New York Law Journal

A NEW YORK LAW JOURNAL SPECIAL SECTION

ALM

Intellectual PROPERTY

Web address: http://www.nylj.com

MONDAY, APRIL 21, 2008

Patent Pools

Legal structures that combine rights foster development of new technologies but could raise competitive concerns.

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ASK a layperson, and he or she might say that the phrase "patent pool" refers to a table game played by patent lawyers at a bar. Or it is what results when patent lawyers bet on college basketball.

But to patent lawyers and, increasingly, corporate in-house counsel, a "patent pool" is an approach to patent licensing that can foster the development and acceptance of new technologies, or alternatively, can raise serious competitive and antitrust concerns. The topic of patent pools has received renewed attention of late with the recent move to create a patent pool for the 4G wireless communication standard, along with recent lawsuits by the patent pool administrator MPEG LA against certain licensors and licensees of its MPEG-2 patent pool licensing program.

This article discusses the current case law on patent pools, the avoidance of antitrust pitfalls, and legal structures for creating patent pools.

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Patent Pools: What Are They?

Patent pools can take many forms, but generally involve the "pooling" of patents owned by several companies for collective licensing and enforcement. A patent pool thus results from a pact between multiple patentees to "pool" their patent rights and to offer these rights as a package to third parties for licensing. The patentees themselves may manage the patent pool, or the patentees may appoint a separate administrator to oversee the licensing of the patents. Patent pools overseen by separate administrators include the MPEG-2 patent pool (overseen by MPEG LA). Patent pools overseen by one of the patentees include the DVD 3C patent pool (overseen by Koninklijke Philips Electronics, N.V.).

Companies often form patent pools when the rights to several patents are needed to make a standardized product or where product compatibility is required. Patent pools can thus help ease the bottleneck that results when one or two key patent owners hold out for high royalties for the use of a patent needed to produce a product that meets an industry standard. In this way, patent pools can lower the transaction costs for licensees and foster the acceptance of new technologies. In short, patent pools promise a streamlined way for companies to obtain licenses to multiple patents owned by multiple entities.

On the flip side, however, patent pools can raise competitive concerns, especially when the package license offered to licensees includes patents that are not essential to making the standardized product or includes patents of questionable validity. Other possible anticompetitive practices include exclusive license agreements that bar patent pool members from licensing their patents outside of the pool, broad grantback agreements that require patent pool licensees to disclose and license back improvements that the licensees develop, and requirements that patent pool members and licensees disclose confidential business data to the pool administrator. See generally U.S. Department of Justice and Federal Trade Commission, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition 64-85 (2007) (discussing competitive concerns raised by patent pools).

Supreme Court (1931)

The seminal U.S. Supreme Court case analyzing patent pools is *Standard Oil Co. v. United States*, 283 U.S. 163 (1931). The case established the basic groundwork for the economic analysis that courts continue to use in antitrust cases involving patent pools.

In *Standard Oil*, the federal government sued four patentees and 46 licensees, alleging that the defendants violated the Sherman Antitrust Act by creating and licensing a pool of patents pertaining to the "cracking" of gasoline. The Supreme Court rejected the government's claim that, by dividing the patent royalties between them, the four patentees showed monopolistic intent. The Court stated that, if the patentees made the patents available "on reasonable terms to all manufacturers, such interchange may promote rather than restrain competition." Id. at 171. This did not necessarily mean that the patentees had to charge reasonable rates: "Unless the industry is dominated, or interstate commerce directly restrained, the Sherman Act does not require cross-licensing patentees to license at reasonable rates others engaged in interstate commerce." Id. at 172.

During the decades following *Standard Oil*, courts grappled with the questions that the Supreme Court left unanswered. May the administrator of a patent pool include non-essential patents in a package license offered to prospective licensees? What pooling practices do pose a possible problem?

Antitrust Guidelines (1995)

In 1995, the U.S. Department of Justice and the Federal Trade Commission reviewed the case law and released a set of antitrust enforcement policies concerning patent licensing. In the Antitrust Guidelines for the Licensing of Intellectual Property, the DOJ and FTC generally stressed the positive features of patent pools, but noted a few practices that might cause problems. For example, courts may deem collective price or output restraints in pooling arrangements to be unlawful if the restraints fail to promote the integration of economic activity among the participants. Such restraints may take the form of joint marketing of the pooled intellectual property rights with collective price setting or coordinated output restrictions. Naked price fixing and market division are also certainly subject to challenge. See Antitrust Guidelines at 28.

The Antitrust Guidelines also stated that anticompetitive effects are unlikely to arise from excluding a company from a patent pool, unless (1) the excluded company cannot effectively compete in the relevant market for the good incorporating the licensed technologies; and (2) the pool participants collectively possess market power in the relevant market. If these circumstances exist, then the DOJ and FTC will decide whether the pool's restrictions on participation are reasonably related to the efficient development and exploitation of the pooled technologies and will assess the net effect of those limitations in the relevant market. Antitrust Guidelines at 28-29.

There are several ways to form a patent pool that are likely to combine complementary patent rights and are not likely to impede competition. Whether other structures are likely to pass antitrust scrutiny will of course depend on the facts of the case.

Additionally, the Antitrust Guidelines noted that patent pools might have an anticompetitive effect if the pool deters or discourages participants from engaging in research and development. For example, a patent pool might reduce the incentive to engage in research and development if the pool requires members to grant licenses to each other for current and future technology at minimal cost. Such a requirement might motivate pool members to free ride on the accomplishments of other pool members. Antitrust Guidelines at 29. See generally Daniel P. Homiller, "Patent Misuse in Patent Pool Licensing: From National Harrow to 'the Nine No-Nos' to Not Likely," 2006 DUKE L. & TECH. REV. 7 (discussing the Antitrust Guidelines).

Thus, from the Antitrust Guidelines, it appears that the DOJ and FTC will examine most patent pools under the rule of reason, which require that the agencies analyze a pool's anticompetitive effect. To obtain greater certainty as to whether a particular patent pool meets antitrust scrutiny, some pools have requested "business review letters" from the DOJ, seeking a statement of the DOJ's antitrust enforcement intentions respecting a proposed pool. The DOJ has issued several business review letters addressing patent pools, including letters addressing the MPEG-2 patent pool, the DVD 6C patent pool, the DVD 3C patent pool, and the 3G patent pool (overseen by the 3G Patent Platform Partnership). The 3G patent pool pertains to 3G (third generation) mobile phone standards and technology. The DVD 6C patent pool and the DVD 3C patent pool are described later in this article.

The DOJ business review letters relating to these patent pools are available on the DOJ Web site at http://www.usdoj.gov/atr/public/busreview/.

Federal Circuit Weighs In (2005)

Despite the guidance given by the courts, DOJ and FTC, questions have remained about the standard of review that should be applied to patent pools and about the inclusion of non-essential patents in package licenses offered to prospective licensees. The U.S. Court of Appeals for the Federal Circuit recently confronted these and other questions in *U.S. Philips Corp. v. International Trade Commission*, 424 F.3d 1179 (Fed. Cir. 2005).

In *U.S. Philips*, the Federal Circuit reviewed an International Trade Commission (ITC) decision finding a package license unenforceable due to patent misuse. Patent misuse is an equitable defense to patent infringement that bars a patent owner from using the leverage of the patent "to derive a benefit not attributable to the use of the patent's teachings." *Zenith Radio Corp v. Hazeltine Research Inc.*, 395 U.S. 100 (1969). The ITC used a per se standard of review because the package license included "non-essential" patents. The per se rule refers to categories of anticompetitive behavior that are simply presumed to create an unreasonable restraint on trade. In contrast, under the rule of reason, a practice is impermissible only if it can be shown that its effect is to restrain competition in a relevant market. See *U.S. Philips*, 424 F.3d at 1185 (Fed. Cir. 2005).

The Federal Circuit reversed the ITC, stating that patent pools should generally be reviewed under the rule of reason, regardless of whether the pools comprise "non-essential" patents, and further finding that Philips' CD-R and CD-RW patent pools did not comprise any "non-essential" patents in any event. In its opinion, the Federal Circuit distinguished patent pools from the practice of block-booking movies, noting that patent pool licensees are not required to use every patent in the pool and, in fact, may use commercial alternatives to any of the included non-essential patents. *U.S. Philips*, 424 F.3d at 1188. (Block-booking is a practice whereby movie studios bundle several films together and sell them to a theater as a unit.) Additionally, including a non-essential

patent in a patent pool is unlikely to have anticompetitive effects, since the pools' value is based largely upon the essential patents, with the non-essential patents offered more or less for free. Id. at 1191.

In any event, Philips' patent pools did not comprise any non-essential patents, because the facts failed to show any commercially viable alternatives for the allegedly non-essential patents. Id. at 1194-96. Additionally, the Federal Circuit confirmed that whether a patent is essential or non-essential is determined at the time of licensing, not the time of litigation, and thus could shift with time. Id. at 1197. Applying the rule of reason standard, the Federal Circuit concluded that the Philips patent pool did not constitute patent misuse.

The *U.S. Philips* case thus clarified the proper standard of review for patent pools, generally rejecting a per se approach in favor of the rule of reason. The opinion suggests that patent pools are intrinsically pro-competitive and that challengers face a heavy burden in showing anticompetitive harm. The opinion also suggests that licensors can lessen the likelihood of a finding of anticompetitive harm by having an outside expert confirm at the outset that only essential patents have been included in the patent pool. See generally David W. Van Etten, "Note: Everyone in the Patent Pool: *U.S. Philips Corp. v. International Trade Commission*," 22 BERKELEY TECH. L.J. 241 (2007) (discussing *U.S. Philips*). This has also been a factor considered by the DOJ in several of its business review letters.

Legal Structures

As noted above, patent pools can be formed in several different ways. For example, the MPEG-2 patent pool was started when the firms that participated in the development of the MPEG-2 compression technology standard hired an independent patent expert to identify the patents that were essential for compliance with the video and systems parts of the MPEG-2 standard. Letter from Joel I. Klein, Acting Assistant Attorney Gen., U.S. Dept. of Justice to G[a]rrard R. Benney, Esq. (June 26, 1997) at 3-4, available at http://www.usdoj.gov/atr/public/busreview/215742.pdf (MPEG-2 Business Review Letter).

Nine companies that held 27 essential patents, along with one other company (Cable Television Laboratories Inc.), formed MPEG LA, which administers the patent pool. Id. at 1, 3, 4. MPEG LA retains an independent expert to review patents submitted to any of the licensors for inclusion in the pool and to review any patent in the pool that anyone believes in good faith is non-essential to practicing the MPEG-2 standard. Id. at 5. MPEG LA itself grants package licenses to patents in the pool, collects royalties, and distributes the royalties among the licensors on a per-patent basis. Id. at 3. The pool license agreement also contains a grantback provision requiring every licensee to grant the pool members and other licensees a non-exclusive worldwide license or sublicense on any essential patent that the licensee has the right to license or sublicense. Id. at 7.

A somewhat different structure was set up for the DVD 3C patent pool. This pool was created by three companies (Koninklijke Philips Electronics, N.V., Sony Corporation of Japan, and Pioneer Electronic Corporation of Japan) and comprised 210 patents. Letter from Joel I. Klein, Assistant Attorney Gen., U.S. Dept. of Justice to Garrard R. Benney, Esq. (Dec. 16, 1998) at 1-4, available at http://www.usdoj.gov/atr/public/busreview/2121.pdf (DVD 3C Business Review Letter). Rather than appointing an independent administrator, the pool chose one of the licensors (Philips) to act as the pool administrator and to grant licenses on the essential patents in the pool for use in conformity with certain standard specifications for the DVD-ROM and DVD-Video formats. Id. at 5.

The pool members grant non-exclusive licenses to the pool and remain free to license their patents independently of the pool. Id. at 5-6. To determine which patents are essential for making products that conform to the standard DVD-ROM and DVD-Video specifications, the pool members retained a patent expert to review the patents that the individual licensors designated as essential and to make an independent determination as to whether these patents are truly essential. Id. at 4. The allocation of royalties among the pool members is not a function of the number of patents contributed to the pool. Id. at 6. Rather, Sony and Pioneer entered into separate licenses with Philips, and these licenses fix the royalty share that Sony and Pioneer are to receive. Id.

In 1999, six other developers of DVD technology and formats formed a separate patent pool. This pool contains additional patents that are designated as essential for making products that conform to the standard DVD-ROM and DVD-Video specifications. Like the DVD 3C patent pool, the DVD 6C patent pool is administered by one of the members, Toshiba Corporation. Letter from Joel I. Klein, Assistant Attorney Gen., U.S. Dept. of Justice to Carey R. Ramos, Esq. (June 10, 1999) at 2, available at http://www.usdoj.gov/atr/public/busreview/2485.pdf (DVD 6C Business Review Letter). Toshiba aggregates the pool members' essential patents, licenses these patents to makers of DVDs, DVD players and DVD decoders, and distributes royalties to the pool members. Id. Also like the DVD 6C patent pool, the pool licenses are non-exclusive. Id. at 3. In fact, each pool member affirmatively agrees to "offer to license its essential DVD patents on a non-exclusive basis to interested third-party licensees pursuant to separate negotiations on fair, reasonable and non-discriminatory terms." Id.

To determine which patents are essential for making products that conform to the standard DVD-ROM and DVD-Video specifications, an expert individual or panel reviews the patents that each pool member designates as essential. Id. at 4. The individual or panel then determines whether the patent would be "necessarily infringed" in implementing the DVD standard specifications (or whether "there is no realistic alternative" to the patent). Id. at 3. The expert is required to complete a comprehensive review of all patents in the pool every four years. Id. at 4. Toshiba distributes royalties among the pool members pursuant to an agreed allocation formula that considers, among other things, how often a pool member's essential patents are infringed, the age of the patents, and in some circumstances whether the patents concern optional or mandatory features of the DVD-ROM or DVD-Video standards. Id. at 7.

As a comparison of the MPEG-2, DVD 3C, and DVD 6C patent pools makes clear, there are several ways to form a patent pool that are likely to combine complementary patent rights and are not likely to impede competition. Whether other structures are likely to pass antitrust scrutiny will of course depend on the facts of the case. Obtaining a business review letter from the Antitrust Division of the Department of Justice, however, might provide guidance on the likelihood of an antitrust enforcement action and provide peace of mind.