PATENT TRANSFERS, FRAND COMMITMENTS, AND TRANSPARENCY

Jay P. Kesan, Ph.D., J.D.
Professor & Workman Research Scholar
Carol M. Hayes, J.D.
Research Associate
University of Illinois at Urbana-Champaign College of Law

Standards and Patents

- A standard (created by a SSO) is a written specification that fosters interoperability by facilitating uniformity
- Patents provide incentives for innovation – if you innovate and obtain a patent, you can control who can practice the patent for the statutory period
- Standards may describe technologies that are covered by patents – Standard Essential Patents

Standard Essential Patents (SEPs)

- Technologically Essential
  - "Core" essential – Standard cannot be implemented without using technology covered by claims of the patent(s)
  - "Non-core" essential – Option described by in the standard, but cannot be implemented without using technology covered by claims of the patent(s)
- Non-essential patents – the standard refers to multiple alternatives for implementing part of the standard or optional features of the standard

Commercially Essential Patents

- Commercially Essential (sliding scale relation to technical grounds)
  - Narrow – non-essential patents that are part of the standard, but may become essential because:
    - Out of several alternatives, market demand is overwhelmingly for one technology; or
    - Out of several alternatives, only one is economically feasible
  - Intermediate – patented technology enables interoperability, competitors have produced complementary technologies that require access to some patents to compete, and it is broadly adopted by the market
  - Broad – patented technology is related to, but it is not referenced by the standard; market demand is near unanimous, and must include feature to compete

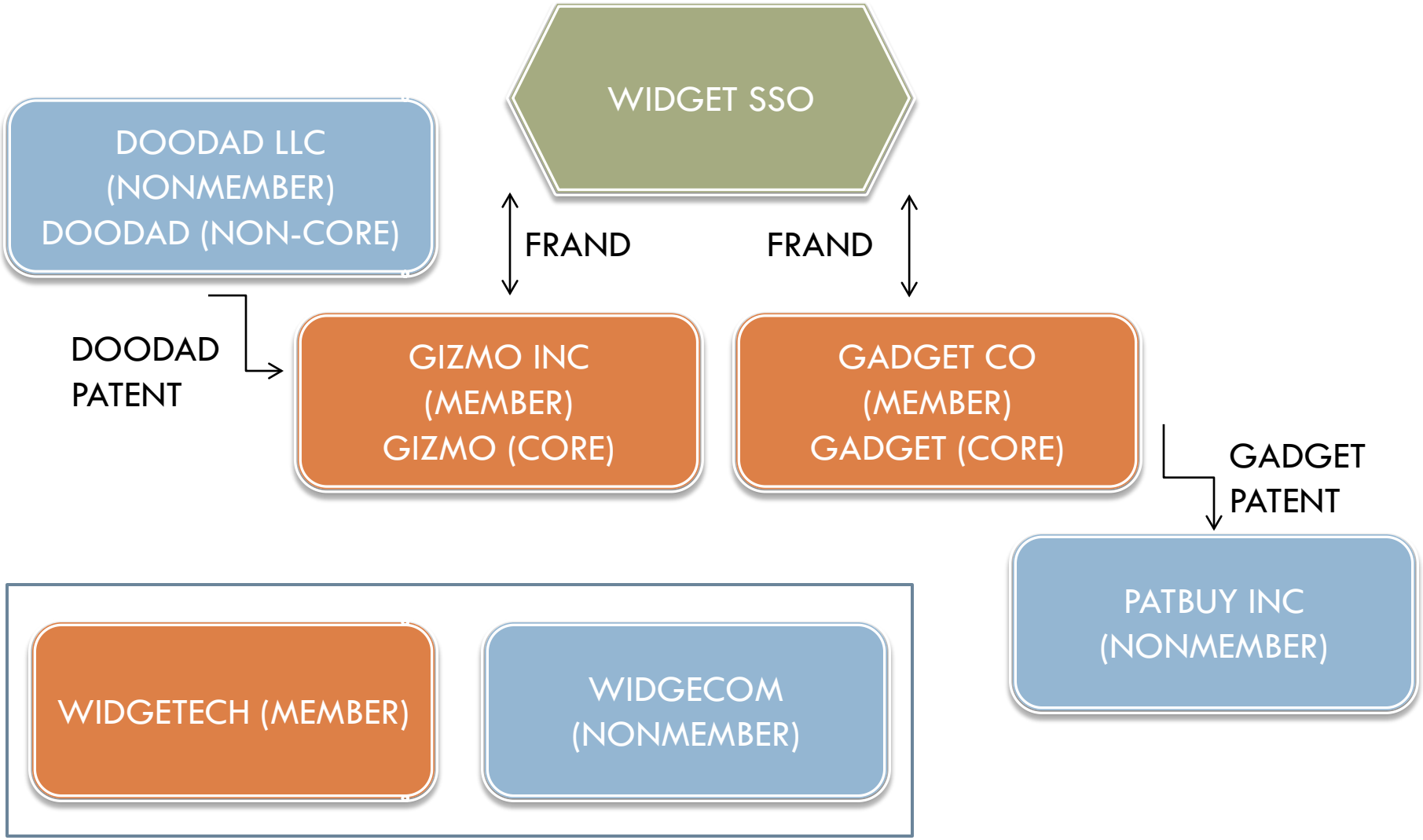
SSOs and IPR Policies

- SSOs have Intellectual Property Rights Policies (IPR Policies)
- IPR Policies often:
  - Often require members to make FRAND agreements
    - FRAND agreement: a commitment to license SEPs on fair, reasonable, and nondiscriminatory (FRAND) terms
  - Address whether members must assign patents subject to this commitment
- IPR policies vary between SSOs
- Royalty-free (FRAND-RF) terms
  - A few SSOs require members to license patents on FRAND-RF terms
  - More often, an SSO that requires FRAND-RF licensing does so in a punitive manner – a member that intentionally fails to disclose a SEP may be required to license that SEP to standard implementers on FRAND-RF terms

FRAND and SSO Hypothetical

- New Widget standard
  - Requires gizmo and gadget patents, notes doodad patent as an optional feature. Owned by Gizmo, Inc, Gadget Co, and Doodad LLC, respectively.
  - Gizmo, Inc and Gadget Co make FRAND commitments re. their SEPs
  - Widgetech and Widgecom want to implement the standard
- Widgetech, Gizmo Inc, and Gadget Co are SSO members; Widgecom and Doodad LLC are not
- Doodad LLC assigns doodad patent to Gizmo Inc
- Gadget Co assigns gadget patent to PatBuy, Inc
  - PatBuy is a patent assertion entity (PAE)
- A year later, everyone wants a doodad in their widgets, and won't buy widgets without doodads

FRAND and SSO Hypothetical



Problems with the Widget Standard

- **Transferability of FRAND obligations**
  - After Gadget Co transfers the gadget patent to PatBuy, is PatBuy bound by the FRAND agreement made by Gadget Co?
- **Application of FRAND obligations to members & nonmembers**
  - Widgecom is not a member. Can Widgecom enforce the FRAND agreement?
- **Essential patents – technologically essential, commercially essential**
  - The doodad patent is a non-core essential patent. Are non-core essential patents SEPs in the Widget SSO?
  - Does it matter that the doodad patent is now commercially essential? Does the Widget SSO consider those as SEPs?

Problems with the Widget Standard

- **After-acquired patents**
  - If yes to either of the above questions about essential patents, does the FRAND agreement that Gizmo Inc made with the SSO apply to the doodad patent that Gizmo Inc did not own at the time they made the agreement?
- **Remedies and enforcing the FRAND commitment**
  - Damages versus injunctive relief

Litigation and Standards

- Three typical circumstances:
  - Member intentionally concealed patent
    - Rambus v. FTC (DC Cir. 2008)
  - Member made FRAND commitment, but no longer wants to adhere to the commitment
    - Research in Motion Ltd. v. Motorola, Inc. (N.D. Tex. 2008)
  - Member assigned patent; assignee does not want to adhere to the commitment
    - Rembrandt Tech. v. Harris Corp. (Del. Super. 2008)
- Causes of action often grounded in antitrust law, contract law, or both
- Several courts view FRAND agreements as creating a duty in the patent owner to negotiate licenses in good faith
  - Apple v. Samsung (N.D. Cal. 2012)
  - Microsoft v. Motorola (W.D. Wash. 2012)

Cases: Transferability

- Licenses
  - Rembrandt v. AOL (Fed. Cir. 2011) – current owner of the patent is bound by prior license agreements and subsequent sublicensing agreements
- FRAND Agreement
  - Rembrandt v. Harris (Del. Super. 2009)
    - Court initially held that Rembrandt was bound by FRAND agreement made by predecessor in interest
    - MDL and patent validity disputes made that unwind quickly
      - Harris could not admit validity in the contract case, or else that would be used as evidence in the MDL patent litigation (Harris not a party in MDL)
  - Litigation over the same patent in different courts can be very complicated

Cases: Transferability

- European law
  - Competition law is applied to horizontal cooperation agreements
  - EU requests that FRAND commitments be binding on assignees
  - Microsoft v. Motorola (9th Cir. 2012) – Motorola obtained injunction against Microsoft in German court; according to the Ninth Circuit, German law does not recognize third party contractual rights; this limits enforcement of FRAND agreement by standard adopter

Legal Theories and FRAND Problems

- Transferability of FRAND obligations
- Application of FRAND obligations to members & nonmembers
- Essential patents – technological essential, commercial essential
- After-acquired patents
- Remedies and enforcing the FRAND commitment
- Theories that might be helpful in thinking about these problems: Patent, Antitrust, Contract (including detrimental reliance), and Property

Patent Theory and FRAND

- Patent Law
  - Potential licensee may argue for a license based on:
    - Equitable estoppel - claim that patent owner's conduct reasonably gave rise to an inference of non-enforcement
    - Implied license
  - Standard adopter can seek to avoid need for license by raising an inequitable conduct defense
    - Previous owner's intentional deception re. the patent can be imputed to the successor in interest to render the patent unenforceable
    - Barnes & Noble v. LSI (N.D. Cal. 2012)

Patent Law and the 5 Problems

- Does patent law address the 5 problems?
  - **Transferability** – maybe equitable estoppel; turns on what assignee did or said
  - **Enforceability by nonmembers** – unclear; no legal relationship between non-member and patent owner
  - **Determining whether FRAND agreement includes different types of essentiality** – doubtful; patent infringement is a strict liability tort
  - **After-acquired patents** – doubtful, unless there was inequitable conduct (e.g., assignee delays acquisition of patent until after they have made a commitment, aiming for commitment to not apply to the after-acquired patent)
  - **Remedies** – maybe; reasonable royalties are the most common measure for money damages when infringement is found
    - The bigger problem is how to address requests for injunctions in the context of SEPs

Antitrust and FRAND

- Antitrust cases – generally very fact-specific inquiries. Courts require intentional deception, and anticompetitive harm needs to be alleged/proven
  - Broadcom Corp. v. Qualcomm Inc. (3d. Cir. 2007)
    - Active deception of SSO may result in antitrust liability
  - Research In Motion Ltd. v. Motorola Inc. (N.D. Tex. 2008)
    - Breach of FRAND promise (via refusal to renegotiate new license) was harmful to competition
  - Vizio Inc. v. Funai Elec. Co. Ltd. (C.D. Cal. 2010)
    - Antitrust liability possible when active attempt to conspire to harm competition; but assignee's refusal to abide by assignor's FRAND agreement is not inherently a harm to competition
  - Rambus Inc. v. FTC (D.C. Cir. 2008)
    - Mere failure to disclose a patent may not be enough to establish anticompetitive harm; must show that, but for the nondisclosure, SSO would have picked alternative technology

FTC Actions: Antitrust

- FTC Actions
  - In re Rambus (2007) – FTC concluded that Rambus's actions did amount to anticompetitive conduct under Section 2 of the Sherman Act and Section 5 of the FTC Act
    - Reversed on appeal to DC Circuit in Rambus v. FTC
  - In re Dell (1996) – consent decree – FTC concluded that Dell violated Section 5 of the FTC Act by intentionally failing to disclose a SEP
  - In re Negotiated Data Solutions (2008) – consent decree – FTC concluded that NData violated Section 5 of the FTC Act, and NData was bound by FRAND agreement made by predecessor in interest

Antitrust Theory

- Antitrust Law and Unfair Competition
  - Monopolization claim requires showing defendant's market power, anticompetitive conduct, and intent
    - But patents create a lawful monopoly – must balance patent owner's rights against competitive harm beyond normal and lawful patent effects
  - Unfair competition – Section 5 of FTC Act
- Antitrust Law and the 5 problems
  - **Transferability** – doubtful; obligation might not transfer for antitrust purposes in the absence of a conspiracy. Vizio v. Funai (C.D. Cal. 2010)
  - **Nonmembers** – likely yes; antitrust focuses on the market, not parties to contract
  - **Essentiality** – maybe; non-SEPs likely less relevant to anticompetitive issues, but unfair competition law may apply to commercial essentiality
  - **After-acquired patents** – not likely to apply in the absence of conspiracy to monopolize
  - **Remedies** – parties in private litigation may seek money damages; equitable relief may be possible in appropriate circumstances

Pitfalls of Antitrust

- Antitrust and Unfair Competition
  - May not be well-suited to address FRAND transfer-related problems, in the absence of other evidence
  - Concealing patents not an antitrust issue when concealment is for purpose of avoiding limits on royalties (Rambus)
  - To show anticompetitive harm, must show causation – but for the deception of the SSO, the SSO would have picked a different technology for the standard (Rambus)
  - Fraudulent behavior + increased prices to consumers also not *per se* antitrust violation when the increased prices are due to exercise of lawful monopoly power (NYNEX v. Discon (S.Ct. 1998))
  - Noerr-Pennington doctrine limits viability of antitrust counterclaims

Contract Law and FRAND

- Is there a contract?
  - Yes, between the SSO and the patent owner
    - Apple v. Samsung (N.D. Cal. 2012)
    - Microsoft v. Motorola (W.D. Wash. 2012)
- Who can sue under the contract?
  - Must be an intended beneficiary of the contract – look to language of IPR policy – members and nonmembers?
    - ESS Tech v. PC-Tel (N.D. Cal. 1999) – applied to nonmembers; also noted that specific performance may be an option for enforcing FRAND agreement
- What does the contract create?
  - Duty for patent owner to negotiate in good faith
  - SSO policy may require license to be *granted* on FRAND terms.
  - Microsoft v. Motorola (W.D. Wash. 2012) – no duty on licensee to make first contact; owner not required to make initial offer on FRAND terms, but offer must be in good faith
- Determining reasonable royalties
  - Georgia-Pacific Corp. v. US Plywood Corp. (S.D.N.Y. 1970) – 15 factors

Cases: Contract Law

- Recent cases about FRAND agreements
  - Ericsson v. Samsung (E.D. Tex. 2007) – parties may sue for FRAND breach if there is failure to reach agreement
  - Microsoft v. Motorola
    - W.D. Wash. 2012 – Licensee does not have to make first contact for FRAND commitment to apply; initial offer by patentee need not be FRAND, but must comport with principles of good faith and fair dealing
    - 9th Cir. 2012 – District court's conclusion that FRAND agreement created a contract enforceable by MS was not "legally erroneous"
  - Apple v. Motorola
    - N.D. Ill. 2012 (Motorola & Motorola Mobility) – the proper starting point for calculating reasonable royalty is the cost that a licensee would have had to pay to license the patent *before* it was declared essential; injunctive relief would not be appropriate because the FRAND agreement means that the patent owner acknowledges that a royalty would be a sufficient remedy for infringement
    - W.D. Wis. 2012 (Motorola Mobility only) – accepting IPR policy and FRAND commitment therein creates a contract between patent owner-member and SSO; Apple is a third party beneficiary because they are a potential user of the standard and a prospective licensee of the patent

Formal Contract Theory

- Formal Contract
  - Parties can agree to things that don't violate the law, aren't against public policy, and aren't unconscionable
  - U.S. courts often view FRAND agreements as lawful contracts that can be enforced by third party beneficiaries; e.g., ESS Tech. v. PC-Tel (N.D. Cal 1999), Microsoft v. Motorola (W.D. Wash. 2012)
- 5 problems
  - **Transferability** – yes, IF the new owner agrees to be bound by prior contract
    - SSO may require that transfers are made subject to FRAND agreement
  - **Nonmembers** – yes, IF the SSO agreement uses broad language about who is entitled to a FRAND license; third party beneficiary doctrine is helpful
  - **Essentiality** – what is essential would be determined by the language of the agreement; should not assume that non-essential and commercially essential patents are included by default
  - **After-acquired patents** – yes, IF the agreement language addresses this issue
    - Finding contractual interests in after-acquired property has precedent – UCC Article 9
  - **Remedy** – specific performance is disfavored; licensee who is denied a license may be limited to money damages

Remedies in Formal Contract Law

- Remedies
  - Specific performance generally not available
  - Damages hard to calculate
    - Expectation damages – where would licensee be if patent owner had performed? Must attribute apportion of value
    - Reliance damages
      - Where would infringer have been if they hadn't made investment?
      - Could apportion percentage of value out of investment made
      - But maybe it could deter patent holdup to require patent owner to compensate standard implementer for all development costs related to implementing the standard

Detrimental Reliance and FRAND

- Licensee (standards implementer) relied to their detriment on the availability of a FRAND license
  - Focus is on whether specific agreement is binding against other entities outside the four corners of the agreement because of the expectation that this agreement creates for third parties
- Detrimental Reliance and the 5 problems
  - **Transferability** – likely transferable, because focus is on reliance by the standards implementer instead of solely on representations of new patent owner
  - **Nonmembers** – unclear; depends on whether it is reasonable for Party A to rely on what Party B promises an SSO when Party A is *not* a member of the SSO
  - **Essentiality** – maybe; likely turns on the standard implementer's knowledge of patents disclosed to the SSO subject to the FRAND agreement
  - **After-acquired** – no, unless the original owner made a FRAND commitment to the same SSO
  - **Remedies** – equitable relief available (injunction, specific performance)

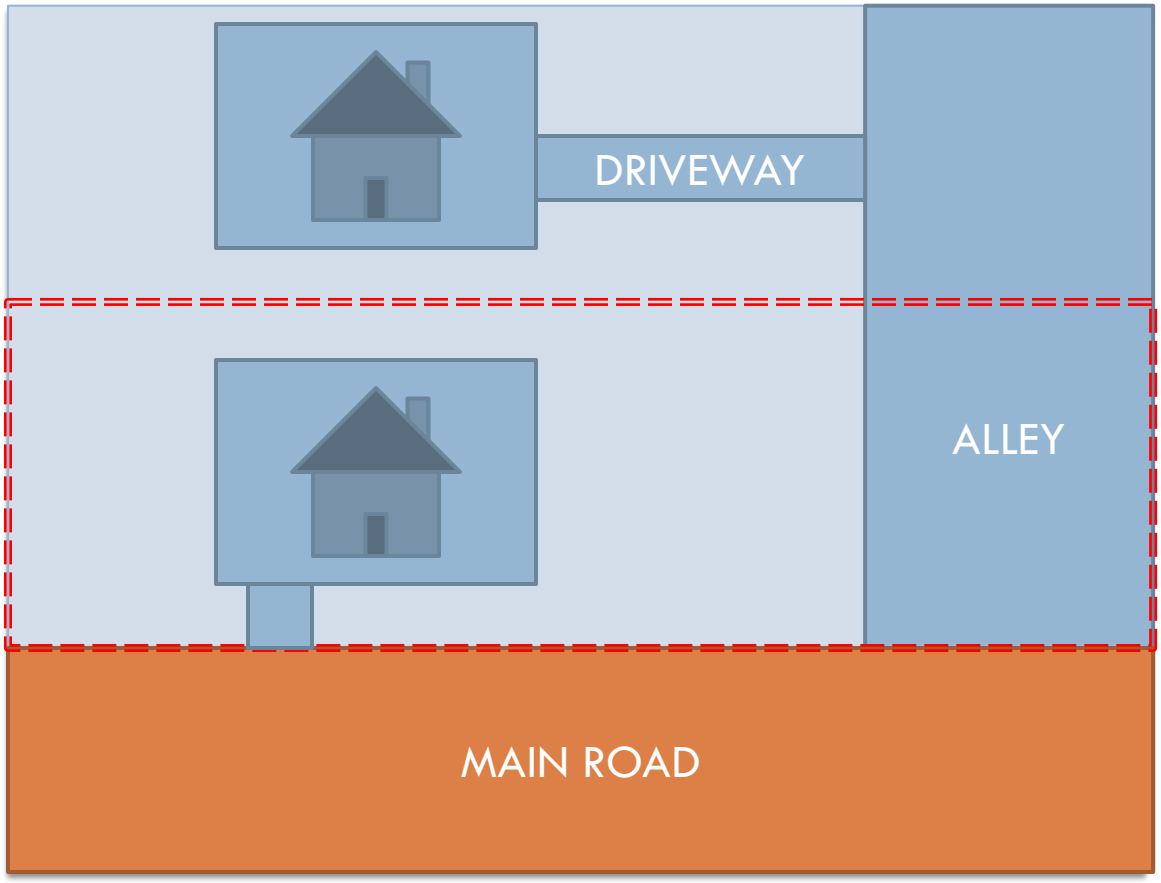
Patents, Property Law and FRAND

- Patents only grant a right to exclude others from practicing invention; the patent does not give the owner a right to practice the invention
- Patents are treated as personal property under the statute – this right to exclude is a right against the world
  - 35 U.S.C. § 261: "Subject to the provisions of this title, patents shall have the attributes of personal property…"
- Licenses and FRAND agreements are encumbrances on this right to exclude against the world
  - License – covenant not to sue
  - FRAND agreement – conditional covenant not to sue
- These encumbrances are similar to servitudes in real property law

Property Theory and FRAND

- Is a patent license a property interest? Can a commitment to license be a property interest?
  - Some scholarship suggests that an IP license is a property interest, not just an instrument created by contract (Newman 2012; Van Houweling 2008)
- Patent licenses often viewed as covenant not to sue – De Forest Radio Telephone & Telegraph Co. v. United States (S.Ct. 1927)
- FRAND agreement may be a *conditional* covenant not to sue – owner promises to not sue for infringement *unless and until* good faith attempts at negotiation fail
- Property approach: Encumbrance on the right to exclude; FRAND agreement creates an interest in the patent analogous to a servitude with a benefit held in gross for standards implementers
  - If licenses are viewed as servitudes – appurtenant benefit and burden
- Servitudes in real property run with the land; FRAND can be seen as an encumbrance running with the patent right
  - Transfer of servitude often turns on transferee having notice (actual or constructive) of the servitude

Servitude on Subdivided Lot



Servitude Theory and FRAND

- Benefits of servitudes can be appurtenant (benefit is connected to the land) or in gross (benefit is not connected to the land)
- Servitudes generally valid unless they meet a condition listed in Restatement for being contrary to public policy
  - Arbitrary, spiteful, or capricious; Unreasonably burdensome of a fundamental constitutional right; Unreasonably restrains alienability; Unreasonably restrains trade or competition; Unconscionable
- Patent license as a servitude – appurtenant benefit; probably easier for beneficiary to show that they are entitled to use
- FRAND agreement as a servitude – benefit being held by a SSO in gross for standard implementers
- Servitudes on land generally survive bankruptcy proceedings
  - Analogizing to servitudes might make it easier to allow FRAND agreements to survive bankruptcy

Servitudes and the 5 problems

- **Transferability** – yes, assignee can have constructive or actual notice
  - Servitudes generally run with the land if the new owner has notice; notice may be actual or constructive
- **Nonmembers** – likely yes; outcome may turn on specific language of IPR policy, but servitudes can be held in gross for the benefit of adopters
- **Essentiality** – if SSO policy addresses non-essential, commercially essential, non-core essential, as being patents deserving of FRAND, servitude can attach
  - Servitudes can exist when there is not strict necessity
- **After-acquired patents** – doubtful; servitude would likely need to attach to specific patents when the agreement is made
- **Remedies** – equitable relief or damages
  - When contract involves real property, equitable remedy is more possible because property tract is unique
  - Similarly, SEPs are unique insofar as an alternative is not available to allow the standard to be implemented
  - Analogizing to real property thus makes specific performance more likely than under formal contract theory

Transfers: Three Options Out of Four SSO Policies

- Statement that SSO has a preference for transferability, without imposing additional obligations beyond making reasonable efforts to obtain assignee's consent to be bound
  - ITU – applies when there is a reasonable belief that member is bound by a FRAND agreement but has not specifically identified patents to the SSO
- Imposing some responsibility for obtaining FRAND agreement from assignees on the SSO itself
  - ETSI
- Explicit language that transfers must be made subject to the FRAND commitment
  - AVS
  - IEEE

Essentiality

- When should FRAND agreements apply? 3 main options
  - Should apply to both technologically and commercially essential (narrowly defined) patents that are part of the standard – best approach; balance between minimizing injunction-seeking behavior and maximizing innovation
  - Apply only to the core technologically essential patents, let market self-regulate any commercially essential patents
  - Let market self-regulate both technologically and commercially essential patents – might maximize innovation
- FRAND agreements should probably apply equally to patents that were not essential when standard was adopted and that later became essential, but are part of the standard on technical grounds

Recommendations

- Need more consistent outcomes in disputes
  - SSOs need to establish baseline guidelines for FRAND issues
  - Government regulation could set baselines
  - Either option would require careful examination of existing SSO policies and the effects thereof
- Aspects of IPR policies must address:
  - SSO's approach to licensing obligations (e.g., FRAND or FRAND-RF; transfer of FRAND and rights of assignees subject to FRAND)
  - If there is a FRAND agreement, consider:
    - What is the SSO's approach to transfers?
    - Does IPR policy apply equally to members and nonmembers?
    - Address core essential, non-core essential, or commercially essential
    - Does IPR address after-acquired patents?

Recordation of Assignments

- Why record?
  - Makes it easier to do due diligence and find who owns a patent
  - If standard implementer can quickly identify the owner, identification can have a signaling effect
    - Will act more cautious if owner is known to be litigious
    - Put at ease if owner has a record of licensing on reasonable terms
  - Easier for SSO to research patent ownership interests and design the standard to mitigate future conflict
- FTC and USPTO say that accurate assignment records would assist with clearing patent rights
  - November 2011 – request for comments by USPTO

Recordation

- Other areas of law
  - Security interests under UCC Article 9 must be recorded to perfect
  - Registration of automobiles
- In patent law
  - 35 U.S.C. § 261 – assignment is void against subsequent purchaser for value unless earlier assignment is recorded with USPTO
    - Recordation here is a largely prophylactic rule aimed at protecting interest of earlier assignee
  - Executive Order 9,424 (Feb. 1944) – requires prompt recordation of licenses and assignments in patents held by government entities

RFC by the USPTO

- Proposed rule change would make assignment recordation mandatory
- Would require
  - Disclosure at time patent application is filed
  - Patent to issue in name of entity listed as assignee when issue fee is paid
  - Update of assignment information for inclusion in PGPub
  - Patentees to identify new ownership rights that affect whether issued patent is entitled to small entity status
- Would also provide discount to maintenance fees when patentee verifies or updates assignee information around the time maintenance fees are paid

Responses to RFC

- 17 comments submitted by 1/23/12 deadline
  - 5 from IP organizations – 4 against
  - 1 law firm – against
  - 4 private companies – 3 in favor
  - 7 individuals – mostly in favor
- Reasons for opposition
  - Mandatory recordation would increase costs for applicants, require additional expensive legal analysis
  - Is there really a problem to solve? AIPLA said there's no empirical data indicating that any problems are caused by failure to record
    - IBM (in favor) said that lack of recordation creates uncertainty, and uncertainty and potential costs and risks could deter licensees from entering the market altogether
  - Authority – does the regulation exceed statutory authority?
    - IBM says recordation requirements are supported by authority to make procedural requirements under Section 2(b)(2)
    - And Phillips (in favor) says recordation requirements could reduce back-and-forth between applicant and USPTO, thus making the regulation authorized because it would "facilitate and expedite the processing of patent applications"

Balancing the Interests

- If recordation requirements increase costs, are the costs outweighed by the benefits to the public?
- AIPLA suggests having patentees submit a single "chain of title" document instead of submitting multiple updates
- Requiring disclosure when application is filed may not have public benefit – application is not public until 18 months after filing
- Opponents argue that regulation would especially increase costs for large organizations that transfer patents internally for legitimate business purposes
  - USPTO could instead specify that recordation of assignments by corporate orgs is only required for non-internal transfers
- Post-issuance assignment changes
  - Confirming/updating recorded assignments when maintenance fees are due may strike good balance, perhaps with discounted fees

Conclusions

- FRAND Agreements
  - Need SSOs to focus on:
    - Transferability of FRAND agreements
    - Application to technologically essential, commercially essential
    - Application to members and nonmembers
    - Application to after-acquired patents
  - Application of servitude theory to FRAND agreements can solve some issues left open by the contract approach
- Transparency and Recordation Requirements
  - RFC by USPTO; making assignment recordation mandatory
  - Opponents claim recordation would increase costs
  - Need to balance these interests