BNA Insights

PATENTS

The author discusses the strategic and compliance implications of owning or using standard essential patents.

Standard Essential Patents—The Transactional Side

BY JEFFREY C. JOHNSON

Until very recently, standard essential patents (SEPs) have been a topic of discussion for a relatively small number of industries, such as telecommunications and consumer electronics.

SEPs are patents that cover technologies that are considered an established standard in a particular industry. Some standards are *de facto*, meaning a particular industry has simply chosen to adopt that standard without any pre-existing agreement or intentional coordination; others are *de jure*, meaning a government agency has imposed that standard on the industry; and still others have been adopted by a standard setting organization (SSO) to which many, if not all, of the participants in a particular industry belong on a voluntary basis. They are also increasingly at the core of high stakes litigation among major players in SEP-reliant industries.[1]

Jeffrey C. Johnson is based in New York City and is a partner in Pryor Cashman's Intellectual Property Group. He specializes in the transactional aspects of patents, trade secrets, and related intellectual property as part of mergers and acquisitions, licensing, patent investment funds, joint ventures, strategic alliances, joint development and marketing agreements, and private placements in a variety of industries.

With the spate of technological convergence seen in the past decade or so, however, SEPs are becoming an issue for more and more sectors. This convergence is perhaps most readily understood in the context of wireless communications.

It has long been true that consumers used cell phones and other products to communicate with each other. More recently, however, wireless communication is being adopted by other industries for purposes that have nothing to do with two people talking to each other.

The utility industries, for example, use wireless smart meters installed in homes and commercial buildings to communicate usage information directly with the utility provider for billing purposes. Medical device manufacturers are adopting wireless technologies to allow implanted devices to communicate with machines outside the patient's body in order to identify and, where possible, fix malfunctions without requiring an operation or other invasive procedure.

At the same time, SEPs can be attractive to what are commonly referred to as non-practicing entities (NPEs). These are businesses that own patents, but don't typically manufacture or sell products covered by those patents. This is increasingly the case because SEPs typically come with a guaranteed pool of existing and/or prospective licensees.

As a business model, NPEs have proliferated in recent years, and there has been a corresponding increase in the number of SEPs whose owners are not direct participants in a relevant industry. These owners are primarily interested in monetizing the SEP portfolio, through litigation or licensing.

Some NPEs are focused on a litigation business model, where they have accumulated a patent portfolio because they believe there are a substantial number of existing infringers from whom a claim for damages based on past infringement can be made. Other NPEs are organized in much the same way as private equity funds, only they focus on assembling a patent portfolio from multiple sources in order to create a package of patents that may be attractive for resale to third parties

[1] *See, e.g., Microsoft Corp. v. Motorola Inc.*, No. 2:10-cv-01823-JLR (W.D. Wash. April 25, 2013) (86 PTCJ 19, 5/3/13).

   ISSN 0148-7965

looking to acquire patents for strategic purposes, such as expanding their own business.

As industries new to SEPs proliferate, executives and inhouse counsel responsible for patent management and licensing in those industries are being introduced to an area of patent law that, for many, may be entirely new, certainly unusual, and potentially dangerous. Accordingly, these executives and their inhouse legal counterparts need to be prepared to carefully and thoughtfully address the transactional issues that are implicated by SEPs, both from the perspective of licensees and licensors.

Licensing

Because standards and the SEPs that cover them can have the effect of creating substantial barriers to entry in a particular industry, the licensing of SEPs is subject to different rules than traditional patent licensing. In particular, owners of SEPs are ordinarily subject to an obligation to offer non-exclusive licenses to prospective licensees on fair, reasonable, and nondiscriminatory (FRAND, or often simply RAND) terms. This obligation is coupled with some related limitations. SEP licensors, for example, may not be entitled to injunctive relief to prevent infringers from selling products covered by those SEPs. Another limitation comes with licensing SEPs as part of a portfolio that includes some patents that are not SEPs, an approach which can substantially complicate license negotiations and litigation strategies for asserting the portfolio.

The most obvious starting point for SEPs is the meaning of the FRAND obligation imposed on SEP licensors. Ordinarily, this obligation is expressly assumed as a result of a SEP owner's voluntary agreement to be bound by FRAND obligations imposed by an applicable SSO. The essence of the bargain is that an SSO only agrees to establish a standard that may be covered by a particular SEP if the owner of that SEP agrees to be bound by the FRAND obligations imposed by the SSO. But there is precious little concrete guidance on exactly what is meant by FRAND.

For example, members of one prominent SSO, the Institute of Electrical and Electronics Engineers, who seek to promote the IEEE's adoption of a standard that may be covered by one or more SEPs owned by that member must submit a ''Letter of Assurance'' to the IEEE, in which the owner is asked to adopt a position regarding third party licensing. The option most consistent with a RAND commitment simply constitutes a statement that if the standard is adopted, the member will ''grant a license under reasonable rates to an unrestricted number of applicants on a worldwide basis with reasonable terms and conditions that are demonstrably free of unfair discrimination.''[2]

The IEEE does not otherwise define a RAND commitment, and much like beauty, RAND may be in the eye of the beholder.

SEPs also give rise to unusual concerns regarding portfolio licenses. Specifically, if a relevant portfolio consists of both SEPs and patents that are not standard essential, prospective licensees and licensors need to take into consideration the possible complications that arise from having two categories of patents under one license: SEPs, which are subject to FRAND or comparable obligations, and patents that are not SEPs, which are not subject to these kinds of obligations. There is very little guidance, either from case law, statutes, SSO publications, or other sources, requiring a particular approach to how SEP and non-SEP patents should be treated when licensed together.

Acquisitions and Dispositions

Participants in an industry that is dependent on SEPs generally have an interest in developing their own portfolio of SEPs for strategic purposes. In other words, these participants want to have their own bargaining chip when sitting down with other SEP owners, thereby giving both parties an incentive to consider cross-licensing arrangements. In industries that are new to all this, one strategic option is to purchase its own portfolio of relevant SEPs, perhaps from an NPE or from the estate of an entity in bankruptcy.

Regardless of how a portfolio of SEPs is assembled, once it is pieced together it can put the new owner in a position to offset licensing costs through a cross-licensing approach, or to assert those patents against others who are active in that particular industry but who, for whatever reason, do not have their own portfolio of SEPs to assert.

Typically, acquisition agreements for SEPs present unusual due diligence challenges to buyers, particularly those whose background is in traditional mergers and acquisitions, rather than patent exploitation. In addition to customary issues, such as the extent to which particular patents are already licensed to parties that manufacture or sell products covered by relevant standards, there are less obvious challenges, such as the history of a patent's presentation to SSOs. It is important for a buyer to fully understand whether a patent has been nominated as an SEP in accordance with the requirements and processes of a particular SSO.

If not, a technical analysis of the patent's scope, as compared to any relevant standards, will be critical to understanding whether it is, in fact, a good SEP candidate. Similarly, the SSOs that govern a particular industry must be fully understood.

The IEEE, by way of example, acts as an SSO for many different industries including, among others, communications, aerospace, computing and robotics. The European Telecommunications Standards Institute, on the other hand, is somewhat more limited, primarily focusing on information and communications technologies.

Each SSO has its own particular rules for nominating SEPs and the licensing obligations that are imposed upon owners of SEPs. Knowing how any previous owners have interacted with relevant SSOs, and the extent, if at all, they have complied with SSO requirements applicable to particular SEPs (or prospective SEPs) is absolutely critical to ensuring a buyer gets what it is paying for.

Conclusion

More and more industries are finding themselves governed by, or relying on, SEPs. As SEPs become relevant to a larger range of industries, more and more executives and inhouse counsel responsible for managing patent portfolios are being asked to confront the unique strategic and compliance implications of dealing with SEPs. These implications can in large part be managed

[2] *See* IEEE form ''Letter of Assurance for Essential Patent Claims,'' at https://development.standards.ieee.org/myproject/Public//mytools/mob/loa.pdf.

with a well thought-out plan for acquiring, asserting, licensing and managing SEPS. The most critical first step is fully appreciating that SEPs are fundamentally different from patents that do not cover such standards.

Parties who wish to establish, acquire, assert, or grant licenses to SEPs are ordinarily assuming obligations that are entirely different from those imposed upon owners of patents that are not SEPs. Parties to whom SEP licenses are granted may have rights that are materially different from those of licensees to patents that are not SEPs.

Perhaps most important, however, is the fact that the law governing the rights, duties, and obligations of the various participants in SEP-reliant industries is far from settled. Knowing how that law is changing, and how possible changes may affect your rights, duties, and obligations, is a responsibility being imposed upon more and more patent managers and their inhouse counsel.

ISSN 0148-7965