Hold Up or Hold Out: Differing Perspectives on Standard Essential Patent Licensing at the DOJ and FTC

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Antitrust regulators have been giving increasing thought to the intersection of intellectual property and antitrust as technology has taken a central role in the day-to-day life of consumers. Industry standards play a vital role in ensuring that this technology functions properly and that complementary products interoperate. In a series of recent speeches, Makan Delrahim, the Assistant Attorney General ("AAG") for the Antitrust Division of the Department of Justice ("DOJ"), has signaled a departure from previous DOJ guidance focused on the behavior of patent holders in the standard setting space. Instead, AAG Delrahim suggests that the true risk lies with entities seeking to use standard patented technology in their products. This shift in attention is in stark contrast to the ongoing enforcement action by the Federal Trade Commission ("FTC") against Qualcomm, a patent holder alleged to have used the inclusion of its technology in a standard to maintain a monopoly.

I. What is Standard Setting?

Standard setting organizations ("SSOs") are private organizations that adopt standards containing technical specifications and other criteria to ensure that the components of technological devices are interoperable. Standards are voted on by SSO members, who are industry participants—both those that invent technology ("innovators") and those that incorporate technology into their products ("implementers"). Standard-essential patents ("SEPs") are patents for any part of the technology that are necessary to meet a technical standard. Some SSO members may own the SEPs that are incorporated into these standards. Implementers seeking to use the technology claimed by a SEP must seek a license from the innovator who owns that SEP.

To prevent innovators from charging excessive royalties on SEPs required to meet a chosen technical standard, many SSOs rely on voluntary licensing commitments by SSO members.[2] Under these voluntary commitments, member SEP holders agree to license their patents on fair, reasonable, and non-discriminatory ("FRAND" or "RAND") terms to both SSO members and non-members. These commitments facilitate negotiations between innovators and implementers and enable industry-wide adoption of standards.

II. History of Standard-Setting Guidance at the FTC and DOJ

Historically, guidance from the DOJ and FTC has been concerned with the issue of patent "hold up," which includes the charging of high licensing royalties or fees by a SEP owner once the technology claimed by its patent has been adopted as an industry-wide standard

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[2] While non-member patent holders typically have no legal obligations under SSO policies, an SSO may request that a non-member undertake to grant licenses to patents that may be included in a technical standard on FRAND terms. *See, e.g.*, ETSI, Guide on Intellectual Property Rights (IPRs) 54 (Sept. 19, 2013).

and implementers have no choice but to use that technology. Less discussion has focused on patent "hold out," or an implementer's refusal to pay FRAND royalties or negotiate FRAND terms after an innovator has incurred sunk costs into developing technology.

In 2007, the DOJ and FTC published a joint report that provided guidance to SSOs to help "mitigate the potential for hold up," suggesting mechanisms such as the *ex ante* consideration of licensing terms.[3] In 2011, the FTC published a report stating that "[h]old-up may have especially severe consequences for innovation and competition in the context of standardized technology."[4] Noting that RAND is not clearly defined, the report provided guidance to courts attempting to value RAND royalties.[5] Both this 2011 report and a 2013 joint policy statement released by the DOJ and U.S. Patent and Trademark Office ("USPTO")[6] addressed the use of injunctions in patent infringement suits involving a SEP. The reports suggested that a RAND commitment by a SEP holder evinces that royalties may suffice as a remedy and could weigh against the granting of an injunction.[7] Further, the 2011 report stated that courts should consider whether an injunction would "deprive consumers of interoperable products; raise costs above the incremental value of the invention compared to alternatives at the time the standard was set; or threaten to undermine the collaborative innovation that can result from the standard setting process."[8]

This concern was reiterated in the 2013 statement, which stated that "determinations on the appropriate remedy in cases involving FRAND-encumbered, standards-essential patents should be made against the backdrop of promoting both appropriate compensation to patent holders and strong incentives for innovators to participate in standards-setting activities."[9] However, the 2013 statement acknowledged that an injunction may be appropriate where an implementer is unable or refuses to take a FRAND license in an attempt to avoid compensating the SEP holder or where a court could not award damages.[10]

III. Recent DOJ Statements

AAG Delrahim, the first registered patent lawyer to head the Antitrust Division,[11] has discussed the application of antitrust law to intellectual property rights at length. Describing

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[3] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 37 (2007).
[4] FED. TRADE COMM'N, THE EVOLVING IP MARKETPLACE: ALIGNING PATENT NOTICE AND REMEDIES WITH COMPETITION 22 (2011) [hereinafter *2011 Report*].
[5] *Id.* at 23.
[6] U.S. DEP'T OF JUSTICE & U.S. PATENT & TRADEMARK OFFICE, *Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments* (2013) [hereinafter *2013 Statement*].
[7] *2011 Report*, *supra* note 4, at 28; *2013 Statement*, *supra* note 6, at 5 n.11.
[8] *2011 Report*, *supra* note 4, at 28.
[9] *2013 Statement*, *supra* note 6, at 10.
[10] *Id.* at 7.
[11] Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Remarks at the USC Gould School of Law's Center for Transnational Law and Business Conference (Nov. 10, 2017).

his "New Madison" approach, AAG Delrahim set out four basic principles aimed at ensuring continued innovation and dynamic competition in the context of standard setting:

> (1) antitrust law should not be used as a tool to police FRAND commitments that innovators make to SSOs;
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> (2) SSOs should not become vehicles for concerted action by implementers, which would reduce incentives to innovate and encourage hold out;
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> (3) a key feature of patent rights is the right to exclude, therefore SSOs and courts should have a very high burden before adopting rules that restrict that right or amount to a compulsory licensing scheme; and
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> (4) consistent with this right to exclude, unilateral and unconditional refusals to license a patent are *per se* legal under the antitrust laws.[12]

First, AAG Delrahim posited that condemning hold up in isolation, while ignoring hold out, risks over-enforcement under the antitrust laws.[13] This over-enforcement would, in turn, discourage innovation, particularly in light of the deterrent effect of treble damages available under the Sherman Act.[14] Therefore, antitrust laws should not be used as a tool to ensure that SEP holders fulfill voluntary FRAND commitments. AAG Delrahim supported this principle by pointing to Supreme Court jurisprudence interpreting the Sherman Act, which cautioned against "false positives" condemning lawful pro-competitive conduct and found that there is no antitrust duty to deal with another company or a competitor.[15] Additionally, the Supreme Court has emphasized that the Sherman Act does not recognize a cause of action that would require antitrust courts to determine pricing and deal terms.[16] With this Supreme Court guidance in mind, AAG Delrahim stated that a unilateral refusal to license a SEP is not a form of unlawful exclusionary conduct, and that there is no antitrust-imposed duty for a SEP holder to license on FRAND terms, even after making a voluntary commitment.[17] Further, contrary to the FTC's guidance in its 2011 report, AAG Delrahim counseled that antitrust courts are not authorized to determine what royalty rates meet FRAND requirements.[18] Instead, AAG Delrahim suggested that FRAND disputes are best remedied under contract law because "contract remedies do not involve the threat of treble damages that can deter lawful, pro-competitive conduct."[19]

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[12] Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, The "New Madison" Approach to Antitrust and Intellectual Property Law (Mar. 16, 2018).
[13] *Id.*
[14] Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Remarks at IAM's Patent Licensing Conference in San Francisco (Sept. 18, 2018).
[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.*; Delrahim, *supra* note 11.

In support of the second New Madison principle, AAG Delrahim warned against the "collective exertion of monopsony power" by implementers within an SSO who "come together to dictate licensing terms to a patent holder as a condition for inclusion in a standard."[20] AAG Delrahim described this collective hold out as "a more serious impediment to innovation" than hold up and asserted that "under-investment by the innovator should be of greater concern than under-investment by the implementer."[21] This is because, unlike implementers who may not have incurred certain sunk costs when faced with hold up, innovators must invest in the patent before the standard setting process even begins.[22] To mitigate against the risk that implementers will exploit the standard setting process, AAG Delrahim encouraged SSOs to institute safeguards to avoid voting blocks of competitors and to implement a diversity of patent policies among SSOs within the same industry.[23]

In support of the third New Madison principle, which is based on a patent holder's right to exclude, AAG Delrahim cited to the "Copyright and Patent Clause" of the Constitution, which grants "to authors and inventors the exclusive right to their respective writings and discoveries."[24] In recognition of this exclusive right, AAG Delrahim stated that "[r]ules that deprive a patent holder from exercising this right—whether imposed by an SSO or by a court—undermine the incentive to innovate and worsen the problem of hold-out. After all, without the threat of an injunction, the implementer can proceed to infringe without a license, knowing that it is only on the hook only for reasonable royalties."[25] Accordingly, AAG Delrahim contended that injunctions against infringement serve the public interest by incentivizing and rewarding inventors.[26] Clarifying that the 2013 Joint DOJ/USPTO Statement misconstrued the DOJ's position about when SEP holders should be allowed to exclude competitors, AAG Delrahim withdrew the DOJ's assent to that policy statement.[27] He stated that the DOJ and USPTO would engage to draft a clearer joint statement that balances the interests at stake when a SEP holder seeks an injunction against an infringer.[28]

Turning to the final principle, AAG Delrahim again cited to the protection of patent rights by statute and the Constitution.[29] He asserted that the enforcement of valid patent rights should not be a violation of antitrust law, and a patent holder cannot violate the antitrust laws by properly asserting its right to exclude (*e.g.*, by seeking an injunction or refusing to license).[30] AAG Delrahim elaborated that while "contract law may very well require a SEP-holder to deal with any willing licensee, . . . the Sherman Act does not convert FRAND commitments into a

[20] Makan Delrahim, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Remarks at the 19th Annual Berkeley-Stanford Advanced Patent Law Institute (Dec. 7, 2018).
[21] Delrahim, *supra* note 11.
[22] *Id.*
[23] Delrahim, *supra* note 12, at 12; Delrahim, *supra* note 20.
[24] Delrahim, *supra* note 20 (citing U.S. CONST. art. I, § 8, cl. 8).
[25] Delrahim, *supra* note 11.
[26] *Id.*
[27] *Id.*
[28] *2013 Statement*, *supra* note 6, at 8.
[29] Delrahim, *supra* note 11.
[30] *Id.*

compulsory licensing scheme."[31] Therefore, it would be an error to infer that a FRAND commitment establishes an antitrust duty to license.[32] AAG Delrahim concluded that a SEP holder's unilateral and unconditional refusal to license is *per se* legal under the antitrust laws, noting that "competition and consumers both benefit when inventors have full incentives to exploit their patent rights."[33]

In summary, AAG Delrahim's recent statements signal a shift in DOJ policy, from a focus on the competitive harm that can result from SEP holders seeking injunctive relief to the negative effects on innovation that can result from implementers misusing the SSO process to strong arm SEP holders into unfavorable licensing terms. To avoid the latter harm, AAG Delrahim strongly supports the use of injunctive relief by SEP holders to protect their patent rights, in accordance with a patent holder's constitutionally recognized right to exclude. He also recommends against the use of antitrust laws to police FRAND commitments, suggesting that contract law is a more appropriate forum for FRAND disputes.

IV. Recent FTC Statements and Enforcement Actions

Joseph Simons, Chairman of the FTC, has expressed agreement with AAG Delrahim's view that neither breach of a FRAND commitment nor a fraudulent promise to license on FRAND terms alone constitute a violation of the Sherman Act.[34] However, Chairman Simons recognized that the standard-setting process "can be exclusionary or anticompetitive" where breach of a FRAND commitment "contribute[s] to the acquisition or maintenance of monopoly power in a properly-defined market, or involve[s] an agreement that unreasonably restrains trade."[35] Chairman Simons clarified that exclusionary conduct is not exempt from antitrust scrutiny just because the conduct occurred within a standard setting process.[36] Stating that the FTC is not focused on whether hold up or hold out is more likely, Chairman Simons made clear that "the FTC will continue . . . economically grounded and fact-based enforcement of the antitrust laws in this area."[37] Notably, the FTC has brought seven significant enforcement actions challenging patent hold up over the past two decades, whereas the DOJ has never brought an action on hold up grounds.[38]

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[31] Delrahim, *supra* note 14.
[32] *Id.*
[33] Delrahim, *supra* note 11, at 16.
[34] Joseph Simons, Chairman, Fed. Trade Comm'n, Prepared Remarks at Georgetown Law Global Antitrust Enforcement Symposium 5-6 (Sept. 25, 2018).
[35] *Id.* at 6.
[36] *Id.*
[37] *Id.*
[38] Terrell McSweeny, Commissioner, Fed. Trade Comm'n, Holding the Line on Patent Holdup: Why Antitrust Enforcement Matters n.21 (Mar. 21, 2018) (listing *In re Dell*, 121 F.T.C. 616 (1996); *In re Rambus, Inc.*, No. 9302 (2002); *In re Union Oil Co. of Cal.*, No. 9305 (2003); *In re Negotiated Data Solutions LLC*, No. 051-0094 (2008); *In re Robert Bosch GmbH*, No. 121-0081 (2012); *In re Motorola Mobility*, No. 121-0120 (2013); and *FTC v. Qualcomm* (N.D. Cal. filed Jan. 17, 2017)).

The FTC policy articulated by Chairman Simons is consistent with the Commission's enforcement action against Qualcomm.[39] In its complaint, the FTC alleged that Qualcomm violated the FTC Act by using anticompetitive tactics to maintain a monopoly in baseband processors, which enable cellular communications in mobile products.[40] In order to communicate with a particular cellphone network, a baseband processor must comply with the cellular communication standards supported by that network.[41] Qualcomm owns several cellular SEPs which it advocated for inclusion in industry standards and had committed to license on FRAND terms to several SSOs' members.[42] Specific to these cellular SEPs, the FTC alleged that Qualcomm:

> (1) maintains a "no license-no chips" policy under which it withholds baseband processors unless a customer accepts Qualcomm's preferred licensing terms for its cellular SEPs, including elevated royalties if a customer uses competitors' processors;
>
> (2) has consistently refused to license its related SEPs to competitors, violating its FRAND commitments.[43]

In its Complaint, the FTC stated that in a typical dispute between a SEP holder and implementer, the SEP holder can use patent litigation to be awarded reasonable royalties—usually well below the rates offered by a SEP holder prior to litigation.[44] Since SEP holders know an implementer can go to court to seek better terms, the parties' negotiations occur "in the shadow of the law," which benefits implementers to the extent the costs of defending against infringement are not too high.[45] Qualcomm's "no license-no chips" policy, the FTC argued, "effectively denies OEMs the opportunity to challenge Qualcomm's royalty demands . . . by dramatically increasing OEMs' costs of going to court."[46] These costs include not only the typical costs associated with litigation, but also the cost of losing access to Qualcomm's "dominant" supply of baseband processors.[47] Because Qualcomm could threaten implementers with supply disruptions by virtue of its alleged dominance, the FTC asserted that

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[39] Chairman Simons was not at the FTC when the complaint was filed and recused himself from the Qualcomm lawsuit after joining the agency.
[40] Complaint at 2, *Fed. Trade Comm'n v. Qualcomm*, No. 17-cv-00220-LHK (N.D. Cal. Feb. 1, 2017) [hereinafter *Complaint*].
[41] Order Denying Motion to Dismiss at 4, *Fed. Trade Comm'n v. Qualcomm*, No. 17-cv-00220-LHK (N.D. Cal. June 26, 2017).
[42] *Complaint*, *supra* note 40, at 12.
[43] *Id.* at 2-3. The FTC also alleged that Qualcomm violated the antitrust laws by (1) offering customers incentive payments, often tied to the purchase of Qualcomm processors, to induce customers to accept Qualcomm's license terms and (2) entering into exclusive dealing arrangements with Apple, Inc.
[44] *Id.* at 16.
[45] *Id.*
[46] *Id.* at 18.
[47] *Id.*

implementers acceded to non-FRAND terms in order to have access to Qualcomm processors.[48]

Addressing Qualcomm's refusal to license its SEPs to baseband processor competitors, the FTC stated that Qualcomm is, in the first instance, violating its FRAND commitments to several SSOs.[49] Additionally, Qualcomm's refusal to license its SEPs to competitors contributes to its ability to charge implementers elevated royalties for using a competitor's processor.[50] The FTC concluded that Qualcomm would be unable to charge these elevated royalties if it granted SEPs to its competitors—since baseband processor competitors, unlike implementers, do not depend on Qualcomm for processor supply, Qualcomm could not use the threat of supply disruption to skew negotiations in its favor.[51]

The FTC's arguments against Qualcomm are seemingly misaligned with AAG Delrahim's New Madison approach, which views antitrust as the improper vehicle for litigating FRAND disputes, particularly around appropriate licensing rates. Further, in AAG Delrahim's view, SEP holders like Qualcomm have an absolute right to exclude and no duty to deal with a competitor.[52] However, in a move more aligned with AAG Delrahim's suggestion that FRAND commitments be policed under contract law, the FTC moved for partial summary judgment under California contract law and not the FTC Act, claiming that Qualcomm's failure to license to competitors on FRAND terms violated its written commitment to two SSOs. The district court agreed with the FTC that "as a matter of law, the [SSOs'] policies both require

[48] *Id.*
[49] *Id.* at 24.
[50] *Id.*
[51] *Id.*
[52] In July 2017, Qualcomm filed a patent infringement case against Apple at the U.S. International Trade Commission ("ITC"), alleging infringement of certain SEPs related to smartphone battery maintenance and requesting an import ban on infringing Apple devices. The USITC, which adjudicates cases involving imports that allegedly infringe intellectual property rights, in its initial determination declined to issue an exclusion order against Apple despite finding that imported iPhones using Intel chips infringed Qualcomm SEPs. *In re Certain Mobile Electronic Devices and Radio Frequency and Processing Components Thereof*, Inv. No. 337-TA-1065 (Sept. 28, 2018). While it has issued exclusion orders in previous cases (e.g., against Sony for infringement of Fujifilm's SEPs), historically the ITC has limited exclusion orders due to concerns including those around patent hold up. J. Gregory Sidak, *International Trade Commission Exclusion Orders for the Infringement of Standard-Essential Patents*, 26 CORNELL J.L. & PUB. POL'Y 125 (2016). On March 26, 2019, an ITC administrative judge issued an initial determination that Apple infringed on certain Qualcomm patents, but this non-binding determination is still subject to review by the ITC. *In re Certain Mobile Electronic Devices and Radio Frequency and Processing Components Thereof (II)*, Inv. No. 337-TA-1093 (Mar. 26, 2019). On the same day, the ITC rejected Qualcomm's patent infringement claim based on another patent, finding that Apple presented "clear and convincing evidence" that Qualcomm's intellectual property claim was invalid as obvious over two previously issued patents. *In re Certain Mobile Electronic Devices and Radio Frequency and Processing Components Thereof*, Inv. No. 337-TA-1065 (Mar. 26, 2019).

Qualcomm to license its SEPs' to competitors, and required Qualcomm to begin licensing its patents to all comers in accordance with those policies.[53]

V. Conclusion

At a recent event, AAG Delrahim appeared to criticize the FTC, referring to it as "another agency that happens to share enforcement powers with the Justice Department antitrust division that shall go unnamed," for basing its enforcement action against Qualcomm on a theory of excessive SEP royalties.[54] A few days later, the FTC concluded its trial against Qualcomm and the court's decision is currently pending. While the divergence in views between the DOJ and FTC may signal a theoretical policy rift in the agencies' views of standard setting, in practice there may not be much real-world change: the FTC likely will continue to challenge hold up by SEP holders as it has over the past two decades, while the DOJ, in accordance with past practice, likely will continue not to pursue enforcement actions in this area.

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[53] Order Granting FTC's Partial Motion for Summary Judgment at 25, Fed. Trade Comm'n v. Qualcomm, No. 17-cv-00220-LHK (N.D. Cal. Nov. 6, 2018).

[54] Leah Nylen, *DOJ's Delrahim criticizes "theory" underlying FTC's Qualcomm case*, MLEX (Jan. 25, 2019).