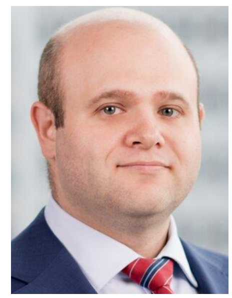
5th Circ. Antitrust Ruling Misinterprets FRAND's Purpose

By **Timothy Syrett and David Katz** (May 3, 2022)

Timothy Syrett



David Katz

The U.S. Court of Appeals for the Fifth Circuit recently held in Continental Automotive Systems Inc. v. Avanci LLC that Continental lacked Article III standing to pursue antitrust claims.

Continental alleged that the defendants' refusal to offer patent licenses to component manufacturers breached commitments they made to standard-setting organizations, or SSOs, to license their patents on fair, reasonable and nondiscriminatory, or FRAND, terms.[1]

Specifically, the Fifth Circuit concluded that, as a component supplier, Continental was neither an intended third-party beneficiary of the SSO commitments nor had it suffered any injury because the defendant licensors offered licenses to Continental's customers so Continental was not being denied the opportunity to make sales.

The Continental decision presents an overly narrow reading of the FRAND commitment based on fundamentally misapprehending its nature and purpose. The decision purports to divine the limits of FRAND without even considering Continental's allegations about the actual language of the particular commitments at issue.

Instead, the court's mistaken interpretation is based on looking to the facts of other cases, while simultaneously ignoring key aspects of those cases. The decision will undermine the intended benefits of FRAND licensing and pose particular challenges to emerging innovations for the Internet of Things, or IoT.

The Fifth Circuit fundamentally erred in interpreting the FRAND commitments at issue in Continental's claims. Rather than address the language of those commitments, the court looked to decisions in other circuits and, without justification, drew boundaries based on facts that were notably immaterial to the outcomes in those cases.

In particular — relying on the 2012 Microsoft Corp. v. Motorola Inc. decision in the U.S. Court of Appeals for the Ninth Circuit and the 2007 Broadcom Corp. v. Qualcomm Inc decision in the U.S. Court of Appeals for the Third Circuit — the court observed that "entities that create standard-conforming products can be third-party beneficiaries under FRAND contracts between SSOs and SEP holders."[2]

So far, so good. But then the court concluded that "Continental is conspicuously different from the parties that our sister circuits have identified as third-party beneficiaries."[3] As to Microsoft, the court observed that "Microsoft was itself a member of the SSOs that had negotiated FRAND contracts with Motorola."[4]

And as to Broadcom, it noted that "third-party beneficiary Broadcom was a direct competitor of standard-essential patent, or SEP, holder Qualcomm that needed its SEP licenses to operate."[5] Based on these facts, the court held that "Continental is not similarly situated to Microsoft and Broadcom" because it "does not claim membership in the relevant SSOs and, crucially, it does not need SEP licenses from the Defendants-Appellees to operate."[6]

Accordingly, the Fifth Circuit read into the determination of third-party beneficiary status consideration of whether the licensee:

- Is a member of the relevant SSO; or
- Demonstrates a need for a license as a competitor of the patent holder.[7]

Microsoft and Broadcom support neither conclusion.

In Microsoft, the district court concluded that "Microsoft, as a potential user of the 802.11 Standard and the H.264 Standard, is a third-party beneficiary to the agreements between Motorola and the IEEE and Motorola and the ITU."[8]

The district court stressed that a FRAND commitment is intended to ensure that everybody can use the standard, stating:

> These commitments are clearly designed to benefit potential licensees of Motorola's standard essential patent by ensuring that such patents are readily accessible to everybody at reasonable rates.[9]

The Ninth Circuit agreed with the district court's broad view of FRAND commitments and emphasized the particular commitments at issue in the case imposed "no limitations" on who can obtain a license:

> Motorola, in its declarations to the ITU, promised to "grant a license to an unrestricted number of applicants on a worldwide, non-discriminatory basis and on reasonable terms and conditions to use the patented material necessary" to practice the ITU standards. This language admits of no limitations as to who or how many applicants could receive a license ("unrestricted number of applicants") or as to which country's patents would be included ("worldwide," "the patented material necessary"). Implicit in such a sweeping promise is, at least arguably, a guarantee that the patent-holder will not take steps to keep would-be users from using the patented material, such as seeking an injunction, but will instead proffer licenses consistent with the commitment made.[10]

In short, Microsoft demonstrates that the ability to license FRAND-committed patents should be available to all and not narrowly restricted to members of the SSO to which the commitment was made.

The Fifth Circuit's reliance on Broadcom to limit the availability of FRAND licenses to competitors that need a license is equally unfounded. Looking to Broadcom, the court observed that "crucially, [Continental] does not need SEP licenses from Defendants-Appellees to operate; Avanci and Patent-Holder Defendants license the OEMs that incorporate Continental's products."[11]

But nothing in Broadcom suggests that the right to obtain a FRAND license is limited to competitors. To the contrary, in describing the problem of patent hold up, the court addressed the risk that "industry participants" generally—not competitors—would be denied FRAND terms.[12]

The facts in Broadcom also cannot be squared with the Fifth Circuit's narrow view of the availability of FRAND licenses.

Broadcom addressed one of the SSOs — the European Telecommunications Standards Institute — that was also at issue in Continental. And Broadcom — just like Continental — was a component supplier dealing with a SEP licensor that was also licensing original equipment manufacturers, or OEMs.[13]

Despite these facts, the Fifth Circuit inexplicably interpreted Broadcom to mean that component suppliers should generally not be able to license FRAND-committed patents and would be able to do so only to the extent they are competitors of the patent holders.[14]

This interpretation of FRAND commitments would give rise to a haphazard and inefficient trickle-down-licensing system in which upstream component suppliers are only entitled to obtain FRAND licenses from direct competitors.

Ultimately, this approach would eviscerate component level licensing because a partially licensed component adds relatively little value for downstream manufacturers because they would still be burdened with obtaining their own licensing rights in order to fill in the gaps.

Not only did the Fifth Circuit misconstrue Microsoft and Broadcom, but it inexplicably chose to extrapolate from the facts in those cases — rather than look at Continental's allegations or the actual SSO obligations at issue — to conclude Continental was not an intended beneficiary of the FRAND commitments.[15]

While it is true that courts may look beyond the complaint when addressing a factual challenge to jurisdiction, the actual facts of the case are nonetheless relevant.[16] The panel's decision to rely on facts plucked from Microsoft and Broadcom without even mentioning the relevant SSO intellectual property rights policies is particularly confusing.

The Fifth Circuit also erred in concluding that "licensing of third parties up the chain" is "unnecessary to effectuate the purpose of the FRAND commitments and reduce patent hold-up."[17]

The very purpose of refusing to license upstream component suppliers is to extract higher royalties from suppliers of end products. For example, "Qualcomm previously licensed its SEPs to rivals, but stopped doing so because Qualcomm concluded that instead licensing its SEPs to only OEMs is 'humongously more lucrative.'"[18]

Further, a Qualcomm executive also

> told the IRS that Nokia and Ericsson have imitated Qualcomm's practice and license only OEMs in order to make more money: "[S]o they also – following our lead I might say – you know, decided hey, we can license these patents and make money by doing and we can make more money licensing this than licensing the chip. So like they licensed the cell phone, not the chip."[19]

The Continental decision threatens to undermine the promise of FRAND licensing by restricting its availability. It spells a particular threat to small companies that want to introduce innovative products using 5G for IoT. The breadth of IoT product functionality and the potential for specialization in a particular product is likely to mean the ultimate IoT landscape may involve thousands of companies.

The practical result of the Continental decision will require each IoT producer to engage in its own licensing negotiation with each SEP holder despite the fact that many IoT companies are likely to be sourcing chips supplying cellular connectivity from the same suppliers. This will force small companies with limited licensing experience to engage in costly negotiations with deep-pocketed and experienced SEP holders.

These duplicative negotiations will create significant levels of risk regarding final licensing rates in addition to significant transaction costs for emerging companies that could have a long-term chilling effect. SSO commitments, as they currently stand, are intended to benefit upstream component manufacturers.

Moreover, very few — if any — of these startups are members of SSOs and, given that some of these companies are pioneering entirely new product categories, they may not have competitors that own SEPs. Thus, under Continental, these companies would not be third-party beneficiaries of the FRAND commitments and unable to claim a right to FRAND terms. The end result will be more expensive licenses and, ultimately, more expensive, or fewer consumer products.

Timothy D. Syrett is a partner and David Katz is a senior associate at WilmerHale.

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[1] 27 F.4th 326 (5th Cir. 2022).

[2] Id. at 334. Also,Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 884 (9th Cir. 2012), and Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, 304, 313-14 (3d Cir. 2007).

[3] Id.

[4] Id.

[5] Id.

[6] Id.

[7] It is not clear whether the third-party beneficiary analysis was even relevant to Continental's antitrust claims. Third-party beneficiary analysis implicates standing in identifying a "legally cognizable interest." Bochese v. Town of Ponce Inlet , 405 F.3d 964, 984 (11th Cir. 2005). Continental's complaint was premised on Sherman Act violations as well breach of contracts, each of which would constitute an independent legal basis for standing. As the panel's injury determination was sufficient to reach its standing decision for the antitrust claims, the third-party beneficiary analysis is, at most, dicta with regard to the Sherman Act claims.

[8] Microsoft Corp. v. Motorola, Inc ., 864 F. Supp. 2d 1023, 1032 (W.D. Wash. 2012).

[9] Id. at 1023.

[10] Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 884 (9th Cir. 2012) (emphases added).

[11] Op. at 11.

[12] 501 F.3d at 310 ("An SDO may complete its lengthy process of evaluating technologies and adopting a new standard, only to discover that certain technologies essential to implementing the standard are patented. When this occurs, the patent holder is in a position to 'hold up' industry participants from implementing the standard. Industry participants who have invested significant resources developing products and technologies that conform to the standard will find it prohibitively expensive to abandon their investment and switch to another standard.").

[13] Id. at 304 ("The Complaint also alleged that Qualcomm ignored its FRAND commitment to the ETSI and other SDOs by demanding discriminatorily higher (i.e., non-FRAND) royalties from competitors and customers using chipsets not manufactured by Qualcomm."); id. at 305 ("Broadcom claims to have been preparing to enter the UMTS chipset market for several years prior to its filing of the Complaint.").

[14] The Continental decision also contradicts Broadcom with regards to injury-in-fact. The Continental panel ultimately held that component manufacturers do not suffer an injury-in-fact from being denied a license. Given that Broadcom involved a component manufacturer, under Continental, the case should have been dismissed on the grounds that the injury was too speculative. Importantly, this was not an oversight as the Third Circuit explicitly dismissed claims associated with components that Broadcom did not manufacture as "extremely remote" and not "inextricably intertwined" with the alleged anticompetitive conduct. Id. at 320–21.

[15] Continental, for example, pleaded that "the IPR policies of all relevant SSOs expressly prohibit owners of FRAND-encumbered SEPs from discriminating among users of the standards. For example, the ETSI IPR Policy requires SEP owners to commit to provide "irrevocable licenses on fair, reasonable and nondiscriminatory ('FRAND') terms and conditions." Complaint ¶ 14, Continental Auto. Sys., Inc. v. Avanci, LLC, No. 19-cv-2520 (N.D. Cal. May 10, 2019).

[16] See Arbaugh v. Y&H Corp ., 546 U.S. 500, 514 (2006).

[17] Id.

[18] Fed. Trade Comm'n v. Qualcomm Inc ., 411 F. Supp. 3d 658, 751, 821 (N.D. Cal. 2019), rev'd and vacated, 969 F.3d 974 (9th Cir. 2020) (quoting a Qualcomm executive's admission to the IRS).

[19] Id. at 755.