Relation of the Ethyl Gasoline Anti-Trust Case to Restrictions in Patent Licenses

Read before the Patent Law Association of Pittsburgh, April 30, 1940.

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The Ethyl Gasoline case†, decided March 25th of this year, is the latest pronouncement by the Supreme Court on the subject of conditions that may be imposed, and may not be imposed, by patent owners, directly or indirectly, in connection with the grant of licenses to use patented inventions.

The litigation was an anti-trust suit brought by the United States under the Sherman Act. It involves complicated facts and difficult questions of anti-trust law, and debatable public policy, but so far as rights to grant restricted licenses under patents are concerned, the case presents little difficulty.

On first reading it might seem that the Supreme Court has held it illegal for licensor to fix licensees' prices of a patented product. Certain Confucii say that this case establishes new limitations on the rights of patent owners in the exploitation of inventions. The object of this paper is to discuss what, if any, change the *Ethyl* case has made in the law as to price fixing or conditional licensing under patents as it was established before this case was decided.

In order to fully understand the opinion of the Supreme Court, it is necessary to consider also the decision

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†*Ethyl Gasoline Corporation et al v. United States,* 60 S. Ct. 618; *United States v. Ethyl Gasoline Corporation et al,* 27 F. Supp. 959.

of the District Court, from which the case went up by direct appeal. The Supreme Court does what is not infrequently done by appellate tribunals, in that it selects and emphasizes facts that support its conclusions, and discounts or ignores some pertinent facts that make its conclusions more difficult, or doubtful. The trial court went more fully and explicitly into the facts of the case, and since the Supreme Court accepted all the findings below, the two opinions with convenience may be considered together.

The controlling facts are these. The Ethyl Gasoline Corporation (understood to be jointly owned by General Motors, Dupont, and Standard Oil of New Jersey) has patents*, the validity of which was not questioned in this case, covering a compound (tetraethyl lead), which, when added to gasoline, raises the octane rating, and improves its anti-knock qualities as an explosive engine fuel.

The Ethyl Corporation manufactured and sold the lead compound (covered by the first two patents) to licensed gasoline *refiners,* who added it, in accordance with specifications in the licenses, to gasoline which they made. The refiners then sold the treated gasoline (covered by the third patent) to licensed *jobbers,* who in turn sold it to retailers and consumers. The ultimate consumer utilized the process of the fourth patent.

The Ethyl Corporation received its entire remuneration, said by the trial court to be "very substantial," in the profit that it made on the lead compound sold to the licensed refiners. The Ethyl Corporation neither made nor sold gasoline, treated or untreated. Nobody paid any royalties on the manufacture, sale, or use of ethyl fluid or ethyl gasoline.

*It has two patents on (a) the fluid *per se,* (b) one on the combination of the fluid and gasoline, and (c) a fourth on a method involving use of the combination in an explosive motor.

The Ethyl Corporation required in written licenses (and the refiners therein agreed) that the patented product be sold by the licensed refiners only to such jobbers as were in turn and separately licensed in writing by the Ethyl Corporation to sell treated gasoline. The jobbers were required to apply individually for their licenses, granted however directly by the Ethyl Corporation, through the refiners, and ordinarily each jobber had to deal through one particular refiner, both in obtaining a license and in purchasing licensed gasoline. If a jobber changed refiners as his source of supply of treated gasoline, his previously existing license was thereby terminated, and he then had to apply to the Ethyl Corporation for a new license, the application being filed through his new refinery source. He might or might not be granted a new license by the Ethyl Corporation. Licenses to the jobbers could be cancelled at any time at the will of the Ethyl Corporation.

Every major oil refinery in the country (except the Sun Oil Company, which does not use the patented compound in its gasoline), was a licensee and participated in this contractual setup. The licensed refiners produced 88% of all United States gasoline, and 70% of all gasoline was lead treated. Eleven out of twelve thousand jobbers took licenses and participated in the arrangement.

Before a license was granted to a jobber, he was carefully "investigated." The licensor maintained an organization which reported upon the "ethical conduct" of the jobbers, and the retailers to whom the jobbers sold. If a jobber was "unethical" in his method of doing business, or if he permitted his retailers to be "unethical," he might have his license revoked, and, in many but not all instances, that happened.

The Supreme Court's opinion indicates that it believed the "unethical conduct" that might be expected to result in loss of licenses was failure on the part of the jobber to

> "maintain the marketing prices, policies and practices prevailing or ostensibly prevailing in the industry." (p. 624)

That this control also extended to the *retailers** to whom the licensed jobbers sold, appears from the opinion of the trial court:

> "***defendants have refused to issue licenses to a number of jobbers who, investigation showed, were not abiding by the marketing policies prevailing or ostensibly prevailing in the industry or who were not maintaining the *retail* prices on gasoline posted generally in the industry (that is, the policies of, and prices posted by, the major oil companies or the market leaders among such companies) *or whose retail dealers were not maintaining such prices.*" (p. 962-3)

Although admittedly the Ethyl Corporation did not in every instance cancel the license of every jobber who was guilty of "unethical conduct," the courts found in effect that licenses were cancelled for that cause in enough instances to make jobbers believe that if they wished to keep their licenses to sell, and were to be allowed to purchase ethyl gasoline, they must stay in line in the matter of maintaining prices and trade practices established by the refiners. In other words, apparently the courts were convinced from all the facts that most

*While the opinion says little about retailers maintaining prices, it is easy to see that the refiners were in position to require the jobbers to hold their retailers up to the mark. For example, jobbers had to report monthly a list of those to whom they sold the licensed product. In view of the facts of this case, it is no wonder that usually the price of retail gasoline so mysteriously changes at all the stations of the well known brands in a given locality at the same stroke of the clock and to the same fraction of a cent.

of the jobbers believed that they had to maintain the sales policies the refiners established,—or else.

The licenses provided that the refiner had to maintain his "ethyl gasoline" at a *minimum* octane rating of 76, and that the next best grade of gasoline sold must be lead treated and licensed. This second grade of licensed product, called "regular gasoline," must have a *maximum* octane rating of 70. A fixed price differential [two cents] was required between the licensed "ethyl" gasoline and the licensed "regular" gasoline, as sold by the refiner. There was no price fixed in the jobber licenses, but apparently jobbers and retailers were held in line by fear of losing their supply if they did not maintain "ethical" marketing policies.

That second grade provision apparently indirectly prohibited the refiner from selling a gasoline of better than 70 octane made by any means other than adding the patented fluid to it. It indirectly but automatically provided a price restriction on the resale of the patented products. Not much point is made of this feature of the licenses in the opinions. It is apparently not the basis of any part of the decision, although it might well have been more important in its effect on the propriety of the license restrictions.

That the restrictions on sale by refineries to licensed jobbers had been used to control the marketing of gasoline throughout the United States was found as follows:

> "It [this situation] is one in which appellant has established the marketing of the patented fuel in vast amounts on a nationwide scale through the 11,000 jobbers and at the same time, by the leverage of its licensing contracts resting on the fulcrum of its patents, it has built up a combination capable of use, and actually used, as a means of controlling jobbers' prices and suppressing competition among them." (p. 626)

That the restrictions imposed on the refiners, and on the jobbers, were not necessary to protect the patent owner, and to secure to him the full enjoyment of that which his patents covered, was found as follows:

> "The licensing conditions are thus not used as a means of stimulating the commercial development and financial returns of the patented invention which is licensed, but for the commercial development of the business of the refiners and the exploitation of a second patent monopoly not embraced in the first. The patent monopoly of one invention may no more be enlarged for the exploitation of a monopoly of another, see *Standard Sanitary Mfg. Co. v. United States, supra,* than for the exploitation of an unpatented article, [citing the *Shoe Machinery, Carbice, Asphalt,* and *Lecithin* cases], or for the exploitation or promotion of a business not embraced within the patent." (p. 626)

The trial court enjoined the Ethyl Corporation and its officers from granting licenses to jobbers, required cancellation of the outstanding licenses to jobbers, and enjoined defendants from enforcing provisions in the licenses to refiners that would restrict sale of the patented fuel to licensed jobbers. The Supreme Court affirmed these orders.

The defendant corporation sought to justify the foregoing setup on the ground that the conditions imposed were necessary to preserve the trade-marks, good will, and reputation of the Ethyl Corporation, protect the public from gasoline adulteration, secure compliance with health regulations, etc.

On this point the trial court said (p. 966):

> "It is because the defendants have not confined themselves to the attainment of the ends mentioned but have used their licensing system for other purposes that the Government seeks to restrain their licensing activities."

What makes this case of special interest to us is that, as the trial court said (p. 966):

> "Defendants seek to avoid the effect of the anti-trust laws and to support their requirement that jobbers be licensed on the ground that they are merely taking advantage of their patent rights, relying upon the nature of patent monopoly and decision of the Supreme Court in *United States v. General Electric,* 272 U. S. 476."

That price control was not exercised for the benefit of the patent owner, or in fact by the patent owner, was found by the trial court (p. 967):

> "Moreover, the Ethyl Gasoline Corporation does not itself determine the prices or policies, the failure to abide by which has often resulted in the denial of a jobber license. *They are the prices and policies established by some of the refiner licensees, apparently without consulting the defendant corporation.*"

Although the decree was based on the Sherman Act, the Supreme Court considered, in overruling the defenses, restrictions that may properly be imposed by a patent owner in granting licenses. Preliminarily it said:

> "He may grant licenses to make, use or vend, restricted in point of space or time, *or with any other restriction upon the exercise of the granted privilege, save only that by attaching a condition to his license he may not enlarge his monopoly and thus acquire some other which the statute and the patent together did not give.*" (p. 625)

The Court evidently considered it of primary importance that the present case involved control by the patent holder of the marketing of the patented material *after* it had made an outright *sale* of the patented fluid to the refiners who first used it. On this point it said:

"This [refusal to sell to price cutters] we assume, for present purposes, it could lawfully do by virtue of the power conferred by its patent to exclude any or all others from selling the patented product. *But it does not follow that it can lawfully exercise that power in such manner as to control the patented commodity in the hands of the licensed jobbers who had purchased it, or their actions with respect to it in ways not within the limits of the patent monopoly,* and conspicuously among such controls which the Sherman law prohibits and the patent law does not sanction is the regulation of prices and the suppression of competition *among the purchasers of the patented articles.*" (p. 623)

"Appellant, as patentee, possesses exclusive rights to make and sell the fluid and also the lead-treated motor fuel. By its sales to refiners it relinquishes its exclusive right to use the patented fluid and it relinquishes to the licensed jobbers its exclusive rights to sell the lead-treated fuel by permitting the licensed refiners to manufacture and sell the fuel to them. And by the authorized sales of the fuel by refiners to jobbers the patent monopoly over it is *exhausted,* and after the sale neither appellant nor the refiners may longer rely on the patents to exercise any control over the price at which the fuel may be resold." (p. 625)

That is the crux of the decision.

While it is believed that the *Ethyl* case as a whole makes no change in the restrictions that may be imposed legally in granting a license under a patent, some ambiguity may be said to arise because of the following sentence:

"Agreements for price maintenance of articles moving in interstate commerce are, without more, unreasonable restraints within the meaning of the Sherman Act because they eliminate competition***." (p. 626)

But this statement must be read in connection with *U. S. v. Trenton Potteries Co.,* 273 U. S. 392, which is cited as authority for the sentence just above quoted. It must also be construed with the remainder of the opinion, which in several instances seems to reaffirm the law stated in *United States v. General Electric Co.,* 272 U. S. 476.

In the *Potteries* case no patents were involved. Manufacturers and distributors of eighty-two per cent of vitreous pottery fixtures for use in bathrooms joined in an association and by agreement combined to fix prices and to limit sales to jobbers. That was held illegal under the Sherman Act. Obviously statements based on such a situation furnished no authority for holding illegal proper restrictions in a patent license,—in the absence of a direct statement to that effect.

On the other hand, in the *G. E.* case there was involved specifically the legality of a license under valid patents which fixed the price at which the licensee could sell the patented lamps, and required the sales policy of the licensee to be uniform with that of the licensor. That license was held valid by the Supreme Court, which said:

"If the patentee goes further and licenses the selling of the articles, may he limit the selling by limiting the method of sale and the price? We think he may do so *provided the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly.*" (p. 490)

At the same time the Court made it plain that a patent owner can not fix *resale* prices to be charged by one to whom the patentee has *sold* patented articles. It said:

"It is well settled, as already said, that where a patentee makes the patented article, and *sells* it, *he* *can exercise no future control over what the purchaser may wish to do with the article after his purchase.* It has passed beyond the scope of the patentee's rights." (p. 489)

Having the *Potteries* case and the *General Electric* case in mind, it seems clear that the Supreme Court in the *Ethyl* case has not changed, or intended to change, the law as to the extent to which restrictions may be imposed by a patent license. On the contrary it has by employing the same language used in the General Electric case in effect reiterated the law that a patent owner may impose any restrictions on a licensee not illegal by statute, and normally and reasonably adapted to secure pecuniary reward within the patent monopoly. Price control, quotas, territorial limitations, etc., seem to be clearly within the permitted licensee restrictions. The test seems to be whether or not such conditions are reasonably adapted to secure to the patent owner full enjoyment of his exclusive rights in the field within which he has a monopoly by virtue of his patent. Conversely, conditions become illegal when they extend the restrictions beyond the exclusive field granted by the patent, as, for example, by sweeping within the restrictions subject matter not covered by the patent, or when, having secured full pecuniary reward by the outright sale of a patented product, a patent owner attempts thereafter to secure an additional reward, or to establish an additional monopoly after sale, by restrictions following the patented product after it has become owned outright by another. Such restrictions are illegal, and they were so before the *Ethyl* case.

The restrictions and licensing arrangement of the *Ethyl* case apparently went far outside of the patent monopoly, and sought by agreements, and coercion of those not agreeing, to control conditions of competition

for an entire industry, after the patent owner had parted with all property rights in the patented subject matter. The conditions imposed were not shown to be necessary or proper to enable the patent owner to secure full pecuniary reward within the field covered by the patent.

The wonder is that outstanding corporations like General Motors, Dupont, and Standard Oil of New Jersey, with the wealth of legal talent available to them, and with the goldfish-bowl nature of all their licensing and marketing policies, should have lent themselves to a setup of the kind disclosed by this litigation. Probably the answer is that the Sherman Act has been enforced or ignored with great discrimination during several periods and under different administrations, and that one does not know what can or can not be done under that Act without trying to do it. In fact, some administrations, including the present one, have openly encouraged and established situations that are contrary to the Sherman Act,—in spirit if not in letter. Consider, for example, the control of prices, wages, sales policies, and elimination of competition, for various industries under the NRA codes. Whether the Ethyl Corporation regulation of the gasoline industry was a good or bad thing for the public may be arguable. Many would take the affirmative. That question was not considered by the Court, and is not pertinent to this paper.

What patent owners must recognize is that legal price fixing and licensee control are limited to the patented subject matter, that patent owners can not by agreement even in the form of a license extend that control to unpatented things, or to control of patented products in the hands of third parties who have acquired ownership of the patented subject matter.

This case deals with another instance, of which several have recently come to light, involving use of the patent system as an alibi, so to speak, in an attempt to control an industry by *agreements* disguised as patent licenses. The case has received publicity as another misuse of patents, when the patent system was not properly involved at all. The patents were merely used to camouflage agreed policies determined by the oil refiners and carried out with the consent and under the control of all major parties concerned, for the benefit of gasoline producers and distributors who had no interest in any patent involved.

The Supreme Court in this case has manifested no hostility to patents, and has not invalidated any previously allowable restrictions on licensees. On the contrary, the Court has in this latest case referred specifically and repeatedly and with approval to the established right of a patent owner to restrict his license by any conditions

> "normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly."

That is all patent owners ought to ask, or ought to have, whatever they ask. Recognition of that right, and present approval of the law stated in the *General Electric* case, are the important features of the *Ethyl* case so far as patent owners are concerned.