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Patent Policy Change Would Undermine Property Rights and Innovation

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Abstract

American standard-setting organizations (SSOs) are associations through which businesses set voluntary industrial standards. Many SSO participants hold "standard essential patents" (SEPs) that may be needed to implement individual SSO standards. SSOs rely on SEPs to provide the technical wizardry that underlies the high quality standards that underpin many key industries, from smartphones to semiconductors. The Institute of Electrical and Electronics Engineers (IEEE), one of the world's largest and most influential SSOs, recently approved a new policy that will reduce the value of SEPs, discourage involvement by innovative companies in IEEE standard setting, and undermine support for strong patents, which are critical to economic growth and innovation. Rescinding this new patent policy would encourage firms to maintain their active involvement in beneficial IEEE standard setting and promote welfare-enhancing negotiations that spur the implementation of new and desirable technologies.

American standard-setting organizations (SSOs), which are private sector–based associations through which businesses come together to set voluntary industrial standards, confer great benefits on the modern economy. They enable virtually all products that we rely upon in modern society (including mechanical, electrical, information, telecommunications, and other systems) to interoperate, thereby spurring innovation, efficiency, and consumer choice.[1] Standards promote interoperability, for example, by creating common technical interfaces for integrating semiconductor chips or other key components into popular consumer goods such as smartphones.

Key Points

- Standard-setting organizations enable virtually all products that modern society relies on (including mechanical, electrical, information, telecommunications, and other systems) to interoperate, thereby spurring innovation, efficiency, and consumer choice.
- SSOs rely on "standard essential patents" (SEPs) to provide the technical wizardry that underlies the high quality standards that underpin many key industries, from smartphones to semiconductors, and in turn encourages widespread business and consumer use of high-tech products.
- The new Institute of Electrical and Electronics Engineers (IEEE) policy in effect micromanages contractual negotiations among large numbers of firms that often compete among themselves, which may raise questions under U.S. antitrust law.
- The new policy also creates an imbalance between the rights of innovators (whose patents lose value) and implementers of technologies, and interferes in market processes by inappropriately circumscribing the terms of licensing negotiations.

This paper, in its entirety, can be found at **http://report.heritage.org/lm147**

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Many SSO participants hold "standard essential patents" (SEPs) that may be needed to implement individual SSO standards. An SEP covers a technical component that is necessary (hence, essential) in order for a high-technology product to employ a standardized technological system—a system shared by *all* smartphone devices, for example. Being denied access to an SEP may effectively prevent a firm from being able to compete effectively in a market where consumers expect certain standardized features such as fast and versatile Internet browsers and cameras in smartphones.

On the other hand, "implementation" patents that are used to differentiate and promote competition among high-tech devices—such as differences in the operation of iPhones as opposed to Android phones—are not SEPs, because smartphone producers (or producers of other sorts of high-tech devices) do not need access to them in order to compete. Rather, competing firms can "pick and choose" in developing or seeking access to implementation patents that best further the particular product style they are promoting.

SSOs rely on SEPs to provide the technical wizardry that underlies the high quality standards that underpin many key industries, from smartphones to semiconductors, and in turn encourages widespread business and consumer use of high-tech products. Discouraging investment in SEPs would tend to reduce the quality of new SEP-reliant standards and the future high-tech products that they underpin.

From Non-intervention to Micromanagement

In order to promote widespread adoption and application of standards, SSOs often require participants to agree in advance to reveal their SEPs and to license them on "fair, reasonable, and non-discriminatory" (F/RAND) terms. Historically, however, American SEPs have not sought to micromanage the terms of licensing negotiations between holders of SEPs and other patents on the one side and manufacturers that desire access to those patents on the other. These have been left up to free-market processes, which have led to an abundance of innovative products and services (smartphones, for example) that have benefited consumers and spurred the rapid development of high-technology industries.

Unfortunately, ignoring this beneficial tradition of non-intervention in licensing negotiations, the Institute of Electrical and Electronics Engineers (IEEE), one of the largest and most influential SSOs in the world, which claims to be "the world's largest technical professional society,"[2] formally voted on February 8, 2015, to amend its patent policy.[3] The IEEE's new policy will reduce the value of SEPs, discourage involvement by innovative companies in IEEE standard setting, and undermine support for strong patents, which are critical to economic growth and innovation.[4]

Because the new IEEE policy in effect micromanages contractual negotiations among large numbers of firms that often compete among themselves, it may raise questions under U.S. antitrust law, which prohibits contracts that unreasonably restrain trade. Recognizing this, the IEEE availed itself of the U.S. Department of Justice (DOJ) Antitrust Division's "business review letter" procedure, under which DOJ, upon request, may elect to provide a statement about its current enforcement intentions regarding a proposed new course of business conduct.[5] In a February 2, 2015, business review letter,[6] DOJ informed

1. *See* Submission of the United States to Working Party No. 2 on Competition and Regulation, DAF/COMP/WP2/WD(2010)(2) (hereinafter 2010 U.S. Submission), *available at* http://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/usstandardsetting.pdf.
2. As explained on its website, "By 2010, IEEE comprised over 395,000 members in 160 countries. Through its global network of geographical units, publications, Web services, and conferences, IEEE remains the world's largest technical professional association." History of IEEE, *available at* http://www.ieee.org/about/ieee_history.html.
3. *See* Press Release, IEEE Statement Regarding Updating of Its Standards-Related Patent Policy (Feb. 8, 2015), *available at* http://www.ieee.org/about/news/2015/8_february_2015.html.
4. *See generally* Alden F. Abbott, *Abuse of Dominance by Patentees: A Pro-Innovation Perspective*, 14 ANTITRUST SOURCE (No. 1) 1, 8–10 (Oct. 2014) (summarizing recent scholarship), *available at* http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct14_full_source.authcheckdam.pdf.
5. *See* U.S. Dep't of Justice, Business Reviews (accessed Feb. 9, 2015), *available at* http://www.justice.gov/atr/public/busreview/201659a.htm.
6. Letter from Renata B. Hesse, Acting Assistant Attorney Gen., U.S. Dep't of Justice, to Michael A. Lindsey, Esq., Dorsey & Whitney LLP (Feb. 2, 2015), *available at* http://www.justice.gov/atr/public/busreview/311470.htm.

the IEEE that it had no plans to bring an antitrust enforcement action regarding that SSO's proposed new patent policy.

Devaluing SEPs and Undermining Innovation

Wholly aside from the question of whether it constitutes an antitrust violation, however, the new policy greatly devalues SEPs and thereby undermines incentives to make patents available for use in IEEE standards. All told, the new policy creates an imbalance between the rights of innovators (whose patents lose value) and implementers of technologies and interferes in market processes by inappropriately circumscribing the terms of licensing negotiations.

Several of the new IEEE patent policy's key features are especially troublesome.[7] Specifically:

- In order to have its patents included in an IEEE standard, a patent holder will have to provide the IEEE with a letter of assurance waiving its right to seek an injunction against an infringer. This eliminates a great deal of leverage that SEP holders have to get infringers to the negotiating table quickly. Moreover, eliminating an injunction from consideration will encourage widespread and willful patent infringement, with the infringers knowing that the worst fate they can suffer, when and if caught, is to pay royalties that they had a duty to pay in the first place. Infringers that are essentially judgment-proof—for example, parties whose assets are mainly overseas, can be quickly transferred overseas, or are in bankruptcy proceedings—may have a particularly strong incentive to act in a cavalier manner toward SEP holders.

- An analysis of comparable licenses for purposes of determining a F/RAND royalty can consider only licenses for which the SEP holder relinquished the right to seek and enforce an injunction against an unlicensed implementer.

- An SEP holder may seek an injunction only after having fully litigated its claims against an unlicensed implementer through the appeals stage—a process that would essentially strip it of its right to seek an injunction, a core right that it enjoys under the Patent Act.[8]

- An SEP holder cannot condition granting a license on receiving reasonable reciprocal access to non-SEP patents held by the other negotiating party. This means that an SEP holder must grant access to its key standardized technology to another party without being able to insist that the other party reciprocate by allowing it to use that party's technology—technology that the SEP holder may deem vital to the commercialization of its high-tech products. This means that firms with many SEPs may find themselves commercially disadvantaged compared to rivals that focused on non-SEP patenting. As a result, businesses might shy away from developing patents that could be used to improve the quality of standard setting, thereby lowering the usefulness of important standards.

- Royalty negotiations involving an SEP holder must be based on the value of the "relevant functionality of the smallest saleable compliant implementation that practices the essential patent claim." This ignores the fact that the benefit that a claimed invention provides to an end product—which is often key to determining reasonable licensing terms—depends on the specific patent and product to be licensed, not necessarily on the "smallest saleable compliant implementation" (for example, a small microchip). This provision would create an artificially low upper limit on potential SEP royalties and straitjacket SEP owners when they engage in negotiations.

The press release accompanying the release of the February 2 business review letter[9] included this statement by the letter's author, Renata Hesse, DOJ's

7. The changes effectuated by the new policy are set forth at http://grouper.ieee.org/groups/pp-dialog/drafts_comments/SBBylaws_100614_redline_current.pdf.
8. In the United States, a court "may grant injunctions … to prevent the violation of any right secured by patent." 35 U.S.C. § 283.
9. Press Release, U.S. Dep't of Justice, Department of Justice Will Not Challenge Standards-Setting Organization's Proposal to Update Patent Policy (Feb. 2, 2015), *available at* http://www.justice.gov/atr/public/press_releases/2015/311475.htm.

Acting Assistant Attorney General for the Antitrust Division: "IEEE's decision to update its policy, if adopted by the IEEE Board, has the potential to help patent holders and standards implementers to reach mutually beneficial licensing agreements and to facilitate the adoption of pro-competitive standards." Regrettably, this may fairly be read as a DOJ endorsement of the new IEEE policy and, thus, as implicit DOJ support for devaluing SEPs. As such, it threatens to encourage other SSOs to adopt policies that sharply limit the ability of SEP holders to obtain reasonable returns on their patents. Individual contract negotiations that take into account the full set of matter-specific factors that bear on value are more likely to enhance welfare when they are not artificially constrained by "ground rules" that tilt in favor of one of the two sets of interests represented at the negotiating table.

Need to Protect Intellectual Property Rights

In its future pronouncements on the patent–antitrust interface, DOJ should bear in mind its 2013 Joint Policy Statement with the U.S. Patent and Trademark Office (USPTO), in which it stated that:

> DOJ and USPTO strongly support the protection of intellectual property rights and believe that a patent holder who makes ... a F/RAND commitment should receive appropriate compensation that reflects the value of the technology contributed to the standard. It is important for innovators to continue to have incentives to participate in standards-setting activities and for technological breakthroughs in standardized technologies to be fairly rewarded.[10]

Consistent with the DOJ–USPTO Joint Policy Statement, DOJ should clarify its views and explain that it does not support policies that prevent SEP holders from obtaining a fair return on their patents. Such a policy announcement would not require withdrawal of the February 2 business review letter, but it would necessitate a strong statement noting the potential harm to property rights flowing from the IEEE's new patent policy. Such a statement might be accompanied by a critique of SSO policy changes that impose extreme limitations on the negotiating freedom of SEP holders and thus threaten to undermine welfare-enhancing participation in standard setting.

It is to be hoped that the IEEE will also take note of these concerns and rescind its new patent policy. Such a result would encourage firms to maintain their active involvement in beneficial IEEE standard setting and promote welfare-enhancing negotiations that spur the implementation of new and desirable technologies.

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10. Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/Rand Commitments, U.S. Dep't of Justice & U.S. Patent & Trademark Office 8 (2013), *available at* http://www.justice.gov/atr/public/guidelines/290994.pdf.