COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
March 2015 (2)

IEEE Business Review Letter: The DOJ Reveals Its Hand

Hugh M. Hollman
Baker Botts LLP

IEEE Business Review Letter: The DOJ Reveals Its Hand

Hugh M. Hollman[1]

I. INTRODUCTION

Collaboratively set voluntary technology standards, which are developed by private standard development organizations ("SDOs"), are greatly beneficial and ever more significant in our modern economy that relies on rapid innovation and product interoperability to thrive. Many SDO participants contribute proprietary cutting edge technology solutions to standards and, as a result, hold standard-essential patents ("SEPs") that technology users may need to implement a standard.

Many SDOs maintain a balance between technology contributors and technology users through the use of voluntary commitments to license SEPs on fair, reasonable, and non-discriminatory ("F/RAND") commitments. In determining the content of those voluntary commitments, SEP holders and technology users were, until now, left to the free market with parties negotiating their own agreements unconstrained by any mandated SDO requirements. Recently, however, an SDO named the Institute of Electrical and Electronics Engineers, Inc. ("IEEE") voted to change its patent policy, incorporating drastic changes that will directly impact negotiations over what constitutes a F/RAND royalty rate.

On February 2, 2015, the Department of Justice Antitrust Division ("DOJ") issued a Business Review Letter in response to an IEEE request for one stating that it does not have the present intention to challenge the IEEE's proposed revision to its patent policy.[2] This is the IEEE's second Business Review Letter request. It previously made a request in 2007, when the SDO last changed its patent policy.[3] At issue in 2007 was its then-proposed IEEE-SA Letter of Assurance ("LOA") policy and form, which did not require any specific terms for licensing negotiations or royalty rates, but only that the patent holders had the option to disclose and commit to their most restrictive licensing terms. This time, the IEEE proposed two main revisions to its patent policy that do provide for specific terms.

First, the IEEE suggested how a F/RAND royalty rate should be determined: based on the smallest salable compliant implementation and the value of existing licenses covering the use of the essential patent claim. Second, the policy now prohibits injunctive relief as an option for patent holders "unless the implementer fails to participate in, or to comply with the outcome of,

---

[1] Hugh M. Hollman is a Senior Associate in the Antitrust and Competition Practice at Baker Botts LLP. The author would like to thank Mr. James F. Rill, Ms. Dina Kallay, and Ms. Jana Seidl for their comments. The views expressed herein are Mr. Hollman's alone and not necessarily those of Baker Botts, or any individual partner.

[2] DOJ Business Review Letter to Michael A. Lindsay, Esq. on behalf of IEEE (Feb. 2, 2015), *available at* http://www.justice.gov/atr/public/busreview/311470.pdf [hereafter 2015 IEEE Ltr.].

[3] DOJ Business Review Letter to Michael A. Lindsay, Esq. on behalf of IEEE (Apr. 30, 2007), *available at* http://www.justice.gov/atr/public/busreview/222978.pdf.

an adjudication, including an affirming first-level appellate review . . . ."[4] This time around, therefore, the IEEE is making policy choices on behalf of its members, and the DOJ was not simply "offering guidance" about its "enforcement priorities" in issuing its February 2015 Business Review Letter but was making stark policy choices, as well.

Given the impact of technology standards, greater transparency into the mechanics of private SDOs is ultimately very valuable, as are the government's publicized views of those standard setting activities. As explained by Bill Baer, Deputy Attorney General of the DOJ: "[o]ffering guidance about our enforcement priorities, whether through formal guidelines, business review letters, or speeches, helps [businesses] make plans and provides a good opportunity for the Division to educate businesses, the courts, and the public about our current approach to antitrust analysis."[5] But there is a vast difference between providing guidance and transparency as opposed to forcing parties to apply specific terms. With mandatory terms, there are inevitable consequences that may ultimately favor one of the parties in F/RAND negotiations. In this case, the changes appear to reflect a policy choice that favors technology users at the expense of patent holders.

II. SMALLEST SALEABLE COMPLIANT IMPLEMENTATION

According to the revised policy, a "reasonable" royalty must be set with reference to the "smallest saleable Compliant Implementation that practices [an] Essential Patent Claim."[6] The DOJ praises this change for providing additional clarity to what is meant by reasonable rate. Specifically, the DOJ explains: "The Update's Reasonable Rate definition provides additional clarity regarding the IEEE RAND Commitment, which could help speed licensing negotiations, limit patent infringement litigations, enable parties to reach mutually beneficial bargains that appropriately value the patented technology, and lead to increased competition among technologies for inclusion in IEEE standards."[7]

Of course, no one could disagree that these are all benefits that could arise from additional clarity on what constitutes a F/RAND commitment in a given SDO's view. Nevertheless, the industry has already evaluated the smallest salable compliant implementation as a potential benchmark for a F/RAND royalty rate, along with many other rate reference points. Resulting industry practice, however, is to primarily reference the value of the end-use device. This was always deemed as most efficient by both technology users and patent holders because it better reflects consumer valuation of the technology—a neutral market-setting reference point.

As one court recently explained, the problem with basing royalties on the smallest saleable compliant implementation, like chip prices, is that it separates the value of the invention from any meaningful reference to consumer benefit:

---

[4] 2015 IEEE Ltr. at 9.

[5] Bill Baer, Deputy Attorney Gen., Antitrust Division, U.S. Dep't of Justice, "Remarks as Prepared for Delivery at the Global Competition Review Fourth Annual Antitrust Leaders Forum" (Feb. 6, 2015*), available at* http://www.justice.gov/atr/public/speeches/311710.pdf.

[6] 2015 IEEE Ltr. at 12.

[7] 2015 IEEE Ltr. at 14.

> [t]he 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 . . . Basing a royalty solely on chip price is like valuing a copyrighted book based on the costs of the binding, paper, and ink needed to actually produce the physical product. While such a calculation captures the cost of the physical product, it provides no indication of its actual value.[8]

Accordingly, in the face of this precedent, the IEEE (endorsed by the DOJ) very definitely chose the smallest salable compliant implementation as their appropriate rate reference point.

The DOJ went on to cite a number of cases as precedent for its endorsement of the use of the smallest saleable compliant implementation.[9] But the precedent is not clear-cut. For example, in support of the IEEE's selection of the smallest salable compliant implementation standard, the DOJ references the U.S. Court of Appeals for the Federal Circuit's ("Federal Circuit") decision in *VirnetX*. However, in that case, the Federal Circuit did not sanction basing a royalty on only the smallest saleable compliant implementation. It labeled such an approach as "wrong," because this:

> mistakenly suggests that when the smallest salable unit is used as the royalty base, there is necessarily no further constraint on the selection of the base. *That is wrong* . . . . In other words, the requirement that a patentee identify damages associated with the smallest salable patent-practicing unit is simply a step toward meeting the requirement of apportionment.[10]

The Federal Circuit had reached a similar conclusion in *Lucent Technologies, Inc. v. Gateway, Inc*. There, the Federal Circuit explained that using a product's end price as a royalty base makes sense as:

> sophisticated parties routinely enter into license agreements that base the value of the patented inventions as a percentage of the commercial products' sales price. There is nothing inherently wrong with using the market value of the entire product . . . so long as the multiplier accounts for the proportion of the base represented by the infringing component or feature.[11]

Many scholars argue that there is little significance to whether parties begin their negotiations with the smallest salable compliant implementation, or the end price of the product, or any other reference rate. Their point of view is that it is only a matter of metrics; ounces or kilograms do not ultimately change the weight. This is true in a purely scientific context, but in business negotiations the opportunity to bid high and subsequently move one's bid lower as negotiations progress is considered inherently beneficial.

In another case cited by the DOJ, *Ericsson v. D-Link*, the court recognized that "a patent holder does not violate its RAND obligations by seeking a royalty greater than its potential

---

[8] *Commonwealth Scientific and Indus. Research Orgs v. Cisco*, No.6:11-cv-343, 2014 WL 2805817, at *11 (E.D. Tex. July 23, 2014).

[9] The DOJ specifically cited *LaserDynamics, Inc. v. Quanta Computers, Inc.* 694 F.3d, 51, 67 (Fed. Cir. 2012), *VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308, 1327 (Fed. Cir. 2014) and *Ericsson v. D-Link Sys., Inc.*, 773 F.3d 1201 (Fed. Cir. 2014).

[10] *VirnetX*, 767 F.3d at 1327. (emphasis added).

[11] *Lucent Techns., Inc. v. Gateway, Inc.*, 580 F.3d 1301, 1339 (Fed. Cir. 2009).

licensee believes is reasonable. . . both sides' initial offers should be viewed as the starting point in negotiations."[12] The court also explained that there is "nothing inherently wrong or unfair with Ericsson's practice of licensing 'fully compliant' products."[13] There is real significance, therefore, to defining a reference rate, and the IEEE and DOJ—given its approval of the IEEE's policy change—have selected a reference rate that favors technology users at the risk of undercompensating SEP patent holders.

III. INJUNCTIVE RELIEF

Just as the DOJ's reasoning for recommending the use of the smallest salable compliant implementation reflects a policy choice that rests on shaky ground, so too does its logic underlying its support for prohibiting injunctive relief until the parties have litigated to the appellate level. The DOJ reasons as follows:

> The threat of exclusion from a market is a powerful weapon that can enable a patent owner to hold up implementers of a standard. Limiting this threat reduces the possibility that a patent holder will take advantage of the inclusion of its patent in a standard to engage in patent hold up, and provides comfort to implementers in developing their products.[14]

But there is no market evidence of hold-up. No economist has been able to provide data to show that hold-up even exists. As a theoretical concept it could happen but, in reality, it is very unlikely.[15] Patent holders will not hold up technology users if they plan to do repeat business with them. Certainly, a once-off arrangement where a monopolist squeezes out every last drop from a technology user could occur without a F/RAND commitment, but the reputational cost and consequences work against such an incentive to seek supra-competitive rates.

SDOs and technology users would surely not include such patentee's future patents in any new standard if the patent holder engages in this type of bad faith negotiation. This point was recognized by the FTC in a statement before a Senate Judiciary Subcommittee.[16] Citing an earlier FTC report, the testimony explains that "patent holders who manufacture products using the standardized technology 'may find it more profitable to offer attractive licensing terms in order

[12] Mem. Op. and Order, No. 6:10-00473, 2013 WL 2242444, at *50 (E.D. Tex., Aug. 6, 2013), *affirmed Ericsson v. D-Link, Sys., et al.*, 773 F.3d 1201 (Fed. Cir. 2014). For a useful discussion of these decisions, *see* Dina Kallay, *F/RANDly Judicial Advice to the Rescue: Ericsson v. D-Link*, 3(1) CPI ANTITRUST CHRON. (Mar. 2015) (publ. forthcoming).

[13] *Id*. at 47.

[14] 2015 IEEE Ltr. at 9.

[15] Despite Defendants' arguments regarding hold up in *Ericsson v. D-Link*, Judge Davis held that "Defendants had failed to present any evidence of actual hold-up." Mem. Op. and Order, No. 6:10-00473, 2013 WL 2242444 at *36 (E.D. Tex. Aug. 6, 2013), *affirmed Ericsson v. D-Link, Sys., et al.*, 773 F.3d 1201 (Fed. Cir. 2014).

[16] Prepared Statement of the Fed. Trade Comm'n Before the United States Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning "Standard Essential Patent Disputes and Antitrust Law", 6 (July 30, 2013), *available at* https://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf

to promote the adoption of the product using the standard, increasing the demand for its product rather than extracting royalties."[17]

Even if the DOJ is not chasing ghosts, any hold-up concerns are solved by the F/RAND safety valve. The DOJ notes that U.S. patent courts have accepted the principle that a F/RAND commitment means that the patent holder is bound "not to exclude these implementers from using the standard unless they refuse to take a RAND license."[18] If that is the case, then whatever problem the DOJ seeks to solve is purely theoretical. Not only is there no data supporting the existence of hold-up, but the courts do not allow injunctions to be issued in infringement cases, unless there is an unwilling licensee.

The DOJ goes on to say that prohibiting a F/RAND encumbered SEP holder from seeking an injunction, "in practice, . . . will not be significantly more restrictive than current U.S. case law."[19] But this is in error. In fact, the most recent court to speak on the issue, the Federal Circuit, held in its April 2014 *Apple v. Motorola* ruling that an SEP holder does not give up its right to seek an injunction merely because of F/RAND commitments; the district court had erred in suggesting a *per se* rule barring SEP holders from seeking injunctions.[20]

According to the Federal Circuit, there is no reason to establish a separate rule or framework for cases involving SEPs and the four-factor test for injunctions announced in *eBay Inc. v. MercExchange, L.L.C.* applies for SEPs just as it applies in all other patent cases.[21] The *eBay* test "provides ample strength and flexibility for addressing the unique aspects of FRAND committed patents and industry standards in general."[22]

What DOJ is proposing by endorsing the IEEE's policy change approach is thus much more restrictive than U.S. case law. It prevents even "seeking" an injunction in court, which is the only remedy a patent holder has against an unwilling licensee—to stop it from continuing to infringe its patent without a license. The DOJ does recognize the possibility of an unwilling licensee who may delay "paying reasonable compensation for a portfolio of patents until a patent holder has litigated each patent in its portfolio individually."[23] This conduct is otherwise known as hold-out. But, as a solution, the DOJ merely "encourages patent holders and implementers to negotiate licensing agreements that are mutually acceptable . . . ."[24]

As a result, the DOJ has identified a problem that no one is sure really exists, or still exists, and has endorsed a solution that is more restrictive than U.S. case law, even though the DOJ erroneously believes it is in line with current case law. Ironically, in addressing the real problem of an "unwilling licensee," an obviously real problem in the patent-licensing world

---

[17] *Id.* at 6 *citing* Fed. Trade Comm'n & U.S. Dep't of Justice, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* 2 (2007), *available at* http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf.

[18] 2015 IEEE Ltr. at 9.

[19] *Id.* at 10.

[20] *Apple, Inc. v. Motorola, Inc.*, 757 F.3d 1286, 1331-32 (Fed. Cir. Apr. 25, 2014).

[21] *Id.*

[22] *Id.* at 1332.

[23] 2015 IEEE Ltr. at 10.

[24] *Id.*

where intellectual property can be easily copied and infringed, the DOJ only "encourages" the parties to solve the problem themselves. The DOJ also regularly praises the change in IEEE policy as adding additional "clarity" to the IP landscape. Ultimately, it is doubtful whether this additional clarity was needed in the first place and the proposed solution will likely result in more harm than good.[25]

IV. PAST BUSINESS REVIEW LETTERS

Business Review Letters are important policy-making tools available to the DOJ. They merit careful consideration, especially the careful weighing of all the evidence and points of view. Unfortunately, the DOJ's latest IEEE Business Review Letter appears to be based more on opinion than on fact. In an area where speculative harm is rife, and consequences uncertain, the DOJ may have been better advised to refuse IEEE's request for a Business Review Letter.

There is precedent for such refusals. The DOJ noted in its response to a proposal from the American Welding Society in 2002 that the "Department does not possess the information it would need to determine whether the standard that the [applicant] is considering would have a net anticompetitive effect under the rule of reason."[26] The DOJ went even further in its IP Exchange business review letter in 2013.[27] In response to the applicant's request that DOJ state its present enforcement intentions regarding the planned exchange for unit license rights to defined sets of patents, the DOJ declined to provide this. The DOJ explained that

> [d]ue to the inherent uncertainties and potential competitive concerns associated with IPXI's novel business model that are discussed in detail below, the Department declines to state its present enforcement intentions regarding IPXI's proposal at this time. We simply do not know enough to conclude that IPXI's activities, once operational, will not raise competitive concerns.[28]

Additionally, in the 1970s, in response to a request from the American Importers Association, the DOJ responded that the request was inappropriate for its Business Review Letter procedure.[29] It explained that the "potential means of accomplishing the council's proposed

---

[25] In its 2007 IEEE letter the DOJ noted that "[t]he Department likely would challenge under section 1 of the Sherman Act any activities that reduced competition by using IEEE-SA's proposed patent policy as a cover to fix the prices of downstream standardized products." *See* 2007 IEEE Ltr. at 11. The 2015 IEEE Letter notes that there were parties who expressed the concern that the process at the IEEE was ultimately biased in favor of technology users. In response, the DOJ explained that the development of the policy was ultimately voluntary and there were many opportunities for other interests to express "divergent views." *Id.* at 7. By definition, however, there are more technology users than patent holders and, as such, a democratic solution could still be biased in favor of technology users. The fact that the development of this policy was public and voluntary does not eliminate section 1 concerns.

[26] DOJ Business Review Letter to Douglas W. MacDonald, Esq. on behalf of American Welding Society (Oct. 7, 2002), *available at* http://www.justice.gov/atr/public/busreview/200310.htm.

[27] DOJ Business Review Letter to Garrard R. Beeney, Esq. on behalf of Intellectual Property Exchange International, Inc. (Mar. 26, 2013), *available at* http://www.justice.gov/atr/public/busreview/295151.htm.

[28] *Id.* at 1.

[29] DOJ Business Review Letter to Keith I. Clearwaters, Esq. on behalf of American Importers Association, Inc., B.R.L. 77-13 (D.O.J.), 1977 WL 22850 (Jul. 12, 1977).

objectives could be so varied that it was not possible to predict their competitive consequences fully."[30]

With the level of factual uncertainty surrounding the issues raised by the IEEE letter, the better approach for the DOJ might have been to refuse to state its present enforcement intentions. The DOJ could then have gone on to explain the agency's view on F/RAND, etc., but would have been free not to endorse the smallest salable compliant measure or its view on prohibiting injunctions as a resolution of theoretical hold-up concerns. In this case, however, the DOJ chose in both instances to support the option most favorable to technology users.

V. CONCLUSION

There is no hiding the fact that the DOJ has made very apparent policy choices in its 2015 IEEE Business Review Letter—a letter it need not have issued in the first place. Instead of concluding that there is insufficient evidence to reach a conclusion, the DOJ based its findings on ambiguous precedent and little-to-no evidentiary support. This amounts to the DOJ making a clear choice to favor technology users at the expense of technology developers who contributed their technology into an open standard. Whether one believes this to be the correct choice will likely depend on which side of the fence one is on, i.e., with the technology users or patent holders. But it is now clear that the DOJ has sided with technology users.

---

[30] *Id.*