

Patent Hold-Up or Patent Hold-Out? Judge Essex Adds His Voice to the SEP-FRAND Debate

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Administrative Law Judge Essex recently issued the public version of his Initial Determination in ITC investigation No. 337-TA-868, ruling that the respondents are precluded from relying on the defense that the patent holder is required to license the patents-in-suit on fair, reasonable and non-discriminatory (“FRAND”) terms when they failed to seek a license before practicing the standard to which they now claim those patents are essential. Although Judge Essex found that the patents-in-suit were neither infringing nor essential to the standards at issue, he undertook an analysis of respondents’ FRAND defense in the event that the Commission, on review, reversed on both grounds.

Judge Essex’s decision is a noteworthy contribution to what has, to date, been a rather one-sided debate on whether injunctive relief—including in the form of exclusion orders granted by the Commission—should be available to holders of standards-essential patents (“SEPs”). Various government agencies, like the U.S. Department of Justice, the U.S. Patent and Trademark Office, and the U.S. Federal Trade Commission, have weighed in on the issue and have taken the position that such relief should not be available to holders of SEPs except in limited circumstances.

In their joint “Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/Rand Commitments” issued on January 8, 2013, for example, the Justice Department and the PTO express the concern that once a standard becomes established, “it may be prohibitively difficult and expensive [for the user of that standard] to switch to a different technology within the established standard or to a different standard entirely.” Therefore, they reason, allowing the holders of patents incorporated into those standards to enjoin their use would effectively be to allow them to engage in “patent hold-up”—the extraction of higher values from the users of a given standard “than would have been possible before the standard was set, when alternative technologies could have been chosen.” Such an outcome would be contrary to the public interest, they say.

The FTC expresses a similar concern regarding so-called patent hold-up in its Prepared Statement Before the U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning “Standard Essential Patent Disputes and Antitrust Law,” issued July 30, 2013, noting that “hold-up describes the 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.”

The government agencies’ concern is misplaced, according to Judge Essex. Based on his review of the evidence, he concludes that there is no threat of patent hold-up either in the investigation before him or in the telecommunications industry more generally. Indeed, he concludes that the evidence is to the contrary—it is the users of the standards, not the holders of SEPs, who are taking unfair advantage: they are using the patented technology incorporated in the standards not only without a license, but without engaging in licensing negotiations because they know that the worst that can happen is that they get sued and are made to pay the same FRAND rate they would have had to pay for using the patented technology in the first place. As such, he notes, they are “able to shift the risk involved in patent negotiation to the patent holder... There is no risk to the exploiter of the technology in not taking a license before they exhaust their litigation options if the only risk to them for violating the agreement is to pay a FRAND based royalty or fee. This puts the risk of loss entirely on the side of the patent holder, and encourages patent hold-out, which is as unsettling to a fair solution as any patent hold up might be.” Incentivizing such patent hold-out by removing the possibility of obtaining injunctive relief is not in the public interest, he says.

In support of his conclusion, Judge Essex makes a number of important findings that have implications beyond the 868 investigation. First, he notes that although, under certain conditions, patent holders who are members of standards-setting organizations (“SSOs”) have an obligation to declare that their patents might become essential to a given standard, it does not follow that the declared patents are in fact essential to the standard that is ultimately adopted. Whether they are essential is, in any given case, a

factual question. In the investigation at hand, it turns out they are not. Judge Essex explains that this outcome—declared patents later being determined not to be essential—is not unusual, and is in fact to be expected given that “[e]stablishing standards involves input from hundreds of companies over multiple years.” It is therefore “not surprising that some declarations prove to be mistaken,” as was the case here.

Second, Judge Essex notes that even if the patents-in-suit are standard essential, it does not follow that they are automatically subject to FRAND terms. This too is a factual question and depends on the specific terms of the agreement governing the patent holder’s submission of the patents for inclusion in the standard at issue. In the investigation before him, Judge Essex found that as a condition of agreeing to license its patents on FRAND terms, the patent holder had opted to require that those who seek licenses agree to reciprocate. No FRAND obligation is triggered unless that condition precedent, and any others that are operative, are met.

Third, Judge Essex notes that the governing agreement on which the respondents rely for their defense that the patent holder had an obligation to license the patents-in-suit on FRAND terms also required the respondents to try to negotiate a license to use the patented technology *before* using the standard, which they did not do, and to avail themselves of certain procedures for obtaining a license in the event such negotiations failed, which they also did not do. Under such circumstances, Judge Essex argues, it would be inherently unfair to deny patent holders the statutory remedies to which they are entitled if their valid patents are infringed. To hold otherwise, he says, would be to give standards users “a safe haven, where they are free to avoid their own obligations under the [SSO] agreements, can manufacture potentially infringing goods without license or consequence, can seek to invalidate the IPR [intellectual property rights] in question, and yet are free from the risk of remedy under 19 USC 1337.”

Such a “one sided administration of the law” is contrary to the governing statutes and rules, Judge Essex argues, and he cautions that taking “a pre-set position without hearing evidence,” as the Justice Department, the PTO, and the FTC seem to be advocating, “would violate every concept of justice we are tasked to enforce.” Indeed, he writes:



For the Commission to adopt a policy that would favor a speculative and unproven position held by other government agencies, without proof that the harm they considered exists or that the risk of such harm was so great that the Commission should violate its statutory duty would damage the Commission’s reputation for integrity, and violate its duties under the law.

Review of Judge Essex’s Initial Determination in the 868 investigation is currently before the Commission, which has invited comments from the public regarding Judge Essex’s findings and conclusions, including his conclusion that exclusion and cease and desist orders should issue in the event the Commission finds a violation of Section 337. A number of responses have been submitted, most of them supporting Judge Essex’s findings and his arguments against precluding SEP holders from obtaining exclusionary relief at the Commission.

Ericsson Inc., for example, which describes itself as a “leading contributor to standardized technologies,” and “both a licensor and licensee of standard-essential patents,” lauds Judge Essex for taking what it calls “a balanced and comprehensive approach to the consideration of standard-essential patents in section 337 investigations.” In particular, Ericsson agrees with Judge Essex’s findings that (a) the licensing of FRAND-encumbered patents places obligations on both SEP holders and the users of standardized technology, and (b) exclusion orders may be appropriate either when SEP holders have engaged in good-faith licensing negotiations or when users of standardized technology have failed to do so. According to Ericsson, the alternative—categorically precluding SEP holders from obtaining injunctive relief—is unfair and counterproductive: “An approach that deprives essential-patent owners of exclusion orders (or the threat of exclusion orders) ... would unwisely undermine the incentive for future investments in open standards.”

The same concern is echoed by United States Senator Robert P. Casey, Jr. of Pennsylvania, who worries that categorically precluding innovators who have developed standard-essential patented technology from obtaining exclusionary relief “would significantly devalue both the technology and intellectual property that is incorporated into standards and lead technology developers to opt out of the standard-setting process, resulting in more technologically inferior standards.” The Innovation Alliance, “a coalition of companies” that include “longstanding participants” in standards-setting bodies, shares the same concern.

To date, only Microsoft Corporation has submitted a non-party statement expressing disagreement with Judge Essex’s approach and support for the position that SEP holders should be precluded from obtaining injunctive relief.

It remains to be seen how the Commission will respond to Judge Essex’s findings and conclusions. What is clear, however, is that he has given powerful voice to owners of SEPs who turn to the ITC for relief, and

has provided an important counter to the prevailing view that only patent hold-up matters in determining whether injunctive relief should be available to certain patent holders. Judge Essex argues forcefully that patent hold-out is just as important a consideration.

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