



# DISTRIBUTION

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# Good Things for Antitrust & IP: Will *Leegin* Bring GE to Life?

by

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The Supreme Court's analysis in *Leegin*<sup>1</sup> highlights a natural extension of recent legal reasoning, beginning with the landmark *GTE Sylvania*<sup>2</sup> decision in 1977, in which the Court has gradually accepted that its early per se condemnation of many practices was overly restrictive. Since *GTE Sylvania*, the Court has steadily pared back the application of the per se rule against a range of practices, including vertical maximum resale price agreements (*State Oil v. Khan*<sup>3</sup>), price setting within joint ventures (*Texaco v. Dagher*<sup>4</sup>), and tying of unpatented articles to patents (*Illinois Tool Works v. Independent Ink*<sup>5</sup>). This trend to limit the per se rule is consistent with the Court's conviction, expressed in *Leegin*, that the rule is useful only for conduct that "courts can predict with confidence . . . would be invalidated in all or almost all instances under the rule of reason."<sup>6</sup>

The *Leegin* ruling, however, leaves significant controversy in its wake. The Department of Justice, and a majority of the FTC, argued as amicus in support of *Leegin* that the Court should overturn *Dr. Miles*, a position that ultimately garnered 5 votes. Two Commissioners, however, and 37 state Attorneys General, took PSKS's side in the case, and thus the antitrust enforcers were as split as the Supreme Court was on the matter. Since the

5-4 ruling, Senate Democrats have introduced the Discount Pricing Consumer Protection Act (S. 2261), seeking to overturn *Leegin*, and enshrine a prohibition against resale price maintenance in federal legislation.

Given this controversy, manufacturers are not likely to implement new RPM agreements quickly, even if they might otherwise pass muster under the rule of reason. Aside from S.2261's potential ability to reverse *Leegin*, manufacturers must consider the potential response of state antitrust law enforcers to the Supreme Court's decision. A number of state antitrust laws do not require that they be construed consistent with the Sherman Act, and the state attorneys general opposition to reversing *Dr. Miles* should be considered in predicting whether, and how quickly, state antitrust laws will allow for RPM agreements. And, of course, there are a handful of state dealer protection laws, as well as franchise laws, that may limit the wholesale incorporation of minimum RPM into existing agreements, on the grounds that RPM could be viewed as a material change to the terms of the pre-existing relationship.

Instead of a practical signal that current distribution arrangements should be modified wholesale, *Leegin* seems more a signpost to a continuing shift in the

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<sup>1</sup> On June 28th, 2007, the Supreme Court decided *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. \_\_\_, 127 S. Ct. 2705 (2007) overturning the nearly century-old per se condemnation of minimum resale price maintenance ("RPM"), established in *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

<sup>2</sup> 537 F.2d 980 (9th Cir. 1976), *aff'd*, 433 U.S. 36 (1977).

<sup>3</sup> 522 U.S. 3 (1997).

<sup>4</sup> 126 S. Ct. 1276 (2006).

<sup>5</sup> 126 S. Ct. 1281 (2006).

<sup>6</sup> *Leegin*, 127 S. Ct. at 2707, *citing Arizona v. Maricopa Cty. Med. Soc'y*, 457 U.S. 332, 344 (1982).

Supreme Court's thinking. This shift rejects the view that a manufacturer's interest in its product ends at the factory door, and contemplates additional involvement by manufacturers in the downstream distribution of its products.

## THE INTELLECTUAL PROPERTY RPM DOUGHNUT HOLE: GENERAL ELECTRIC

This evolution in the Court's view of distribution law has strong parallels in recent intellectual property jurisprudence. This may have profound implications for patent and copyright owners, whose licensing conduct, while not specifically subject to *Dr. Miles*, has nonetheless been circumscribed for many of the same historical reasons found in *Dr. Miles* and rejected by the Court over the past 30 years.

In an early look at the intersection of antitrust and patent law, the Supreme Court in *United States v. General Electric Co.*,<sup>7</sup> held that it was legal for the owner of intellectual property to condition the license of that IP on the licensee's agreement to sell the resulting product at a specified price. The Supreme Court focused on GE's right to extract monopoly profits from its new invention, noting that "the exclusive right of a patentee is to acquire profit by the price at which the article is sold." The Court found that this right extended to ensuring that licensees did not undercut GE and destroy the margins it might earn on its own light bulbs.

*General Electric's* divergence from the ordinary prohibition on resale price maintenance proved enormously troublesome over the years, with the

Supreme Court alluding to "problems arising from its adoption."<sup>8</sup> However, it has never been overruled. Instead, courts have nibbled away at GE, leaving it a narrow rule surrounded entirely by wide exceptions—the "hole" in the doughnut of cases generally pronouncing the *illegality* of price maintenance practices with respect to intellectual property licenses.

First, courts severely limited *General Electric* by making it inapplicable to cases in which companies cross-license patents in order to facilitate a new product offering. In *Line Material*,<sup>9</sup> the Supreme Court found that multiple patent holders may not enter a cross-licensing scheme that establishes the resale price of products to be manufactured under the cross-licenses.<sup>10</sup> As the Court put it, while "[t]he patent statutes give an exclusive right to the patentee to make, use, and vend and to assign any interest in this monopoly to others, . . . the Sherman Act prohibits agreements to fix prices, [and] any agreement between patentees runs afoul of that prohibition and is outside the patent monopoly."<sup>11</sup>

An argument could be made that where a new product cannot be produced without the assent of multiple patent holders, the *General Electric* rule should apply in order to incentivize cooperation and drive product innovation. *Leegin* does not directly address this issue, but the case does suggest that the Court may come to approach *Line Material* and its progeny from a similar direction. Having rejected the formalism of *Dr. Miles* in the typical RPM context, the Court may also decide to consider agreements on price that arise from cross-licensing arrangements under the rule of reason.

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<sup>7</sup> 272 U.S. 476 (1926).

<sup>8</sup> *United States v. Line Material Co.*, 333 U.S. 287, 303 (1948).

<sup>9</sup> 333 U.S. 287 (1948).

<sup>10</sup> *Line Material*, at 305-21.

<sup>11</sup> *Id.* at 312.

<sup>12</sup> *Newburgh Moire Co. v. Supreme Moire Co.*, 237 F.2d 283, 293-94 (3d Cir. 1956) ("[T]he patent laws were not intended to empower a patentee to grant a plurality of licenses, each containing provisions fixing the price at which the licensee might sell the product or process to the company, and that, if a plurality of licenses are granted, such provisions therein are prohibited by the antitrust laws.").

Where, as in *Line Material*, multiple patent holders agree to cross-licenses in order to facilitate manufacture of a product otherwise unavailable, but are only willing to do so where they can protect “monopoly” revenues deriving from their respective patents, it is possible that courts might judge the cross-license agreement to have pro-competitive justifications that outweigh the potential competitive detriment of the price maintenance terms, thus warranting rule of reason treatment.

Courts have also declined to apply the *General Electric* rule where a patent holder issues multiple patent licenses, each having resale price maintenance provisions.<sup>12</sup> In addition, case law has strongly suggested, without so finding, that *General Electric* would not apply where the patent holder does not continue to manufacture products under his patent alongside the licensee.<sup>13</sup> Reflecting the near elimination of *General Electric*, the Antitrust Guidelines for the Licensing of Intellectual Property state that the “Agencies will enforce the per se rule against resale price maintenance in the intellectual property context,” and then relegate *General Electric* to a footnote.<sup>14</sup>

The decision in *Leegin* provides important new support to companies wishing to exercise price maintenance in multiple licenses of intellectual property, or wishing to license the intellectual property without manufacturing product themselves. While the concept of attributing “monopoly profits” to holders of IP has become almost quaint in the modern era (and the Court’s *Illinois Tool Works* decision legitimizes the enforcement agencies’ previously expressed view that IP is like any other property, and does not automatically give rise to market

power), overturning *Dr. Miles* should breathe new life into *General Electric*’s focus on the incentives to be afforded a patent holder to realize legal “monopoly” profits. There is little reason to conclude that such incentives vary based on whether the IP owner is seeking profits through licenses to multiple manufacturers, or by choosing to license others to the exclusion of its own right to manufacture. More to the point, a price constraint on the licensee does not seem to be the type of limitation that would be invalidated in all, or almost all, circumstances under a rule of reason analysis. Such price restraints would, therefore, be appropriate candidates for rule of reason analysis, under the logic of *GTE Sylvania* and its progeny, including most recently, *Leegin*.

## CONTROLLING COPYRIGHTED CONTENT

*General Electric* itself has been applied directly to copyrights. In *LucasArts Entertainment Co. v. Humongous Entertainment Co.*,<sup>15</sup> the court ruled that price maintenance provisions included in a license of copyrighted software were not *per se* illegal because “[t]he right to license a patent or copyright (and to dictate the terms of such a license) is the “untrammeled right” of the intellectual property owner.”<sup>16</sup> The challenge for copyright owners, however, is that almost none of the “exception” jurisprudence subjecting resale price maintenance in patent licenses to the *per se* rule has been translated into the copyright arena.

This means that copyright holders may have the most to gain from *Leegin*. Take, for example, an owner of copyrighted video content who wishes to license the content for rebroadcast both to a cable company and to

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<sup>13</sup> *Royal Indus. v. St. Regis Paper Co.*, 420 F.2d 449 (9th Cir. 1969).

<sup>14</sup> U.S. Department of Justice and U.S. Federal Trade Commission, *Antitrust Guidelines for the Licensing of Intellectual Property* (Apr. 6, 1995) (hereinafter, “*IP Guidelines*”).

<sup>15</sup> 870 F. Supp. 285 (N.D. Cal. 1993).

<sup>16</sup> *Id.* at 290, quoting *United States v. Westinghouse Elec. Corp.*, 648 F.2d 642, 647 (9th Cir. 1981).

an Internet video service provider, under distinct minimum subscription price terms that will prevent each of the distribution outlets from competing with one another on price. While *Humongous* might provide legal support for a single such license, *Newburgh Moire* by analogy casts doubt on the legality of multiple copyright licenses. After *Leegin*, the video content owner may be much better positioned to argue the “intra-brand” limitation on competition is justified by enabling the content to be created and distributed in a larger “inter-brand” marketplace.

## LOOKING AHEAD

While *Leegin* arises in the context of minimum resale price agreements for the sale of goods, its principles should apply by analogy to the licensing of intellectual property. This application of *Leegin* would be highly consistent with other trends in intellectual property analysis by the Supreme Court—for instance, the relaxation of analysis of tying claims where the tying product is patented in *Illinois Tool Works Inc. v. Independent Ink*. As intellectual property, in cases

including *Independent Ink*, *Humongous*, and others, has come to be viewed as no different from other forms of property, it follows that the rules applicable to such other forms of property should likewise apply to intellectual property.

Perhaps unsurprisingly, these cases brought the law into alignment with the pre-existing consensus from the antitrust agencies, as set forth in the IP Guidelines. As the legal landscape where antitrust and intellectual property laws come together continues to evolve, patent and copyright owners looking to exercise more control over downstream applications of their property may find themselves on firmer ground. Given that the newly-proposed federal RPM legislation does not appear, on its face, to cover price agreements in the licensing context, holders of intellectual property may even find themselves better situated to exert downstream control than manufacturers of more traditional products will be. At least as long as legislators do not explicitly forbid RPM in IP licensing, *Leegin* looks set to bring *General Electric* to life for the holders of IP rights.