Transparent-Wrap – The Continuing Case for Grant-Back Agreements

Catholic University Law Review

COMMENT / *Transparent-Wrap*—The Continuing Case for Grant-Back Agreements

Grant-back agreements are covenants, included in a patent license,[1] which generally provide for the "license or assignment to the licensor of any improvement patented by the licensee in the products or processes of the licensed patent."[2] Consequently, a patent which represents a major technological advance may give the owner an important competitive advantage. By utilization of a grant-back agreement the owner of this patent can acquire rights to all the improvements thereto which are subsequently patented, and may thereby significantly strengthen his competitive position.[3] Twenty years ago, in *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.*,[4] the Supreme Court held that patent grant-back agreements were not illegal per se and unenforceable under the antitrust and patent laws.[5] The legality of grant-back agreements was subsequently recognized by the Supreme Court in two other cases;[6] since the *Transparent-Wrap* case was handed down, the Court has never altered its stand on grant-back agreements.

1. The owner of a patent has the exclusive right to its use and no one can use the patent without his permission for seventeen years. *See* 35 U.S.C. § 154 (1964). A patent license is a grant from the owner, the licensor, to another, the licensee, to use the patent. The normal patent license takes the form of a contract between the licensor and licensee in which the licensee is granted permission to use the patent in return for royalties or similar consideration. The term "license" as used here includes both licenses and assignments of patent rights. *See generally* A. WALKER, PATENTS § 380, at 536 (2d ed. A. Deller 1965).

2. REPORT OF THE ATTY GEN'S NAT'L COMM. TO STUDY THE ANTITRUST LAWS, at 227 (1955) [herein after cited as 1955 REPORT].

3. An improvement patent may, like a patent on a step in a process, have great strategic value. For it may, on expiration of the basic patent, be the key to a whole technology. One who holds it may therefore have a considerable competitive advantage. And one who assigns it and thereby loses negative command of the art may by reason of his assignment have suffered a real competitive handicap.

Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., 329 U.S. 637, 642 (1947).

4. 329 U.S. 637 (1947).

5. *Id.* at 648.

6. United States v. Line Material Co., 333 U.S. 287 (1948); United States v. National Lead Co., 332 U.S. 319 (1947). In these cases the Supreme Court affirmed without comment that part of the decree of the lower courts which allowed the use of grant-back agreements.

The seeming lack of attention given grant-back agreements led two authors ten years ago to comment that in the "shifting sands of antitrust law . . . [the law of grant-back agreements] has . . . shown a refreshing degree of stability."[7] The same may be said today.[8] The validity of *Transparent-Wrap,* however, is still a viable issue[9] and the purpose of this comment is to determine if it is, in fact, a sound decision and to draw some tentative conclusions concerning *Transparent-Wrap* and grant-back agreements.

Transparent-Wrap is the only case in which the Supreme Court considered the *validity* of grant-back agreements. There, pursuant to the purchase of a business, the vendee, Transparent-Wrap Corp., received an exclusive license to use a group of patents on a machine which was trade-marked "Transwrap." The license contained a grant-back agreement whereby Transparent-Wrap (licensee) agreed to assign its improvement patents on the machine to Stokes & Smith (licensor) for inclusion in the group of patents covered by the license. The term of the license was for ten years, with an option in the licensee to renew it for five year periods during the life of any of the patents in the group, including improvements subsequently acquired.[10] Since Transparent-Wrap's improvement patents were assigned to Stokes & Smith, it was forced to renew its licensing agreement with Stokes & Smith until all the patents expired. Every time Transparent-Wrap patented an improvement, it extended the period of time for which a license was necessary.

In finding that the agreement was not illegal per se, the Court considered

7. Linowitz & Simmons, *Antitrust Aspects of Grant Back Clauses in License Agreements,* 43 CORNELL L.Q. 217 (1957).

8. *See, e.g.,* Old Dominion Box Co. v. Continental Can Co., 155 U.S.P.Q. 70 (S.D.N.Y. 1967); Swofford v. B & W, Inc., 251 F. Supp. 811 (S.D. Tex. 1966).

9. Mr. Donald Turner, Assistant Attorney General in charge of the Antitrust Division, in an address before the Antitrust Section of the American Bar Association on August 10, 1965, indicated that the government would seek to overrule *Transparent-Wrap.* Turner. *Antitrust Enforcement Policy,* 29 A.B.A. ANTITRUST L.J. 187-88 (1965).

10. The relevant portions of the license agreement are:

> If the Licensee shall discover or invent an improvement which is applicable to the Transwrap Packaging Machine and suitable for use in connection therewith and applicable to the making and closing of the package, but not to the filling nor to the contents of the package, it shall submit the same to the Licensor, which may, at its option, apply for Letters Patent covering the same. In the event of the failure of the Licensor so to apply for Letters Patent covering such additional improvements, inventions or patentable ideas, the Licensee may apply for the same. In the event that such additional Letters Patent are applied for and are granted to the Licensor, they shall be deemed covered by the terms of this License Agreement and may be used by the Licensee hereunder without any further consideration, license fee or royalty as above provided. In the event that any such additional improvements are patented by the Licensee for use in connection with Transwrap Packaging Machines, (after the refusal or failure of the Licensor to apply for Patents thereon), the Licensor may, nevertheless, have the use but not the exclusive use of the same outside of the several territories covered by this License Agreement. The expenses of obtaining any such Patents shall be paid by the party applying therefor.

Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 639 n.1.

three issues: do grant-back agreements violate the patent law tie-in doctrine; do these agreements reduce the licensee's incentive to invent; and, most importantly from the standpoint of the case law which followed, are grant-back agreements a per se violation of the antitrust law? In order to determine whether or not *Transparent-Wrap* was a sound decision, each of these issues must be analyzed.

Patent Tie-In Doctrine

The patent law tie-in doctrine arises out of a long series of cases beginning with the *Motion Picture Patents Co.* case in 1917.[11] These cases hold that "an owner of a patent may not condition a license [of the patent] so as to tie to the use of the patent the use of other materials, processes or devices which lie outside the monopoly of the patent."[12] The Court, in *Transparent-Wrap,* relied on the patent assignment statute[13] to show that grant-back agreements do not violate this doctrine. In reaching this conclusion, the Court reasoned that a grant-back agreement was an agreement to purchase future patent rights. The presently existing patent rights which were being purchased were but part of the consideration for this purchase. The Court bolstered its position by showing that, by statute, patent rights are property rights and are therefore valid consideration for a contract.[14]

If the Court had stopped there, the logical result of the decision would have been to overrule the patent tie-in cases.[15] By the terms of the grant-back agreement in *Transparent-Wrap,* Stokes & Smith conditioned the license of the patents so as to tie to the use of the original patents the use of future patents which might be acquired and which thereby lie outside the monopoly of the original patents. Indeed, Judge Learned Hand, using similar reasoning in the lower court decision, found the grant-back agreement violated the doctrine of the tie-in cases.[16]

The Supreme Court, however, attempted to distinguish *Transparent-Wrap* from the tie-in cases, stating that the latter were limited to the tying of the use of unpatented articles to the use of a patent, whereas grant-back agreements only tie patents. The Court found that the acquisition of patents

11. Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502 (1917). *See also* Carbice Corp. of America v. American Patents Dev. Corp., 283 U.S. 27 (1931); Morton Salt Co. v. G. S. Suppiger Co., 314 U.S. 488 (1942); Mercoid Corp. v. Mid-Continent Inv. Co., 320 U.S. 661 (1944); Mercoid Corp. v. Minneapolis Honeywell-Regulator Co., 320 U.S. 680 (1944). Patent tie-in agreements should be distinguished from tie-in agreements forbidden by Section 3 of the Clayton Act, 38 Stat. 731 (1914), 15 U.S.C. § 14 (1964). *See* Stedman, *Acquisition of Patents and Know How by Grant, Fraud, Purchase, and Grant Back,* 27 U. PITT. L. REV. 161, 168-72 (1966).

12. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 640.

13. 35 U.S.C. § 47 (Supp. V, 1946), *recodified in* 35 U.S.C. § 154 (1964).

14. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 642-43.

15. *See* cases cited *supra* note 11.

16. Stokes & Smith Co. v. Transparent-Wrap Mach. Corp., 156 F.2d 198, 203 (2d Cir. 1946).

in this manner was legal, since the owner of a patent is merely "using one legalized monopoly to acquire another legalized monopoly."[17] The importance of this distinction is evident, in that the tie-in doctrine is a logical consequence of the public policy against monopolies.[18] It recognizes that while patents are statutory exceptions to this policy, a patent may not be used to obtain a monopoly which is greater than that granted by the patent. The tying of an unpatented article to the use of a patent is lending the sanction of a legal monopoly, *i.e.*, the patent, to an unpatented article. The owner of the patent thereby acquires something resembling a monopoly on the unpatented article, a monopoly neither sanctioned by the law nor favored by public policy.

If the patent tie-in doctrine were limited only to preventing the monopolization of unpatented articles, as the Court held, their distinction would be sound. But the policy behind the tie-in doctrine would seem to run deeper; it seeks to limit the patent holder to the "four corners of his patents."[19] The apparent fallaciousness of the Court's distinction was recognized earlier in *Ethyl Gasoline*[20] where the Supreme Court stated: "[t]he patent monopoly of one invention may no more be enlarged for the exploitation of a monopoly of another . . . than for the exploitation of an unpatented article. . . ."[21] *Ethyl Gasoline* was followed by similar decisions.[22] Although these cases have been interpreted as merely preventing the use of one patent to compel the use or recognition of another patent,[23] they cast serious doubt on the soundness of *Transparent-Wrap*.

The questionable soundness of the Court's reasoning on this issue has recently led one party in *Atlas Scraper & Engineering Co. v. Pursche*[24] to attack a grant-back, objecting that the agreement was an unlawful tie-in. The issue, however, was untimely raised and the suit was dismissed.[25] This objection would also appear to be a ground upon which the Assistant Attorney-General would base his attack on *Transparent-Wrap*.[26]

17. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 644.

18. As a matter of public policy, the common law prohibited or treated as illegal all contracts or acts which were unreasonably restrictive of competitive conditions. *See* Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911). This policy has been manifested in the various antitrust laws enacted by Congress.

19. Morton Salt Co. v. G. S. Suppiger Co. *supra* note 11.

20. Ethyl Gasoline Corp. v. United States, 309 U.S. 436 (1940).

21. *Id.* at 459.

22. *See* United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948); Technograph Printed Circuits, Ltd. v. Bendix Corp., 327 F.2d 497 (4th Cir.), *cert denied,* 379 U.S. 826 (1964).

23. *See* Pugsley, *Antitrust and Misuse Aspects of Licensing Patents and Know-How,* in PATENT LAW DEVELOPMENTS 162 (1964).

24. 357 F.2d 296 (9th Cir.), *cert. denied,* 385 U.S. 846 (1966).

25. *Id.* at 298. *See also* Chevigny, *The Validity of Grant-Back Agreements Under the Antitrust Laws,* 34 FORDHAM L. REV. 569, 574 (1966).

26. In his address to the Antitrust Section of the American Bar Association on August 10, 1965, Mr. Donald Turner said:

Incentive To Invent

The purpose of the patent law is to promote the progress of "[s]cience and the useful [a]rts."[27] Counsel for Transparent-Wrap argued that the enforcement of the grant-back agreement decreased its incentive to develop new inventions, was violative of the very purpose of the patent law, and should therefore not be enforced. This argument was best stated by Judge Hand in the lower court, when he noted that the effect of the license would be to force the licensee "either to cease all efforts to patent improvements, or to keep renewing the [license] in order to escape the consequences of its own ingenuity."[28] The Supreme Court summarily dealt with this issue by showing that benefits did acrue to Transparent-Wrap as a result of obtaining improvement patents. It dismissed further discussion of the issue by stating that Transparent-Wrap's incentive to invent depended on "vicissitudes of business too conjectural on this record to appraise."[29]

The soundness of the Court's reasoning on this point is questionable. It is hard to imagine a more clear-cut example of the incentive to invent being affected. Competition is a prime basis of incentive. As long as the grant-back agreement stands, there can be no competition—between the licensor and the licensee—arising out of improvements developed by the licensee. As one author has stated: "If one assumes that part of the incentive for invention comes from the patent right to exclude others from using the claimed invention, over and above the right to derive revenue from licensing, an agreement involving the interchange of future patents *must,* to some degree, reduce this incentive."[30] Each time Transparent-Wrap patented an improvement, it extended the life of the grant-back agreement which, by its terms, did not expire until all the improvement patents had terminated. Clearly, Transparent-Wrap's incentive to promote the art was affected by the grant-back albatross which hung about its neck.

Any corporation which enters into a grant-back agreement will, in effect, be committing itself to working for the licensor, as well as itself, if it seeks to develop and patent improvements on a licensed patent. This fact must have some negative effect on a corporation's decision to "promote the science or useful art" of the patents involved in grant-back license agreements. In *Line*

> We shall . . . eventually seek to establish, contrary to *Trans-Wrap,* that a clause in a patent license requiring the licensee to grant back to the patentee all future improvement patents should be held unlawful per se for the simple reason that it is much more restrictive than necessary to protect the patentee's legitimate interests.

Turner, *supra* note 9, at 188.

27. U.S. CONST. art. I, § 8.

28. Stokes & Smith Co. v. Transparent-Wrap Mach. Corp., *supra* note 16, at 203.

29. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 646.

30. Gallo, *Patent Interchanges: an Analysis of their Effects on Competition,* 48 J. PAT. OFF. SOC'Y 669, 678 (1966).

Material,[31] the Court invalidated the cross-licensing agreement, whereby each company granted licenses to each of the others on their respective patents. In rendering its decision, the Court stated that the stimulus to seek competitive inventions was reduced.[32] If cross-licensing agreements reduce the stimulus to seek competitive inventions, so too do grant-backs.

United States v. Aluminum Co. of America (Alcoa)[33] represents the best example of the effect of grant-back agreements on the stimulus to invent. As a result of a prior adjudication of monopolization,[34] Alcoa agreed to license certain patents. In the five years that followed, Kaiser Aluminum Co. and Reynolds Metal Co. entered into license agreements with Alcoa. The licenses contained a non-exclusive grant-back agreement, whereby the licensees had to grant back improvement patents to Alcoa. The second case arose out of a proceeding to determine how to increase competition in the aluminum industry. Finding that the grant-back agreements substantially contributed to Alcoa's dominance of the industry, the court reasoned that if one competitor patented an improvement, the innovator and Alcoa could use the patent, to the exclusion of the other competitor. As a matter of simple mathematics, since Alcoa was taking from both competitors and the competitors were taking only from themselves, Alcoa's patent position would continue to be larger than either of the others.[35] The logical consequence would be for Kaiser and Reynolds to limit patent development. The court found that in 1949 this had indeed happened, for Alcoa employed 762 employees in research while Kaiser and Reynolds employed only a combined total of 88.[36]

As with the tie-in cases, the soundness of the Court's reasoning in *Transparent-Wrap* appears to falter. It must be noted, however, that there the Court did not close the door on this approach, but indicated that the decision was limited by the record before it; it lacked evidence as to the adverse effect of the grant-back agreement on Transparent-Wrap's incentive to invent.

Antitrust Violations

The final issue considered in *Transparent-Wrap*—that the grant-back agreement violated the antitrust laws—has given rise to the greatest amount of litigation. The circuit court had not considered this issue. The Supreme Court remanded, *holding:* "the inclusion in the license of the condition re-

31. United States v. Line Material Co., *supra* note 6.
32. *Id.* at 311.
33. 91 F. Supp. 333 (S.D.N.Y. 1950)
34. United States v. Aluminum Co. of America (Alcoa), 148 F.2d 416 (2d Cir. 1945).
35. United States v. Aluminum Co. of America (Alcoa), *supra* note 33, at 409-10.
36. *Id.* at 410. This figure must be tempered by the fact that Alcoa was worth about three times the value of Kaiser and Reynolds.

quiring the licensee to assign improvement patents is not *per se* illegal and unenforceable."[37] The Court did note that a *patent* may be used to violate the antitrust laws. In addition, it recognized that, in the proper setting, *grant-back agreements* may give rise to violations of the antitrust laws.

Here, the Court's reasoning was sound. The policy of the antitrust laws is to foster competition; grant-back agreements, properly used, may in fact achieve this end. This issue has proved to be the most viable factor in grant-back agreements. Any determination of *Transparent-Wrap's* soundness and the legality of grant-back agreements would be shallow without a careful analysis of this area.

A grant-back agreement, by its terms, limits competition for improvement patents between the parties to the agreement and expands the monopoly of the licensor.[38] In the words of Sections 1 and 2 of the Sherman Act, a grant-back is a contract in restraint of trade and is an attempt to monopolize.[39] However, under the oft-quoted "rule of reason," only *unreasonable* violations of the antitrust laws are forbidden.[40] It is with this issue that the courts have struggled.[41]

The *Hartford-Empire*[42] case is the one decision cited by the Court in *Transparent-Wrap* to illustrate how grant-back agreements may be used in violation of the antitrust laws. *Hartford-Empire* involved companies which controlled 94 percent of the glass container manufacturing business. Grant-back agreements effectively enabled control of all the patents of these companies. With this control, the companies divided the market for containers, set production quotas for each company, and zealously discouraged competi-

37. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., *supra* note 4, at 648.

38. There is no competition between the two parties in the improvement patents once the agreement is signed; and a licensor who receives a license on an improvement patent has a "double monopoly," a monopoly for his first patent and a monopoly for the improvement. *See* Stokes & Smith Co. v. Transparent-Wrap Mach. Corp., 161 F.2d 565, 567 (2d Cir.), *cert. denied,* 331 U.S. 837 (1947).

39. 26 Stat. 209 (1890), 15 U.S.C. §§ 1, 2 (1964). The Sections substantially provide:

§ 1. Every contract, combination . . . or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal.

* * *

§ 2. Every person who shall monopolize . . . any part of . . . trade or commerce . . . shall be deemed guilty of a misdemeanor. . . .

40. The "rule of reason" was first enunciated in Standard Oil Co. v. United States, 221 U.S. 1 (1911), and was most succinctly stated in Appalachian Coals, Inc. v. United States, 288 U.S. 344, 360 (1933), where the Court, in speaking of the Sherman Act, said, "Its general phrases, interpreted to attain its fundamental objects, set up the essential standard of reasonableness." *See generally* 1955 REPORT, *supra* note 2, at 5-12.

41. Grant-back agreements have been involved in findings of Sherman 1 violations. *See* United States v. Imperial Chem. Indus., 105 F. Supp. 215 (S.D.N.Y. 1952); United States v. General Elec. Co., 80 F. Supp. 989 (S.D.N.Y. 1948). Grant-back agreements have also permitted a monopolization of patents in violation of Sherman 2. *See* United States v. General Elec. Co. (Lamps), 115 F. Supp. 835, 847 (D.N.J. 1953); United States v. Aluminum Co. of America (Alcoa), *supra* note 33, at 409-10; United States v. General Elec. Co. (Lamps), 82 F. Supp. 753, 815-16 (D.N.J. 1949).

42. Hartford-Empire Co. v. United States, 323 U.S. 386 (1945).

tion.[43] The Court found that there was an unreasonable restraint of trade and monopolization in violation of Sections 1 and 2 of the Sherman Act.[44] The use of grant-back agreements by the companies was forbidden.

In the *Line Material*[45] and *National Lead*[46] cases, decided subsequent to *Transparent-Wrap,* the Supreme Court found that the companies had unreasonably restrained trade in violation of the Sherman Act. In these cases, however, the Supreme Court sanctioned the use of grant-back agreements. In both instances, the Court recognized that the companies involved had, by their patents, obtained control of virtually 100 percent of the market to which the patents related. It noted, however, that in *National Lead* there was no suppression of competition and there was, in fact, active competition between the companies.[47] In *Line Material,* the Court recognized that the companies entered into the violative agreements only when faced with possible infringement suits.[48] In both cases, there was no reasonable substitute for the patented products, and it was necessary for the companies to have rights under the patents in order to enter the field. The effect of the grant-back agreements was not to unreasonably restrain competition and the Court did not forbid their use.

Transparent-Wrap and *Hartford-Empire* indicate that if the effect of grant-back agreements is to lead to unreasonable violations of the Sherman Act, the agreements must be voided. *National Lead* and *Line Material,* paying due consideration to the rule of reason, indicate that those agreements whose effect is reasonable will be upheld.

Reasonableness is an elusive issue, however, and the lower courts have turned to the terms of the grant-back agreements in search of a meaningful standard for establishing the competitive effect of the agreements. Grant-back agreements have been classified as exclusive or non-exclusive.[49] Exclusive agreements encompass *assignment* grant-back agreements, and arise when the licensee may give rights to improvement patents only to the licensor.[50] Under an assignment grant-back, the licensee gives title to the licensor, usually retaining a license for himself. In a non-exclusive agreement, the licensee may license others in addition to the licensor.

The exclusive agreements have been the most carefully considered. In *United States v. General Electric* (*Carboloy*),[51] four companies owned, and

43. *Id.* at 392-400, 406.
44. *Id.* at 392, 435.
45. United States v. Line Material Co., *supra* note 6.
46. United States v. National Lead Co., *supra* note 6.
47. *Id.* at 347-48.
48. United States v. Line Material Co., *supra* note 6, at 292-93.
49. 1955 REPORT, *supra* note 2, at 228-29.
50. *Id.* at 229.
51. 80 F. Supp. 989 (S.D.N.Y. 1948).

acquired by assignment, grant-back agreement patents which gave them control of the entire field of hard metal compositions. This control was, in turn, maintained by the grant-back agreements. The express purpose of these agreements was to restrain competition, to fix prices, to divide territorial markets, and to boycott those companies that did not take licenses.[52] The grant-back agreements provided one of the means by which competition was unreasonably restrained, and were condemned per se by the court because of the scale of competition restrained.[53] In *Hartford-Empire*,[54] discussed previously, assignment grant-back agreements were condemned by the Court.

The competitive effect of exclusive grant-back agreements is twofold. On one side, the license containing the grant-back increases the number of licensees who can use the basic patent, and consequently increases the competition in the use of the basic patent. On the other side, the exclusive agreement may limit the competition in the use of the improvement patents to only the licensor and the licensee. Therefore, the courts have not been willing to find exclusive agreements to be illegal per se, in the absence of a showing of unreasonable restraint or monopolization. *Transparent-Wrap* involved an assignment grant-back agreement. On remand, the court of appeals recognized this twofold aspect and dismissed the action on the grounds that there was an insufficient showing of the effect of the agreements on competition.[55]

The necessity of establishing restraint of competition was recently borne out in *Swofford v. B & W, Inc.*,[56] where it was argued that assignment grant-back agreements were illegal per se. No evidence as to the effect of the agreements on competition was presented. The court, citing *Transparent-Wrap*, upheld the validity of the agreement.[57]

An exclusive grant-back agreement is given closer attention than a nonexclusive because, as was seen in the *Carboloy* case, its effect can be to give control of the improvement patents to the holder of the basic patent. This, in turn, may materially strengthen the holder's patent position, and enhance his opportunity to restrain trade and monopolize the field covered by his patents. The only competition in the use of the improvement patent may be between the licensor and licensee. All others may be shut out by the terms of the agreements. In fact, if the agreement is an assignment grant-back, the licensee may be left without permission to make the improvement, and con-

52. *Id.* at 1015.
53. *Id.* at 1006.
54. Hartford-Empire Co. v. United States, *supra* note 42.
55. Stokes & Smith Co. v. Transparent-Wrap Mach. Corp., 161 F.2d 565, 567 (2d Cir.), *cert. denied,* 331 U.S. 837 (1947).
56. 251 F. Supp. 811 (S.D. Tex. 1966).
57. *Id.* at 821. *See also* Old Dominion Box Co. v. Continental Can Co., 155 U.S.P.Q. 70 (S.D.N.Y. 1967); Stewart-Warner Corp. v. Westinghouse Elec. Corp., 143 U.S.P.Q. 211 (W.D.N.Y. 1964).

sequently there is no competition for the improvement. No determination of the effect of any grant-back agreement on such competition can be made, however, until an improvement is first discovered and its value assessed. If the improvements that may subsequently be patented prove to be of little or no value, the grant-back agreements will have created no unreasonable restraints or monopolizations. Any adverse effects on competition may in turn be balanced by the increase in competition in the basic patent created by the license. The courts in *Transparent-Wrap* and *Swofford* correctly recognized that assignments cannot be invalidated under the Sherman Act without a showing of their effect on competition.

With a non-exclusive agreement, the licensee can license others and effectively stimulate competition in the use of the improvement patents. The difference between the two agreements was noted in *United States v. Huck Manufacturing Co.,*[58] which involved the use of a non-exclusive grant-back agreement. There, the Huck Company obtained patents for lockbolts. These bolts represented a substantial improvement over ordinary rivets and their sale amounted to $16 million annually.[59] Huck was unable to meet the demand for the bolts and entered into a non-exclusive grant-back agreement with the Townsand Manufacturing Co. The court found that the effect of the agreement was neither to restrain competition nor to provide power for monopolization but on the contrary, the effect was to foster competition.[60] The court emphasized that Townsand was free to make, sell, and use the items covered by the improvement patent and could license others to do likewise. The effect of the agreement was to increase competition in the improvement patent.

The mere use of a non-exclusive license, however, will not save a company from antitrust prosecution. Thus, in the *General Electric (Lamps)*[61] case, a non-exclusive grant-back agreement was involved. The court found that the grant-back agreement formed part of a patent acquisition policy the effect of which was to perpetuate control over light bulbs long after the expiration of the basic patents, thereby "regimenting" the entire industry and unreasonably restraining competition.[62] Nor did a non-exclusive license save Alcoa's grant-back agreement in the *Alcoa* case discussed previously.[63]

The major reason that the non-exclusive grant-back agreements were struck down in these cases was not that the agreements of themselves decreased com-

58. 227 F. Supp. 791 (E.D. Mich. 1964), *aff'd on other grounds,* 382 U.S. 197 (1965).
59. *Id.* at 794.
60. *Id.* at 804. *See also* Sperry Prod. Co. v. Aluminum Co. of America, 171 F. Supp. 901 (N.D. Ohio 1959); Well Surveys, Inc. v. McCullough Tool Co., 199 F. Supp. 374 (N.D. Okla. 1961).
61. United States v. General Elec. Co. (Lamps), 82 F. Supp. 753 (D.N.J. 1949).
62. *Id.* at 815-16.
63. United States v. Aluminum Co. of America (Alcoa), *supra* note 33.

petition, but that they were the tools by which General Electric and Alcoa perpetuated their patent supremacy.

The *Huck* case shows that the effect of a non-exclusive agreement, in contradistinction to the exclusive agreement, may be to spread the benefits of the improvement patent and decrease the concentration of the patent monopolies.[64] This, in turn, furthers the purpose of the antitrust law. The courts do not routinely approve non-exclusive agreements. If evidence is introduced, as it was in *General Electric* and *Alcoa*, to show unreasonable restraint or monopolization, the courts will strike them down.

The most interesting aspect of the lower courts' inquiry into grant-back agreements are those instances where the courts have recognized that either exclusive or non-exclusive grant-backs can lead to a substantial increase in competition. *International Nickel Co.*[65] best illustrates this aspect. International Nickel (INCO) patented a new method of alloying steel, a method vastly superior to the prior process. INCO entered into a number of licensing agreements which contained grant-back covenants, whereby INCO obtained the right to license all improvement patents. INCO itself did not utilize this process. Its express purpose in obtaining the improvement patents was to increase the value of its license and to thus stimulate others to obtain licenses from it.[66] The license agreements were to terminate upon the expiration of INCO's basic patent. The court recognized that the effect of this agreement was to markedly increase, and not decrease, competition, and was therefore legal and reasonable.[67]

A new line of attack on grant-back agreements has recently been espoused. Section 7 of the Clayton Act[68] forbids the acquisition of the assets of one corporation by another, where the effects of the acquisition would tend to restrain trade or to create a monopoly. Mergers have generally been attacked under this section.[69] This argument holds patents to be assets within the meaning of Section 7.[70] If this is so, and the effect of the acquisition of a pat-

64. *See also* Binks Mfg. Co. v. Ransburg Electro-Coating Corp., 281 F.2d 252, 259 (7th Cir. 1960), *cert. denied,* 366 U.S. 211 (1961).

65. International Nickel Co. v. Ford Motor Co., 166 F. Supp. 551 (S.D.N.Y. 1958).

66. *Id.* at 566.

67. *See also* Lyophile-Cryochem Corp. v. Cutter Labs., 78 F. Supp. 905 (N.D. Cal. 1948).

68. 38 Stat. 730 (1914), *as amended,* 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964).

69. *See* cases cited note 73 *infra.*

70. In an address before the Second Annual Antitrust Institute in Pittsburg, Pa., on Nov. 4, 1966, Mr. Donald Turner, Asst. Att'y. Gen. in Charge of Antitrust, said: "I assume and I think that it is a completely safe assumption that... a patent [is an] asset within the meaning of Section 7 [of the Clayton Act]." Support for this position may be found in Section 1235 of the Internal Revenue Code of 1954. This section generally states that a transfer (other than by gift, inheritance, or devise) of rights to a patent is considered to be the sale or exchange of a capital asset held for more than six months. Further support may be found in Section 1231 of the Internal Revenue Act of 1954. *See also* Armco Steel Corp. v. United States, 263 F. Supp. 749 (S.D. Ohio 1966); Bell Intercontinental Corp. v. United States, 152 U.S.P.Q. 182 (Ct. Cl. 1966).

ent or group of patents tends to lessen competition or to monopolize, then it could be attacked under Clayton 7. If this acquisition is by grant-back agreement then the agreement will be illegal.[71] The importance of this argument is that under the classical structuring of the antitrust laws the burden of proof needed to establish a violation of Clayton 7 is substantially less than that needed to establish a violation of Sections 1 and 2 of the Sherman Act.[72] Under Clayton 7, an actual restraint of trade or monopolization need not be shown; only a tendency in those directions must be proven. The government has had notable success with this section.[73]

Even under this new theory, however, more than the *existence* of a grant-back agreement must be shown. Ability to restrain competition and monopolize depends on many things, including corporate size and market position. Absent such a showing, a grant-back agreement will be legal. This theory does not detract from the soundness of the Court's holding in *Transparent-Wrap* that grant-back agreements are not illegal per se.

The cases, as well as the discussion of Clayton 7, are persuasive support of the Court's reasoning in *Transparent-Wrap* that grant-back agreements are not per se violations of the antitrust law. While the *Hartford-Empire* and *General Electric* cases are evidence of the anticompetitive effects of grant-back agreements, the *Huck* and *International Nickel* situations demonstrate their useful effects and show that a per se rule would vitiate a potentially effective competitive tool.

Conclusion

The issue at hand is the substantive validity of *Transparent-Wrap*. The underlying consideration is the legality of grant-back agreements. *Transparent-Wrap* derives its significance from its connection with the antitrust laws and any conclusion as to its soundness must be structured to reflect this relationship.

If the case is viewed from the standpoint of efficacy, it must be said that the decision is sound for it has proved workable. The Court's holding that grant-backs do not per se restrain competition or monopolize has been borne out by the case law. It has been clearly shown that the effect of grant-back agreements may further the purposes of the antitrust laws by increasing competition. From this viewpoint, the Court's reasoning is eminently sound; in the appropriate setting grant-back agreements will be sustained.

Theoretically, however, *Transparent-Wrap* presents a problem. From this

71. Stedman, *Acquisition of Patents and Know How by Grant, Fraud, Purchase and Grant-back*, 27 U. PITT. L. REV. 161, 168-72 (1966).

72. H.R. REP. No. 1191, 81st Cong., 1st Sess. 5-12 (1949), reprinted in C. OPPENHEIMER, FEDERAL ANTITRUST LAW, CASES AND COMMENTS 551 (2d ed. 1964).

73. *See, e.g.*, FTC v. Procter & Gamble Co., 386 U.S. 568 (1967); United States v. Pabst Brewing Co., 384 U.S. 546 (1966); United States v. Von's Grocery Co., 384 U.S. 270 (1966).

standpoint, there is little difference between tying an unpatentable article to a patented article; this is probably what the Court was thinking of in the *Ethyl* case.[74] If this is viewed from an efficable point, however, there is a major difference. No new monopoly is created by a grant-back agreement. It only involves the transfer of a previously sanctioned monopoly, *i.e.*, an improvement patent. This acquisition is within the bounds of a legally sanctioned monopoly and does not attempt to monopolize unpatented articles which clearly fall outside the realm of the patent. If the theoretical argument is sustained, all grant-backs would be invalid. However, as these agreements have moved to be competitive stimulants, the efficacy argument should hold sway.

The incentive issue is often moot. Thus, in *Alcoa* the grant-back agreements were voided not because they detracted from Kaiser's and Reynolds' incentive to invent, but because of its anticompetitive effects. In many cases, this will be the result, and the court will not reach the issue.

The issue does have practical as well as theoretical value in a situation such as presented in *Transparent-Wrap*. Under the grant-back agreement used, it was to the decided advantage of Transparent-Wrap to stop inventing.

Incentive to invent is an elusive factor and there are many considerations to be taken into account. The most important of these is the caliber and quantity of the competition. If the grant-back agreement involves a patent in a highly competitive area, the licensee must constantly innovate to keep pace with the competition. Another important factor is the type of grant-back agreement entered into. If the licensee receives royalties from the licensor for the improvement patents or if the agreement is non-exclusive and the licensee can sublicense the improvement patents, he may be in a position to obtain substantial financial reward. His incentive to invent will therefore be stimulated by the grant-back agreement which put him in the position to discover these improvements.[75] The final consideration is the actual effect of patents on the incentive to invent. A recent congressional report estimated that less than 20 percent of the inventions made in America were patent motivated and ranged as low as 0.5 percent for some industries.[76]

Grant-back agreements can reduce a licensee's incentive to invent. However, if a licensee seeks to have the agreement voided on this issue, evidence establishing the effects of the above considerations must be produced. Absent this evidence, a licensee may find himself out of court for presenting an issue "too conjectural on [the] record to appraise."[77]

74. *See* text *supra* at note 20, for discussion of the *Ethyl* case.
75. *See* text *supra* at note 58, for discussion of the *Huck* case. *See also* AM. PAT. LAW ASS'N BULL. 392-96 (1966).
76. STAFF JOINT ECONOM. COMM., 88th Cong., 2d Sess., INVENTION AND THE PATENT SYSTEM, at 50, 51 (1964). *See also* STAFF OF SENATE COMM. ON THE JUDICIARY, 85th Cong., 2d Sess., STUDY No. 11, THE IMPACT OF THE PATENT SYSTEM ON RESEARCH (1958).
77. Transparent-Wrap Mach. Corp. v. Stokes & Smith Co., 329 U.S. 637, 646 (1947).

Transparent-Wrap is sound. The Court's failure to distinguish the *Ethyl* case does not detract from its logic. Grant-back agreements *can* stimulate competition and *can* implement the policy of antitrust legislation. The efficacy of *Transparent-Wrap* has been established. The continued stability of grant-back agreements should be encouraged, and not subverted.