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F/RANDly Judicial Advice to the Rescue: *Ericsson v. D-Link*

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I. INTRODUCTION

On December 4, 2014, the U.S. Court of Appeals for the Federal Circuit issued its long-awaited decision in the *Ericsson v. D-Link* matter[2] ("CAFC Decision" or "Decision"). The Decision marks the first U.S. appellate review guidance on the much-debated issue of determining appropriate royalties for standard-essential patents that are subject to reasonable and non-discriminatory ("RAND") licensing commitments. This note summarizes pertinent aspects of the District Court opinion and the subsequent CAFC Decision, and examines their consistency with competition developments in this area.

II. THE FACTUAL BACKGROUND AND THE *ERICSSON V. D-LINK* DISTRICT COURT DECISION

Ericsson filed the original patent infringement complaint that started this matter on its course through the courts in September, 2010. It did so after years of fruitless licensing negotiations with six makers of routers and other devices compliant with IEEE 802.11 (Wi-Fi) standards: D-Link, Netgear, Acer/Gateway, Dell, Toshiba, and Belkin.[3] Intel, the wireless chip supplier for the products in question, subsequently intervened in the case, and was thus added as a defendant. In June 2013, a jury found several of the patents infringed, and therefore awarded Ericsson damages of about U.S. $10,000, 000.[4]

The jury verdict addressed only issues of validity, infringement, and damages. In addition, the defendants had asserted a counterclaim alleging that Ericsson had acted in a manner inconsistent with its RAND licensing obligations to IEEE. These claims were adjudicated in a separate bench trial before presiding Judge Leonard Davis.

On August 6, 2013, Judge Davis issued a lengthy memorandum opinion and order ("Opinion") broadly upholding the jury verdict, and rejecting the defendants' contentions that Ericsson's licensing and enforcement conduct was inconsistent with its RAND commitment.[5]

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[2] Ericsson, Inc. v. D-Link Sys. Inc., et al., 773 F.3d 1201 (Fed. Cir. 2014), *available at* http://www.cafc.uscourts.gov/images/stories/opinions-orders/13-1625.Opinion.12-2-2014.1.PDF.

[3] Original Compl. for Patent Infringement, Ericsson, Inc. v. D-Link Sys. Inc. et al. [hereinafter *Ericsson v. D-Link*], No. 6:10-00473 (E. D. Tex. Sept. 14, 2010), 2013 WL 4046225 , ECF No. 1.

[4] Final Verdict Form, *Ericsson v. D-Link*, No. 6:10-00473 (June 13, 2013), ECF No. 508.

[5] Memorandum Opinion and Order, *Ericsson v. D-Link*, No. 6:10-00473, 2013 WL 2242444 (Aug. 6, 2013).

The opinion offers valuable guidance on the interpretation of a RAND commitment in a number of areas:

A. Basic Principles of RAND Licensing

1. **Initial RAND licensing offer is a starting point; seeking a royalty greater than what the infringer believes reasonable is not a RAND-violation.** The court noted that RAND licensing:

> creates a situation ripe for judicial resolution. If two parties negotiating a RAND license are unable to agree to the financial terms of an agreement, it is entirely appropriate to resolve their dispute in court. A patent holder does not violate its RAND obligations by seeking a royalty greater than its potential licensee believes is reasonable. Similarly, a potential licensee does not violate its RAND obligations by refusing a royalty that the patent holder believes is reasonable. Instead, both sides' initial offers should be viewed as the starting point in negotiations. Even if a court or jury must ultimately determine an appropriate rate, merely seeking a higher royalty than a potential licensee believes is reasonable is not a RAND violation." (p. 50)

2. **RAND licensing is a two-way street.** The court held that:

> RAND licensing also includes an obligation to negotiate in good faith. This obligation is a two-way street. As potential licensees in a RAND negotiation, Defendants possessed an obligation to negotiate in good faith and earnestly seek an amicable royalty rate. . . . Defendants never meaningfully engaged Ericsson in RAND licensing negotiations after the initial [Ericsson] offer. Further, the fact that the RAND rate was ultimately litigated in court does not make Ericsson's initial offer unreasonable. (pp. 50-51)

B. Level of Licensing

1. **No duty to assert patents.** The argument that Ericsson may have breached its RAND obligation to offer licenses to an unrestricted number of licensees "by not suing Intel, then not seeking damages against Intel after it intervened in the case" was rejected on two grounds. First, the court noted that "[a]s the plaintiff, [Ericsson] is the master of its own case… and Defendants cite no law requiring a patentee to sue all potential licensees." Second, the court noted that "Ericsson offered Intel a license prior to trial" but the latter "never meaningfully engaged in licensing talks with Ericsson after Ericsson's initial offer…[and] cannot rely on its failure to negotiate to prove Ericsson's failure to make a legitimate license offer." (pp. 32-33).

   In rejecting the defendants' allegation that such behavior is equivalent to a refusal to offer somehow inconsistent with Ericsson's RAND obligations, the court effectively held that a patent holder's duty to offer a license on RAND terms applies only where it actually asserts its patents against that infringer.

2. **Licensing at the end-user product is consistent with RAND.** The court found Ericsson's policy of licensing only end-user products to be consistent with its RAND licensing commitment to IEEE, and noted that:

> Participation in standard-setting organizations such as the IEEE is voluntary, and parties are free to restrict or limit their level of participation. There is nothing inherently wrong or unfair with

> Ericsson's practice of licensing 'fully compliant' products, and they gave notice of this position in their initial letter of assurance. Further, other large companies have adopted similar policies of only licensing fully compliant products. (p. 47).

C. The Establishment of RAND Royalties:

1. **Alleged use of "non-comparable" licenses**. Defendants' argument that the licenses presented by Ericsson were incomparable because "there [was] no evidence that the licenses were negotiated with Ericsson's RAND obligations in mind" was rejected, both as a matter of law and as a matter of fact. The Court saw "no binding authority that a prior license is incomparable as a matter of law if it was not negotiated within the RAND framework" and held that "[e]ven if there were binding authority on the issue, [Ericsson's expert] testified that the prior licenses were all negotiated within the framework of Ericsson's RAND obligations" (p. 35).
2. **Royalty stacking and hold-up arguments rejected as "theoretical."** The court rejected Defendants' argument that the jury's award failed to account for the "danger that royalty stacking would block or impede the 802.11 standard," dismissing the argument as "theoretical" (pp. 35-36), and noting that "Defendants did not present any evidence of an actual royalty stack on the asserted patents" (p. 49). Similarly, it found "Defendants failed to present any evidence of *actual* hold-up" (p. 36).

III. THE COURT OF APPEALS DECISION

The defendants chose not to appeal the aforementioned RAND Opinion, thus rendering it final. Instead, their appeal raised two other issues that may be of interest to the antitrust bar: First, whether Ericsson's damages theory was presented in violation of the Entire Market Value Rule by relying on licenses that were based on the value of the end products; and, second, whether the jury was instructed properly regarding Ericsson's RAND obligations. In reviewing these issues, the Court made the following important findings:

1. **Damages may be based on end-user product.** The Court rejected the argument that a RAND royalty must always be based on the "smallest saleable unit" explaining that "where the entire market value of a machine as a marketable article is 'properly and legally attributable to the patented feature,' the damages…may be calculated by reference to that value" (pp. 40-41). The Court further explained that the "ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the *end product*." (emphasis added) (p. 40) and found that that the District court did not err in allowing Ericsson's damages theory that was based on an end-product royalty base.
2. **Use of comparable licenses as evidence.** The CAFC confirmed that "licenses may be presented to the jury to help the jury decide an appropriate royalty award" (p. 41) and noted that "the fact that a license is not perfectly analogous generally goes to the weight of the evidence, not its admissibility." (p. 42). It concluded that "when licenses based on the value of a multi-component product are admitted…the court should…ensure that the [jury] instructions fully explain the need to apportion the ultimate royalty award to the incremental value of the patented feature from the overall product," but such licenses could be admissible, comparable licenses, and were so in the case (p. 43).

3. **Actual evidence of theoretical stacking and hold-up must be presented in order to obtain a jury instruction.** The Court agreed with the District Court's finding that "D-Link failed to provide evidence of patent hold-up and royalty stacking sufficient to warrant a jury instruction" (p. 54). It explained that "the district court need not instruct the jury on hold-up or stacking unless the accused infringer presents actual evidence of hold-up or stacking." (p. 54). Additionally, it noted that "[t]he mere fact that thousands of patents are declared to be essential to a standard does not mean that a standard-compliant company will necessarily have to pay a royalty to each SEP holder" (p. 55). The Court thus concluded that "the district court did not err by refusing to instruct the jury on the general concepts of patent hold-up and royalty stacking." (p. 55).

4. **There is no one-size-fits-all modified *Georgia-Pacific* formula to calculate RAND damages.** In rejecting the *Innovatio*[6] and *Microsoft*[7] decisions' approach, the Court recognized the need to evaluate RAND commitments and conduct on a case-by-case basis:

   > [t]o be clear, we do not hold that there is a modified version of the *Georgia-Pacific* factors that should be used for all RAND-encumbered patents. . . . We believe it unwise to create a new set of *Georgia-Pacific*-like factors for all cases involving RAND-encumbered patents. Although we recognize the desire for bright line rules and the need for district courts to start somewhere, courts must consider the facts of record when instructing the jury and should avoid rote reference to any particular damages formula. (pp. 49-50).

5. **Value of the patented technology in the context of standardization.** The CAFC found that a "royalty award for a [standard essential patent] must be apportioned to the value of the patented invention. . . not the value of the standard as a whole" and a jury must be instructed accordingly (p. 52). It cautioned, however, that this decision "does not suggest that all standard-essential patents make up only a small part of the technology in the standard. Indeed, if a patentee can show that his invention makes up 'the entire value of the' standard, an apportionment instruction [to the jury] probably would not be appropriate." (p. 52).

   In the context of apportioning "the value of the patented technology from the value of its standardization" the Court explained that "the patent holder should only be compensated for the approximate incremental benefit derived from his invention." (p. 52). It then went on to note that "widespread adoption of standard essential technology is not entirely indicative of the added usefulness of an innovation over the prior art" but that "[t]his is not meant to imply that [standard essential patents] never claim valuable technological contributions." Rather, the Court explained: "[w]e merely hold that the royalty for [standard essential patents] should reflect the approximate value of that technological contribution, not the value of its widespread adoption due to standardization." (p. 53).

[6] *In re* Innovatio IP Ventures, 2013 WL 5593609 (N.D. Ill. Oct. 3, 2013).

[7] Microsoft v. Motorola, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013).

IV. THE DECISIONS FROM AN ANTITRUST PERSPECTIVE

The issues of whether and how a party has acted consistent with its RAND obligations have recently been the subject of interest to the antitrust community. Therefore, while the Opinion and the Decision did not address antitrust issues, it is interesting to draw some lines between them and existing antirust jurisprudence as well as antitrust agencies' advocacy and actions. Such a review reveals some consistencies with antitrust law and policy statements, and some inconsistencies.

First, the finding that damages may be calculated based on an end-user product is consistent with views echoed by at least two competition agencies. China's National Development and Reform Commission followed this approach in February, 2015, in the settled outcome of its investigation of Qualcomm's licensing practices. The settlement suggests that basing royalties on the end device is not, in and of itself,[8] an antitrust or excessive pricing issue, and goes on to accept a proposed remedy formula that is in fact based on the end device. Similarly, in a September, 2014, speech, FTC Chairwoman Edith Ramirez stated that "it is important to recognize that a contractual dispute over royalty terms, whether the rate or the base used, does not in itself raise antitrust concerns."[9]

Second, the theoretical and unsubstantiated nature of "stacking" and "hold-up" allegations that are commonly raised by infringers as a defense strategy is reflected both in the decisions as well as in competition agencies' advocacy and enforcement records. Both the FTC 2011 *Evolving IP Marketplace* Report, and the 2007 *FTC/DOJ Antitrust Enforcement and IP Rights* Report address stacking and hold-up in theoretical terms. They do not suggest the existence of any widespread problem, let alone attempt to cite proof for the same.

Agencies' speeches and statements from the past two years are no different; they merely state that the agencies continue to closely monitor for such behavior. Thus, for example, in a July 2013 FTC statement, the Commission's discussion of hold-up was theoretical and did not point to any empirical direction.[10] The author is not aware of the U.S. or EC antitrust agencies ever proving hold-up or stacking in court, which leads one to wonder how these issues would have been decided by an independent adjudicator had the targets of these investigations chosen not to settle them.

Third, and on a higher level of abstraction, the CAFC determination that there is no one-size-fits-all formula to calculate RAND damages is philosophically consistent with modern

[8] The decision section that discusses the supposedly excessive royalties is based on a list of multiple practices, and concludes with NDRC's view that it is the combination of these factors that led to supposedly excessive pricing.

[9] Edith Ramirez, Chairwoman, Fed. Trade Comm'n, Standard-Essential Patents and Licensing: An Antitrust Enforcement Perspective, Address at 8th Annual Global Antitrust Enforcement Symposium 11 (Sept. 10, 2014), http://www.ftc.gov/system/files/documents/public_statements/582451/140915georgetownlaw.pdf.

[10] Suzanne Munck, Chief Counsel for Intellectual Property, Fed. Trade Comm'n, Standard Essential Patent Disputes and Antitrust Law: Hearing Before the Subcomm. on Antitrust, Competition Policy and Consumer Rights of the S. Comm. of the Judiciary 6 (July 30, 2013) (also recognizing "several market-based factors [that] may mitigate the risk of hold-up"), https://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf.

antitrust law's general coalescence towards a case-by-case *rule of reason* analysis of antitrust scenarios.

Fourth, the CAFC analysis of how to determine the value of a standard-essential patent is different from the FTC analysis of the same. As noted earlier, the CAFC held that the "ultimate reasonable royalty award must be based on the incremental value that the patented invention adds to the *end product*." (p. 40) (emphasis added). It then went on to explain that the royalty award for a standard essential patent must be "apportioned to the value of the patented invention. . . not the value of the standard as a whole." However, the Court cautioned that this principle "does not suggest that all standard-essential patents make up only a small part of the technology in the standard" and recognized that a patentee could possibly show that his invention makes up "the entire value of the" standard. In other words, the CAFC focuses on the total contribution the patented technology makes to the standard as a whole.

By contrast, in a 2011 Report, the FTC has suggested a formulation of the correct RAND value of a standard-essential patent to be the "ex ante value of the patented technology at the time the standard is set" and recommended that "Courts should cap the royalty at the incremental value of the patented technology over alternatives available at the time the standard was defined."[11]

In adopting a very different formulation for determining the value of standard-essential patents, the CAFC thus rejected the FTC recommendation in this area.

Finally, in finding that a RAND obligation to license applies only towards standard implementers against whom a standard-essential patent holder chooses to assert its patents, the Opinion's outcome is consistent with the rationale of competition enforcers. Competition agencies have explained that a (F)RAND licensing commitment's purpose is ensuring access to the standard. For example, the FTC explains that companies "rely on a FRAND commitment to *ensure access* to SEPs"[12] and the European Commission Horizontal Guidelines explain that the aim of FRAND commitments is to "*ensure effective access* to the standard."[13] An infringer against whom standard-essential patents are not asserted effectively enjoys free and unobstructed access to the standard even without a license. Therefore, there is no competition law reason to interfere in such a scenario.

V. CONCLUSION

The *Ericsson v. D-Link* Opinion and Decision provide much needed guidance in the heavily contested realm of RAND licensing. They are mostly consistent with antitrust agencies' work and thinking in this area to date. However, the CAFC formulation for determining the

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[11] Fed. Trade Comm'n, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 194 (Mar. 2011), https://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf.

[12] Letter from Donald S. Clark (Sec'y, Fed. Trade Comm'n), *"Response to Commenters" Re: In the Matter of Motorola Mobility LLC and Google Inc., File No. 121 0120, Docket No. C-4410* 2 at 2 (July 23, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/07/130724googlemotorolaletter.pdf.

[13] European Comm'n, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*, 2011 O. J. (C 11) Art. 285 (Jan. 14, 2011), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011XC0114(04)&from=EN.

RAND value of standard-essential patents is different from the FTC formulation of the same. As the expert authority on patent valuation, it would be useful to follow the CAFC's FRANDly advice on this matter moving forward.