Why Incentives for "Patent Holdout" Threaten to Dismantle FRAND, and Why It Matters

Richard A. Epstein[1] *& Kayvan B. Noroozi*[2] [3]

This version: January 18, 2017[4]

Abstract

An increasing number of judges, legislators and scholars wrongly believe that the FRAND commitment was principally created to advance the interests of technology implementers, and should be interpreted by giving a presumptive preference toward those interests. That premise has led courts to take a categorically hostile view toward awarding injunctions against implementers under all circumstances. Some courts have even allowed implementers to sue innovators for making an opening licensing offer that is "too high," without making any counteroffer. An implementer-centric view of FRAND has also caused courts to conclude that innovators are not entitled to any share of the commercial benefits arising from the standardization of their technologies.

We demonstrate that an implementer-centric view of FRAND's origins and purposes is false. FRAND is a contractual agreement that reflects a voluntary reciprocal exchange of benefits and obligations driven by the need to solve significant coordination problems in the face of otherwise prohibitive transaction costs. As part of that bargain, innovators agree to disclose their latest, confidential discoveries to standard-development organizations, and to waive their injunction

---

[1] Laurence A. Tisch Professor of Law, New York University School of Law; Peter and

[2] Principal at Noroozi PC and CEO of Koios Pharmaceuticals LLC. The author is trial counsel to Core Wireless Licensing S.a.r.l. in litigation against LG Electronics and Apple with respect to FRAND-committed declared standard-essential patents. The views expressed in this article, however, are entirely the author's and were not discussed with or supported by any client or company.

[3] The authors thank Bijan Aboutarabi, Philip Cooper, and John Tienken of the University of Chicago Law School for their excellent research assistance.

[4] This is a working draft and may alter prior to the article's publication in the Berkeley Technology Law Journal in mid-2017.

rights as to eventual patents on those discoveries, in exchange for contractual protection against patent holdout by implementers who in turn are permitted to use standard-essential patents only on their willingness to pay fair and adequate royalties for that use.

Accordingly, we stress that implementers owe a significant duty to negotiate FRAND licenses in good faith, which courts have largely overlooked and under-enforced. We demonstrate that implementers' good faith obligations are a critical component of basic FRAND architecture that is strictly necessary to the development of innovation-driven standards. We further observe that the FRAND bargain gives implementers access to otherwise confidential discoveries—inventions too recent to be disclosed in patents or published applications. In this way, FRAND supplies a solution to an iteration of Kenneth Arrow's paradox of information, enabling the standards development effort to yield commercial benefits that would not exist absent innovators' voluntary participation. We show both theoretically and empirically that courts' failure to appreciate these aspects of the FRAND bargain, combined with their over-reliance on liability rules, *i.e.*, damages over injunctions, incentivizes the very patent holdout problem FRAND was intended to avoid. That outcome, in turn, has motivated innovators to reduce their participation in FRAND bargains, threatening to unravel a massive innovation-commercialization marketplace, and its innumerable positive externalities to all parties.

To reverse these harms, we recommend that courts automatically issue an injunction where an implementer is found to infringe FRAND-committed patents that it did not attempt to license in good faith. We also recommend that a proper FRAND licensing rate should include some portion of the benefits achieved through standardization of the innovation(s) in question.

More broadly, we suggest that courts, policymakers, and academic commentators have wrongly favored implementation over innovation—"things" over ideas—unwisely frustrating the emergence of an "ideas economy" that correctly assigns profits to upstream innovators, and not to the low-margin firms that specialize in developing their commercial embodiments.