

Intellectual Property ADVISORY

March 8, 2011

Case Study: Patent Licensing in a Standards Making Process

Scenario (Hypothetical)

Innovator Co., a manufacturer of servers, routers and power grid management software, has an active R&D program and aggressively seeks patents for its inventions. Innovator Co. also participates in “working groups” of a standards development organization (SDO) that brings together industry representatives to develop technical standards, so that systems can be assembled from interoperable components made by different manufacturers. In connection with one such proposed standard for a data link, Innovator Co. discloses to the SDO its patent on a state-of-the-art technology being considered for the standard. In response, the SDO formally asks Innovator Co. for assurance that if the SDO incorporates the patented invention into the standard, Innovator Co. will grant licenses to everyone who asks, on a reasonable and nondiscriminatory basis (RAND licensing). However, Innovator Co. would not be required by the SDO rules to state in advance a specific royalty rate or other terms that it would ask from those requesting a license.

Should Innovator Co. agree to RAND licensing?

STORY 1: Innovator Co.’s patent is for an interface that provides a data link between utility computer systems (not its main profit center). Innovator Co. agrees to RAND licensing, and develops terms for the license that couple a relatively low royalty rate with a reciprocal rights clause under which licensees must grant Innovator Co. a license under any patent rights they may have that are essential to comply with the standard. The ability to standardize on state-of-the-art technology helps the industry segment to grow. As a result, Innovator Co. enjoys increased sales of its primary products that are used with the data link, as well as royalty income from a high volume of licensees, and the freedom to operate in the industry segment provided by the reciprocal rights.

STORY 2: Innovator Co.’s patent is for power grid management software (a key product), and although it would like to have a patent on the industry standard, Innovator Co. is unwilling to allow competitors and others to use the key technology that differentiates its software from competitors’ products. Therefore, Innovator Co. opts out of RAND licensing. As a result, the SDO bases the standard on an older, unpatented technology. Innovator Co. protects its software profit margin with its patent in lieu of royalty income. Initially, the rest of the industry, offering an inferior product, struggles to compete and Innovator Co.’s sales are strong. Later, however, a competitor develops

a competitive software program that complies with the standard and is not patented. Eventually non-infringing products based on the new software draw sales away from Innovator Co.'s software, diluting the value of its patent.

Discussion

Innovator Co. faced a business decision depending on several factors related to the potential success of its business plan. The main difference between the two hypothetical stories above lies in the coverage of the patent that may be incorporated into the standard—in one case it covered a key profit center, and in the other it covered a technology that played more of a supporting role in the business plan.

- In the case of the interface patent, allowing the technology to be incorporated into the standard increased the market for other products important to Innovator Co.'s business plan, and might have been advantageous even without collecting royalties. There was little potential downside risk of submitting the patent.
 - One risk, however, is that an implementer of the standard who disputes the reasonableness of the royalty or other terms of Innovator Co.'s RAND proposal will sue, asserting that Innovator Co. has violated its commitment to the SDO.
- In the case of the patent for a key software product, the path to maximizing profits is less clear.
 - Innovator Co. was properly cautious because agreeing to a RAND license would have immediately diluted market share protected by the exclusive right granted under the patent. The opportunities and threats should be carefully weighed to determine which approach has the greatest profit potential and overall benefit.
 - More important than having a patent on the standard may be Innovator Co.'s ability to sell products meeting the standard without paying a royalty. If competitors' patents could be incorporated into the standard, the ability to negotiate favorable reciprocal rights terms in RAND licenses might weigh in favor of submitting Innovator Co.'s patent. Alternatively, Innovator Co.'s better technology might displace the competitors' patents in the standard.
 - In the hypothetical Story 2 above, holding the software patent outside of the standard gave Innovator Co.'s competitors an incentive to design around the patent in order to market competitive products within the standard. This highlights the fact that every patent has a particular scope of coverage (sometimes broad, sometimes narrow) and fits into a particular role in a competitive environment. When making the decision whether or not to submit a patent to RAND licensing in a standards process, a company should carefully consider how technically dominant its patented approach is likely to remain over time, and also whether any design-around options are available to competitors.

Cautions

Companies should investigate both the published patent policy of an SDO and its anecdotal history before participating in a standards making process, in order to understand the obligations and expectations of the SDO regarding participants' patent rights. A full discussion of the rights, responsibilities and risks of participating in an SDO process is beyond the scope of this case study.

Some SDOs require an advance agreement to RAND licensing in order to participate in their working groups.

SDO rules regarding the timing of disclosure of patents and patent applications differ. Violation of such rules or other unfair dealing that "hides" relevant patents during an SDO standards-making process can result in the offender's patents being unenforceable, or draw charges that the offender's actions violate regulations or laws.

Unreasonable reciprocal rights provisions might be challenged as inconsistent with a RAND licensing assurance. For example, if the provisions required a license back or covenant not to sue with regard to all patents of the licensee, rather than only with regard to patents essential to the relevant standard, a challenge would be more likely.

Implementing a formal industry standard does not guarantee a party freedom from infringement. Patents needed to comply with a standard may be owned by parties who did not participate in making the standard and are not bound by a RAND licensing commitment. If the SDO knows of such patents, the technology they describe usually will be omitted from the standard. However, if the SDO incorporates a patented technology without knowledge of the patents, implementers of the standard may be surprised to find themselves charged with patent infringement. SDOs often do not investigate the risk of patent infringement. Therefore, companies should consider obtaining a freedom to operate study prior to investing in production and sale of a new product or service, even one that implements a standard.

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