Some Thoughts on Hold-Up, the IEEE Patent Policy, and the Imperiling of Patent Rights

Kurt M. Kjelland
Sr. Dir., Legal Counsel

16th Advanced Patent Law Institute
Berkeley Center for Law and Technology
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The Hold-up Myth

- The sole articulated antitrust concern with SEPs is “Hold-up”
- Patent hold-up:
  - “[T]he potential that a SEP holder can use the leverage it may acquire as a result of the standard setting process to negotiate higher royalty rates or other favorable terms after the standard is adopted than it could have credibly demanded beforehand.” (U.S. FTC’s definition.)
- But the FRAND commitment grants the implementer a right to have a neutral third party decide the royalty, which must be reasonable by definition
  - This is an important right that is rarely considered
  - It means that the SEP-holder does not have unilateral power over price (unlike an NEP-holder)
  - Many other market considerations moderate opportunistic licensor behaviors
What Is Not Hold-up

The following are **not** instances of patent hold-up:

- Deciding not to include a feature in a product because of the IPR cost
- Disputes over FRAND terms that end up in litigation or ADR*
- Unaccepted licensing offers
- Licenses that are consistent with licensing terms made public before the standard was approved
- Theoretical models, speculation, or academic conjectures

* Joseph Farrell, formerly the FTC’s Chief Economist, has stated: “So first of all, evidence of problems and evidence of lack of problems… There’s a temptation, I think, to say, to identify problems with disputes, maybe even for lawyers’ problems with disputes that make it to litigation. I don’t think you can do that, and I don’t think you can do it in either direction. **Just because there’s a dispute, doesn’t mean that this is a breakdown of the system. Somebody might be being unreasonable, certainly if you had that as a rule of general inference or procedure, it would give whacko incentives to people to dispute perfectly reasonable offers. So we can’t assume that the presence of a dispute means the presence of a problem.**” Transcript, Fed. Trade Comm’n “Tools to Prevent Patent ‘Hold-Up’” Workshop, at 239:9-15 (June 21, 2011).
There is No Economic Evidence of Hold-up

- If hold-up occurred, we would expect to see evidence of:
  - Decreased performance of standardized products,
  - Fewer new product introductions,
  - Diminished development of next-generation solutions,
  - Fewer competitors for standardized solutions, and fewer new entrants
  - Higher prices for standardized goods and services
  - Reduced or slow uptake of standardized products

- In the wireless telecommunications industry, key economic indicators of hold-up are missing, and there is vigorous competition at all levels of the value chain
Justification for the IEEE’s Policy Change

- Settled on “clarity” as the justification in its application for BRL
  - “IEEE-SA has not provided sufficient clarity in its policy – regardless of which party’s valuation is in fact closer to a reasonable rate.”
  - “The Federal Trade commission has also called for greater clarity. For example, just this month, FTC Chair Edity Ramirez stated that ‘additional clarity on a framework for determining FRAND royalties would benefit industry stakeholders and consumers alike...Greater clarity on the terms of a FRAND license is likely to facilitate private negotiations and limit the need to seek a third-party determination of a FRAND rate.’”
  - “In October 2012, Deputy Assistant Attorney General Renata Hesse delivered a speech entitled ‘Six Small Proposals for SSOs Before Lunch (“Six Proposals”)’, suggesting that SDOs consider taking steps to ‘eliminate some of the ambiguity that requires difficult ex post deciphering of the scope of a F/RAND commitment.’”

- Notably, IEEE never provided any empirical evidence showing either hold-up or market failure caused by the old FRAND Policy
Key Changes to IEEE’s Patent Policy

The New IEEE Patent Policy Cannot be Called “FRAND”

1) Cannot reasonably be called a clarification; it is a total rewrite that requires *material, binding concessions* by SEP-owners

2) Requires licensing of components that implement only a portion of a standard

3) Defines “reasonable” royalty rates for SEPs using controversial methodologies not used in real-world licensing

4) Severely limits injunctive relief available to SEP owners
IEEE Patent Policy - Licensing Level

The IEEE’s New Policy Requires Licensing of Component Manufacturers

“The licensing assurance shall be either:

b) A statement that the Submitter will make available a license for Essential Patent Claims to an unrestricted number of Applicants on a worldwide basis without compensation or under Reasonable Rates, with other reasonable terms and conditions that are demonstrably free of any unfair discrimination to make, have made, use, sell, offer to sell, or import any Compliant Implementation that practices the Essential Patent Claims for use in conforming with the IEEE Standard. An Accepted LOA that contains such a statement signifies that reasonable terms and conditions, including without compensation or under Reasonable Rates, are sufficient compensation for a license to use those Essential Patent Claims and precludes seeking, or seeking to enforce, a Prohibitive Order except as provided in this policy.”

“Compliant Implementation” shall mean any product (e.g., component, sub-assembly, or end-product) or service that conforms to any mandatory or optional portion of a normative clause of an IEEE Standard.”
What About the Scope of the Patent?

- The claim defines the invention, and does not necessarily read on a component.
- The one-sized fits-all rule abrogates important value metrics (such as the patentee’s “use” right), particularly for fundamental, system-level innovations.
- Where an invention might be implemented (and the cost of that implementation does not necessarily correlate to the value created by that invention).
- Multiple license levels create inefficiencies, and leads to more disputes.
- What exactly is a mandatory or optional *portion* of a normative clause?
- Concession of important patent rights:
  - Component may not be made, used, or sold in the US by the component manufacturer.
  - Potentially eliminates direct infringement theories.
  - An owner of a US patent has the right to determine how it will license, including refusing to license. *United States v. Westinghouse Elec. Corp.*, 648 F.2d 642, 648 (9thCir. 1981).
  - “A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly.” *Brulotte v. Thys Co.*, 379 US 29, 33 (1964).
Patent Value Is Not Realized at Component Level

- The nature of the patent right provides the patentee an exclusive right to make, use, or sell the invention in any form or combination. It is all those property rights that are licensed and need to be properly valued, not simply the right to sell the smallest component in which the patented technology could be embodied.

  “The primary problem with Cisco’s damages model is the fact that it bases royalties on chip prices. CSIRO did not invent a wireless chip. Although it is largely undisputed that the inventive aspect of the ‘069 patent is carried out in the PHY layer of the wireless chip, the chip itself is not the invention. The ‘069 patent is a combination of techniques that largely solved the multipath problem for indoor wireless data communication. The benefit of the patent lies in the idea, not in the small amount of silicon that happens to be where that idea is physically implemented.” CSIRO v. Cisco (E.D. Tex. 2014)
No Justification to Upset Industry Practice

- If the holder of SEPs licenses at the end device/system level and is not asserting at the component level, there is no reason to impose an obligation to license at the component level
  - Component suppliers often have access to the SEPs in other ways such as “have made” rights of end device/system licensees or non-exhaustive “patent peace” agreements with the SEP holder
“Reasonable Rate” shall mean appropriate compensation to the patent holder for the practice of an Essential Patent Claim excluding the value, if any, resulting from the inclusion of that Essential Patent Claim's technology in the IEEE Standard. In addition, determination of such Reasonable Rates should include, but need not be limited to, the consideration of:

- The value that the functionality of the claimed invention or inventive feature within the Essential Patent Claim contributes to the value of the relevant functionality of the smallest saleable Compliant Implementation that practices the Essential Patent Claim.

- The value that the Essential Patent Claim contributes to the smallest saleable Compliant Implementation that practices that claim, in light of the value contributed by all Essential Patent Claims for the same IEEE Standard practiced in that Compliant Implementation.

- Existing licenses covering use of the Essential Patent Claim, where such licenses were not obtained under the explicit or implicit threat of a Prohibitive Order, and where the circumstances and resulting licenses are otherwise sufficiently comparable to the circumstances of the contemplated license.
Determination of SEP value should include consideration of:

- Apportionment to the smallest saleable patent practicing unit (SSPPU)
- Royalty stacking of other SEPs
- Rejection of all market-based evidence of value
Mandatory SSPPU Is Unworkable

- SSPPU was not intended to be a one-size-fits-all approach to patent valuation, much less as a one-size-fits-all approach to valuing SEPs. This has been twice confirmed by the Federal Circuit.

- SSPPU is unworkable as a valuation method for large patent portfolios
  - SSPPU relates to the scope of the infringed patent claims; it would be nearly impossible to map tens of thousands of claims in a large portfolio
  - The “SSPPU” for a portfolio of patents would likely be an end-user device sold by the infringer

- The value contributed by the SEP or its use may be much more than the cost of implementing the idea

- SSPPU puts an artificial ceiling on every SEP, and eliminates any analysis of the contribution of the invention
Hypothetical Royalty Stacks Are Necessarily Speculative

- Moving target
  - Standards evolve
  - No requirement to disclose potential SEPs, and
  - No determination of whether potential SEPs are actually SEPs
  - New SEPs issue and other expire
- Who decides what is the appropriate cumulative rate?
  - Implicates interests of many companies who are not a party to any one proceeding
  - Should rate be per percentage of price, fixed per unit amount, or something else?
  - How to account for up-front license fees and other consideration/terms?
- How to decide one SEP holder’s fair share?
  - Patent quality or quantity?
No Empirical Evidence of Royalty Stacking

No court has ever found evidence of royalty stacking:

“In this case, we agree with the district court that D-Link failed to provide evidence of patent hold-up and royalty stacking sufficient to warrant a jury instruction. JMOL Order, 2013 WL 4046225, at *25–26 (“Defendants failed to present any evidence of actual hold-up or royalty stacking.” (emphasis in original)).” Ericsson, Inc. v. D-Link Sys., Inc., 773 F.3d 1201 (Fed. Cir. 2014)
The “Existing License” Provision Shows Anti-Patent Bias

The Policy:

Existing licenses covering use of the Essential Patent Claim, where such licenses were not obtained under the explicit or implicit threat of a Prohibitive Order, and where the circumstances and resulting licenses are otherwise sufficiently comparable to the circumstances of the contemplated license.

- All patent license negotiations occur in the shadow of a potential infringement action and the panoply of available remedies
- Presumptively rejects what may be the only real-world evidence of value
- Ignores the negotiating leverage that FRAND commitments provide to potential licensees
FRAND is a two-way street

- A voluntary FRAND commitment is a contract formed through an essential patent holder’s commitment to the [SSO] to license patents on FRAND terms. *Microsoft Corp. v. Motorola, Inc.*, 864 F.Supp.2d 1023, 1031 (W.D.Wash. 2012)

- **Purpose**
  - *Incentivize innovators* to undertake the substantial risks and expense to discover, develop, and contribute technologies to the standardization process
  - Provide implementers *access* to standard essential patents
  - FRAND is not a device to devalue SEPs; rather it protects *both* innovators and implementers and must implement the balance of incentives and access
The IEEE Went Too Far

- Lost site of the long-standing FRAND balance
  - No provisions that balance innovator concerns or could be deemed as patentee-friendly
- New policy requires many new concessions, undermining patent value, and impacting important patent rights that before were unaffected
  - Codifies SSPPU
  - Mandates licensing level
  - Requires a royalty-stacking analysis
- The new Policy goes far beyond codification of existing law on injunctions for SEPs -- eBay already restricts the ability of patent owners to get injunctions.
The Controversy Rages On

- Many wireless innovators have publicly rejected the new policy
  - Contributors of nearly 45% of declared SEPs to IEEE standards have raised objections
- Only 7 LOAs have been received under the new policy
- IEEE is outside the mainstream
  - ETSI has indicated that IEEE’s policy is incompatible with ETSI’s IPR policy
- Legislates rampant inefficiencies
  - FAQ indicates that an offer of a portfolio licensing will not satisfy the FRAND obligation
- Encourages Hold-out and disputes
- At least one standard has been stalled because of an IPR issue