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RPM In IP: RIP To Per Se?

Monday, April 09, 2007 --- On March 26, the Supreme Court heard oral argument in Leegin Creative Leather Products Inc. v. PSKS Inc., a case which asks the Court to decide whether to overturn its nearly century-old per se condemnation of minimum resale price maintenance (RPM), established in Dr. Miles Medical Co. v. John D. Park and Sons, 220 U.S. 373 (1911).

The Leegin case can be seen as a natural extension of a line of cases beginning with the landmark GTE Sylvania decision in 1977, in which the Supreme Court has gradually accepted that its early per se condemnation of many practices was overly restrictive.

Since GTE Sylvania, the Supreme 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), price setting within joint ventures (Texaco v. Dagher), and tying agreements involving patents (Illinois Tool Works v. Independent Ink).

Despite a spirited argument, in which at least four Justices asked questions suggesting they may still support the per se condemnation of minimum RPM agreements, many observers have conjectured that the prohibition will be swept away in favor of a rule of reason analysis, consistent with the modern Supreme Court's characterization of the rule of reason as "the prevailing standard of analysis." Continental T.V. Inc. v. GTE Sylvania Inc., 433 U.S. 36, 49 (1977).

The Department of Justice, and a majority of the FTC, have argued for overturning Dr. Miles as amicus in support of Leegin; interestingly, Commissioner Harbour, and 37 state Attorneys General, have taken PSKS's side in the case, and thus the antitrust enforcers are split on the matter. If history is any guide, Leegin has the better of the support—nearly every state AG opposed the federal antitrust agencies in Khan, but to no avail there.

Assuming that the Court overturns Dr. Miles, the result will not be that minimum RPM agreements will be per se lawful. Rather, Leegin will simply be a very good reason to review and re-evaluate current distribution arrangements.

At least some manufacturers and franchisors may find it appropriate to modify existing Colgate policies to embody RPM directly into the distribution agreement documents, allowing for termination of the distributor or dealer for violation of the minimum resale price provision.

The revision of distribution agreements, however, may have to await the conversion of state antitrust law enforcement to the Supreme Court's decision, as state laws do not always require the same analytical approach as the Sherman Act, and the state AG opposition to reversing Dr. Miles needs to 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.

* The Intellectual Property RPM Doughnut Hole: General Electric *

The outcome in Leegin may, however, be of particular interest to patent and copyright owners, whose licensing conduct has not specifically been subject to Dr. Miles. In an early look at the intersection of antitrust and patent law, the Supreme Court in United States v. General Electric Co., 272 U.S. 476 (1926), 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 the right to ensure that licensees did not undercut GE and destroy the margins it might earn on its own lightbulbs.

General Electric's divergence from the ordinary prohibition on resale price maintenance has proved troublesome over the years, with the Supreme Court going so far as to allude to "problems arising from its adoption." United States v. Line Material Co., 333 U.S. 287, 303 (1948). However, it has never been overruled.

Instead, over the years, courts have nibbled away at it, 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 have 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, the Supreme Court found that multiple patent holders could not enter a cross-licensing scheme that establishes the resale price of products to be manufactured under the cross-licenses. 333 U.S. at 305-321.

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." Id. at 312.

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 will not directly address this issue. However, it is possible that, should Leegin generally subject price maintenance agreements to the rule of reason, courts might then come to approach Line Material and its progeny from a similar direction.

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 procompetitive justifications that outweigh the potential competitive detriment of the price maintenance terms.

Courts have also declined to apply the General Electric rule where a patent holder issues multiple patent licenses each having resale price maintenance provisions. 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.").

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. Royal Industries v. St. Regis Paper Co., 420 F.2d 449 (9th Cir. 1969).

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.

Should Dr. Miles be overturned, companies wishing to exercise price maintenance in multiple licenses of intellectual property, or wishing to license the intellectual property without manufacturing product themselves, would gain important new support.

While the concept of attributing "monopoly profits" to holders of IP has become almost quaint in the modern era (which recognizes 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.

* Controlling Copyrighted Content *

General Electric itself has been applied directly to copyrights. In LucasArts Entertainment Co. v. Humongous Entertainment Co., 870 F.Supp. 285 (N.D. Cal. 1993), 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.” Id. at 290, quoting United States v. Westinghouse Electric Corp., 648 F.2d 642, 647 (9th Cir. 1981).

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 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. Should Dr. Miles be overturned, the video content owner would 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 are likely to apply by analogy to the licensing of intellectual property.

As intellectual property 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—indeed, this was the essence of the Supreme Court’s decision last term in Independent Ink, which brought the case law in line with the antitrust agencies’ views, as set forth in the Guidelines for the Licensing of Intellectual Property.

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.

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