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"The U.S. government does not dictate patent policy choices to private SSOs"
– DOJ Press Release announcing its Business Review Letter to IEEE

I. INTRODUCTION

The Antitrust Division of the Department of Justice ("DOJ") failed to give adequate attention to the effects on innovation incentives when issuing a favorable Business Review Letter ("BRL") to the Institute of Electrical and Electronic Engineers, Inc. ("IEEE") regarding the IEEE's Update to its patent policy ("Update"). Instead, the DOJ appears to have based its conclusion that the Update will have pro-competitive effects on policy preferences rather than a careful Rule of Reason analysis.

The DOJ's devaluing of concerns about harm to innovation incentives has serious implications that will affect the choices made by other SSOs, as well as enforcement policies of foreign competition authorities looking to U.S. antitrust law for guidance on the proper relationship between antitrust laws and intellectual property laws.

II. BACKGROUND

On February 2, 2015 Acting Assistant Attorney General for the Antitrust Division Renata Hesse stated in a BRL to the IEEE that it has no present intention to challenge the proposed Update to the patent policy of the IEEE Standards Association ("IEEE-SA").[2] The Update changes the terms and meaning of the licensing obligations that IEEE asks holders of potentially standard-essential patent claims ("SEPs") to accept in the form of a Letter of Assurance ("LOA"). The LOA includes a promise by the submitter to license its SEPs to implementers of an IEEE standard on reasonable and non-discriminatory ("RAND") terms.[3] The IEEE requested the BRL from the DOJ after some members had expressed concerns that the Update, and the process for drafting and approving the Update, might raise antitrust risks to the IEEE and its Members.

The DOJ examined the competitive effects of four key changes made by the Update:

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[2] Business Review Letter to the Institute of Electrical and Electronics Engineers (Feb. 2, 2015), *available online at* http://www.justice.gov/atr/public/busreview/311470.htm.

[3] SEP claim holders may alternatively submit an LOA committing not to enforce their SEP claims against implementers of the standard, or to license their SEP claims without compensation.

i. prioritized factors that should be considered in determining a "Reasonable Rate;"

ii. an effective ban on submitters of LOAs seeking injunctive remedies against standards implementers;

iii. a requirement that LOA submitters be willing to license any person or entity to make, have made, use, sell, offer to sell, or import any Compliant Implementation that practice a SEP for use in conforming with an IEEE standard;[4] and

iv. limitations on when a SEP license can be made conditional on the licensee's grant of a reciprocal license.

The DOJ determined that the revisions contemplated by the Update would have pro-competitive effects by increasing clarity about the meaning of RAND commitments. According to the Department's BRL, this greater clarity would improve the standards-setting process, broaden *ex ante* competition among technologies for inclusion in the standard, facilitate licensing negotiations, reduce patent infringement litigation, and mitigate hold-up. The DOJ found that any anticompetitive effects were unlikely and that even if there were some anticompetitive harms that might flow from the Update, they would likely be outweighed by the Update's pro-competitive benefits. The DOJ therefore concluded that there is no basis to take antitrust enforcement action against the proposed adoption of the Update.

One key potential competitive harm that the DOJ did not adequately address is whether the Update is likely to reduce innovation incentives to such an extent that it might lead to sub-optimal output of innovation and a lessening of dynamic competition. The BRL briefly acknowledges that, in the absence of compensation to patent holders that reflects the value of their technology, patent holders may become reluctant to contribute technology to standards or invest in future R&D that leads to innovation. However, the DOJ's cursory analysis of that competitive risk suggests that it was giving mere lip service to that concern, as it made no serious effort to evaluate that risk in ultimately concluding that the Update would have pro-competitive effects.

Of the four key changes examined by the DOJ, the first two—prioritized factors in determining a Reasonable Rate and the effective ban on injunctive remedies—appear to have as their primary goal the elimination of hold-up risks and a reduction in the level of royalty rates that will be considered RAND. The question for antitrust enforcers in analyzing these two patent policy changes should have been whether achievement of those goals through the vehicle of this Update—which is essentially an agreement by the members of IEEE on behalf of all implementers of IEEE standards—is likely to have an adverse effect on innovation incentives that would lead to an anticompetitive reduction in innovation and, if so, whether the pro-competitive benefits of the patent policy change outweigh those anticompetitive effects. Unfortunately, the BRL does not address those issues concretely. It instead appears to assume, without empirical evidence or analysis, that the elimination of hold-up risks and a reduction in royalty rates paid by users of SEPs will always be on net pro-competitive.

[4] A Compliant Implementation is defined as "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."

III. PRIORITIZED FACTORS FOR DETERMINING A REASONABLE RATE

The Update adds a definition of "Reasonable Rate" that requires that appropriate compensation for a SEP exclude any value resulting from the inclusion of the technology covered by the SEP in the standard. This provision appears to be an attempt to implement U.S. court decisions taking that position, such as the Federal Circuit's holding in *Ericsson, Inc. v. D-Link Sys.* that it is necessary "to ensure that the royalty award is based on the incremental value that the patented *invention* adds to the product, not any value added by the standardization of that technology."[5] An important feature of Judge O'Malley's formulation in that decision is that it is necessary to look at the incremental value to the product from the technology, which will likely be a positive number, rather than to the incremental value over alternative technologies that may have been considered or available to the IEEE working group. This may or may not be the intent of the Update.

The new definition of Reasonable Rate also specifies three factors that "should" be considered in determining a Reasonable Rate, although the Update makes clear that other factors may be considered as well:

1. The value that the functionality contributes to the value of the smallest saleable unit ("SSU") that practices the SEP;
2. The value contributed to the SSU in light of the value contributed by all SEPs practiced by the SSU; and
3. Existing licenses covering use of the SEP where the circumstances are sufficiently comparable and such licenses were not obtained under the explicit or implicit threat of injunctive remedies.

The first two factors go to the well-established concept of apportionment, although the reference to the value of the SSU is still a hotly debated issue that goes beyond the scope of this article. Noteworthy in the third factor above is the suggested rejection of any comparable licenses if they were obtained under the "explicit or implicit" threat of injunctive remedies. A strict reading of this factor might have the effect of excluding consideration of all prior licenses, since injunctive remedies have in the past potentially been available to patent holders, and licensees were doubtless implicitly aware of the possibility that such remedies might be sought if they were to sell infringing devices without taking a license. However, as the DOJ's letter points out, the IEEE's FAQ on this point makes clear that the policy "does not prevent consideration of any other licensing agreements."[6]

The above three prioritized factors all weigh in the direction of lowering royalty rates; other *Georgia Pacific* factors that might weigh in the other direction are notably absent from the list. Nevertheless, the Update makes clear that parties and the courts are not precluded from considering other factors. This caveat allowed the DOJ to conclude that the Update's definition of Reasonable Rate is unlikely to result in competitive harm.

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[5] *Ericsson, Inc. v. D-Link Sys., Inc.* 773 F.3d 1201, 1232 (Fed. Cir. 2014).

[6] Business Review Letter to IEEE, *supra* note 2, at 13, fn 49.

IV. THE AVAILABILITY OF INJUNCTIVE REMEDIES

As discussed below, the change in the IEEE's patent policy likely to have the most significant impact on the royalties that SEP holders will be able to negotiate, or otherwise receive as damages compensation, is the severe restriction on the availability of injunctive relief to SEP holders that submit LOAs. The Update effectively bans submitters of LOAs from seeking or enforcing any Prohibitive Order.[7] Submitters of LOAs would only be permitted to seek a Prohibition Order after there has been an adjudication in a court that has the authority to: (i) determine royalty rates and other reasonable terms and conditions; (ii) adjudicate patent validity; enforceability, essentiality and infringement; (iii) award monetary damages; and (iv) resolve any defenses and counterclaims, and then only if the infringer fails to participate in the adjudication—including a first-level appellate review—or fails to comply with the outcome of that adjudication.

Notably, an action at the U.S. International Trade Commission ("ITC") would not meet this precondition. The ITC is not a court and does not possess the full range of powers required by the Update, such as the authority to determine royalty rates or award monetary damages. Thus, a submitter of an LOA could seek Section 337 remedies only after (i) it obtains a judgment by a qualified court that the implementer has infringed a valid and enforceable patent, (ii) the court has awarded damages for such infringement and/or set a RAND royalty rate, (iii) that decision is upheld on appeal, and (iv) the infringer does not comply with the decision (or fails to participate in the aforementioned proceedings).

This approach creates especially difficult problems for LOA Submitters that possess a large portfolio of SEPs covering many jurisdictions and whose practice is to license on a worldwide portfolio basis. For example, one 2010 study reported that there were eight companies that had disclosed more than 100 patents as potentially essential to the 4G-LTE ETSI standard by that time.[8] If patents and patent applications covering 2G and 3G standards are added, those companies likely each have thousands of SEPs in their portfolios. For implementers of a standard that are unwilling to enter into license agreements, these SEP holders would have to file damage actions for infringement of every SEP and in every jurisdiction in which they own patents before they would receive full RAND compensation for their portfolio. And for jurisdictions where courts do not issue orders for on-going royalties, such actions would need to be filed over and over again.

Opportunistic users of the standard who hope to gain a competitive advantage over competitors that have taken RAND licenses will refrain from entering into licenses with these SEP holders, knowing that no company will engage in such extensive and continuous infringement litigation on all of their SEPs and that, for patents that are enforced, they will never have to pay more than a RAND royalty rate. It is for these types of situations involving

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[7] The Update defines a Prohibitive Order as including an "injunction, exclusion order, or similar adjudicative directive that limits or prevents making, having made, using, selling, offering to sell, or importing a Compliant Implementation."

[8] *See, e.g.* E. Stasik, Royalty Rates And Licensing Strategies For Essential Patents On LTE (4G). Telecommunication Standards, Sept. 2010, *available at* http://www.investorvillage.com/uploads/82827/files/leSI-Royalty-Rates.pdf.

opportunistic unwilling licensees that the threat of injunctive remedies can play a pro-competitive role in encouraging recalcitrant users to engage in good faith negotiations for a RAND license.

The DOJ cited a number of factors in concluding that the effective ban on injunctive remedies is pro-competitive and unlikely to result in competitive harm. On the pro-competitive effects, the DOJ determined that the restriction on injunctive remedies would:

- Reduce the possibility of anti-competitive hold-up.
- Provide further clarity on the options available to SEP holders, with the pro-competitive effects of (i) facilitating licensing negotiations, (ii) reducing infringement litigation, and (iii) enabling parties to reach negotiated license agreements that "appropriately value" the patented technology.

On the other side of the ledger, the DOJ concluded that the effective ban on injunctive remedies would likely not have anticompetitive effects because:

- It is consistent with the direction of U.S. case law.
- In any event, SEP holders can avoid the Update's requirements by simply declining to submit an LOA.
- The DOJ is not concerned that the effective ban will lead to hold-out behavior by implementers, since there already exist several incentives favoring a negotiated solution, including reduced uncertainty on product licensing costs, avoidance of litigation expenses, and insurance against the risk that a court might award a higher royalty than that offered by the SEP holder pre-litigation.

A closer look at each of the points cited by the DOJ suggests that the DOJ approached this revision from the perspective that any measure that avoids patent hold-up and leads to lower royalty rates to standards implementers will have pro-competitive benefits that will virtually always outweigh any anticompetitive effects on innovation incentives and technology contributors. However, that conclusion is not obvious and the BRL provides no empirical evidence to support that perspective.

First, the DOJ appears to have embraced the oft-heard concerns about a serious patent hold-up problem in the mobile phone market. However, there is scant evidence that hold-up is anything more than a theoretical concern, at least in that market. The Federal Circuit in its recent *D-Link v. Ericsson* decision rejected the need to instruct the jury on the possibility of patent hold-up in the absence of actual evidence of such hold-up, of which D-Link failed to provide any such evidence.[9]

Second, by concluding that restrictions on the availability of injunctive remedies will help parties reach license agreements, the DOJ appears to be embracing the fact that the ban on injunctive remedies will force SEP holders to lower the royalty rates that they are seeking. This may in fact be accurate, since the elimination of one of the only tools patent holders possess to

[9] *Ericsson, supra* note 5 at 1234.

bring unwilling licensees to the license negotiating table will act to reduce the negotiating leverage of SEP holders. However, whether that will have pro-competitive or anticompetitive effects is not apparent.

In a similar vein, the DOJ posits that SEP holders will offer "discounted" royalty rates rather than filing infringement litigation and that implementers will be prone to take such offers rather than litigate. Again, the DOJ's emphasis appears to be on the effect that the ban on injunctions will have on encouraging SEP holders to lower the royalty rates they are seeking, not on whether SEP holders will receive adequate compensation for their technology contributions.

In evaluating the settlement incentives for implementers, the DOJ appears to have ignored the unique nature of the licensing of RAND-encumbered patent claims—the royalty rates are already subject to the RAND limitation. Thus, ordinarily the worst outcome that a SEP user would likely face from infringement litigation is that it would be required to pay a RAND rate. Therefore, unless the SEP holder offers a license with royalty terms that are substantially below such a RAND rate, standards implementers that are recalcitrant—if not unwilling—licensees will have little incentive to take a license with a RAND royalty rate.

In other words, unlike the situation with non-RAND-encumbered patents, the limit on royalties imposed by the RAND obligation incentivizes hold-out behavior. It shifts the risks of litigation onto SEP holders who are already shouldering the sunk costs and long-term investment risks of having invested in R&D to develop technologies for possible incorporation into future standards many years before any possible payoff.

Third, the DOJ suggests that the effective elimination of injunctive remedies is unlikely to have any anticompetitive effects because the direction of U.S. case law already makes the likelihood of a SEP holder securing an injunction in the courts remote. This conclusion does not appear to be well supported by current U.S. case law. U.S. courts have not held that injunctive remedies should never be available to holders of RAND-encumbered patent claims, such as where a FRAND licensing offer has been made by the patent holder and the licensing offer has been refused by the infringer.[10]

Moreover, the DOJ completely ignored the fact that the Update effectively precludes SEP holders from filing a section 337 complaint with the ITC, and that the ITC has never indicated that it will not issue exclusion orders based on the infringement of SEPs. In fact, in his Initial Determination in the 337-TA-868 complaint filed by InterDigital, the Administrative Law Judge concluded that there was no evidence in that case that the Commission ought to go beyond the statute and assume that the remedy of an exclusion order should be removed from that case.[11]

[10] *Apple, Inc, v. Motorola, Inc.*, 757 F.3d 1286, 1331 (Fed. Cir. 2014) ("To the extent that the district court applied a per se rule that injunctions are unavailable for SEPs, it erred."); *see also Realtek Semiconductor v. LSI*, 946 F.Supp.2d 998, 1007–08 (E.D. Cal. 2013).

[11] *Certain Wireless Devices With 3G and/or 4G Capabilities*, Inv. No. 337-TA-868, Initial Determination and Recommended Determination (USITC June 26, 2014) at 125.

Finally, the DOJ's own Joint DOJ-PTO Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments[12] specifically contemplates that it might be appropriate for the ITC to issue an exclusion order based on infringement of RAND-encumbered patents where, for example, the infringer refuses or constructively refuses to negotiate a license on RAND terms.

Thus, the DOJ's claim that the Update's effective ban on injunctions will not lead to competitive harm because such remedies are not, in actuality, available to SEP holders does not appear to accurately reflect the true legal situation in the United States.

The vigor with which companies on both sides of the debate have battled on this issue further belies the notion that injunctive remedies in the U.S. play no significant role in the dynamics of RAND-licensing negotiations. To the contrary, to the extent that the criteria for an injunction or an exclusion order can be satisfied by a SEP holder, the elimination of the threat of such remedies is likely to reduce the RAND royalty rates that they will be able to negotiate, and might even impede—rather than facilitate—negotiation of license agreements that provide reasonable compensation to SEP holders for the technologies that they have contributed to a particular standard. This effect may well have anticompetitive consequences that were not well considered by the DOJ in its BRL.

As discussed earlier, injunctive remedies may be particularly important in facilitating good faith license negotiations with companies that have large SEP portfolios that are licensed on a worldwide portfolio basis. The DOJ assumes that damages remedies are adequate for these situations, citing Judge Holderman's *Innovatio*[13] decision as proof that infringement litigation is an adequate mechanism for companies with large SEP portfolios to resolve RAND licensing disputes. In actuality, the *Innovatio* decision involved a portfolio of just 19 patents that were essential to the 802.11 Wi-Fi standard. No U.S. court has assessed damages for infringement of a portfolio of hundreds or thousands of SEPs, or has set a RAND royalty rate and other terms of a license agreement for such a large portfolio.

The DOJ's last rationale for determining that the Update's effective ban on injunctive remedies is unlikely to have anticompetitive effects is to point out that SEP holders can continue to participate in IEEE standards-setting activities even without submitting an LOA, and that they can always choose to leave the IEEE and join a different SSO. It is true that the Update does not require companies with SEPs to submit LOAs as a condition of participation in technical committees, and that SEP holders can potentially avoid the legal implications for submitting LOAs under the Update's new patent policy.[14] However, that does not mean that there will not be

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[12] DOJ-PTO Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments, at 9, *available at http://www.justice.gov/atr/public/guidelines/290994.pdf. See also*, Letter from U.S. Trade Representative Michael Froman to ITC Chairman Irving Williamson, August 3, 2013, *available at* http://ustr.gov/sites/default/files/08032013%20Letter_1.pdf

[13] *In re Innovatio IP Ventures, LLC Patent Litig.*, No. 11 C 9308, 2013 WL 5593609, at *1 (N.D. Ill. Oct. 3, 2013).

[14] In fact, after the IEEE approved the Update, Qualcomm announced that it will not submit licensing commitments under the new policy. *See*, "Qualcomm Says It Won't Follow New Wi-Fi Rules on Patents," *available at* http://www.bloomberg.com/news/articles/2015-02-11/qualcomm-says-new-wi-fi-standard-rules-unfair-may-not-take-part.

consequences to SEP holders that refuse to submit LOAs. IEEE working groups will be informed when technologies proposed for inclusion in a standard are not covered by an LOA, and this may lead the working group to avoid including such technologies in the standard. And while companies participating in the IEEE may be free to leave the IEEE and join other SSOs, that fact says nothing about the competitive effects of such a decision.

Also noticeably absent from the BRL is any rigorous analysis of the competitive effects of the Update's effective ban on injunctive remedies, and of whether a patent policy change that forces innovative companies to refuse to submit commitments under the new patent policy, or to resign from the IEEE because of concerns that they will not receive adequate compensation for their technologies, will have anticompetitive consequences.

V. CONCLUDING THOUGHTS

The DOJ's rationale for concluding that the Update's effective ban on injunctive remedies is unlikely to have anticompetitive effects appears to have been based on policy preferences, rather than on sound economic and legal analysis. The DOJ assumes that a ban on injunctive remedies will have pro-competitive effects by eliminating the possibility of hold-up and lead to lower royalty rates for users. The DOJ may be correct in that intuition, but that conclusion is not at all obvious and the DOJ's analysis in the BRL is not convincing. The BRL does not consider whether there are pro-competitive benefits of limiting reverse hold-up (or "hold-out") that will be lost as a result of the IEEE's new patent policy, or whether the resulting lower royalty rates will in fact chill innovation incentives with anticompetitive effects.

The DOJ could have based its conclusions on a careful Rule of Reason analysis of whether, and how, the Update might affect innovation incentives, and what the long-term consequences might be on innovation and dynamic competition. For example, the DOJ could have evaluated whether the ban on injunctive remedies and the lower expected royalty rates that may flow from that restriction would lead some companies to decide to reduce R&D investment and whether the structure of the market is such that such decisions would—or would not—have significant competitive effects on innovation or the potential for dynamic competition. The DOJ could have evaluated whether entry barriers are sufficiently low enough in areas covered by IEEE standards that it is a viable alternative for technology contributors to leave IEEE and start a competing standard.

Instead, the approach and rationale taken by the DOJ in the IEEE BRL could be read to call into question whether the DOJ would challenge even a blatant agreement by members of SSOs with collective monopoly power to fix the royalty rate that they will pay to patent holders. By foregoing rigorous antitrust analysis in favor of a decision based on policy preferences, the DOJ appears to be using this BRL as a vehicle for expressing its view that the patent laws and antitrust laws are not fully complementary, and that antitrust goals favor a readjustment in the form of lower compensation for patent holders, at least when standard-essential patents are involved.

The DOJ's business review letter to the IEEE may have far reaching consequences, as it provides a roadmap for other SSOs to follow in adopting similar patent policies. It will also be read with great interest by competition authorities in other jurisdictions that may hope to use their competition laws as an instrument of a broader industrial policy to undermine the current structure of global standards-setting and holdings of standards-essential patents.

The DOJ stresses in its BRL and accompanying press release that the U.S. government "does not dictate patent policy choices to private standards setting organizations." However, it is the job of the DOJ to engage in careful antitrust analysis to ensure that SSOs and their members do not adopt patent policies or engage in other practices that may be harmful to competition. The DOJ could have done a better job in its analysis and conclusions with respect to the competitive effects of IEEE's effective ban on injunctive remedies.