the relevant product market was limited to industry-anticipated, top-grossing motion pictures. There were only 30 per year.

[67] For example, the substitutable product market for cellophane was held to include waxed paper, glassine, foil, Pliofilm, and greaseproof paper. United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 400 (1956).

[68] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 608-10 (1985).

uct at the increased price, cross-elasticity is low and monopoly power is high. However, there are few patented products that will not be rejected by consumers when prices are raised unreasonably. The more likely result is that competing products will satisfy consumer preference.

Patents with some degree of market control are usually found in newly developed industries where a few competitors have initially scratched the surface of a bright new technology. There are always a few patented products that are so innovative that substitution is impossible. For example, no acceptable substitute will exist for the patented drug that cures the common cold rather than merely treats the symptoms. Pioneer patents initially protected the high prices of the first electronic calculators and video cassette recorders, until competitors were able to invent around the patents or the original patents expired. Such highly innovative patents should assume major roles in antitrust cases. Pioneer patents enjoy greater monopoly power and the antitrust consequences are more likely where the owners misuse market control. In sum, while the cross-elasticity of demand for patented products may vary considerably, it must be ascertained before monopolization may be found.

B. *The Ability of the Denied Licensee to Compete*

The offense of monopolization under section 2 of the Sherman Act is anchored in market structure characteristics. The proportion of the market controlled by the alleged monopolist and the degree of market concentration are of paramount importance. No specific proportion of market control always indicates monopoly power,[69] but some monopoly power must exist if section 2 is to apply. One who wields monopoly power and refuses to deal with a horizontal competitor will face no section 2 violation. A violation could arise if the power is utilized to reduce the competitor's fair opportunity to compete.[70] However, reducing the competitor's op-

[69] In United States v. Aluminum Co. of Am., the court held that a 90% market share indicated monopoly power but that 64% probably did not. 148 F.2d 416, 424 (2d Cir. 1945). *See* H. HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW 139-40 (1985).

[70] Paradoxically, cooperation between horizontal competitors may be an unreasonable restraint of trade under section 1 of the Sherman Act. In fact, horizontal restraints are held to be per se illegal far more frequently than vertical restraints. If competitors in a relevant market collectively have monopoly power they cooperate with each other only at their extreme peril.

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portunity to compete will depend upon the amount of control that the monopolist can exercise in the market and the competitor's ability to control a reasonable share of the market in the face of that monopoly power. If the patent owner corners a substantial share of the market because of the qualitative merits of the patented product, there should be no antitrust consequences when rivals are denied licenses.[71]

When a monopolist terminates an important patent license, the harm, if any, is measured by the resulting decrease in the competitor's share of the market. Yet where a patent owner has refused to license at all, the effect on the denied licensee is measured by the change in market shares when the patented product was first introduced. In the latter case, it is more difficult to show that the refusal was based upon an anticompetitive intent, and that the change in market shares was not due to the commercial merits of the patented product.

In *Aspen Skiing Co.*, the pecuniary injury caused by the Aspen Ski Company's discontinuance of the all-area lift ticket was not disputed. Highland's share of the relevant market steadily declined,[72] and the Court ascribed this as a direct result of Highland's reduced ability to compete after the termination of the cooperative arrangement.[73] The termination, coupled with the defendant's monopoly power, resulted in a violation of section 2 of the Sherman Act. If Aspen Ski Company had never cooperated in an all-area lift ticket, the Court may not have found any anticompetitive intent in a unilateral refusal to deal. However, if Aspen Ski had controlled 100% of the relevant market, there is precedent for the proposition that Aspen should be required to cooperate with a potential entrant into that market.[74]

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[71] *See also cf.* United States v. Citizens & S. Nat'l Bank, 422 U.S. 86, 116 (1975); 3 P. AREEDA & D. TURNER, ANTITRUST LAW 286 (1978).

[72] *Aspen Skiing Co.*, 472 U.S. at 594-95. The jury calculated Highland's actual damages at $2.5 million. *Id.* at 595.

[73] The Court stated that similar conduct carried out by the concerted action of independent rivals would be a per se violation of section 1 of the Sherman Act. *Id.* at 604 n.31.

[74] Lorain Journal Co. v. United States, 342 U.S. 143, 154-55 (1951). The Lorain Journal, a newspaper enjoying a substantial monopoly in the relevant market area, had refused to accept local advertising from customers who also advertised through a newly established radio station. *See also* Otter Tail Power Co. v. United States, 410 U.S. 366, 377 (1973); Eastman Kodak Co. v. Southern Photo Materials Co., 273 U.S. 359, 375 (1927).

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When a monopolist licenses an important patent to a nonmonopolistic horizontal competitor and the licensee gains some control over a portion of the relevant market during the license, antitrust implications may result if the license is suddenly terminated. If the terminated licensee can show subsequent substantial impairment of its ability to compete in the market because of the termination, and the monopolist cannot offer legitimate business justifications, *Aspen Skiing Co.* indicates that section 2 overtones will arise. If the termination was reasonable, then the former licensee's diminished capacity to compete results from an exclusionary right that is clearly contemplated by the Patent Act and no antitrust violation exists.

C. *The Business Justification for Termination*

In *Aspen Skiing Co.*, the defendant Aspen Skiing Company gave no acceptable business efficiency justification for its refusal to continue the all-area lift ticket with Aspen Highlands.[75] In fact, the defendant was willing to forego the short-run benefits obtainable from continuing the all-area ticket because, in the long run, the plaintiff's ability to compete would be reduced in the Aspen area market. Moreover, Aspen Ski Company's cooperation with horizontal competitors in other geographical ski area markets was most significant in the Court's eyes.[76] Similarly, the monopolist who terminates a patent license does so at its peril, unless there is a good economical business justification for the decision.

A patent licensor frequently has an excellent business reason for terminating a license. For example, if the licensor and licensee compete in selling the patented invention, and the licensee's share of the market increases, termination by the licensor would seem appropriate. This is a prerogative that inures with the patent grant. In some cases, a reviewing court will make every effort to accept a reasonable explanation for a refusal to deal.

In *Mannington Mills, Inc. v. Congoleum Industries, Inc.*,[77] Congoleum licensed Mannington to manufacture and sell its em-

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[75] 472 U.S. at 606. A similar analysis has been applied in rationing cases where the court determines if a manufacturer's rationed sale of a product was motivated by a legitimate business aim and not done to acquire monopoly power. Independent Iron Works, Inc. v. United States Steel Corp., 322 F.2d 656, 667-68 (9th Cir.), *cert. denied*, 375 U.S. 922 (1963).

[76] *Aspen Skiing Co.*, 472 U.S. at 608-09.

[77] 610 F.2d 1059 (3rd Cir. 1979).

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bossed vinyl product but refused to license its relevant unpatented know-how. Congoleum did, however, license the know-how and the patent to Mannington's competitors. Mannington alleged that this was arbitrary and therefore violated section 2. The Third Circuit Court of Appeals held that the refusal was not arbitrary because none of Mannington's competitors had any prior manufacturing experience at the time that the know-how licenses were issued. In contrast, Mannington had been manufacturing the patented product for a number of years. The substantial and undisputed difference between Mannington and its competitors justified the refusal and it was therefore neither arbitrary nor unreasonable. Section 2 was not violated.[78] A different outcome might have occurred had Congoleum been an unlawful monopolist, particularly if the refusal was part of a plan to exclude Mannington from the relevant market.

The patent licensor who enjoys monopoly power in a broad relevant market, of which the patented product is but a part, may be suspected of having ulterior anticompetitive motives for terminating a license. This is especially so if the license royalties have been substantial. The patent owner may have built up sales in unpatented complementary products[79] that are sold together with the patented product. Yet, over the duration of the license, the licensee may begin to compete successfully in the complementary product market. In addition, the licensee may have used sales of the patented product to build up good will. Terminating the license may be an excellent way to limit the licensee's sales of such related products. If the licensor has monopoly power in the relevant market in addition to that attributable to the patent itself, termination of the license may be exclusionary conduct that actually extends the power of the patent to areas not contemplated by the Patent Act.

D. The Effect on the Consuming Public

The antitrust laws were enacted to foster fair competition,[80] while keeping in mind the consuming public's welfare.[81] If no con-

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[78] *Id.* at 1069.

[79] On patentee control of unpatented end products, see Kaplow, *supra* note 35, at 1882-87 (1984).

[80] Brown Shoe Co., Inc. v. United States, 370 U.S. 294, 320 (1962).

[81] The Sherman Act was conceived primarily as a remedy for individuals, especially consumers. Reiter v. Sonotone Corp., 442 U.S. 330, 343 (1979).

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sumer interest is discernible in a competitor's antitrust suit, a court may question whether any antitrust violation exists.[82] The interests of the ultimate consumer are protected when the court considers public policies representing antitrust laws.

In the *Aspen Skiing Co.* case, the Supreme Court gave careful attention to consumer welfare. The average consumer of an all-area lift ticket was "a well-educated, relatively affluent, experienced skier who has skied a number of times in the past."[83] Over eighty percent of the skiers visiting the resort had been there before. They had experienced the convenient, all-area ski ticket and were angered by its discontinuance. During the fifteen-year period in which the all-area ticket was sold, skier demand could not be satisfied by separate tickets at separate areas. The cross-elasticity of demand between all-area tickets and separate area tickets was very low. Even if skiers could not save money on the all-area ticket, convenience made it the obvious preference. The Court viewed this impact on consumers as a major factor in reaching its decision.[84]

There are at least three reasons that consumer welfare suffers after the termination of a patented product license. First and most obvious, there may be one less competitive outlet for the product. Even greater harm results if the patented product is available only from a seller possessing monopoly power in the relevant market. Monopoly power includes the power to control prices and, as price competition is reduced, consumer welfare may suffer. While the minimum price charged by a patent licensee is limited through the license royalty, the consumer still benefits from some competition because price competition is only one of many facets of business competition. Second, product promotion will diminish as the number of sales outlets are reduced. Advertising engenders its own variety of benefits, especially when coupled with a strong trademark. The good will created by sellers through propitious use of trademarks benefits consumers through educational processes that are available only through advertising channels. Third, consumer convenience can suffer through loss of repair and replacement services and reduction of geographical locational convenience. In

[82] Brunswick Corp. v. Riegel Textile Corp., 752 F.2d 261, 266-67 (7th Cir. 1984), *cert. denied*, 472 U.S. 1018 (1985).

[83] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 605 (1985).

[84] *Id.* at 606-07.

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sum, through patent licensing the invention is available to a larger segment of the consuming public and, if there is more than one seller of the product, substantial benefits to the consumer exist. Though the direct harm is not easily quantified, the consumer is usually better off under conditions of competitive marketing, even if the competitors sell the same patented product.[85]

CONCLUSION

The business competitor has the right to choose those with whom it will deal. Similarly, the patent owner should have the right to refuse to grant licenses and to terminate a license for any good business reason that is not a breach of contract. The antitrust laws narrow this right if the patent owner has monopoly power in the relevant market of which the invention is a part. A refusal resulting in anticompetitive consequences beyond that which is contemplated by the Patent Act subjects the patent owner to antitrust law scrutiny.

The recent Supreme Court decision in *Aspen Skiing Co.*, although not a patent case, provides a warning to the patent owner who terminates a license. If the licensor has monopoly power in the relevant market of the invention, the four factors discussed in *Aspen Skiing Co.* determine whether a termination violates section 2 of the Sherman Act. In *Aspen Skiing Co.*, the defendant's monopoly power and the uniqueness of the terminated cooperative service closely parallels that of many patent licensors. *Aspen Skiing Co.* is a highly persuasive precedent for use in patent license termination cases.

Most antitrust cases uphold the right of the patent owner to refuse to license or to terminate a license at will. However, *Aspen Skiing Co.* suggests problems for the patent owner who ignores its clear warning. The patent owner with monopoly power may no longer refuse to deal at will.

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[85] *See* Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

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