The Dangerous Adventurism of the United States Trade Representative:

Lifting The Ban Against Apple Products Unnecessarily Opens A Can Of Worms In Patent Law

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In ordinary times, the business of the International Trade Commission does not appear as the lead story in the *Wall Street Journal*, predicting massive changes in the high-stakes patent battles.[1] But these are not ordinary times, given the ongoing multi-front war between Apple and Samsung, in which each side has accused the other of serious acts of patent infringement. So when the International Trade Commission issued its order excluding Apple's still popular iPhone 4 and older versions of the iPad, the smart money predicted that the Obama Administration, acting through the United States Trade Representative, would for the first time in 25 years decide to overrule a decision of the ITC, which it pointedly did in a three page letter of August 3, 2012, signed by Ambassador Michael B. G. Froman and addressed to Irving A. Williamson, Chairman of the ITC, whose wings have definitely been clipped.[2]

Injunctions, Damages, or Something in Between

Properly understood, that letter should be regarded as a patent bombshell whose significance goes far beyond the individual case. The choice of remedy in patent disputes has been, at least since the much-cited 2006 Supreme Court decision in *eBay v. MercExchange*,[3] one of the central issues in patent law. In the academic literature there has been an extensive debate as to whether various forms of injunctive relief should be allowed as a matter of course, or whether the court should place great weight on so-called public interest factors that many modern patent lawyers claim should displace a remedy which under prior legal practice had been awarded largely "as a matter of course."

That last phrase is not intended to indicate that blanket injunctions should be awarded in any and all cases. Instead, by analogy to traditional equitable principles as applied in various other contexts, including ordinary nuisance cases, the basic principle is subject to some important qualifications that do not undermine the force of the basic rule. First, any patentee may forfeit in whole or in part the right to an injunction by improper conduct on his own part: taking undue delay with respect to enforcement could lead to a loss in some cases of injunctive relief. But the application of this doctrine is within the control of the patentee, who can preserve his rights by promptly asserting them, which means that this issue almost never comes into play with valuable patents that are consistently asserted. Second, traditional doctrine allows a court to delay the enforcement of an injunction to allow the infringer to fix his device, and perhaps even deny the injunction in those cases where a complex device contains many patented components, of which only one is in violation.

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The Magic of Section 337 in FRAND Cases

The decision of the Trade Representative did not point to any such complications in the case justifying a departure from the usual remedy of an injunction. Indeed the ITC order was not lightly entered into, for it was agreed by all commissioners that Apple had indeed infringed the Samsung patents in ways that would have resulted in extensive damage awards if the case had been tried in a federal court. The ITC does not have statutory powers to award damages, so the Commission thought, perhaps mistakenly, that it was bound to make an all-or-nothing choice: allow or exclude the importation of the infringing device. Under the applicable statutory provisions of Section 337 of the Tariff Act of 1930, the ITC is supposed to take into account a number of "public interest factors" that address "the effect of such [exclusion or order] upon the public health and welfare, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, and United States consumers . . ."

The language in this section is quite broad on its face, and if it were applied in a literal fashion, the history of proceedings before the ITC should be replete with decisions that let infringing products into the United States. The words "public health and welfare" are in modern American English broad enough to allow foreign pharmaceuticals into the United States even if they infringe key pharmaceutical patents. Any mysterious reference to competitive principles would again seem to invite a wide-ranging inquiry that could easily turn this provision of the Tariff Act into an open sesame for infringing products. The 25-year gap between decisions allowing importation of infringing products makes it quite clear that this provision has never been read to invite the broad type of "facts and circumstances inquiry" that the Trade Representative invoked to decide whether to grant or deny injunctive relief.

Against this background, it is critical to note that the dispute in this case boiled down to the question of the scope of Samsung to license its key patent on fair, reasonable and nondiscriminatory, or FRAND terms, to all comers including Apple. In ordinary cases, no owner of property is required to license or sell its property to a competitor. But for hundreds of years, common carriers have by virtue of their monopoly power been under an obligation to take all passengers on fair and reasonable terms. The thumbnail sketch for this position runs as follows. The obligation to do business on these terms is an offset to the dangers of monopoly power. The prohibition against discrimination is intended to make sure that the common carrier does not duck its obligation by offering its products only at prices so high that it is confident that no passenger will pay them. The concern with nondiscrimination is intended to make sure that the firm does not play favorites among potential customers to whom it can supply the essential service at roughly identical cost.

The carryover of FRAND obligations to the patent space arises only in connection with what are termed "standard-essential patents," which are those patents that cover an invention that is incorporated in an industry standard that all parties must use in order to market and deploy their own products.[4] The FRAND obligation requires parties to enter into negotiations to make sure that all market participants have a fair shot, so that the owner of the essential patent cannot hold out against a potential user.

In dealing with this issue, the Trade Representative took the position that a White House Report from January 2013 dealing with standard-essential patents revealed the manifest risk of holdout that could take place in these contexts, and recommended a fact-specific inquiry be made into each dispute to determine whether the action of the patent holder was unreasonable under the circumstances.[5] The Trade Representative then extended his discretion further into this situation by insisting that "reverse holdouts" (i.e. those by a potential licensee) should be subject to a similar analysis.

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How the Trade Representative Overreaches

It would be foolish to respond to the position of the Trade Representative by saying that there is no holdout risk at stake whenever a party has monopoly power. But there is a vast disagreement over the proper institutional arrangements to deal with these FRAND obligations. The implicit subtext of the Trade Representative's Report is that holdout is a major risk in these settings that requires some heavy lifting to combat, not only before the ITC, but also in ordinary patent disputes. Just that position was taken by Commissioner Dean Pinkert in dissent below,[6] who relied on some recent work by the well-known Professors Mark Lemley of Stanford and Carl Shapiro of Berkeley, who have proposed major intervention in a form of "final offer baseball arbitration," whereby the arbitrator chooses between the royalty rates proposed by the two parties.[7]

The obvious point is that this baseball form of arbitration seems ill-suited to determine the complex set of terms that are normally found in any complex licensing agreement. Why propose something that no one has ever used in the voluntary market? But put that point aside, and address the prior question of whether any compulsory remedy is needed to deal with the asserted holdout problem at all. The issue is one to which I have some exposure because I have worked on this question as a legal consultant with Qualcomm. On the strength of that work, and other work of my own on the biomedical anticommons, coauthored with Bruce Kuhlik (now general counsel at Merck), I have concluded that the frequency and severity of the holdout problem is in fact far less than asserted by the overwrought statements of those who advance this theory.[8] In work that I did with Scott Kieff and Dan Spulber, we reported that Qualcomm was a member of some 84 standard organizations and reported few if any problems in working through the details with any of them.[9] Indeed, apart from the citation of a few cases that dealt with tangential issues, there is nothing in the Lemley and Shapiro paper that indicates that this problem has serious dimensions.

The question then arises why this might be so, and the answer is a collection of factors, none of which is decisive but all of which are to some degree relevant. The process of standard-setting does not take place in a vacuum, but involves repeat play by individual firms, all of whom know that coordination is key to their mutual success. The common pattern of standard-setting involves having technical people coming up with a sound technical solution before worrying about who holds what patent position. Standard-setting organizations then require their participants to disclose patents that read onto the standard. These organizations typically revisit standards as circumstances and technology change, which creates a subtle threat for patentees that the standard may migrate away from their patented technology if the patentee's license terms become too risky. The threat of retaliation is real as well, and all parties know that if they hold up a standard they not only hurt their competitors but also themselves. The process may not look pretty, but in the hands of experienced professionals, the evidence is that it works well.

The choice in question here thus boils down to whether the low rate of voluntary failure justifies the introduction of an expensive and error-filled judicial process that gives all parties the incentive to posture before a public agency that has more business than it can possibly handle. It is on this matter critical to remember that all standards issues are not the same as this particularly nasty, high-stake dispute between two behemoths whose vital interests make this a highly atypical standard-setting dispute. Yet at no point in the Trade Representative's report is there any mention of how this mega-dispute might be an outlier. Indeed, without so much as a single reference to its own limited institutional role, the decision uses a short three-page document to set out a dogmatic position on issues on which there is, as I have argued elsewhere, good reason to be suspicious of the overwrought claims of the White House on a point that is, to say the least, fraught with political intrigue.[10]

Ironically, there was, moreover a way to write this opinion that could have narrowed the dispute and exposed for public deliberation a point that does require serious consideration. The thoughtful dissenting opinion of Commissioner Pinkert pointed the way. Commissioner Pinkert contended that the key factor weighing against granting Samsung an exclusion order is that Samsung in its FRAND negotiations demanded from Apple rights to use certain non standard-essential patents as part of the overall deal. In this view, the introduction of nonprice terms on nonstandard patents represents an abuse of the FRAND standard. Assume for the moment that this contention is indeed correct, and the magnitude of the problem is cut a hundred or a thousand fold. This particular objection is easy to police and companies will know that they cannot introduce collateral matters into their negotiations over standards, at which point the massive and pointless overkill of the Trade Representative's order is largely eliminated. No longer do we have to treat as gospel truth the highly dubious assertions about the behavior of key parties to standard-setting disputes.

The brave new world of discretionary remedies could easily backfire and undermine cooperative behavior by rewarding those who refuse to cooperate.

But is Pinkert correct? On the one side, it is possible to invoke a monopoly leverage theory similar to that used in some tie-in cases to block this extension. But those theories are themselves tricky to apply, and the counter argument could well be that the addition of new terms expands the bargaining space and thus increases the likelihood of an agreement. To answer that question to my mind requires some close attention to the actual and customary dynamics of these negotiations, which could easily vary across different standards. I would want to reserve judgment on a question this complex, and I think that the Trade Representative would have done everyone a great service if he had addressed the hard question. But what we have instead is a grand political overgeneralization that reflects a simple-minded and erroneous view of current practices.

The enormous technical advances in all these fields are not consistent with the claim that holdout problems have brought an industry to a standstill. The brave new world of discretionary remedies could easily backfire and undermine cooperative behavior by rewarding those who refuse to cooperate. If the critics of the current system focused on that one background fact, they might well be more diffident about pushing vast industries into uncharted territories on their regrettable overconfidence in their own untested judgments.

ENDNOTES

1 See Ian Sherr & Brett Kendall, Veto of Apple Ruling Likely to Upend Big Patent Battles, WALL ST. J., Aug. 5, 2013, http://online.wsj.com/article/SB10001424127887323420604578648272862276836.html.

2 See http://www.ustr.gov/sites/default/files/08032013%20Letter_1.PDF.

3 547 U.S. 388 (2006).

4 Gregory M. Huffman, FRAND and Injunctive Relief: Exploring a Standard-Essential Patent Owner's Right to Injunctive Relief (Summer 2012), at http://www.mbhb.com/pubs/xpqPublicationDetail.aspx?xpST=PubDetail&pub=239.

5 See 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 (Jan. 8, 2013), at http://www.uspto.gov/about/offices/ogc/Final_DOJ-PTO_Policy_Statement_on_FRAND_SEPs_1-8-13.pdf.

6 See Philip Elmer-Dewitt, How the ITC Forced a Veto in the Samsung-Apple Patent Case, CNNMONEY, Aug. 5, 2013, at http://tech.fortune.cnn.com/2013/08/05/apple-samsung-itc-pinkert/.

7 See Mark A. Lemley & Carl Shapiro, A Simple Approach to Setting Reasonable Royalties for Standard-Essential Patents (Mar. 30, 2013), at http://ssrn.com/abstract=2243026.

8 See Richard A. Epstein & Bruce N. Kuhlik, Is there a Biomedical Anticommons?, REGULATION (Summer 2004), at http://www.cato.org/sites/cato.org/files/serials/files/regulation/2004/7/v27n2-7.pdf.

9 See Richard A. Epstein, F. Scott Kieff & Daniel F. Spulber, The FTC, IP, and SSOs: Government Hold-Up Replacing Private Coordination, 8 J. COMP. L. & ECON. 1 (2012), at http://jcle.oxfordjournals.org/content/8/1/1.full?keytype=ref&ijkey=1tuKfhz2vhZ1CdU%20.

10 See Richard A. Epstein, Trolling for "Patent Trolls," DEFINING IDEAS (June 11, 2013), at http://www.hoover.org/publications/defining-ideas/article/149096.

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