

SEP Draft Policy Imperils US Investment In Innovation

By **David Kappos and Andrei Iancu** (April 6, 2022, 2:53 PM EDT)

Standardized technology is now so ubiquitous that we hardly have to think about it. The fact that words like USB, Wi-Fi and 5G come up in daily discourse shows just how accustomed we've become to the seamless interoperability of technology fostered by standardization.

Beyond facilitating everyday conveniences, standardization is vital to the infrastructure undergirding our global economy. Almost by definition, many standards are global in nature. With such high stakes, it is imperative that the U.S. continue to lead the world in the development of technology that is incorporated in standards, lest we be forced to depend on innovations created in other countries, some of which are our economic competitors.

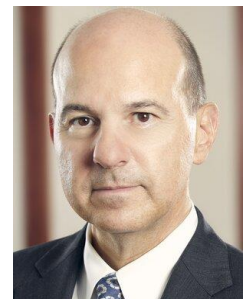
In a free market system such as ours, intellectual property protection is key in order to ensure the appropriate incentives are in place for private industry to invest in risky new enterprises.

Unfortunately, the intersection between patents and standards has been under siege in recent years. The foremost target is standard-essential patents, which cover technology required for compliance with industry standards. The perceived threat, commonly referred to as patent holdup, is that SEP owners might refuse to grant licenses unless excessive fees are paid, potentially locking out participants in standards-dependent industries.

Yet the data demonstrates[1] patent holdup does not occur in practice. This is because, before a patented technology can be contributed to an adopted standard, the patentee must commit to licensing its applicable patents on fair, reasonable and nondiscriminatory terms. Where SEPs are anchored to FRAND, access to required technology is assured.

Misplaced concern over patent holdup is nonetheless steering the current U.S. administration toward a dangerous tilting of SEP policy. In its December draft policy statement on licensing SEPs,[2] the administration set forth a policy skewing heavily against patent owners. Such policy would only disincentivize innovation in vital standards-dependent industries, ultimately harming the very consumers the draft statement purportedly seeks to protect.

The clearest disincentive comes from the draft statement's constriction of remedies. It advocates



David Kappos



Andrei Iancu

against availability of injunctions, announcing that monetary remedies alone can provide adequate redress for infringement. But the absence of injunctive relief would make SEP infringement the most attractive expedient for implementers seeking to use patentees' innovative technologies without paying.

Think about it: If it's okay to drive a new car off the lot without paying the dealership, with the worst-case scenario being the scofflaw pays the sticker price later and the best case scenario being the dealer is forced to offer the car for less — or even for free — then what policy incentive would motivate people to pay up front? If the salesperson's not even allowed to take back the keys, why not just take off with the car and dare the dealer to come after you?

The data demonstrates^[3] that opportunistic implementers — particularly ones with sizable legal budgets — are already opting for the free ride. This is due to the significant value derived from pilfering proprietary technology while holding technology owners hostage to meandering, disingenuous licensing discussions or resource-draining litigation.

This pattern of conduct is known as patent holdout.^[4] Take away the backstop of an injunction and SEP owners will have even less leverage to bring unwilling licensees to the table. After all, the licensees' worst case is paying damages calculated according to the FRAND terms available from the outset and their best case is that litigation yields a lesser license fee, while they get to use the technology gratis in the meantime. Perplexingly, it is the imaginary peril of patent holdup — not documented occurrences of patent holdout — driving the draft policy's proposed reform.

To be clear, standardization is not going away. But, in the absence of viable intellectual property protections, its gravitational center will surely shift. China is determined to take pole position in standards-implemented innovation — as a Chinese official noted in 2015, "the one who obtains the standards gains the world."^[5] In this way, the draft policy invites serious repercussions on the world economic stage.

Condoning holdout tactics would serve up a double blow to America's international competitiveness. In the near term, it would decrease costs for Chinese infringers, undercutting the value of U.S. IP — one of the few exports in which the U.S. enjoys a favorable trade balance with China. In the long term, it would cause rational American investors, exercising their free-market discretion, to redirect investment toward other sectors — just as China is directing its centrally controlled, heavily resourced economy toward overtaking the U.S. as the leader in standards-implemented innovation.

The winner from undercutting existing SEP protections won't be American inventors. It won't be American consumers. Rather, the clearest winner would be China — the world's largest consumer of SEP-based technology.

To win the future of standards-implemented innovation, the proper course for the administration's SEP policy must be driven by data. The data shows that patent holdup is a myth and patent holdout is real. Before the draft policy becomes official U.S. policy, it's incumbent on the administration to follow the facts, resist the rhetoric and ultimately rededicate its efforts toward protecting the integrity of patents — SEPs included — which are and long have been the fuel for America's innovation engine.

David J. Kappos is a partner at Cravath Swaine & Moore LLP and a former director of the U.S. Patent and Trademark Office.

Andrei Iancu is a partner at Irell & Manella LLP and a former director of the USPTO.

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[1] See Alexander Galetovic, Stephen Haber, THE FALLACIES OF PATENT-HOLDUP THEORY, Journal of Competition Law & Economics, Volume 13, Issue 1, March 2017, Pages 6–10, <https://doi.org/10.1093/joclec/nhx006>.

[2] <https://www.justice.gov/opa/press-release/file/1453826/download>.

[3] Article by Andrei Iancu with real life examples of efficient breaches: Andrei Iancu, Patent 'Holdouts' Are Sapping U.S. Innovation, Newsweek, Oct. 18, 2021, available at <https://www.newsweek.com/patent-holdouts-are-sapping-us-innovation-opinion-1639417> . See also Richard A. Epstein & Kayvan B. Noroozi, WHY INCENTIVES FOR "PATENT HOLDOUT" THREATEN TO DISMANTLE FRAND, AND WHY IT MATTERS, Berkeley Technology Law Journal, Vol. 32:1381, <https://doi.org/10.15779/Z38WD3Q19B>.

[4] <https://www.law360.com/articles/1407311/how-sep-holders-can-mitigate-the-effects-of-holdout/>.

[5] https://www.brookings.edu/wp-content/uploads/2021/04/FP_20210405_china_cyber_power_handout.pdf.