

The Patent Refuge of Monopolists

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\$50,000, brings a derivative action he may be required to give security to the corporation and other defendants. In two recent cases³⁷ the federal court held that the statute in no way affected substantive rights and the federal court was not bound to apply the state law. Had the same actions been brought in the New York courts, they could not have been maintained without giving such security. It would seem that *Angel v. Bullington* would require the federal court to give effect to this statute requiring security, when the action is being tried in a federal court on the basis of diversity grounds alone.

It should be noted that where resort is had to a federal court, not on grounds of diversity of citizenship, but because a federal right is claimed, the limitation upon the courts of a state do not control a federal court sitting in that state.³⁸

It is evident that the holding in the *Angel v. Bullington* case is within the spirit of the *Erie* case. The federal court is not administering another body of law, it merely gives out-of-state litigants a court free from local bias. Although it may at times be difficult to designate a particular law as substantive or adjective, it is evident that where a state closes its doors to a particular type of action, the law is substantive in nature and is expressive of the state's public policy. Since the *Erie* case, Congress has permitted the holding, without statutory change, and none is needed. A federal court in diversity cases is only another court of the state, and the result of a case tried before its tribunal should be substantially the same as that of a state court.

The plaintiff is *not entitled to a greater right* in federal courts, on the basis of diversity of citizenship, than he would receive in the state court.

GEORGE H. HEMPSTEAD, JR.

THE PATENT REFUGE OF MONOPOLISTS

There has long been uncertainty as to the extent to which patent holders might extend their patent monopoly without infringing the purposes of the antitrust laws. In *United States v. Line Material Co.*,¹ a case involving an industry-wide patent license price-fixing scheme, Judge Duffy likened this clash to "what would happen if an

³⁷ *Boyd v. Bell*, 64 F. Supp. 22 (S. D. N. Y. 1945); *Craftsman Finance & Mortgage Co. v. Brown*, 64 F. Supp. 168 (S. D. N. Y. 1945).

³⁸ *Holmberg v. Armbecht*, 327 U. S. 392, 90 L. ed. 743 (1946).

¹ 64 F. Supp. 970 (E. D. Wis. 1946).

irresistible force came into collision with an unbreakable and immovable object.”² He decided that the immovable object, *i.e.*, the patent laws, should prevail and his decision was followed in *United States v. United States Gypsum Co.*³ As unsound in law, and inviting disastrous consequences to the free and competitive economy that has been in large measure responsible for America’s growth to its present position of world leadership, both cases have been appealed. The Supreme Court will now be given the opportunity to serve notice on all foes of a stable, expanding economy that an abuse of the patent privilege, in order to provide a refuge for monopolists, will not be tolerated.

I

Development of Patent Legislation

Federal legislation with regard to the patent law is derived from the Constitution, which provides that Congress shall have power:⁴

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . .

The actual conditions and terms upon which patents may be granted to foster the purpose set forth in the Constitution are left to the discretion of Congress, which may at any time alter these terms and conditions. It is unquestionable, then, that the patent monopoly is a state granted monopoly and is subject to the will of the people, as conditioned by the constitutional provision.

In pursuance of the powers thus granted, Congress has passed several statutes. The first legislation by Congress under this grant was in 1790 when Congress provided that a patentee was granted “the sole and exclusive right and liberty of making, constructing, using and vending to others to be used, the said invention or discovery.”⁵ This definition, with certain slight changes continued until the Act of July 8, 1870,⁶ provided that the patentee be given the exclusive right “to make, use, and vend the invention or discovery throughout the United States and the Territories thereof, . . .”

The constitutionality of this statutory provision is unquestioned, and the courts have emphasized its position by construing it to be directed primarily toward the promotion of science and the useful arts, and toward the benefit of the community at large. The reasonable reward held out to the patentee is said to be of secondary importance, and is a benefit conferred by the people in recognition of

² *Id.* at 972.

³ 67 F. Supp. 397 (D. C. 1946).

⁴ U. S. CONST. Art. I, § 8, Clause 8.

⁵ 1 STAT. 109 (1790), as amended, 35 U. S. C. § 40 (1940).

⁶ REV. STAT. § 4884 (1870), 35 U. S. C. § 40 (1940).

the public benefit conferred upon them by the inventors. The purpose of the monopoly grant is to stimulate genius in the interest of science.⁷ It would, therefore, seem that if an extension of the monopoly grant became violative of the above constitutional purpose, such extension would not be upheld.

II

Delimiting the Patent Monopoly

The controversy over just what limitations on the patent monopoly granted by Congress had been introduced with the passage of the Sherman Act⁸ has been renewed with nearly every new anti-trust case involving patents. Fully respectable authorities have been cited on either side of the question, but despite such early cases as *Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co.*,⁹ where the court took the position that the Sherman Law was inapplicable to patents, because there was no reference in the Antitrust Act to the patent law, and the *A. B. Dick* case,¹⁰ where it was held that the owner of a patented device could control the sale of unpatented articles, the courts have gradually cut down on the formerly unlimited patent refuge of monopolists and would-be monopolists.

It is now well established that the fact that the patent owner may keep the use of his patent to himself does not authorize him, should he choose to license the manufacture or sale of the patented product, to impose conditions or restrictions indiscriminately. For example, in *National Harrow Co. v. Hench*,¹¹ the court, holding that an arrangement among the manufacturers of 70% of all harrows to maintain prices as part of a patent pool was illegal, said: Patents confer monopoly as respects the property covered by them, but they confer no right upon the owners of several distinct patents to combine for the purpose of restraining competition and trade. Patented property does not differ in this respect from any other. . . . Patentees may compose their differences, as the owners of other property may, but they cannot make the occasion an excuse or cloak for the creation of monopolies to the public disadvantage.

In November 1912, eight months after the decision in the *A. B.*

⁷ See *Kendall v. Winsor*, 21 How. 322, 328, 16 L. ed. 165, 168 (U. S. 1859); *Grant v. Raymond*, 6 Pet. 218, 241, 8 L. ed. 376, 384 (U. S. 1832); *Pennock v. Dialogue*, 2 Pet. 1, 18, 7 L. ed. 327, 333 (U. S. 1829).

⁸ "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. . . ." 26 STAT. 209 (1891), 15 U. S. C. § 1 (1940).

⁹ 154 Fed. 358 (C. C. A. 7th 1907).

¹⁰ *Henry v. Dick Co.*, 224 U. S. 1, 56 L. ed. 645 (1912).

¹¹ 83 Fed. 36, 38 (C. C. A. 3d 1897).

Dick case, the Supreme Court, in an equity suit by the Government¹² against 85% of the enamel-ware manufacturers in the United States, held that a price-fixing arrangement among the manufacturers based upon a patent relating to a process for enameling was illegal within the prohibitions of the antitrust law and without the protection of the patent law. Mr. Justice McKenna said:¹³

The agreements clearly, therefore, transcended what was necessary to protect the use of the patent or the monopoly which the law conferred upon it. They passed to the purpose and accomplished a restraint of trade condemned by the Sherman law. . . . Rights conferred by patents are indeed very definite and extensive, but they do not give any more than other rights, a universal license against positive prohibitions. The Sherman law is a limitation of rights—rights which may be pushed to evil consequences, and therefore restrained.

In *Motion Picture Co. v. Universal Film Co.*,¹⁴ specifically overruling the *A. B. Dick* case, the Supreme Court applied the test of whether the power sought to be exercised by the patent owner was reasonably to be found within the monopoly which Congress intended to confer under the patent laws. The Court said:¹⁵

Whatever right the owner may have to control by restriction the materials to be used in operating the machine must be derived through the general law from the ownership of the property in the machine and it cannot be derived from or protected by the patent law, which allows a grant only of the right to an exclusive use of the new and useful discovery which has been made—this and nothing more. . . .

[The opposite view, as reflected in the *Button Fastener* case¹⁶] proceeds upon the argument that, since the patentee may withhold his patent altogether from public use he must logically and necessarily be permitted to impose any conditions which he chooses upon any use which he may allow of it. The defect in this thinking springs from the substituting of inference and argument for the language of the statute and from failure to distinguish between the rights which are given to the inventor by the patent law and which he may assert against all the world through an infringement proceeding and rights which he may create for himself by private contract which, however, are subject to the rules of general as distinguished from those of the patent law. . . .

The Court also said in the *Motion Picture Co.* case:¹⁷

In interpreting this language of the statute it will be of service to keep in mind three rules long established by this court, applicable to the patent law and to the construction of patents, *viz.*:

1st. The scope of every patent is limited to the invention described in the claims contained in it, read in the light of the specification . . .

2nd. It has long been settled that the patentee receives nothing from the law which he did not have before, . . .

¹² *Standard Sanitary Mfg. Co. v. United States*, 226 U. S. 20, 57 L. ed. 107 (1912).

¹³ *Id.* at 48, 49, 57 L. ed. at 117.

¹⁴ 243 U. S. 502, 61 L. ed. 871 (1917).

¹⁵ *Id.* at 513, 61 L. ed. at 877.

¹⁶ *Heaton-Peninsular Button-Fastener Co. v. Eureka Specialty Co.*, 77 Fed. 288 (C. C. A. 6th 1896).

¹⁷ 243 U. S. 502 at 510-511, 513, 516, 61 L. ed. at 876, 877, 879 (1917).

3rd. Since *Pemock v. Dialogue*,¹⁸ . . . was decided in 1829 this court has consistently held that the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is "to promote the progress of science and useful arts . . ."

In the *Oil Cracking* case,¹⁹ Mr. Justice Brandeis pointed out that, if there were domination or restraints, the fact that the agreements were made pursuant to patents would not justify the monopoly or the restraints, saying:

If combining patent owners effectively dominate an industry, the power to fix and maintain royalties is tantamount to the power to fix prices . . . Where domination exists, a pooling of competing process patents, . . . is beyond the privileges conferred by the patents and constitutes a violation of the Sherman Act.²⁰

In 1926, however, in *United States v. General Electric Co.*²¹ the Supreme Court, in an often criticized opinion,²² held that a license agreement by the General Electric Company to Westinghouse requiring the fixing of prices by consignment contracts with their distributors was a reasonable restriction within the power of the patentee.

It is important to note that in the aforementioned case General Electric Company had developed and controlled the basic incandescent lamp patents, and also that the court was ruling on a situation where a licensor was licensing a single licensee and asserting a limited control over the latter's selling conditions.

In the *General Electric* case, the court relied heavily on *Bement v. National Harrow Company*²³ where the holding was confined to the legality of the particular contract between the parties. The decision more than likely would have been otherwise had the situation of other manufacturers, the extent of domination of the industry and the purpose of the licensor been considered. In *United States v. Standard Sanitary Mfg. Co.*,²⁴ the *Bement* case was distinguished from it on the foregoing grounds. The *Standard Sanitary* case is, at least in spirit, definitely in conflict with the *General Electric* case. The *Bement* case was held inapplicable in *Blount Mfg. Co. v. Yale & Towne Mfg. Co.*,²⁵ thus holding contracts relating to the control of the production of door checks by patent license agreements was an abuse of the patent privilege and violative of the Sherman Act.

¹⁸ 2 Pet. 1, 7 L. ed. 327 (1829).

¹⁹ *Standard Oil Co. v. United States*, 283 U. S. 163, 75 L. ed. 926 (1931).

²⁰ *Id.* at 174, 75 L. ed. at 948.

²¹ 272 U. S. 476, 71 L. ed. 362 (1926).

²² See Steffen, *Invalid Patents and Price Control*, 56 YALE L. J. 1, 2-6 (1946); Hagighurst, *The Legal Status of Industrial Control by Patents*, 35 ILL. L. REV. 495, 517-518 (1941); Chafee, *Equitable Servitudes on Chattels*, 41 HARV. L. REV. 945, 993 (1928).

²³ 186 U. S. 70, 94, 46 L. ed. 1058, 1070 (1902).

²⁴ 226 U. S. 20, 57 L. ed. 107 (1912).

²⁵ 166 Fed. 555, 559 (D. Mass. 1909); see also *National Harrow Co. v. Hench*, 76 Fed. 667 (E. D. Pa. 1896), *aff'd*, 83 Fed. 36 (C. C. A. 3d 1897).

III

Applicability of the General Electric Doctrine

The decision in the *General Electric* case has since been relied on extensively by groups desiring to assure themselves of greater profits through the elimination of competition within their industries. This type of conduct was the basis of the Government's complaint in two recent cases. In *United States v. Line Material Co.*²⁶ the court extended the *General Electric* case to sanction industry-wide price-fixing. In *United States v. United States Gypsum Company*,²⁷ the Court held that the *General Electric* case was applicable to a situation where a group controlled the manufacture and distribution of all of the gypsum board and 80% of the plaster and miscellaneous gypsum products manufactured and sold in the area East of the Rocky Mountains under a license by United States Gypsum Co. to use certain of its patents. Thus they organized a combination whereby prices were fixed and uniform production and distribution methods were adopted. It went on to state that the license agreements in this case "were patterned upon the *General Electric* decision and the license agreements which in that case were sanctioned by the Supreme Court."²⁸

Not only can it be said that the *General Electric* doctrine is inapplicable to industry-wide situations such as appear in the *Line Materials* and *Gypsum* cases, but one would be well justified in questioning the *General Electric* holding itself as being contrary to the principles of patent law repeatedly approved and applied by the courts.

Taking the latter point first, it would be well to keep in mind the purpose of the patent grants as interpreted by the courts. Since *Pennock v. Dialogue* and *Kendall v. Winsor*, it has been held that the patent monopoly was primarily granted, not for the creation of private fortunes, but for the promotion of scientific progress and the best interests of the public. This view has been followed consistently by the courts and was affirmed in *United States v. Masonite Corp.*,²⁹ where the court went further to say that since the monopoly

²⁶ 64 F. Supp. 970 (E. D. Wis. 1946).

²⁷ 67 F. Supp. 397 (D. C. 1946).

²⁸ *Id.* at 437.

²⁹ 316 U. S. 265, 280, 86 L. ed. 1461, 1477 (1942). See other leading cases, indicating the extent to which the doctrine in the *General Electric* case has been limited or distinguished either expressly or impliedly: *MacGregor v. Westinghouse Electric & Manufacturing Co.*, 329 U. S. 402, 91 L. ed. 319 (1947); *Hartford-Empire Co. v. United States*, 323 U. S. 386, 406, 89 L. ed. 322 (1944); *Sola Electric Co. v. Jefferson Electric Co.*, 317 U. S. 173, 87 L. ed. 165 (1942); *United States v. Univis Lens Co.*, 316 U. S. 241, 249, 86 L. ed. 1408 (1941); *B. B. Chemical Co. v. Ellis*, 314 U. S. 495, 86 L. ed. 367 (1941); *Morton Salt Co. v. Suppiger Co.*, 314 U. S. 488, 86 L. ed. 363

rights conferred by patents constitute a grant of a special privilege in derogation of the policy of equal opportunity and freedom of trade embodied both in the common law and federal statutory law, the rights given by the patent law are to be strictly confined to those expressly granted. Nowhere in the patent statutes can there be found anything remotely suggesting the power to fix prices in license agreements.

The Court in the *General Electric* case used as its test of legality of price-fixing agreements in a patent license whether it was "normally and reasonably adapted" as a means of securing to the patentee pecuniary reward for his monopoly, and to encourage the licensing of other manufacturers. As pointed out by Professor Steffen,³⁰ ". . . the last two decades have demonstrated fairly well that the court by so holding not only eliminated all real competition between licensor and licensee, contrary to the broad purposes of Congress as declared in the Sherman Act, but destroyed the chief incentive to the development of new and better products, contrary to the constitutional warrant for the patent system itself By bringing both licensee and licensor—in fact, whole industries—within the shelter of the monopoly price, at only a modest royalty, the competitive necessity either (a) to contest the patentee's patents or (b) to develop a new and better product, is almost wholly removed. So far from promoting 'the progress of science and useful arts', therefore, the decision has operated as a deterrent."

In the *General Electric* case the Court was swayed by the argument that where both licensor and licensee are making and selling the patented product, a provision in the licensing agreement that his licensee not sell at a lower price would be normally and reasonably adapted to secure to the patentee the reward granted him in the patent statute, and would tend to promote the progress of science in that he would not hold back his license for fear of ruinous competition by his licensees. Can the Court have failed to realize that the right to exact such royalty payments as the patentee chose would not only secure to him the reasonable reward to which he is entitled, but would also serve to protect him from competition by his licensees inasmuch as the royalty fixed by him would add as much as he desired to their production costs?³¹ To allow the patentee a greater reward by giving him the right to fix the prices of his li-

(1941); *Watson v. Buck*, 313 U. S. 387, 85 L. ed. 1416 (1941); *Marsh v. Buck*, 313 U. S. 406, 85 L. ed. 1426 (1941); *Ethyl Gasoline Corp. v. United States*, 309 U. S. 436, 84 L. ed. 852 (1940); *Gibbs v. Buck*, 307 U. S. 66, 83 L. ed. 1111 (1939). See also Marcus, *Patents, Antitrust Law and Antitrust Judgments Through Hartford-Empire*, 34 GEO. L. J. 1 (1945); Bennett, *Some Reflections on the Interpretation of the Sherman Act Since the Emergency*, in a forthcoming issue of THE FEDERAL BAR JOURNAL (1947).

³⁰ Steffen, *Invalid Patents and Price Control*, 56 YALE L. J. 1, 6 (1946).

³¹ But see Mr. Justice Frankfurter dissenting in *Edward Katzinger Co. v. Chicago Metallic Mfg. Co.*, — U. S. —, —, 91 L. ed. 319, 329 (1947).

censees would go beyond the scope of the patent grant and should subject him to all the interdictions against restraints of trade and the suppression of competition known to the general law.

Taking up the consideration of the applicability of the *General Electric* doctrine to industry-wide price-fixing based on licensing of erstwhile competitors, it is difficult to see how the courts in *United States v. Line Material Company* and in *United States v. United States Gypsum Co.* would consent to such an extension of the patent monopoly. The court in the *General Electric* case merely held that it is within the scope of his patent grant for a patentee to enter into a single and isolated license agreement which requires the licensee not to sell below the licensor's own selling price. By what reasoning can this be stretched to the point where an industry-wide combination of manufacturers is to be allowed to restrain trade through joining in a licensing agreement equipped with price-fixing provisions under a patent held by one? ". . . if an entire industry made up of erstwhile competitors were to be signed up under a patent, . . . price fixing, in such a case . . . would not only give the licensor a pecuniary reward for his invention, but would give the whole combination a much larger and surer profit by the elimination of competition between themselves."³²

In *United States v. Masonite Corp.*,³³ it was held that when a patentee unites and uses the marketing systems of competitors by means of *del credere* agency agreements, for the purpose of fixing the prices at which the competitors may market the product, this is an enlargement of the patent privilege and a violation of the Sherman Act because its effect is to secure to the patentee rewards flowing from industry-wide protection against price competition rather than, or in addition to, such reward as the patentee might secure from exercise of the right of exclusion conferred by patent law. It would seem that no real distinction can be drawn where the patent holder goes further and licenses his competitors to *make*, as well as to sell, the patented article. In the one case, as in the other, the ensuing industry-wide price-fixing should constitute a violation of the Sherman Act.

Conclusion

The disclosures in the many suits brought by the Antitrust Division of the Department of Justice have affirmed the truth of the

³² See Steffen, *Invalid Patents and Price Control*, 56 YALE L. J. 1, 5 (1946), citing Mr. Justice Douglas, speaking of a similar situation in *United States v. Masonite Corp.*, 316 U. S. 265, 278, 279, 86 L. ed. 1461, 1475 (1942), "That would allow the patent owner, under guise of his patent monopoly, not merely to secure a reward for his invention but to secure protection from competition which the patent law, unaided by restrictive agreements, does not afford."

³³ 316 U. S. 265, 86 L. ed. 1461 (1942).

view long held in some quarters that businessmen often would rather combine to attain risk-free profits than to chance the uncertainties of competition.³⁴ It would be far too simple for would-be monopolists and price fixers to utilize the *General Electric* doctrine as a "dodge" to enable them to do through the abuse of patent rights what the Antitrust laws prohibit directly.³⁵ Price-fixing in a license agreement is not necessary in order to insure a normal and reasonable "pecuniary reward" to the patentee. The reservation of a fair royalty by the licensor should be enough to satisfy all but the monopoly-minded businessman.

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IS EVIDENCE OF THE DEFENDANT'S WEALTH ADMISSIBLE WHEN
PUNITIVE DAMAGES ARE AWARDED IN NEW YORK?

I

In a tort action that warrants an award of punitive damages, should evidence of the financial status of the defendant be admitted to enable the jury to determine the amount of the judgment? It is conceded that in assessing compensatory damages the wealth of the defendant should play no part,¹ for by their very nature they are given simply to make good or replace the loss caused by the wrong and to compensate for the injuries sustained, nothing more.² The

³⁴ "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." 1 SMITH, WEALTH OF NATIONS (Rogers' ed. 1869) 135, 136.

³⁵ See *United States v. Masonite Corp.*, 316 U. S. 265, 278, 86 L. ed. 1461, 1475 (1942), where the Court, keeping in mind the fact that the patent grant is primarily for the public benefit, said that this must be the point of departure for decision on the facts of antitrust cases involving patents "lest the limited patent privilege be enlarged by private agreements so as to by-pass the Sherman Act." See also Mr. Justice Story's statement in *Pennock v. Dialogue*, 2 Pet. 1, 19, 7 L. ed. 327, 333 (U. S. 1829), that the promotion of the progress of science and the useful arts is the main objective of the patent laws and that the reward of inventors is secondary and merely a means to that end; and Mr. Justice Daniel's statement in *Kendall v. Winsor*, 21 How. 322, 329, 16 L. ed. 165, 168 (U. S. 1858), that "Whilst the remuneration of genius and useful ingenuity is a duty incumbent upon the public, the rights and welfare of the community must be fairly dealt with and effectually guarded. Considerations of individual emolument can never be permitted to operate to the injury of these."

¹ *Laidlaw v. Sage*, 158 N. Y. 73, 52 N. E. 679 (1899).

² *Reid v. Terwilliger*, 116 N. Y. 530, 22 N. E. 1091 (1889).