The Patentee's Dilemma -- Is Price Fixing Legal?

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The patent laws and the anti-trust laws were enacted in pursuance of Constitutional authority and professedly to advance the welfare of the nation. The area between the two is extremely narrow and the courts have been faced with the difficult problem of construing them together—giving full force and effect to each. The process has resulted in a series of inconsistent decisions1 which clearly reflect the lack of proper guideposts for a comprehensive approach to the problem. The fault cannot be attributed entirely to the courts, for the source of difficulty lies in the lack of sufficient legislative determination of the nature of the patent grant. It is, therefore, the purpose of this article to reveal the difficulties and inconsistencies existing in our patent laws today with the view to reflect the legislative shortcomings through an analysis of the cases involving patents and price fixing arrangements.

The Constitution2 empowers Congress "... To promote the Progress of Science and the useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." This provision was originally implemented in 1790 by statute which has been amended on numerous occasions to provide that every patent shall contain "... a grant to the patentee, his heirs and assigns for the term of seventeen years, of the exclusive right to make, use and vend the invention or discovery."3 It is not the right to make, use or vend a patented article which is derived from the patent law for that right existed prior to its passage. Rather, its purpose was designed to protect the patentee from the effects of disclosure existing at the common law4 by securing to him the exclusive right to make, use or vend the patented article and to prevent others from doing so without his consent.5 Thus, the narrow and limited monopoly conferred upon a patentee has been defined as consisting "... altogether in the right to exclude everyone from making, using, or vending the thing patented, without the permission of the patentee."6 The exclusive right is the equivalent of the right to restrain others from manufacturing and using the article which the patentee has invented.7

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1. See, TNEC Monograph 31 (1941); TNEC Monograph 38 (1941) 74-83.
2. U.S. Const. Art. 1, § 8, Cl. 8.
4. At common law the inventor had a valueless right since the exclusive right to the patent was destroyed by publication.
5. Bloomer v. McQuenan, 14 How. 539, 549 (1852).
6. Id. at 545.
With the passage of the Sherman Act in 1890, efforts were made to distinguish the patent monopoly from the monopoly condemned by the Act. This was believed necessary in order to give force and effect to the patent laws since the Sherman Act contained no mention of the patent grant and by its terms condemned *every* monopoly or attempt to monopolize. Thus it was declared that the patents "... are not in the usual sense, the subjects of monopoly," since "... a patent is that which brings out from the realm of the mind something which never existed before, and gives it to the country." But the monopoly of the anti-trust laws, so the argument went, is the restraint of trade or commerce in articles which had formerly been the subject of trade or commerce. The fallacy of this argument was soon recognized; however, it served and still serves to support the statement that the passage of the Sherman Act and the uncertainty of the nature of the patent grant made it inevitable that confusion develop. Through a series of decisions involving the patent—anti-trust relationship, the courts were forced to acknowledge that the patent is in a very substantial sense a monopoly excepted, however, from the operation of the anti-trust laws. Thus, it has been declared, "A peculiarity of the rights of the owner of a patent, as distinguished from other property, is this: Each has the right to sell that which is his, but the owner of the patent has the exclusive right to sell his patented article. This is, in a very substantial sense, a monopoly. It must be, however, that the monopoly here meant is not the monopoly condemned by the Act of 1890." Since the exclusive right of the patentee to the use and enjoyment of his invention is excepted from the operation of the anti-trust laws, various arrangements have been devised by patentees in order to secure the stability and security normally incident to *price fixing*. The legality of these price fixing schemes is dependent upon the extent of the patent monopoly, the uncertainty of which constitutes the basis for the confusion in our patent law cases today.

Despite the fact that the prime purpose of our patent law is to secure to the public the benefit of scientific achievement by guaranteeing to the patentee, as an inducement, the exclusive enjoyment of his invention for seventeen years, there has emerged the doctrine of "non use" of patents. "If the patent is valid the owner can, of course, prohibit entirely the manufacture, sale or use of..." the device made pursuant to the patent. In the first case in

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which the doctrine was announced, the Supreme Court rejected the argument based on the purpose of the patent grant and considered the patent as a property right which the owner could have kept entirely to himself. Since the suppression of patents and the promotion of science and the useful arts is a contradiction of terms, the doctrine of "non use" has permitted the self interest of patentees to come into the ascendancy and the much abused public interest becomes of secondary importance.

The right of the patentee to withhold the patented article completely gave rise to the concept that the patentee was justified in imposing conditions upon the use of the patented article. The fact that an article is patented was formerly regarded as having the effect to enable the patentee to impose, by notice accompanying the goods, a restriction as to the resale price which would accompany them into the hands of ultimate consumers. If a subsequent purchaser knowingly violated the restriction, he became liable as a contributory infringer. Thus, in Edison Phonograph Co. v. Kaufman, in upholding a resale price restriction imposed in a "jobber's agreement" on phonographs, the court declared, "I cannot doubt that the complainants have the right to sell their patented phonographs with the restrictions and upon the conditions contained in their "jobber's agreement," and that dealers buying the patented instruments from the jobbers with notice of those restrictions and conditions are bound thereby." Although the case was decided after the passage of the Sherman Act no mention of that act was made. The patentee, while acting within his domain, was regarded as czar. The people had the option of either taking the invention on the terms he dictated or leaving it alone for the seventeen year period of exclusion. Cries of restraint of trade and of impairment of the freedom of sales were regarded as unavailing, for the Constitution and statutes granting the patent right were interpreted as conveying a complete monopoly excepted from the operation of the anti-trust laws.

The theory of this holding was based strictly upon an economic approach with no attempt to regard the relationship of the patent monopoly to the monopoly and restraint of trade condemned by the anti-trust laws. The patent was regarded as a property right which belonged exclusively to the patentee, and since the true test of violation of the Sherman Act was whether the people were injured by being deprived of something to which they were

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17. Ibid.
how could the patentee's control of prices of articles to which the people had no right be said to cause injury? The fact that price restrictions imposed upon patented articles deprived the public of competition which the Sherman Act was designed to promote was of no avail for the courts concluded that the exclusive nature of the patent grant negatived any right in the public to free competition in articles covered by patents. This holding was the palliative for the practice of accumulating and suppressing patents. It subscribed to the inference that a practice proper in the case of one patent continued to be proper though applied to more than one. Thus, where a manufacturer of straw stackers acquired all patents on such articles and licensed all manufacturers of threshing machines to make, use or vend the patented articles on condition that the resale price was to be established by the licensor, the license agreements were held legal.

The first case to reach the Supreme Court in which the exercise of patent rights was challenged under the Sherman Act was Bement v. National Harrow Co. The owner of a patent licensed certain manufacturers to use the patent under specified restrictions including a stipulation that the licensees should sell the articles only at a fixed price. The defendant licensee violated the conditions and the plaintiff brought suit for patent infringement. In sustaining the action, the Court held that the Federal Anti-Trust Law did not refer to that kind of a restraint of interstate commerce which may arise from reasonable and legal conditions imposed upon the assignee or licensee of a patent by the owner restricting the terms upon which the article may be used and the price to be demanded. With reference to the price stipulation, the Court announced, "The provision in regard to the price at which the licensee would sell the article manufactured under the license was also an appropriate and reasonable condition. It tended to keep up the price of the implements manufactured and sold, but that was only recognizing the nature of the property dealt in, and providing for its value so far as possible. This the parties were legally entitled to do. The owner of a patent may assign it, or sell the right to manufacture and sell the article patented, upon the condition that the assignee shall charge a certain amount for such article." Although the Bement case constituted a precedent for departing from the holding that the anti-trust laws did not apply to rights granted under a valid patent, it created a great deal of doubt by adopting the uncertain and indefinite test of reasonableness. If the condition or restriction imposed by the

22. Ibid.
23. 186 U.S. 70 (1902).
24. Id. at 93.
patentee upon the assignee or licensee is reasonable, it does not come within
the condemnation of the anti-trust laws. Although the Bement case involved
the legality of a price restriction upon the intangible right to manufacture ac-
cording to a patented process, it was not long before it was cited as authority
for upholding restrictions upon the use of the patented article itself.

In Henry v. A. B. Dick Co. the plaintiff sold mimeograph machines,
upon which it had a valid patent, with the restriction that the machines be
used only with a certain kind of unpatented ink which the plaintiff manu-
factured. Such a restriction would be advantageous to the patentee since by
dictating the sole source of supply for unpatented materials used with the
patented machine, he could establish an exclusive market in articles not
protected by a legal monopoly. The defendant, with knowledge of this restric-
tion, sold to S a different kind of ink aware that it was to be used in the patented
mimeograph machine manufactured by the plaintiff. The lower court enjoined
the activities of the defendant, and on appeal it was assumed by the Supreme
Court that the Bement case sanctioned price restrictions attached to a patented
article. Mr. Justice Lurton, speaking for the Court, declared, “If the stipulation
in an agreement between patentees and dealers in patented articles, which
among other things, fixed a price below which the patented articles should not
be sold, would be a reasonable and valid condition, it must follow that any
other reasonable stipulation, not inherently violative of some substantive law,
imposed by a patentee as a part of a sale of a patented machine, would be
equally valid and enforceable.”

The uncertainty of the Bement case was not only evidenced by its
extension to justify price restrictions imposed on patented articles, but was also
apparent in cases involving the legality of price restrictions imposed on un-
patented articles manufactured under secret process. In John D. Park & Sons
v. Hartman an attempt was made to set up a distinction between articles
manufactured under a secret process and ordinary articles—the argument
being that the former are more nearly analogous to patented articles and come
within the then existing rule allowing price restrictions on patented articles.
This argument was not novel, for by this time it had contributed considerably
to the confusion resulting from the uncertainty of the Bement holding. In
Park & Sons Co. v. National Druggist’s Association the plaintiff referred
to the proprietary article in question as a patent medicine. The court assumed
that it was in fact patented and upheld a price maintenance scheme under what
it considered to be the Bement doctrine. Other courts, unaware of the error,
supposed from this case that there was a peculiar rule which was applicable to
articles manufactured under secret process. The confusion was recognized by

25. 224 U.S. 1 (1912).
26. Id. at 31.
27. 153 Fed. 24 (6th Cir. 1907).
28. 175 N.Y. 1, 67 N.E. 136 (1903).
Justice Lurton in *John D. Park & Sons Co. v. Hartman* and the distinction was definitely rejected by the Supreme Court in *Dr. Miles Medical Co. v. Park & Sons Co.* Thus, within a 10 year period after the *Bement* case was decided, price restrictions imposed on unpatented articles manufactured by a secret process and conditions as to the resale price of patented articles were upheld. The former was sanctioned as a result of an error and a maze of uncertainty regarding the extent of the *Bement* holding and the latter derived its legality through a misinterpretation of the *Bement* doctrine.

The general impression that the patent laws authorized price restrictions on the sale of patented articles was in effect overthrown in *Bauer v. O'Donnell*. In that case the Supreme Court held invalid and beyond the scope of the patent monopoly a restriction appearing on packages containing a patented article and providing: "Licensed by us for sale and use at a price not less than $1." The use of the word "license" was clearly an attempt to simulate the facts presented in the *Bement* case, for the patented articles were sold by the patentee and the notice appearing on the packages was an obvious attempt to regulate the resale price. In other words, an attempt to camouflage the real transaction was made. In denouncing the arrangement, the decision was limited to the holding that a patentee who sells his patented article exhausts his patent monopoly and any attempt to regulate the resale price is invalid. The case did not hold that the price restriction was contrary to the Sherman Act. In fact, the argument was still possible that the policy of the patent laws being in favor of monopoly would serve to take the patented articles out of the condemnation of the Anti-Trust Law. However, since the Court held that the sale of the patented article exhausts the patent monopoly, the query is raised—what about the *Dick* case? It is to be remembered the Supreme Court held in that case that a condition requiring the use of unpatented materials with a patented mimeograph machine is valid and enforceable even though it was to take effect after the sale of the patented machine to which it was attached. Is there any logical distinction? The Court thought so by declaring that the arrangement in the *Dick* case was legal since it was a limitation on the use of the patented article only, whereas the restriction imposed in the *Bauer* case presented an attempt to control the resale price of the patented article. This distinction was obviously falacious since the condition imposed on the mimeograph machines in the *Dick* case was to take effect after the sale of the machine by the patentee. If the patent monopoly is exhausted by the sale of the patented article to invalidate a condition as to resale price maintenance it must certainly

30. See note 27 supra.
31. 220 U.S. 373 (1911).
32. 229 U.S. 1 (1913).
have a similar effect upon any other condition to take effect subsequent to the sale. The practice of distinguishing facts which warrant the application of a similar legal principal was disapproved by the Supreme Court in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*\(^\text{33}\) and the *Dick* case was specifically overruled. The Court held that the owner of a patent may not restrict its use by a purchaser, by a notice attached to a machine embodying the patent, to specific materials necessary to its operation which were not a part of the patented machine. The plaintiff, owner of a patent on a mechanism used in motion picture exhibiting machines, granted to *X* the right to manufacture and sell machines embodying the invention on conditions that the minimum resale price was to be established by the plaintiff and that all machines sold should be used solely for exhibiting motion pictures owned and patented by the plaintiff. *X* further agreed to attach a notice to each machine stating the condition as to the use attached to the sale. *X* sold one of the machines to *Y* who in turn leased it to *Z*. After the patent on the film, the use of which constituted the condition, had expired *Z* commenced using film manufactured by the defendant. In an action for patent infringement, the plaintiff relied upon the *Dick* case which was squarely in point. In denying the relief sought, the Court declared, “It is obvious that the conclusions arrived at in this opinion are such that the decision in *Henry v. A. B. Dick Co.*... must be regarded as overruled.”\(^\text{34}\) The same result could have been accomplished under statutory authority, for with the *Dick* case freshly in mind, Congress enacted the Clayton Act,\(^\text{35}\) the pertinent section of which provides:

That it shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale... or fix a price charged therefore,... on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods,... of a competitor... where the effect may be to substantially lessen competition or tend to create a monopoly in any line of commerce.\(^\text{36}\)

The Court considered it unnecessary to decide the case under the Clayton Act but referred to it only as an expression of the public policy confirming the conclusion reached. The exclusive right granted by the patent was considered as limited to the invention and could not be extended to permit restrictions on its use to materials not a part of the patented article.

At this stage in the process of ascertaining the nature of the patent monopoly certain legal principles became crystallized. First, it became settled that a patentee cannot, by virtue of his statutory monopoly, impose conditions

\(^{33}\) 243 U.S. 502 (1917).
\(^{34}\) Id. at 518.
\(^{36}\) §§ 3.
as to the resale price so as to render one who fails to abide by them a contributory infringer of the patent. Second, although a patentee is authorized to withhold his patented machine from public use, if he sells it, the article passes beyond the limits of the statutory monopoly; and in considering the validity of a contractual restraint as to the resale price at which the article is to be sold, the case is to be considered under the general law and as if there were no patent. Third, the exclusive use secured by a patent means "... the use of the invention as it is described in the claims of patent, and not as it may be expanded by limitations as to materials and supplies necessary to the operation of it. ..." Fourth, there is a distinction between the sale of the patented articles themselves and an assignment of the right to produce and vend such articles. While the former is prohibited under the anti-trust laws, the owner of a patent is authorized, under the patent grant, to assign the right to manufacture and sell the patented article upon the condition that the assignee will sell the article at prices fixed by the patentee. What is the justification for this distinction? It is said to be warranted by the patent laws which merely secure to the inventor "the exclusive right" to his invention for a period of seventeen years. This right confers the power to exclude others and nothing more. There is no language in the patent laws which permits the patentee to fix the price at which the patented articles are to be sold by his assignees, nor is there any prohibition against the practice of a patentee of fixing the resale price at which the patented articles are to be resold. With respect to the anti-trust laws, no such distinction is sanctioned and every combination in restraint of trade is regarded as unlawful.

Suppose a patentee, who is engaged in interstate commerce, requires a licensee to join other licensees in a combination or pool to control prices and output of the patented article. Would such an arrangement constitute a violation of the anti-trust laws? That such a combination, in the absence of a patent, would have the effect of restraining commerce was early settled. "The aim and result of every price fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonable or not, involves power to control the market and fix arbitrary and unreasonable prices. ... Agreements which create such potential power may well be held to be in themselves unreasonable or unlawful restraints. ..." True, the Sherman


Act makes no mention of the patent laws, but it was passed subsequent to their enactment and embraces "every combination" within its terms. The wording of the patent and anti-trust laws, when considered together, would indicate such a combination was not clothed under the protection of the patent grant and was therefore illegal. Certainly, a combination to fix prices is much more than the exclusive right granted by the patent laws to make, use or vend the invention.

That identical case was presented in Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co.\textsuperscript{42} The plaintiff was the owner of a patent on rubber tires and licensed eighteen companies to make, use and sell the patented article for a period of one year. Under the terms of the license agreement, the licensees were required to sell the patented tires at prices established by the plaintiff and agreed to pay specified royalties for the right to make, use and vend the patented article. The defendant licensee refused to pay the specified royalties contending that the arrangement was in violation of the Sherman Act. In denouncing this contention, the court declared, "If the plaintiff were the sole maker of Grant tires, how could the plaintiff's control of prices and output injure the people, deprive them of something to which they have no right?"\textsuperscript{43} The true test of violation of the Sherman Act, reasoned the court, is whether the people are deprived of something to which they are entitled. That same test is also applicable with equal force to uphold control of the resale price of the patented article by the patentee and yet the courts refuse to apply it to such cases.

Since price fixing results in security and stability by constituting one of the most important inducements for the abandonment of competition, it was natural that the ingenuity of man would be utilized to conceive elaborate devices in order to extend the very narrow limits of the patent monopoly. This process was facilitated by the Supreme Court's adherence to the Bement doctrine and arrangements were fast to develop simulating the facts presented in the Bement case. In many instances important deviations were accomplished and the arrangements upheld—clearly reflecting the uncertainty of the Bement doctrine which constitutes the basis for the animadversion of our patent laws today.

In United States v. General Electric Co.\textsuperscript{44} an important extension of the Bement holding was made. The defendant was the owner of three patents covering the manufacture, use and sale of electric light bulbs with tungsten filaments. For the purpose of effectuating its plan of distribution, the defendant designated others as agents. The contracts of agency provided that the defendant was to maintain a stock of the patented lamps on consignment in the

\textsuperscript{42} 154 Fed. 358 (7th Cir. 1907), \textit{cert. granted} 207 U.S. 589 (1907) but dismissed in 210 U.S. 439 (1907).
\textsuperscript{43} \textit{Id.} at 363.
\textsuperscript{44} 272 U.S. 476 (1926).
custody of the agent, that the agent would keep records and accounts of all
transactions with the defendant, that the agent would sell the bulbs only at
prices established by the defendant and that title to the bulbs remained in the
defendant until sold by the agent. The number of agents established was large
and included small retailers as well as large wholesalers. The defendant also
licensed Westinghouse, a large company, to manufacture and sell the patented
bulb upon the condition that the selling price and terms of sale were to be
dictated by the defendant. The government contended that both arrangements
violated the Sherman Act—first, because the agency arrangement was a mere
camouflage since it was very large and included small retailers as well as large
wholesalers. Second, the license agreement with Westinghouse permitted that
company to follow the same conditions of sale as those observed by the de-
fendant. In answer to the first contention, the Supreme Court concluded that
a genuine agency relation was established. In reply to the second government
contention, the Court replied in effect, so what! “As long as he (patentee)
makes no effort to fasten upon ownership of the articles he sells control of the
prices at which his purchaser shall sell, it makes no difference how widespread
his monopoly. It is only when he adopts a combination with others by which
he steps out of the scope of his patent rights and seeks to control and restrain
those to whom he has sold his patented articles in their subsequent disposition
of what is theirs, that he comes within the operation of the Anti-Trust Act.”
Although the arrangement with Westinghouse constituted a combination
controlling 93% of the entire output of bulbs, the Court was careful to
distinguish it from the combination condemned in Standard Sanitary Mfg. Co.
v. United States. In that case a number of manufactures, one of whom was
the owner of a patent covering enamelware, entered into an agreement accord-
ing to the terms of which each agreed to accept a license to make the patented
articles and to sell them in interstate commerce only to jobbers who would
agree to sell at the prices fixed by the combination. In holding the combination
violative of the Sherman Act, the Court stated in effect that the agreements
transcended what was essential to the use of the patent and accomplished a
restraint of trade. The patent monopoly could not be utilized to sanction such
an arrangement since the sale of the patented article terminated the right of
the patentee to impose conditions. With respect to the nature of the Sherman
Act, it was stated, “the Sherman law is a limitation of rights, rights which may
be pushed to evil consequences and therefore restrained.” When applied to
the General Electric case, this statement immediately raises the query—isn’t
the right to license the manufacture and sale of a patented article “pushed to
evil consequences” when it results in a combination consisting of 93% of the

45. Id. at 485.
46. 226 U.S. 20 (1912).
47. Id. at 49.
entire output in the United States and the selling price is established by the patentee? Obviously the Court thought not and in holding the arrangement within the patent monopoly subscribed to the Bement doctrine for justification.

Although there was a contention in the Bement case that the contract involved was part of a combination, that fact was not established and the Court treated the case as one between the parties before it—the one granting and the other receiving the right to use a patent with the price maintenance condition. Thus the General Electric case became a new leader as a precedent to justify price fixing agreements entered into between licensor and licensee of a patent.

Suppose $X$, an owner of a valid patent, licenses others to manufacture and sell the patented article on condition that it be used for a specified purpose only and the licensee breaches the condition and sells the article to $Y$, a vendee who has knowledge of the facts. Would $Y$ be held liable as an infringer? According to the settled rule laid down by the Supreme Court in Motion Picture Patents v. Universal Film Co.\(^\text{48}\) when a patentee sells his patented product, it is no longer within the limits of the patent monopoly. Under this doctrine, the fact that both vendor and purchaser had knowledge that the article was purchased for use outside the field authorized by the patentee was regarded as immaterial.\(^\text{49}\) Would the result be changed because of the presence of an intervening licensee? The Supreme Court in General Talking Picture Corporation v. Western Electric Co.\(^\text{50}\) answered in the affirmative. In that case, the plaintiff was the owner of an invention embodied in an amplifier. It licensed the defendant to manufacture and sell the patented article only for use in radio amateur reception, radio experimental reception and in radio broadcast reception. The defendant, in breach of the license agreement, manufactured the amplifiers for use in theatres as a part of a talking picture equipment and sold them to $Y$ for that commercial use. In holding the defendant liable, the Court subscribed to the reasoning formerly expounded in the Bement case—a patentee may impose reasonable and legal conditions upon his licensee. In this respect, the only difference from the facts presented in the Bement case was that here the restriction was to the use rather than to the selling price. This difference was immaterial since it was settled earlier that "the statutory authority to grant the exclusive right to 'use' a patented machine . . . is precisely the same as the authority to grant the exclusive right to 'vend' . . ."\(^\text{51}\) In holding $Y$ liable as an infringer, the Court reasoned that since $Y$ knew of the condition and breach by the defendant, he was in no better position than if he had manufactured the patented amplifier itself without a license. What about the settled doctrine announced in the Motion Picture case that the sale of a

\(^{48}\) 243 U.S. 502 (1917).
\(^{50}\) 305 U.S. 124 (1938).
patented article removes it beyond the control of the patentee? Mr. Justice Black raised the same question in his dissenting opinion; however, it remains unanswered.

Since the General Electric case decided that a patentee has the right to impose price restriction on any and all of his licensees regardless of the size of the arrangement, does it follow that a patentee can bind himself to an agreement to impose identical restrictions on the licensee's competitors? The Supreme Court was faced with that precise problem in a case involving copyrights; however, the Court made as its basic premise the assumption that the rule regarding patent licenses and price fixing would apply with equal force to a license under a copyright. In Interstate Circuit, Inc. v. United States suit was brought by the United States to enjoin the defendants from continuing a conspiracy and from enforcing certain contracts as violative of the Sherman Act. The defendant, a large group of moving picture exhibitors, demanded that the moving picture distributors (owners of the copyrights on the moving pictures shown in the defendant's theatres) agree that in distributing moving pictures in other theatres, they would require that admission prices be at least 25 cents. The defendant, as a group, constituted one licensee of the distributor's copyrighted film and required the agreement as a condition of its continued exhibition of the distributor's first run films in its own theatres at a price of 40 cents or more. The lower court held as a matter of law that each separate agreement between the defendant and a distributor (copyright owner) requiring the distributor to impose the restrictions on all other theatres was a violation of the Sherman Act. The defendant appealed on the ground that the separate contracts entered into with the individual distributors were within the protection of the copyright monopoly and hence excepted from the condemnation of the Sherman Act. The Supreme Court, through Mr. Justice Stone, held that even conceding the right of each copyright holder to impose restrictions on its licensee, it had no right to contract with the defendant as to the imposition of those restrictions with the purpose and effect of restraining the defendant's competitors in the theatre business by forcing an increase in their admission price: "A contract between a copyright owner and one who has no copyright, restraining the competitive distribution of the copyrighted articles in the open market in order to protect the latter from competition, can no more be valid than a like agreement between two copyright owners or patentees." Thus we find the Court very much concerned over the purpose of the arrangement, for in legal effect how does it differ from the General Electric case? It is to be remembered in that case, the arrangement between the General Electric Company and Westinghouse constituted a virtual monopoly in the manufacture of electric light bulbs. Although the

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52. 306 U.S. 208 (1939).
53. Id. at 227.
arrangement was designed to protect the patentee (General Electric) in the development of its patent monopoly, the exclusive nature of it had the effect of restraining competition in the manufacture of electric light bulbs. Thus, although the result in both the General Electric and Interstate cases was the same—contrary to the avowed purpose of the Sherman Act—the difference in holding was attributed to the fact that the primary purpose in the Interstate case was to protect a licensee, while in the General Electric case, the purpose was to protect the licensor which brought it under the protection of the patent monopoly. "Price fixing is usually the essence of that which secures proper reward to the patentee; it is immaterial how widespread his monopoly may become, so long as he makes no effort to fasten upon ownership of the articles he sells control of the prices at which his purchaser shall sell." 54

Suppose X, Y and Z were owners of competing patents and with the view of entering into a settlement, Y and Z recognized the legality of X’s patent for the right to manufacture and sell the patented article. Would the arrangement be legal if X alone fixed the resale price of the patented article? The Supreme Court in United States v. Masonite Corporation 65 answered the question in the negative. The defendant was the manufacturer and distributor of hardboard upon which it had a patent. Y commenced manufacturing hardboard and the defendant brought suit for patent infringement. The circuit court upheld the validity of the defendant’s patent and concluded that Y was liable as an infringer. With a view to terminate further litigation, the defendant and Y entered into a settlement which resulted in the execution of an agreement establishing Y as the agent of the defendant. The terms of the agreement provided that the price and conditions of sale of the patented article were to be fixed by the defendant, that the agent held the hardboard on consignment with title in the defendant until sold, that the agent’s compensation was to be fixed by way of commission on each sale, that the agent would compensate the defendant by advancing one-half of the purchase price of the hardboard 20 days after the close of the month in which delivery was made and that the balance would be paid 20 days after the end of the month in which the product was sold. The agents further agreed to keep accounts and records of all transactions with the defendant and to recognize the validity of the defendant’s patent. Similar agreements were made with other manufacturers of building supplies—some of whom had competing patents. After each agreement was made, the defendant notified the other agents of its existence; however, each agent acted independently of the other in executing the agreement. There was no problem here of an attempt by an agent to impose as a condition of acceptance that the defendant patentee enter into a like arrangement with others. On the contrary, as recognized by the district court a successful attempt to duplicate

55. 316 U.S. 265 (1942).
the arrangement in the *General Electric* case was made to afford the patentee the right to establish the price at which the product was sold. In reversing that holding, the Supreme Court through Mr. Justice Douglas declared, "In this case some of the appellees had patents on hardboard, some did not. But each was tied to Masonite (patentee) by an agreement which expressly recognized the validity of Masonite's patents during the life of the agreement and which required the distribution of the patented product at fixed prices. In the *General Electric* case the Court thought that the purpose and effect of the marketing plan was to secure to the patentee only a reward for his invention. We cannot agree that that is true here. In this case the price regulation was based on mutual agreement among distributors of competing products, some of whom had competing patents. ... if it were sanctioned in this situation it would permit the patentee to add to his domain at public expense by obtaining command over a competitor. He would enhance the value of his own trade position by eliminating or impairing competition." 58 This holding reflects the reluctance of the Court to apply the doctrine announced in the *General Electric* case for fear of the adverse effect it would have upon the fundamental purpose of the anti-trust legislation. This fear became apparent through the use of such statements as—"The power of Masonite (patentee) to fix the price of the product which it manufactures, and which the entire group sells and with respect to which all have been and are now actual or potential competitors, is a powerful inducement to abandon competition." 57 It was regrettable that the Court did not take the opportunity to reconsider the *General Electric* doctrine particularly since it was announced to uphold an arrangement negativing competition between actual competitors—agents of the General Electric Co.—and between potential competitors—General Electric and Westinghouse. This effect must have been recognized by the Court in deciding the *Masonite* case for it emphasized two factors which were not present in the *General Electric* case to formulate the justification for the different result. First, the Masonite Corporation, patentee, notified all the agents of each agreement entered into. Second, some of Masonite's agents had similar patents on hardboard and their validity was not determined. With respect to the first factor, it gave the arrangement the air of a combination and conspiracy to fix prices; however, the district court found that Masonite alone fixed the prices and that the agents had no intention of joining a combination or to fix prices. The Supreme Court disregarded these findings declaring, "And as respects statements of various appellees that they did not intend to join a combination or to fix prices, we need only say that they must be held to have intended the necessary and direct consequences of their acts. ... Nor can the fact that Masonite alone

56. *Id.* at 280.
57. 316 U.S. 265, 281 (1942).
fixed the prices and that the other appellees never consulted with Masonite concerning them make the combination any the less illegal." 58

It is difficult to ascertain a valid distinction, for the purpose of upholding or condemning a combination, between the case where the vending licensees of a patented article are notified by the patentee of the existence of other licensees, who have nothing whatsoever to do with them, and the case where the patentee does not divulge such information. It does make it appear as though a combination or conspiracy was in existence; however, when the facts establish to the contrary, the difference in legal effect disappears. With respect to the second factor distinguishing the Masonite case from the General Electric case the district court found that the patent owned by Masonite was fundamental and basic and that the licensees exercised an honest intent to recognize the rights belonging to Masonite. The Supreme Court has never held that a patent infringer was regarded as a bona fide competitor for to do so would deny the patentee of the patent grant—the exclusive right to make, use or vend the invention. Yet, the Court, without going into the question of the legality of the patents owned by the licensees, held them to be competing with the one owned by Masonite and to be evidence of a conspiracy to fix prices.

The process of distinguishing the General Electric case from facts warranting the application of the same principle has reflected the concern of the Supreme Court over the vast economic control which that principle makes possible. The Masonite case is an example, however; if the General Electric doctrine carries with it the conviction that it constitutes a valid interpretation of the extent of the patent monopoly, why hesitate to apply it? If changes in economic circumstances render it incompatible to the anti-trust laws and an impediment to their effective enforcement, why not expressly overrule it? The result of permitting it to stand on the books as a precedent when it has in fact been overruled has created a great deal of uncertainty which is hampering the government in launching a successful anti-trust policy and the patentee who seeks to establish an arrangement protected by the patent monopoly.

If there was any doubt after the Masonite case as to whether the General Electric doctrine was in fact overruled, it was dispelled in United States v. Line Material Co. 59 The defendant, Southern, was the owner of a patent on a fuse cutoff which was not commercially acceptable. The defendant, Line, obtained a patent on an improved type of fuse cutoff which was dominated by the patent owned by Southern. Thus, in order to produce a commercially accepted device, it was necessary that an agreement be entered into between Southern and Line. Such an agreement was arrived at and according to the terms of which Line granted to Southern the right to manufacture and vend under Line's improved patent and in turn Line obtained the right to make

58. 316 U.S. 265, 275 (1942).
and vend under Southern’s dominant patent plus the exclusive right to grant sublicenses thereunder. This cross license agreement permitted Line to grant licenses for the manufacture and sale of the improved device under both patents and to impose conditions as to the maintenance of a fixed selling price. Six others were sublicensed by Line and agreed to maintain the prices fixed by Line. The arrangement involved 40% of all competitive cutoffs and was entered into in good faith. In an action brought by the government to enjoin the defendants from carrying out the conditions as to price maintenance as violative of the Sherman Act, the trial court held the rule in the General Electric case to be controlling and the injunction was denied. In reversing the trial court’s holding, the Supreme Court split three ways with three different opinions being rendered. To grant the injunction, the majority of the Court had the alternative of either expressly overruling the General Electric case or of distinguishing it once again. As the holding in the Masonite case would indicate, the Court with greater reluctance selected the latter course. The theory of the Court’s holding being that in the General Electric case the licensor issued a price fixing license based solely on his own patents which right was included in the patent monopoly. On the other hand, in the Line Material case the price fixing licenses were based not only on the licensor’s own patent, but also on the dominant patent owned by Southern with the alleged result that “The merging of the benefits of price fixing under the patents restrains trade in violation of the Sherman Act in the same way as would the fixing of prices between producers of non-patentable goods.” 60 The General Electric case was ostensibly reaffirmed by use of dictum to the effect that a price fixing agreement between patentee and licensee is a reasonable restraint which accords with the patent monopoly. Such an arrangement is held distinguishable from an agreement between cross licensing patentees to fix prices which is beyond the scope of the patent monopoly and illegal under the Sherman Act. “... When patentees join in an agreement as here to maintain prices on their several products, that agreement, however advantageous it may be to stimulate that broader use of patents, is unlawful per se under the Sherman Act. It is more than an exploitation of patents. There is the vice that patentees have combined to fix prices on patented products. It is not the cross licensing to promote efficient production which is unlawful. There is nothing unlawful in the requirement that a licensee should pay a royalty to compensate the patentee for the invention and the use of the patent. The unlawful element is the use of the control that cross licensing gives to fix prices.” 61

It is settled that an agreement between patentees to fix prices of competing non-infringing patented products is unlawful, for in such a case the subject of the attempted control is in excess of or different from the patent grant of a

60. Id. at 311.
single patentee and falls within the condemnation of the Sherman Act. Similarly, it is settled law that a patentee who has a valid patent on a combination of unpatented articles cannot use the patent to control the sale of the unpatented component parts. However, neither of the above settled principles have application in the instant case. Whether the arrangement in the Line case is upheld or denounced is dependent entirely upon the attitude of the Supreme Court toward the General Electric case, for according to the principle there laid down, the price fixing condition imposed in the Line case was precisely coextensive with the statutory monopoly conferred by the patent grant to Line. The license entered into between Line and Southern did not impose any price fixing condition or royalty. The only effect of the license was an agreement that Southern would not impede the right of Line to manufacture and sell the patented article under its own patent where the exercise of that right would infringe the exclusiveness of Southern's patent right. In short, it constituted nothing more than a covenant not to sue. The price fixing provision was attached solely to Line's patent and contrary to the basis for the Court's holding, two patents were not combined for the purpose of fixing prices. The right of Line to fix prices under its own patent was neither enlarged nor diminished by the license agreement with Southern. Thus the legality of the arrangement became dependent upon the conduct of Line to its licensees which was identical to that between General Electric and Westinghouse in the General Electric case.

Although the General Electric and Line Material cases justified the application of similar principles of law, the ability of the Court to distinguish them was made possible by the "rule of reason" which has been held applicable to price fixing under a valid patent. However, even under this standard of conduct it is certainly illogical to distinguish the cases solely because a patentee's covenant not to sue was superimposed on a price fixing agreement which was protected under the patent monopoly. In effect the majority of the Court overruled the General Electric case but couldn't agree to say so. If there is any validity attached to the General Electric case today, the servient patent owner will be permitted to issue licenses on his own patent and to regulate the selling price of the patented article and the licensees will be permitted to secure licenses from the dominant patent holder subject to price restrictions. In legal effect, what is the difference between that type of an arrangement and the one presented in the Line Material case? The same result is accomplished which would not be countenanced by the Court, for in denouncing the arrangement in the Line Material case, the Court reflected great concern over the effect of the arrangement upon our economy. "Where two or more patentees with competitive, non-infringing patents combine them and fix prices on all devices produced under any of the patents, competition is impeded to a greater degree than where a single patentee fixes prices for his licensees. The struggle for profit is less acute. Even when, as here, the devices are not commercially com-
petitive because the subservient patent cannot be practiced without consent of the dominant, the statement holds good. The stimulus to seek competitive inventions is reduced by the mutually advantageous price fixing arrangement."

This statement serves the commendable purpose of revealing the Court's acceptance of economic reality in the laws relating to patents; however, of what avail is it if adherence to the General Electric doctrine permits the very evils advised against?

In United States v. United States Gypsum Company the Supreme Court refused to extend the General Electric rule solely for the reason that the effect would constitute a nation-wide price fixing scheme. The United States Gypsum Co., owner of patents on gypsum products, granted licenses to others in the industry to manufacture and vend the patented articles and by so doing, has had control of the entire output of gypsum board and 80% of the plaster and miscellaneous gypsum products manufactured and sold in the area east of the Rocky Mountains. All the licenses contained a provision granting the licensor the right to fix minimum prices at which the gypsum board embodying the patent was to be sold. The licensor and licensees not only agreed to maintain uniform prices, but took steps to organize the entire industry, i.e. elimination of a class of distributors, suppression of production of competitive unpatented products, stabilization of prices on unpatented products and several others. The district court found that the license agreements entered into by Gypsum were similar to those involved in the General Electric case and upheld the arrangement. The Supreme Court took the step which could have been anticipated from the Masonite holding and reversed the lower court's decision however, on different grounds. In the Masonite case the Court held that the patent monopoly became exhausted by transfer of the articles to the agents. In other words, the transaction was really a sale which placed the patented article beyond the control of the patentee to impose conditions. In the Gypsum case the Court followed a different line of reasoning and held that the patent was enlarged and violated the Sherman Act because the effect of the arrangement was to secure to the patentee rewards coming from industry wide price maintenance rather than rewards which flow from the right of exclusion granted by the patent laws. The Court relied heavily upon the Masonite case and stated some of the dangers inherent in industry wide price maintenance schemes, i.e. powerful inducement for the abandonment of competition, cessation of litigation concerning the validity of patents, etc. In short the Court was determined to denounce the arrangement because of its widespread effect. Since that consideration appears to be paramount with the Court today, how can an arrangement like the one presented in the General Electric case involving 93% of all the electric light bulbs manu-

62. Id. at 310.
63. 333 U.S. 364 (1948).
factured in the United States be approved? It is to be remembered in that case the Court stated, “As long as he (patentee) makes no effort to fasten upon ownership of the articles he sells control of the prices at which his purchaser shall sell, it makes no difference how widespread his monopoly.”\(^{64}\) (Italics added). The rejection of this reasoning, as evidenced in the Gypsum case, indicates further that the General Electric case remains a precedent in name only and the process of distinguishing it from other similar factual situations will continue until the majority of the Court can agree to bury it.

The right of a patentee to impose price restrictions in license agreements has been subject to animadversion from an early date. As early as 1912, a bill\(^ {65}\) was introduced in Congress forbidding the patentee from controlling the price at which his patented article is to be sold by others. Many other bills\(^ {66}\) have been subsequently submitted however, none enacted.

In 1933, when the nation was in the midst of a depression, a clamor for a more effective anti-trust program was met by the appointment of the Temporary National Economic Committee. This body investigated our economic structure and with respect to patents recommended in its final report\(^ {67}\) that a patentee be deprived of the right to fix prices of the patented articles sold by his licensees. As yet Congress has not acted on the recommendation. It is unlikely that congressional inactivity on the subject will be interpreted as approval of the present treatment given by the courts, since such acquiescence would also constitute approval of the confusion resulting from uncertainty. The uncertainty will be removed and consistency restored only after the long overdue legislative action is taken to define the patent-anti-trust relationship with a reasonable degree of definitiveness.

\(^{64}\) 272 U.S. 476, 485 (1926).