

SEPs In The Wake Of Qualcomm: 4 Defense Issues

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Standards are critical to promoting interoperability, manufacturing efficiencies and the full realization of technological innovation. Whenever major technological advances occur that require interoperability among equipment and service providers, a heightened tension exists between standards and patent rights.

The rollout of standards-based 5G wireless technologies highlights this tension. The huge economic potential and game-changing nature of 5G wireless capabilities, which impact many industries such as communications, home automation, automotive, medical devices and the like has dramatically increased the complexity of managing the tension between standards and patents, which has resulted in unsettled and rapidly evolving standard-essential patent case law.

This is the third and final article in a series of articles designed to examine key SEP issues, while highlighting recent developments in the case law. Previous articles highlighted key issues to consider when patenting standardized technologies and when seeking to enforce SEPs. We conclude the series with considerations for defending against SEP enforcement.

In addition to assessing invalidity and noninfringement positions, entities that implement standardized technologies should consider issues unique to SEP litigation, including whether the patent owner has met all requirements set by the relevant standard-setting organizations, whether the SEP truly reads on the industry standard and whether the royalty base is premised on the value of the patented features as opposed to the value of the end product as a whole.

By quickly highlighting potential weaknesses in an SEP holder's enforcement strategy, an implementer can reduce its exposure to liability and preserve leverage in litigation.

Short-Term Defense Strategy

When approached by an SEP holder seeking to enforce or license its patent, an SEP implementer should first conduct a thorough noninfringement analysis. Implementers should demand



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detailed infringement contentions from the patentee, including claim charts to show the application of each claim. General or vague allegations are insufficient.

Further, implementers should not assume that because the patent is identified as essential to a standard that their product infringes. After receiving detailed contentions, implementers should demand sufficient time to examine the patentee's infringement and essentiality claims before taking any next steps.

In conducting their infringement analysis, implementers should look for any low-hanging fruit or weak patent claims that may have critical issues that can be attacked quickly.

For example, if an SEP holder identifies several patents in its initial demand letter, implementers should identify any blatant deficiencies, such as whether the claims trigger divided infringement, are directed to an entity at a different level of implementation (e.g., the claims are directed towards a network or platform and the SEP implementer is instead an end-product manufacturer), or only cover optional features within the standard.

By identifying such issues, the implementer can shift the burden of proof back to the SEP holder and ultimately help reduce exposure to infringement liability.

After the implementer has assessed the infringement claims and shifted focus to licensing negotiations, an implementer should remember that an SEP holder is obligated to offer a license on fair and reasonable nondiscriminatory terms. In determining whether an offered licensing rate is FRAND, SEP implementers should ask the patentee to provide copies of license agreements it has with other implementers to ensure that the negotiated rate is comparable.

An SEP holder's failure to honor its commitment to offer FRAND terms may enable implementers to bring a breach of contract claim against the SEP holder. This was the outcome in *Realtek Semiconductor Corp. v. LSI Corp.* where the court held that the patentees "breached their contractual obligations to IEEE and to Realtek as a third-party beneficiary of that contract by seeking injunctive relief against Realtek before offering Realtek a license."^[1]

There, one of the patent owners had reached out to Realtek to suggest that it take a license to the SEPs. In response, Realtek had sought more information about the alleged infringement, and the patent owner had offered to set up a call with counsel but never heard back from Realtek. In a subsequent correspondence, the other patent owner sent a cease and desist letter to Realtek but did not offer a license. Soon thereafter, the patent owners filed a complaint with the ITC.

The court found that initiating litigation before negotiating FRAND terms was a "clear attempt [by the patent owners] to gain leverage in future licensing negotiations and [wa]s improper."^[2] The court further noted that Realtek was harmed as a result of the breach of contract because "the pending threat of an exclusion order [would give patent owners] inherent bargaining power in any RAND licensing negotiation that may now take place."^[3]

This is helpful precedent for would-be licensees as the court found it insufficient that the patent owners only reached out to the practicing entity and did not actually discuss FRAND terms. Realtek's lack of an immediate or eager response to license did not waive the patent owner's obligations or strengthen its enforcement case.

When SEP holders attempt to skip meaningful licensing negotiations to seek quick relief from courts, defendants can use this to their advantage as the pending option (and obligation) to enter into a FRAND license will likely only argue against the patentee's case for an injunction.

In *Microsoft Corp. v. Motorola, Inc.*, Microsoft contended that Motorola offered unreasonable royalty rates and breached its obligations to the Institute of Electrical and Electronics Engineers to grant a license on FRAND terms.^[4] In response, Motorola argued that Microsoft had repudiated and/or rejected the benefits of Motorola's FRAND obligations and subsequently was not entitled to a license to the SEPs.

Motorola also filed patent infringement counterclaims and sought injunctive relief. The court ruled that Motorola could not show the requisite irreparable harm for injunctive relief because it was obligated to license its patents to Microsoft under FRAND terms, which would ultimately constitute a sufficient remedy. The court concluded that Motorola could not show that it had no adequate remedy other than injunctive relief.

Thus, in initial licensing negotiations with SEP holders, implementing entities should ensure that the offered terms are in fact fair and reasonable and not feel forced into accepting unreasonable terms. As a third-party beneficiary of the patentee's FRAND obligations, the implementers are entitled to a fair license.

However, this of course does not give implementers unlimited bargaining power. SEP holders' obligation is to offer terms that are fair and reasonable, not necessarily terms that the would-be licensee is willing to accept. Once FRAND terms are offered, a court will likely find that the SEP holder met its SSOs obligations, and implementers lose this defense.

In looking ahead to possibly defending against a request for an injunction, SEP implementers can build up their defense early by indicating their willingness to negotiate FRAND licensing terms in good faith throughout their interactions with the patentee. This may weaken any future argument that an injunction is the patentee's only available remedy.

Although injunctions are not common, the U.S. Department of Justice recently hinted at a shift in approach that may have rippling effects to other agencies and courts. In December 2018, Assistant Attorney General Makan Delrahim announced that the DOJ's Antitrust Division would withdraw from a 2013 joint policy statement with the U.S. Patent and Trademark Office that had discouraged granting injunctions to SEP holders out of concern for the effect on competition.

Delrahim now takes the alternative position that a FRAND commitment "should not create a compulsory licensing scheme."^[5] It is still unclear whether the DOJ's position will affect rulings from courts, so implementers should consider challenging injunctions as part of their defense strategy.

Long-Term Defense Strategy

When facing SEP enforcement, an implementer's options are typically to take a license, fight against the patent in litigation or seek indemnification through another party. An implementer will need to assess which long-term strategy is best in light of the unique facts of each case.

If an initial assessment confirms that the accused product likely reads on the SEP, and the SEP holder offers reasonable licensing terms, pursuing a license and avoiding litigation may be the most cost-

efficient option. However, an implementer can also consider what evidence or information may be gained through litigation and discovery that could support a more licensee-friendly royalty rate (i.e., licensing terms provided to third parties, the strength of the validity case, the strength of essentiality claims, etc.).

In the Microsoft v. Motorola litigation, the court eventually determined royalty rates that were much lower than the 2.25% of the end unit selling price that Motorola had requested in its initial offer letters to Microsoft.[6] Thus, whether the royalty rate is actually determined by the court or litigation merely exposes the possibility that the court may calculate a lower rate, implementers may find that being willing to initially fight the SEP or challenge the licensing terms may play to their benefit and even inspire a more cooperative patentee.

Additionally, where an implementer can seek indemnification from a supplier or another entity on the supply chain, it may be able to avoid liability altogether. Thus as part of a long term strategy, implementers should carefully consider indemnity clauses in their agreements with other manufacturers. Of course, component suppliers will have the same motivation to push liability further down the supply chain, so implementers should seek favorable indemnification agreements early on in their interactions with other entities.

Implementers can also reduce their exposure to liability by pushing their component suppliers to seek a license from the SEP holder, which will exhaust the patent rights once the component is sold farther down the supply chain. At least one court has ruled that a patentee's practice of only licensing to downstream manufacturers is improper. In Federal Trade Commission v. Qualcomm Inc., the district court condemned Qualcomm's practice of refusing to license its cellular SEPs to rival modem chip suppliers and only licensing to the more lucrative original equipment manufacturers.[7]

The court found that the evidence demonstrated that Qualcomm purposely did not license its patents to chip suppliers in order to profit from higher royalty rates from OEMs, whose rates were based on the price of the end product.[8] Despite Qualcomm's argument that this was industry practice, the court found that this improperly excluded rival chip suppliers from the market. As we note below, not all courts have taken this approach, and the Qualcomm decision is still on appeal. Yet regardless, pushing suppliers to seek a license can be part of a multifront defense for implementers.

Reduce Exposure

Implementers should also consider various ways in which they can reduce exposure to infringement liability.

First, as part of their noninfringement defense, implementers should assess and challenge whether the SEP actually reads on the accused product, or, similarly, whether the SEP truly reads on the relevant industry standard. Implementers should not assume that just because a patent has been identified as essential to a standard, it embodies the technology that complies with the industry standard. Typically, SSOs do not conduct their own assessments as to whether a declared patent is essential to a standard.[9] In addition to blatant error by the patentee, it is possible that the standard evolved or changed subsequent to the patentee identifying its patent to the SSO.

Similarly, it is important to understand whether the patent in question is directed to mandatory or opinion features within the standard. If the patent is merely directed towards optional features, it may not be standard essential, and infringement may not be shown by simply making the claim that the

accused product practices the standard. Without subsequent checks by the patentee or SSO, it is left to would-be licensees to ensure that the patent is relevant and licensing is warranted.

Second, implementers should also prepare a strong invalidity defense, including filing inter partes review petitions early in the process. Implementers should look to earlier drafts specifications of the working group responsible for developing the industry standard in question. Because current and next generation industry standards usually build on earlier versions of a standard, drafts specifications can be an important source for proving that incremental changes in a standard were obvious.

This may serve to stay and eventually moot district court proceedings. At the very least, it can provide the implementer with leverage in district court or ITC litigation and enable the party to take an offensive position. Further, to the extent that the implementer can settle or invalidate some of the asserted claims, it can reduce its exposure to damages.

Reduce Potential Royalty Base

Implementers should also be mindful of how SEP holders attempt to calculate royalties. Patentees may try to circumvent FRAND terms by calculating royalties based on the price of the finished product rather than the individual component that embodies the patented technology. In litigation, implementers should assert proper apportionment, and as part of general licensing practices, they should consider implementing royalty stacking clauses in their agreements.

The case law is still developing on the issue of when the royalty rate can be based on the entire market value of the product. In *Qualcomm*, the court concluded that it was unreasonable and a violation of FRAND for Qualcomm to base the royalty rates for its SEPs on the price of an entire phone rather than on the baseband chip.^[10] The evidence presented showed that the user experience, rather than the modem chips, drove the value of the handset.^[11]

Further, the court also noted that “requiring Qualcomm to license its SEPs to rival modem chip suppliers on FRAND terms [would] enable a fair valuation of Qualcomm's modem chip SEPs because modem chip suppliers are unaffected by chip supply leverage.”^[12]

However, in a recent ruling from another district, the court rejected the argument that the royalty rate for SEPs needed to be based on the value of baseband chips rather than the phone or end product. In *HTC v. Ericsson*, the court considered that the smallest saleable unit was not the baseband chip and that comparable licenses showed similar royalty rates to what Ericsson had offered HTC.

Moreover, the court found persuasive market evidence that showed that consumers valued the cellular technology provided by the baseband processor. Thus, as these two cases demonstrate, this inquiry can be very fact-dependent. However, the general rule seems to be that a royalty can be based on the entire market value of accused multicomponent product only when the patented feature creates the basis of customer demand for the product.

In calculating royalty rates, some implementers have been successful in asserting a top-down method in order to avoid overvaluing any one SEP. Under this approach, a court would first identify the aggregate royalty rate for all SEPs. The Central District of California has permitted this approach and noted:

Because the top down methods starts with the maximum aggregate royalty burden and works down to a fair and reasonable rate, it avoid[s] the possibility that licensees will be forced to pay an unreasonable

amount in total. If the total aggregate royalty is properly based upon the total value of the patents in the standard, it can also prevent hold-up because it prevents SEP owners from charging a premium for the value added by standardization.[13]

Royalty rates calculated using the top-down method tend to be lower and more favorable to implementers. When considering the royalty base, implementers should similarly consider proper apportionment and focus on the value of the smallest sellable unit that practices the patent, rather than the final product. Implementers should ensure that SEP holders are not getting the value of unpatented features covered by the standard, as “[t]he ultimate combination of royalty base and royalty rate must reflect the value attributable to the infringing features of the product, and no more.”[14]

As a final point, implementers should use royalty stacking clauses to their advantage. Royalty-stacking refers to the situation where multiple SEPs read on a product and a licensee must pay royalties to multiple parties.

In order to avoid paying more in royalties than the value of the SEP, licensees should consider including a clause in each license agreement permitting the licensee to reduce the amount of royalties under the agreement if later a royalty must be paid to another patent holder for the standardized technology.

Thus royalty-stacking clauses can prevent any one component from being overvalued and can avoid overburdening implementers with fees.

Conclusion

SEPs can present unique challenges for both SEP holders and implementers. By carefully establishing short-term and long-term strategies, including reducing the overall exposure, proper calculation of the royalty base and continually shifting the burden of proof, SEP implementers can put themselves in a stronger position for licensing negotiations and for potential future litigation.

SEP implementers must also be mindful of satisfying their good-faith negotiation obligations so as to avoid being subject to potential injunctions. Finally, SEP implementers should closely monitor SEP case law, which remains unsettled and is rapidly evolving.

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[1] See *Realtek Semiconductor Corp. v. LSI Corp.*, 946 F. Supp. 2d 998, 1008 (N.D. Cal. 2013).

[2] *Id.*

[3] *Id.*

[4] 2012 WL 5993202, *6-*8 (W.D. Wash. 2012).

[5] Delrahim, Makan, “Telegraph Road: Incentivizing Innovation at the Intersection of Patent and Antitrust Law,” 19th Annual Berkeley-Stanford Advanced Patent Law Institute, Palo Alto, CA (December 7, 2018), available at <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-19th-annual-berkeley-stanford>

[6] Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2013 WL 2111217, at *4 (W.D. Wash. Apr. 25, 2013).

[7] FTC v. Qualcomm Inc., No. 17-CV-00220-LHK, qualc (N.D. Cal. May 21, 2019).

[8] Id. at *77.

[9] See, e.g., Understanding Patent Issues During IEEE Standards Development, IEEE Standards Association, <https://standards.ieee.org/content/dam/ieee-standards/standards/web/documents/other/patents.pdf> (June 2019).

[10] Qualcomm Inc., 2019 WL 2206013, at *127.

[11] Id. at 101.

[12] Id. at *138.

[13] TCL Commc'n Tech. Holdings, Ltd. v. Telefonaktiebolaget LM Ericsson, No. CV 15-2370 JVS(DFMX), 2018 WL 4488286, at *8 (C.D. Cal. Sept. 14, 2018).

[14] Ericsson, Inc. v. D-Link Sys., Inc., 773 F.3d 1201, 1226 (Fed. Cir. 2014).