



CPI Antitrust Chronicle

October 2013 (1)

Turning the Page: The Next Chapter of Disputes Involving Standard-Essential Patents

John (“Jay”) Jurata, Jr. &
David B. Smith

Orrick, Herrington & Sutcliffe LLP

Turning the Page: The Next Chapter of Disputes Involving Standard- Essential Patents

John (“Jay”) Jurata, Jr. & David B. Smith¹

I. INTRODUCTION

A technology company is on the verge of introducing a cutting-edge device that builds on a widely adopted industry standard. To do so, it must use patented technology that is technically essential to the standard. The patent owner, despite committing to license its standard-essential patents (“SEPs”) on fair, reasonable, and non-discriminatory (“FRAND”) terms to all potential licensees, makes an extreme royalty demand. When the company refuses this offer, the patent owner threatens to seek an injunction in court. The potential licensee is at a crossroads—should it infringe the SEP and risk its product being excluded from further sale, or agree to pay what it believes is an excessive royalty and attempt to pass on the cost to its customers?

In recent years, competition agencies, courts, and scholars have become increasingly alarmed over exactly this scenario.² These concerns have been prompted by the ability of SEP owners, using the market power conferred upon them as a result of the standard-setting process and “lock in” nature of SEPs, to distort competition for downstream products implementing that standard.

Although industry standards carry great benefits (consider WiFi, Bluetooth, or HDTV), they also pose risks. Companies owning SEPs might refuse to license them to competitors, or demand exorbitant or otherwise unreasonable license terms. This is known as “patent hold-up.”

To prevent hold-up and encourage widespread adoption of the standard, standard-setting organizations (“SSOs”) typically request participants to promise to license their SEPs on FRAND terms to anyone seeking to employ the standard. Thus, SEP owners voluntarily waive the usual patent-owner’s right to seek to prevent others from practicing the patented technology, in return for that technology being incorporated within the standard. Court rulings, enforcement actions, and government policy statements over the past year suggest an emerging consensus on what this FRAND promise means: SEP owners cannot tie the licensing of their SEPs to the licensing of non-SEPs; the threat of injunctions leads to royalty rates in excess of FRAND; and, thus, injunctions for SEPs should be rare.

While the court rulings, enforcement actions and policy statements issued over the last year place important limits on the ability to distort the competitive process, the potential for SEP abuse remains. This article analyzes several problems yet to be thoroughly addressed: (A) whether a patent owner can condition licensing a single SEP on also licensing other SEPs in the

¹ Mr. Jurata and Mr. Smith are attorneys at Orrick, Herrington & Sutcliffe LLP, where they specialize in the intersection of antitrust and intellectual property. They represent multiple technology clients, including Apple and Microsoft.

² In this article, only FRAND-encumbered SEPs are discussed.

standard; (B) when is it appropriate to label a putative licensee as unwilling to enter into a FRAND license, thus arguably permitting a SEP owner to seek an injunction; and (C) to what extent should “royalty stacking”—piling royalties from multiple SEP owners onto each other—be considered when determining FRAND?

II. EMERGING CONSENSUS

Developments over the last year suggest an emerging consensus on several issues. *First*, a SEP owner cannot tie its SEPs to non-SEPs (i.e., other patents not essential to the standard). “[I]t is neither fair nor non-discriminatory for the holder of the FRAND-encumbered patent to *require* licenses to non-FRAND-encumbered patents as a condition for licensing its patent.”³ Similarly, while a SEP owner can condition a license to its SEPs on a cross-license to a would-be licensee’s SEPs for the same standard, both the U.S. Federal Trade Commission (“FTC”) and the U.S. Department of Justice (DOJ) have stated that it is inappropriate to condition access to a SEP on a cross-license to a would-be licensee’s *differentiating* technology.⁴

Second, the threat of an injunction can increase royalty rates above FRAND levels. “[O]nce a patent becomes essential to a standard, the patentee’s bargaining power surges because a prospective licensee has no alternative to licensing the patent; he is at the patentee’s mercy.”⁵ As a result, a potential licensee’s willingness to pay will reflect sunk investments to implement the standard, as opposed to the value of the patented technology.⁶ Indeed, a recent economic paper explained that even a risk-neutral licensee would be willing to pay more than three times the FRAND value of a SEP to avoid the smallest chance of losing in court.⁷

Third, seeking injunctive relief for SEP infringement should be rare.⁸ When a SEP owner makes a FRAND commitment, it acknowledges that a reasonable royalty is adequate

³ Dissenting Views of Commissioner Pinkert, *In the Matter of Certain Elec. Devices, Including Wireless Commc’n Devices, Portable Music and Data Processing Devices, and Tablet Computers*, ITC Inv. No. 337-TA-794, at D3 (July 5, 2013) (emphasis in original); see also Mark A. Lemley & Carl Shapiro, *A Simple Approach to Setting Reasonable Royalties for Standard-Essential Patents* 18 (Stanford Public Law Working Paper No. 2243026, 2013) (“While the issue is not free from doubt, we think that an offer made conditional on the would-be licensee licensing any patents other than standard-essential patents reading on the standard at issue is not a FRAND offer.”).

⁴ See *In the Matter of Motorola Mobility LLC*, FTC File No. 121 0120, Docket No. C-4410, 2013 WL 3944149, at *10, 27 (F.T.C. July 23, 2013); Renata Hesse, Deputy Assistant Attorney General, U.S. Dep’t of Justice, Six “Small” Proposals for SSOs Before Lunch, at ITU-T Patent Roundtable (Oct. 10, 2012), at 9.

⁵ *Apple, Inc. v. Motorola, Inc.*, 869 F. Supp. 2d 901, 913 (N.D. Ill. 2012).

⁶ See Prepared Statement of the FTC Before the U.S. Senate Committee on the Judiciary Concerning “Oversight of the Impact on Competition of Exclusion Orders to Enforce Standard-Essential Patents,” July 11, 2012, at 5 (“FTC Senate Testimony”) (“[A] SEP owner [has] the ability to demand and obtain royalty payments much higher than might have been available prior to adoption of the standard because these rates need not be based on the true market value of its patents, but instead on the costs and delays of switching away from the standardized technology.”); Joaquín Almunia, Vice President of the European Comm’n for Competition Policy, *Competition Policy for Innovation and Growth: Keeping Markets Open and Efficient* (Mar. 3, 2012) (same).

⁷ Fiona Scott Morton & Carl Shapiro, *Strategic Patent Acquisitions* 5-6 (Working Paper 2013), available at <http://faculty.haas.berkeley.edu/shapiro/pae.pdf>.

⁸ See, e.g., *Apple*, 869 F. Supp. 2d at 913-14; U.S. Dep’t of Justice & U.S. Patent & Trademark Office, *Policy Statement on Remedies for Standard-Essential Patents Subject to Voluntary F/RAND Commitments*, Jan. 8, 2013, at 6 (“DOJ & PTO Policy Statement”); FTC Senate Testimony, *supra* note 6, at 6-7; Press Release, Directorate-General

compensation for the use of the relevant patent.⁹ Seeking injunctive relief despite this acknowledgment breaches the FRAND commitment. And such a breach can negatively affect competition, consumers, and innovation because of the market power conferred in return for a SEP owner's FRAND promise.¹⁰ Thus, the emerging consensus holds that the ability to seek injunctive relief should be limited to: (1) when there is no ability to obtain jurisdiction over an infringing product for monetary damages;¹¹ or (2) when a company that infringes a SEP refuses to pay a FRAND royalty.¹²

III. UNRESOLVED ISSUES THAT CAN DISTORT COMPETITION

Despite this emerging consensus, there remains room for abuse by SEP owners. Although a detailed analysis of these issues is beyond the scope of this article, a brief discussion of three particularly problematic issues follows.

A. Tying SEPs to Other SEPs Within the Same Standard

As with tying SEPs to non-SEPs, access to an individual SEP should not be conditioned on licensing other SEPs within the same standard. By conditioning a license to any one SEP on an agreement to license all of its SEPs for that standard, an entity can use the market power conferred upon its strongest SEPs to force potential licensees to also license weaker SEPs in the portfolio. In such a scenario, the combined royalty for the package can exceed the FRAND price for a single or smaller subgroup of SEPs.

A tying arrangement occurs when a seller conditions the sale of one product (the tying product) on the customer's agreement to take a second product (the tied product). Although tying, in many circumstances can be procompetitive, it can be anticompetitive in certain situations. Tying SEPs that a potential licensee desires to license immediately to SEPs that it wants tested in court is one such scenario.

The reason such tying is problematic is because SEP owners tend to over-declare the number of patents that are essential to a standard. At most SSOs, patent owners unilaterally declare their patents to be essential, with no independent verification. Further, patent owners often are encouraged or required to declare patents that are *potentially* essential well before a standard is finalized. Some studies estimate that the majority of patents that have been declared potentially essential to modern standards are, in fact, not technically essential.¹³ As a result, SEP

for Competition, European Commission, Commission Sends Statement of Objections to Motorola on Potential Misuse of Mobile Phone Standard-Essential Patents (May 6, 2013).

⁹ *Realtek Semiconductor Corp. v. LSI Corp.*, 2013 WL 2181717, at *6 (N.D. Cal. May 20, 2013).

¹⁰ *In the Matter of Robert Bosch GmbH*, FTC File No. 121 0081, Docket No. C-4377, Statement of the Comm'n, at 1-2 (Nov. 26, 2012).

¹¹ *Motorola Mobility*, 2013 WL 3944149, at *11; DOJ & PTO Policy Statement, *supra* note 8, at 7.

¹² *Realtek Semiconductor*, 2013 WL 2181717, at *7; *Motorola Mobility*, 2013 WL 3944149, at *11-12; DOJ & PTO Policy Statement, *supra* note 8, at 7.

¹³ For example, over 7,300 patents have been declared as essential to UMTS, a 3G cellular standard.

Independent third-party analysis suggests that the majority of these patents are not technically essential to this standard. See PA Consulting Group, *Essential Intellectual Property in 3GPP-FDD 17* (May 2006) (finding that only 36 percent of declared SEPs for 3GPP-FDD standards, including UMTS, were actually essential); see also PA Consulting Group, *LTE Essential IP R: PA's 3GP P-LTE Database and Report 13* (July 2012) (finding only 40 percent of declared SEPs for LTE were essential).

owners that demand would-be licensees take a portfolio to all their SEPs in a particular standard are requiring payment for patents that may not be necessary to practice the standard or are invalid.

Recent litigation statistics confirm this point. Since 2009, the three companies that have sued on the most SEPs are InterDigital, Motorola, and Samsung. Collectively, these three companies filed on 85 SEPs in 15 jurisdictions, 58 of which have proceeded to judgment. Of those 58 SEPs, only 7 have been deemed to be valid and infringed. In contrast, 18 have been declared invalid, 17 have been found not to be infringed, and 16 have been either withdrawn or dismissed. In other words, *only 1 of every 8 SEPs tested in court has, in fact, been valid and technically essential to practice the standard:*

Table: Success Rate of SEPs in Adjudicated Litigation

	Asserted	Invalid	Not Infringed	Withdrawn	Dismissed	Valid & Infringed
InterDigital	8	3	4	0	1	0
Motorola	16	2	4	6	1	3
Samsung	34	13	9	8	0	4
TOTAL	58	18	17	14	2	7

Source: Appendix

Because of SEP over-declaration, would-be licensees should be allowed to pick and choose which SEPs within a portfolio they want to license, and the FRAND rate should be based on those patents alone. If the SEP owner believes additional patents are infringed, it can file suit on those additional patents and seek monetary damages. But the SEP owner should not be able to force a company to pay for SEPs that it may not need by threatening an injunction on SEPs that the putative licensee needs and wants to license.

Tying SEPs in such a manner can result in royalties that exceed FRAND. Economists have long warned that tying can be used to evade price regulation in the tying market.¹⁴ The combined royalty for the tying product (i.e., the strongest SEPs) and the tied product (i.e., weaker SEPs) may exceed FRAND for the tying product alone. In other words, the “one monopoly rent” theory does not apply—having given a FRAND commitment, a SEP owner cannot charge more than a reasonable royalty for the tying product.¹⁵ And while licensing all SEPs in a single standard

¹⁴ See, e.g., Einer Elhauge, *Tying, Bundled Discounts and the Death of the Single Monopoly Profit Theory*, 123 HARV. L. REV. 397, 426 n.75 (2009) (“[Even] [t]he Chicago School theorists also conceded that tying might be used to evade price regulation . . .”).

¹⁵ Cf. *U.S. Philips Corp. v. Int’l Trade Comm’n*, 424 F.3d 1179 (Fed Cir. 2005).

at once can be efficient, that justification must be balanced against the competitive harm that can arise by forcing would-be licensees to pay for patents they may not need.¹⁶

B. When Does a Potential Licensee Become Unwilling to Enter Into a License?

Many of the court decisions, government enforcement actions, and policy statements discussed in Section II state that injunctive relief should only be sought in rare cases, such as when the potential licensee is unwilling to enter into a license agreement with the SEP owner.¹⁷ But that limited exception, designed to address recalcitrant infringers, likely creates more problems than it solves.

On January 8, 2013, the DOJ and U.S. Patent Trademark Office issued a joint policy statement on the competitive concerns that can arise from SEP enforcement. The statement is largely devoted to describing the importance of standards, outlining the risk of patent hold-up, and explaining why an exclusion order “appears to be incompatible with the terms of a patent owner’s existing F/RAND licensing commitment” and thus may harm competition.¹⁸ The statement also briefly mentions that an injunction might be appropriate when a putative licensee insists on terms clearly below FRAND.¹⁹ That theoretical concern, buried within a 10-page policy statement with no empirical support, has since taken a life of its own.

Predictably, every SEP owner seeking injunctive relief now calls the defendant an “unwilling licensee.” Some SEP owners have even tried to argue that challenging the validity, value, infringement, or essentiality of a given patent amounts to a “refusal” to take a license. Not only is this inconsistent with due process and traditional burdens of proof in patent cases, but using the threat of injunctive relief to extract payment for self-declared SEPs that have not been determined to be valid or infringed is exactly the type of conduct that harms competition.²⁰

Alternatively, some SEP owners have suggested that a putative licensee is “unwilling” if it does not agree to pay a FRAND royalty after binding arbitration. But absent certain procedural defenses—such as meaningful discovery, transparent and reasoned adjudication of *all* of the underlying issues, and appellate review—the threat of vaguely-defined arbitration can be leveraged by SEP owners almost to the same extent as the threat of injunction.

For these reasons, a simpler option with less potential for gamesmanship and harm to competition is to permit injunctive relief only when a putative licensee: (1) does not submit to jurisdiction of a court that can award monetary damages for that SEP; or (2) refuses to pay a royalty proven by the SEP owner to comply with FRAND, determined *after* a SEP is deemed to

¹⁶ Of course, there will be cases where a potential licensee will want to license all of a SEP owner’s patents in a standard. But such negotiations should not be distorted by the threat of injunction on individual SEPs that the licensee wishes to license.

¹⁷ See, e.g., *Realtek Semiconductor*, 2013 WL 2181717, at *7; *Motorola Mobility*, 2013 WL 3944149, at *11-12; DOJ & PTO Policy Statement, *supra* note 8, at 7.

¹⁸ DOJ & PTO Policy Statement, *supra* note 8, at 3-6.

¹⁹ *Id.* at 7.

²⁰ *Motorola Mobility*, 2013 WL 3944149, at *11-12, *15; Press Release, Directorate-General for Competition, European Commission, Commission Sends Statement of Objections to Motorola Mobility on Potential Misuse of Mobile Phone Standard-Essential Patents (May 6, 2013).

be valid, infringed, and enforceable under traditional burdens of proof in an adjudication with adequate procedural protections and appellate review.

C. Royalty Stacking

Another problem that can harm consumers is “royalty stacking.” Royalty stacking occurs when multiple SEP owners within a standard pursue individual royalties with no regard to the total royalties a licensee must pay to use the standard. In such cases, the aggregate royalty could be so large as to impede adoption of the standard.

Two recent decisions offer conflicting holdings on the effect of royalty stacking on FRAND negotiations. In *Microsoft Corp. v. Motorola, Inc.*,²¹ the district court concluded that FRAND negotiations cannot be conducted “in a vacuum” and must consider the effect of other patented technologies within the standard, even if licensing negotiations for those other patents have not yet commenced.²² In contrast, the district court in *Ericsson Inc. v. D-Link Systems, Inc.*²³ concluded that concerns over royalty stacking are “theoretical” absent proof of “actual” royalties paid for other patented technology in the standard.²⁴

The *Ericsson* court’s requirement that a licensee provide proof of consummated licenses before taking royalty stacking into account is problematic. Such a requirement creates an incentive for the first (or first few) SEP owners within a standard to litigate, as early movers could demand royalties without accounting for the value of other technology in the standard. Second, individual licensees might pay different rates for the same technology based solely on whether they had already entered into a license for other SEPs, which might violate the “non-discriminatory” prong of FRAND. To alleviate these problems, FRAND royalties should be set after taking into consideration *all* potential royalties for the standard.

IV. CONCLUSION

Recent developments show that courts and government bodies are right to be concerned about the harmful effects that SEPs may cause to competition. While many positive steps have been taken to curb the potential for abuse, there continue to be outstanding issues related to SEPs and their impact on competition. Until these issues are resolved, opportunities remain for SEP owners to abuse their market power to restrict competition.

²¹ 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013).

²² *Id.* at *20, *73.

²³ 2013 WL 4046225 (E.D. Tex. Aug. 6, 2013).

²⁴ *Id.* at *18.

APPENDIX: Success Rate Of SEPs in Adjudicated Litigation

SEP Owner	Defendant(s)	Jurisdiction & Case Number	Asserted	Invalid	Not Infringed	Withdrawn	Dismissed	Valid & Infringed
InterDigital	Huawei, Nokia, ZTE	Int'l Trade Comm'n (U.S.), 337-TA-800	8	3	4	0	1	0
Motorola	Apple	Int'l Trade Comm'n (U.S.), 337-TA-745	2	1	1	0	0	0
	Apple	N.D. Ill. (U.S.), 1:10-cv-06381	6	1	2	2	1	0
	Apple	Mannheim D. Ct. (Germany), 7 O 169/11, 7 O 443/11	2	0	1	0	0	1
	Microsoft	Int'l Trade Comm'n (U.S.), 337-TA-752	4	0	0	4	0	0
	Microsoft	Mannheim D. Ct. (Germany), 2 O 240/11, 2 O 273/11, 2 O 376/11, 2 O 387/11	2	0	0	0	0	2
Samsung	Apple	Int'l Trade Comm'n (U.S.), 337-TA-794	2	0	1	0	0	1
	Apple	N.D. Cal. (U.S.), 5:11-cv-02079	7	0	3	4	0	0
	Apple	Seoul Central D. Ct. (South Korea), 2011 Kahap 39552, 2011 Gahap 63647	4	2	0	0	0	2
	Apple	D. Ct. of The Hague (Netherlands), KG 11-730, KG 11-731	4	1	2	0	0	1
	Apple	Mannheim D. Ct. (Germany), 7 O 247/11, 7 O 166/11	3	0	3	0	0	0
	Apple	High Ct. of Justice, Chancery Div. (UK), HC 11 CO 2180	3	3	0	0	0	0
	Apple	D. Ct. of New South Wales (Australia), NSD1243/2011	6	2	0	4	0	0
	Apple	Ct. of Milan (Italy), N.R.G. 59734/2011	4	4	0	0	0	0
	Apple	Tokyo D. Ct. (Japan), 2011 (Yo) No. 22027, 2011 (Yo) No. 22028, 2011 (Yo) No. 22048, 2011 (Yo) No. 22049	1	1	0	0	0	0
TOTAL			58	18	17	14	2	7