

Efficient infringement and the undervaluation of standard-essential patents

Faced with the growing problem of efficient infringement and the difficulty of obtaining adequate protection from the courts, US owners of standard-essential patents need to develop creative strategies to protect the value of their rights

By Michael T Renaud, James M Wodarski and Sandra J Badin

As many commentators and industry insiders have observed, would-be patent licensees appear increasingly reluctant to come to the negotiating table. While the issue is affecting rights holders across the board, it appears particularly acute in the area of standard-essential patents (SEPs), where there is a broad perception that the worst that can happen to an unwilling licensee which is found to infringe a valid SEP is that it pay the same fair, reasonable and non-discriminatory (FRAND) rate it would have had to pay if it had agreed to take a licence in the first instance. Given the not-insignificant possibility that the would-be licensee might be able to invalidate the SEP if it gets sued, there is an increasingly prevalent belief that it is good strategy to hold out on taking a licence, and force the patent owner to litigate. This strategy has become known as ‘efficient infringement’.

How should owners of SEPs respond? This article proposes a multi-pronged approach which takes account of the different degrees of tolerance for efficient infringement in the United States and Europe. Over time it is likely that US courts and policy makers will recognise the harm that efficient infringement is wreaking on incentives to innovate and contribute to the development of standards and will eventually develop responsive legal rules to combat these effects. However, in the meantime, owners of SEPs might see more positive results by using an approach which leverages the more reasonable response to efficient infringement articulated by European courts.

Growing problem

The US Supreme Court’s opinion in June 2016 in *Halo Electronics, Inc v Pulse Electronics, Inc* and *Stryker Corporation v Zimmer, Inc* (decided together) restored the power to determine whether to award enhanced damages for deliberate infringement and in what amount to the district courts, and subjected such determinations to the deferential abuse-of-discretion standard of review. It looks likely that *Halo* will make it more costly for deliberate infringers to decide to infringe, which should make such infringers more willing to enter into licensing negotiations to avoid the possibility of treble damages.

Despite this, *Halo* is unlikely to restore what Paul Michel, former chief judge of the US Court of Appeals for the Federal Circuit, recently called “the honor system where companies that were using technologies patented by others willingly took licenses without being forced by

court order to do so”. His observation that “the honor system is now largely gone” has been echoed by many others over the past few years and is likely to remain true, at least for some time.

As the former director of the US Patent and Trademark Office, David Kappos, and other commentators have observed, efficient infringement is on the rise. The practice is based on the calculation that it is less costly to infringe and take the risk of being sued than it is to take out a licence to use the desired technology. The calculation makes sense in the current legal climate, especially in the United States, in light of a series of US Supreme Court decisions which have had the effect of depressing patent values by:

- making injunctions much more difficult to obtain (*eBay v MercExchange*);
- making licensors more vulnerable to declaratory judgment actions (*MedImmune v Genentech*);
- making patents more vulnerable to obviousness and indefiniteness challenges (*KSR v Teleflex* and *Nautilus v Biosig*);
- broadening the scope of patent exhaustion (*Quanta v LG Electronics*); and
- narrowing the scope of patent eligibility, especially with regard to software (*Alice v CLS Bank*).

Adding to the general negative effect that these decisions have had on patent value is the Federal Circuit’s evolving damages jurisprudence, which has made damages experts more susceptible to *Daubert* challenges, damages harder to prove and damages awards harder to obtain and, once obtained, harder to sustain on post-verdict motions and on appeal.

Equally significant has been the passage of the America Invents Act, which has given accused infringers a much less costly – and at the same time much more potent – means of invalidating patents in a variety of post-grant proceedings brought before the Patent Trial and Appeal Board. To date, the board has cancelled more than 80% of all claims whose validity it has adjudicated.

Against this background, it is little wonder that would-be licensees appear ever less willing to come to the table, given the small likelihood that they will be sued, the even smaller likelihood that the patents in suit will survive a post-grant challenge and the almost negligible likelihood that they will be subjected to an injunction or will ever be made to pay a significant damages award. When the expected impact of a patent

infringement claim is so modest, why should would-be infringers not do as Colleen Chien, former White House senior adviser for intellectual property and innovation at the Office of Science and Technology Policy, recently advised in the *Wall Street Journal*: “The best way to deal with a patent demand may be to take a deep breath – and then do... nothing”?

The strategy of efficient infringement is particularly attractive in the context of SEPs because these are often the subject of a commitment by their owners to offer licences on FRAND terms, which are generally perceived to be lower than ordinary (ie, non-FRAND) royalty rates. This article examines the kinds of relief available to owners of SEPs for infringement of their patented technologies in different forums in the United States and Europe. The divergence in these approaches informs our recommendations on how to combat efficient infringement and restore to SEPs at least some of their lost value.

US courts focus on patent hold-up, not hold-out

In the United States, the development of jurisprudence around SEP infringement and of how FRAND royalties are to be calculated is still in its relative infancy – for example, there is no clear answer to how a patent’s alleged ‘essentiality’ to a standard is to be determined or how a FRAND rate is to be calculated. However, the decisions that have emerged in the past few years make clear that US courts are insufficiently alive to the problem of efficient infringement. Indeed, they seem to be much more concerned with patent hold-up than they are with patent hold-out.

‘Patent hold-up’ is the notion that once a standard has become widely adopted, owners of any patents that have been incorporated into that standard will try to extract a higher value for the use of their rights than they would previously have been able to obtain. This concern is reflected – to the exclusion of any concerns over patent hold-out – in two important recent appellate decisions dealing with the question of what sort of relief is available to the owners of such patents.

Microsoft v Motorola

Last July, the Court of Appeals for the Ninth Circuit issued its opinion in a breach of contract action brought by Microsoft alleging that Motorola had violated its commitment to license its SEPs on FRAND terms (that the patents were standard essential was not in dispute). Microsoft alleged that Motorola violated its FRAND commitment when it offered to license its patents on terms that were ultimately held not to be FRAND and when it later sought to enjoin Microsoft – which had responded to the licensing offers by filing the underlying breach of contract action – from importing its Xbox products into the United States and from selling them in Germany. “The German action was particularly threatening to Microsoft,” the Ninth Circuit observed, “as its European distribution center for all Windows and Xbox products was in Germany”. Fearing an injunction, Microsoft relocated its distribution centre to the Netherlands to protect itself against the economic loss it would suffer if the German court found infringement (which it did). Microsoft also sought – and obtained – an order from the district court enjoining Motorola from enforcing any German-issued injunction.

The jury found that Motorola had breached its duty of good faith and fair dealing by offering licences on non-FRAND terms and by seeking to enjoin Microsoft from selling its products in the United States and Germany. It then awarded Microsoft damages in the amount of \$14.5 million, all but \$3 million of which was for the cost of relocating its distribution centre from Germany to the Netherlands. The district court denied Motorola’s motion for judgment as a matter of law, as to both the verdict and the damages award; the Ninth Circuit affirmed, concluding that there was enough evidence to suggest “that Motorola sought to capture more than the value of its patents by inducing holdup” and that it had filed its injunctive actions to further its hold-up strategy. In arriving at this conclusion, the court did not weigh – or even consider – Microsoft’s apparent refusal to engage Motorola in licensing negotiations or its decision to respond to Motorola’s licensing offer by suing for breach of contract.

Although the Ninth Circuit’s opinion is not binding on the Federal Circuit – which has exclusive jurisdiction to hear cases arising under US patent laws – and its holding is limited to the specific facts of the case, it is a good example of the prevailing assessment of the singular threat of patent hold-up. If more widely adopted, such an assessment would have the unfortunate consequence of incentivising parties that receive licensing offers to respond by means of litigation (suing for breach of contract) rather than coming to the table to negotiate in good faith.

CSIRO v Cisco

In December 2015, the Federal Circuit vacated a \$16 million damages award won by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) in its patent infringement suit against Cisco Systems. The *CSIRO* opinion provides important guidance for determining damages in cases involving SEPs. However, for our purposes the critical holding is the Federal Circuit’s determination that the district court did not take sufficient account of the status of CSIRO’s patent as essential to the standard at issue (the 802.11 wireless standard), and that this may have resulted in the patented technology being overvalued.

Relying on its 2014 opinion in *Ericsson v D-Link Sys*, the appeals court noted that two special apportionment considerations arise when dealing with SEPs. These considerations ensure that the patentee is not improperly compensated for any value derived from the standardisation of a technology and is compensated only for the value of the patented invention itself: “First, the patented feature must be apportioned from all of the unpatented features reflected in the standard. Second, the patentee’s royalty must be premised on the value of the patented feature, not any value added by the standard’s adoption of the patented technology.”

“The decisions that have emerged in the past few years make clear that US courts seem to be much more concerned with patent hold-up than they are with patent hold-out”

These special considerations apply to all SEPs, the court said, not just to SEPs whose owners have agreed to license them on FRAND terms. (As in *Microsoft*, there was no dispute that the patents at issue in *CSIRO* were standard essential, but while Motorola had committed to license its patents on FRAND terms, *CSIRO* had not.) Regardless of whether a patent is FRAND-encumbered, its value “is distinct from any value that artificially accrues to the patent due to the standard’s adoption”, the court noted. Patentees are entitled only to the former;

they are not entitled to the latter. “Without this rule,” the court observed, “patentees would receive all of the benefit created by standardization – benefit that would otherwise flow to consumers and businesses practicing the standard.”

CSIRO has petitioned the Supreme Court to review the Federal Circuit’s decision; but for now, it appears that patents which are admitted or found to be standard essential may be deemed to be subject to FRAND licensing terms regardless of whether their owners committed to license them so.

European courts better understand threat of hold-out

Like their US counterparts, European courts have also recently grappled with the question of what kind of relief is available to SEP owners for infringement of their patented technologies. However, they have focused more on the issue of patent hold-out.

Last summer, in a widely reported opinion, the European Court of Justice (ECJ) addressed the question of whether seeking injunctive relief for infringement of SEPs violates Article 102 of the Treaty on the Functioning of the European Union (TFEU). Article 102 prohibits market-dominant companies from abusing their dominant position by, among other means, “limiting production, markets or technical development to the prejudice of consumers”. The ECJ issued the opinion in response to a request for a preliminary ruling by a German court in a patent infringement action brought by Huawei against ZTE.

The ECJ began by observing that various provisions of EU law protect intellectual property and provide owners of IP rights – which are by nature exclusionary – with recourse to various legal remedies when those rights are infringed. Such remedies include monetary relief in the form of damages, injunctive relief to prevent future infringement and additional relief in the form of the recall and destruction of infringing goods already on the market. At the same time, the ECJ noted, parties are prohibited from abusing their market dominant position under both EU and German law.

While acknowledging that abuse cannot derive from the exercise of the statutory right to seek injunctive relief for patent infringement, the ECJ held that under certain circumstances, the special character of SEPs – which are incorporated into standards that may become widely adopted and are subject to a commitment to be licensed on FRAND terms – may be sufficient to trigger potential abuse. As the ECJ explained: “the fact that that patent has obtained SEP status means that its proprietor can prevent products manufactured by competitors from

appearing or remaining on the market and, thereby, reserve to itself the manufacture of the products in question.” The court concluded: “In those circumstances, and having regard to the fact that an undertaking to grant licences on FRAND terms creates legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licences on such terms, a refusal by the proprietor of the SEP to grant a licence on those terms may, in principle, constitute an abuse within the meaning of Article 102 [of the] TFEU.”

The ECJ went on to elaborate a framework for determining when a patent owner’s request for injunctive relief constitutes abuse of its dominant market position – and when it does not. First, the patent owner must provide the alleged infringer with specific notice that it is infringing and how. Second, “after the alleged infringer has expressed its willingness to conclude a licensing agreement on FRAND terms”, the patent owner must present the alleged infringer with a specific offer to license its patents on FRAND terms, along with a description of how the proposed royalty was calculated. If, after the patent owner has met these obligations, “the alleged infringer has not diligently responded to that offer” without delay, either by accepting it or by making a specific FRAND counter-offer in writing, the patent owner’s election to seek injunctive relief and the recall of infringing goods will not be deemed an abuse of its market position.

German courts have issued a number of decisions over the last year applying and clarifying the ECJ framework, generally confirming the ECJ’s recognition that implementers of standards may not refuse or even delay negotiating for a licence on FRAND terms without running the risk of incurring a costly penalty in the form of an injunction and recall-and-destruction order, or of having to pay ordinary (non-FRAND) damages for the pre-judgment period – regardless of whether the patents are later determined to be FRAND-encumbered.

Certain 3G Mobile Handsets and Certain Wireless Devices with 3G and/or 4G Capabilities

The US International Trade Commission (ITC) is empowered to enjoin the import into the United States and the sale after import of articles that infringe US patents. Respondents in ITC investigations are increasingly relying on the FRAND defence – even when the rights holder disputes whether its asserted patents are standard essential. The FRAND defence posits that the patents in suit are the subject of a commitment to license on FRAND terms, which means that injunctive relief is inappropriate and should not be available even if the patents are found to be infringed and not invalid. Although the ITC has yet to issue an opinion holding that owners of SEPs are categorically excluded from seeking relief before it for the unauthorised use of their inventions, at least one of the administrative law judges who conduct the investigations and initial adjudications – Judge Theodore Essex – has addressed the issue extensively.

In Commission Investigations 337-TA-613 and 337-TA-868, Essex concluded that there is no evidence to support the notion that the owners of SEPs have engaged in patent hold-up either in the investigations before him or in the telecommunications industry more generally. Rather, the evidence is all on the side of patent hold-out: the implementers of the standards are using the patented technology incorporated in the standards without authorisation and without even engaging in licensing negotiations because they know that the worst that can happen is that they get sued, are found to infringe and are made to pay the same FRAND rate that they would have had to pay for using the patented technology in the first place. As such, he observes, 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” (868 investigation). Removing the possibility of injunctive relief would only incentivise such patent hold-out, which he notes, is not in the public interest.

While the judge’s approach to adjudicating the FRAND defence has yet to be tested before the ITC, it has already sparked an important public debate on the relative threats posed by patent hold-up and patent hold-out. Edith Ramirez, chair of the Federal Trade Commission (FTC), publicly disagreed with Essex’s determination that the burden of proving the applicability of the FRAND defence in any given case should be on the party raising it – the respondent – and

not on the patent owner. She urged that the burden should be on patent owners to prove that they did not engage in patent hold-up or run the risk that they will be found not to be entitled to an exclusion order. Two colleagues – Commissioner Maureen Ohlhausen and former Commissioner Joshua Wright – responded by publicly disagreeing with her in turn.

It remains to be seen how the ITC will resolve the question of whether the import of articles that infringe SEPs may be enjoined. In the one instance in which it determined that the SEP owner (Samsung) was entitled to an exclusion order prohibiting its competitor (Apple) from importing infringing articles into the United States, the Office of the US Trade Representative stepped in and blocked the issuance of the injunction as against the public interest, making clear that its determination of the appropriateness of the injunction was limited to the case before it and that each case must be decided on its merits. However, it also made clear that the ITC must ensure that the factual record relating to the status (if contested) of the patents at issue as standard essential – as well as to the presence or absence of either patent hold-up or hold-out – must be sufficiently developed to enable the ITC to determine whether injunctive relief for the infringement of the asserted patents is in the public interest. However, what is clear is that Essex's approach to the adjudication of the FRAND defence is an important step in the development of legal rules governing the enforcement of SEPs by the ITC.

Implications for moving forward

Efficient infringement poses a considerable long-term threat to the health of innovation economies around the world. As Kappos has warned: “the rapid erosion of patent strength places future investment in innovation at risk. It also places at risk the next generation of innovators, who are coming to market without effective patent protection for their innovations.” In the more immediate term, it threatens to rob patent owners of the value of their assets – especially their SEPs.

As we have discussed, the threat of efficient infringement is particularly acute with respect to SEPs because the commitment to license the patents on FRAND terms not only makes getting an injunction harder – and seeking an injunction potentially extremely expensive – but also further depresses the infringer's ultimate damages exposure. The erosion of patent value, especially the value of SEPs, has incentivised doing nothing and remaining silent in the face of licensing offers. So, how should patent owners proceed?

Given the more hospitable environment for enforcing SEPs in Germany compared to the United States, owners of SEPs should consider filing parallel enforcement actions in these two jurisdictions whenever practicable. A German action will bring counter-balancing leverage to any US action, thereby resurrecting the value of SEPs that had been all but declared dead and restoring them to their integral place in any comprehensive patent licensing strategy. German courts generally understand the value of SEPs and are willing to issue injunctive and other appropriate relief in the event that would-be licensees are unwilling to come to the table or unreasonably delay getting there – regardless of the rights holder's identity (ie, whether it

Action plan



The strategy of efficient infringement – refusing to respond to licensing offers and forcing patent owners to litigate – is on the rise. This is unsurprising given the erosion of patent strength over the last decade. In the United States, the strategy is particularly attractive in the area of standard-essential patents (SEPs), where there is a broad perception that the worst that can happen to infringers which refuse to take a licence is that they may get sued and may ultimately have to pay the same fair, reasonable and non-discriminatory (FRAND) royalty rate that they would otherwise have had to pay in the first instance. This belief has been supported by recent case law, which shows a lack of awareness of the threat of efficient infringement among US jurists.

Efficient infringement has so far proved less attractive in Germany, where injunctive relief and compensatory (non-FRAND) damages remain available to SEP owners that follow the framework laid out

by the European Court of Justice (ECJ) last summer in *Huawei v ZTE*.

What does this discrepancy mean for SEP owners?

- SEPs remain a vital source of potential value in any patent portfolio and should be part of any comprehensive patent monetisation strategy.
- Whenever practicable, SEP owners should consider filing parallel enforcement actions in the United States and Germany.
- German courts are specialised and efficient – they understand the value of SEPs and are willing to grant appropriate relief upon a finding of infringement, regardless of the identity of the patent owner.
- To execute successfully on this strategy, SEP owners should make sure to follow the ECJ's framework before bringing any action for injunctive relief.

has commercialised its patents itself), so long as it has met its obligations under the European Court of Justice's (ECJ's) framework. They are also specialised and efficient courts which usually issue decisions in infringement actions within a year of the complaint being filed. They take much less time to prosecute infringement actions than do US courts – even in so-called ‘rocket dockets’ – because discovery is limited and invalidity challenges must be brought in different forums and usually proceed on a slower track.

Conclusion

SEPs in the United States have depreciated in value even more than other patents over the past decade. Ultimately, we expect that the US and European approaches will converge towards the European approach, which incentivises infringers to come to the table and negotiate patent licences in good faith. This strikes the right balance between the rights of patent owners and the interests of standards users, as well as the consuming public, and ensures that the proper incentives are in place for inventors to continue to engage in R&D and to contribute their patented technologies to the development of the standards from which we all benefit.

In the meantime, prosecuting parallel enforcement actions in Germany – where courts have rejected the notion that the implementers of standards may simply ignore licensing offers with impunity – will go some way towards counteracting the silent treatment that SEP owners seeking to license their patents often receive in the United States. **iam**

Michael T Renaud (division head and policy committee member), **James M Wodarski** (member) and **Sandra J Badin** (associate) are part of the IP practice group at Mintz Levin, Boston, United States