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A FRAND Contract's Intended Third-Party Beneficiary

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A patent holder that joins a standard-setting organization (SSO) typically agrees to license its standard-essential patents (SEPs) on fair, reasonable, and nondiscriminatory (FRAND) terms to future implementers of the standard. U.S. courts have found that a commitment to license SEPs on FRAND terms is a binding contract between the SEP holder and the SSO, and that, as a third-party beneficiary, an implementer of that industry standard has the right to enforce the obligations arising from that contract. However, can an implementer exhaust its rights as a third-party beneficiary? Can an implementer's feasance or nonfeasance preclude it from enforcing its rights as a third-party beneficiary of a FRAND contract? In this article, I analyze the scope of the implementer's rights as the intended third-party beneficiary of a FRAND contract, and I determine the circumstances in which an unlicensed implementer would exhaust those rights.

In Part I, I explain that, in the United States, a nonparty typically may enforce a contract only if the nonparty is the contract's *intended* beneficiary. U.S. courts have confirmed that implementers of an industry standard are typically intended third-party beneficiaries of the FRAND contract and, consequently, that they have a right to enforce the SEP holder's obligations arising from that contract. Because a FRAND contract typically imposes on the SEP holder a duty to offer to license its SEPs on FRAND terms before seeking to enforce those SEPs, an implementer may bring an action for breach of contract against an SEP holder that fails to perform that duty.

In Part II, I analyze the circumstances in which an implementer of an industry standard extinguishes its rights as a third-party beneficiary of the FRAND contract. The SEP holder's offer to license its SEPs on FRAND

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terms confers on the implementer the power of acceptance—that is, the power to accept the FRAND offer and transform it into a binding license agreement. However, the FRAND commitment contains no guarantee that, after an SEP holder has made a FRAND offer, a license will eventuate between the SEP holder and a specific implementer. The implementer's power to accept a FRAND offer might terminate (1) if the implementer rejects a FRAND license offer (either explicitly or by making a counteroffer), or (2) by operation of law. In particular, the implementer's power to accept a FRAND offer terminates by operation of law if the implementer fails to respond promptly to the SEP holder's offer. Because time is of the essence in the licensing of SEPs, an implementer may not decline to accept a FRAND offer, prolong a negotiation, and yet still retain an enforceable right pursuant to the SEP holder's FRAND contract with the SSO. After the implementer's power to accept a FRAND offer has terminated, an implementer has exhausted its rights as a third-party beneficiary and may not claim any further rights under the FRAND contract.

In Part III, I explain that an implementer may not use the FRAND contract to extract rights that the SEP holder and the SSO never intended to confer on a third party. As a matter of basic contract law, the FRAND contract between the SEP holder and the SSO grants no greater a bundle of rights to the implementer than what the SEP holder promised to the SSO to convey to an intended third-party beneficiary. In determining the intended scope of the implementer's rights, a court needs to examine the exact terms of the FRAND contract between the SEP holder and the SSO. For example, in a typical FRAND contract, there is no evidence that the SSO and the SEP holder intended to give a third-party beneficiary the right to obtain an offer to license individual SEPs within the SEP holder's portfolio. Even if a court were to determine that the terms of a FRAND contract are ambiguous with respect to the availability of *à la carte* licenses, extrinsic evidence surrounding the formation of that contract would support the conclusion that neither the SEP holder nor the SSO intended to confer on third parties a right to demand *à la carte* licenses. Because the parties to a FRAND contract never intended to offer to an implementer the right to an *à la carte* license, an implementer may not rely on the FRAND contract to demand the legally enforceable right to receive an offer for such a license. The implementer has only as many rights as the FRAND contract creates.

I. Viewing an Implementer of an Industry Standard as a Third-Party Beneficiary of the FRAND Contract

U.S. courts have found that implementers of a standard are third-party beneficiaries of the FRAND contract between the SEP holder and the SSO that promulgates that standard. An implementer may therefore bring a breach-of-contract claim against an SEP holder that fails to perform its obligations to third-party beneficiaries arising from the FRAND contract.

A. When May a Nonparty Enforce a Contract?

The Restatement (Second) of Contracts defines a contract as "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."[1] Although contract law in the United States varies by state, the formation of a contract generally "requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration."[2] The Restatement (Second) of Contracts says that the parties to a contract have manifested mutual assent when "each party either [has made] a promise or [has begun] or [has] render[ed] a performance."[3] For a bargain to produce an enforceable contract, both parties must give some kind of consideration, in addition to their mutual assent—that is, both parties must give something of value to induce the other to enter into the contract.[4]

U.S. courts have recognized that, with few exceptions, only parties to a contract may enforce the rights and obligations that arise from the contract.[5] One such exception arises when a contract has a third-party beneficiary—a nonparty to the contract who, being the intended beneficiary of the contract's performance, may enforce the contract.[6] However, as the Supreme Court observed in 1912, "[b]efore a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement to which he is not a party, he must, at least, show that it was intended for his direct benefit."[7] To determine whether a nonparty may sue to enforce a contract as an intended third-party beneficiary, the Restatement (Second) of Contracts advises courts to use an "intent-to-benefit" test:

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1 Restatement (Second) of Contracts § 1 (Am. Law Inst. 1981).

2 *Id.* § 17.

3 *Id.* § 18.

4 *Id.* § 71(1) ("To constitute consideration, a performance or a return promise must be bargained for.").

5 *See, e.g.*, German Alliance Ins. Co. v. Home Water Supply Co., 226 U.S. 220, 230 (1912) ("The general principle [of contracts] . . . proceeds on the legal and natural presumption that a contract is only intended for the benefit of those who made it."); Caguas Cent. Fed. Sav. Bank v. United States, 215 F.3d 1304, 1309 (Fed. Cir. 2000) ("Ordinarily, only the parties to a contract have rights thereunder that they may enforce." (citing First Hartford Corp. Pension Plan & Trust v. United States, 194 F.3d 1279, 1289 (Fed. Cir. 1999)).

6 *See, e.g.*, Restatement (Second) of Contracts § 302(1)(a)–(b) (Am. Law Inst. 1981). Courts have sometimes used the term "third-party beneficiary" to denote a third party who has the power to enforce a contract. *See, e.g.*, Dravo Corp. v. Robert R. Kerris, Inc., 655 F.2d 503, 510 (3d Cir. 1981) ("[T]he parties did not intend Dravo to be a third-party beneficiary to the . . . contract."). Although there is debate over whether the term "third-party beneficiary" refers to any third party who benefits from a contract (as opposed to only third parties who may enforce a contract), I use "third-party beneficiary" to denote only a nonparty who may enforce a contract. *See* Melvin Aron Eisenberg, *Third-Party Beneficiaries*, 92 Colum. L. Rev. 1358, 1360 n.4 (1992).

7 *German Alliance*, 226 U.S. at 230.

> Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.[8]

In short, only an *intended* third-party beneficiary of the contract whose right to performance will effectuate the intention of the parties may sue to enforce the contract.[9]

The contract need not explicitly identify the intended beneficiary. It suffices that a contract's intended beneficiary "fall[s] within a class clearly intended to be benefited thereby."[10] For example, a FRAND commitment that an SEP holder concludes with the European Telecommunications Standards Institute (ETSI) does not identify each individual third-party beneficiary, but merely a group of "potential users" of ETSI's standards and technical specifications.[11] However, if a particular potential licensee of FRAND-encumbered SEPs has differentiated itself from the class of intended third-party beneficiaries who seek to implement the standard *fully*, then licensing that third party by definition would not effectuate the goal of the SSO and the SEP holder of fully implementing the standard. Consequently, that third party would be outside the class of intended third-party beneficiaries of the FRAND contract.

B. *Is an Implementer the Intended Third-Party Beneficiary of the FRAND Contract?*

When an SEP holder commits to license its SEPs on FRAND terms to implementers of the standard, the FRAND commitment typically constitutes a binding contract between the SEP holder and the SSO. U.S. courts have found that an implementer of an industry standard that seeks to license SEPs on FRAND terms is a third-party beneficiary of the FRAND contract between the SEP holder and the SSO.[12] For example, in *Microsoft Corp. v. Motorola, Inc.*, Judge James Robart of the U.S. District Court for the

8 Restatement (Second) of Contracts § 302(1)(a)–(b) (Am. Law Inst. 1981).

9 *See, e.g.*, *id.*; *German Alliance*, 226 U.S. at 230.

10 Montana v. United States, 124 F.3d 1269, 1273 (Fed. Cir. 1997); *see also* Klamath Water Users Protective Ass'n v. Patterson, 204 F.3d 1206, 1211 (9th Cir. 1999); Massachusetts v. Mylan Labs., 357 F. Supp. 2d 314, 326 (D. Mass. 2005).

11 European Telecommunications Standards Institute [ETSI], ETSI Rules of Procedure, Annex 6: ETSI Intellectual Property Rights Policy § 3.3, at 36 (Nov. 18, 2015) [hereinafter ETSI Rules of Procedure], http://www.etsi.org/images/files/ipr/etsi-ipr-policy.pdf.

12 *See, e.g.*, Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 884 (9th Cir. 2012); *In re* Innovatio IP Ventures, LLC Patent Litig., MDL No. 2303, 2013 WL 5593609, at *4 (N.D. Ill. Oct. 3, 2013); Microsoft Corp. v. Motorola, Inc., 854 F. Supp. 2d 993, 999 (W.D. Wash. 2012); Apple, Inc. v. Motorola Mobility, Inc., No. 11-cv-178-bbc, 2011 WL 7324582, at *10 (W.D. Wis. June 10, 2011).

Western District of Washington found that Microsoft, an implementer of Motorola Mobility's SEPs related to the Wi-Fi standard, was "a third-party beneficiary of Motorola's commitments" to the Institute of Electrical and Electronics Engineers (IEEE) and the International Telecommunication Union (ITU), two of the SSOs with which Motorola had committed to license its SEPs on FRAND terms to implementers.[13] Judge Robart's finding implied that Microsoft had the right to enforce the FRAND contracts between Motorola and each of the two SSOs. On appeal, the Ninth Circuit upheld Judge Robart's findings.[14] Similarly, in *Apple, Inc. v. Motorola Mobility, Inc.*, Judge Barbara Crabb of the U.S. District Court for the Western District of Wisconsin found that Apple, an implementer of Motorola's SEPs related to mobile communication standards, "ha[d] the right to enforce Motorola's contractual obligations [arising from the FRAND contract] as a third-party beneficiary."[15] She said that the primary purpose of a FRAND contract is to "protect" the implementers of the standard, and she consequently found Apple to be an intended third-party beneficiary of the FRAND contract between the SSO and Motorola Mobility.[16]

C. The SEP Holder's Duty Arising from the FRAND Contract

The exact provisions of a FRAND contract vary among SSOs and across the specific declarations of each SEP holder.[17] Therefore, the interpretation of the rights and obligations arising from such a contract is necessarily case-specific—and that interpretation necessarily depends upon the applicable law governing the contract between the SEP holder and the SSO. However, a FRAND contract typically obligates the SEP holder to make an offer to

[13] *Microsoft*, 854 F. Supp. 2d at 999.

[14] *Microsoft*, 696 F.3d at 884 ("[W]e do hold this much: The district court's conclusions that Motorola's RAND declarations to the ITU created a contract enforceable by Microsoft as a third-party beneficiary . . . were not legally erroneous."). In another subsequent appeal, the Ninth Circuit accepted that Microsoft was a third-party beneficiary of Motorola's FRAND contracts. *See* Microsoft Corp. v. Motorola, Inc., 795 F.3d 1024, 1030 (9th Cir. 2015).

[15] *Apple*, 2011 WL 7324582, at *10.

[16] *Id.* In concluding that the primary purpose of a FRAND contract is to protect implementers from being unable to license standard-essential technologies, Judge Crabb failed to consider that another purpose of a FRAND contract is to ensure that the SEP holder receives fair and adequate compensation for its technological contributions to the standard. *See* Damien Geradin, *The Meaning of "Fair and Reasonable" in the Context of Third-Party Determination of FRAND Terms*, 21 Geo. Mason L. Rev. 919, 932 (2014) ("[T]he rationale behind the FRAND commitment . . . is twofold: (1) to ensure that SEPs are *available* for the manufacture, sale, and use of standard-compliant products, while at the same time (2) making certain that holders of IPRs are able to reap *adequate and fair rewards* from their innovations." (emphasis in original)); *see also* J. Gregory Sidak, *The Meaning of FRAND, Part I: Royalties*, 9 J. Competition L. & Econ. 931, 989–92 (2013).

[17] *Compare* International Electrotechnical Commission, International Organization for Standardization & International Telecommunications Union, Guidelines for Implementation of the Common Patent Policy for ITU-T/ITU-R/ISO/IEC Annex 2, at 2 (June 26, 2015) [hereinafter Guidelines for Implementation of the Common Patent Policy for ITU-T/ITU-R/ISO/IEC], http://www.itu.int/dms_pub/itu-t/oth/04/04/T04040000010004PDFE.pdf, *with* ETSI Rules of Procedure, *supra* note 11, Annex 6, § 6.1.

license its SEPs on FRAND terms. In the absence of a FRAND contract, a patent holder may seek to exclude third parties from using its portfolio of SEPs or may decide to license that portfolio to a single implementer on an exclusive basis. However, after making a FRAND commitment, the SEP holder that elects to enforce its SEPs (rather than make them freely available) accepts a duty to offer to license its SEPs on FRAND terms to any implementer meeting the SEP holder's conditions of licensure.[18] An SEP holder that seeks to enforce its SEPs against a particular implementer before making an offer to license them to that implementer thus fails to discharge the SEP holder's duty arising from its FRAND commitment. In that scenario, the implementer may sue the SEP holder for breach of contract.

The SEP holder's offer to license its SEPs needs to be sufficiently certain, such that it gives the implementer the power to accept. The Restatement (Second) of Contracts defines an offer as "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it."[19] The terms of the offer need to be "certain."[20] In contrast, a mere manifestation of a "willingness to enter into a bargain is not an offer."[21] U.S. courts have confirmed that an SEP holder that has merely contacted an implementer and has shown its willingness to negotiate has not made an offer, and the SEP holder therefore has not discharged its duty under the FRAND contract.[22]

A FRAND contract also obligates the SEP holder to make the offer to license in good faith.[23] In the United States, the duty of good faith is an implied duty in every contract.[24] A FRAND contract therefore obligates the SEP holder to offer to license its SEPs in good faith, even if the SEP holder's FRAND commitment does not explicitly include such a duty. I have explained elsewhere that the duty to make an offer in good faith requires the SEP holder to make an offer with a royalty that falls within the FRAND range.[25] Time is of the essence. Consumers and producers stand to reap huge

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[18] *See, e.g.*, Apple, Inc. v. Motorola Mobility, Inc., No. 11-cv-178-bbc, 2012 WL 5416941, at *5 (W.D. Wis. Oct. 29, 2012); Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2012 WL 4827743, at *4 (W.D. Wash. Oct. 10, 2012); *see also* J. Gregory Sidak, *The Meaning of FRAND, Part II: Injunctions*, 11 J. Competition L. & Econ. 201, 214 (2015).

[19] Restatement (Second) of Contracts § 24 (Am. Law Inst. 1981).

[20] *Id.* § 33.

[21] *Id.* § 26; *see also* Interstate Indus., Inc. v. Barclay Indus., Inc., 540 F.2d 868, 873 (7th Cir. 1976) ("It is clear that an offer must be 'sufficiently certain to enable a court to understand what is asked for, and what consideration is to mature the promise.'" (quoting Oedekerk v. Muncie Gear Works, 179 F.2d 821, 824 (7th Cir. 1950)).

[22] *See, e.g.*, Realtek Semiconductor Corp. v. LSI Corp., 946 F. Supp. 2d 998, 1007 (N.D. Cal. 2013).

[23] *See, e.g.*, Microsoft Corp. v. Motorola, Inc., No. C10-1823JLR, 2012 WL 4827743, at *4 (W.D. Wash. Oct. 10, 2012).

[24] Restatement (Second) of Contracts § 205 (Am. Law Inst. 1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); *see also* Microsoft Corp. v. Motorola, Inc., 963 F. Supp. 2d 1176, 1184 (W.D. Wash. 2013).

[25] Sidak, *The Meaning of FRAND, Part II: Injunctions*, *supra* note 18, at 242–43. I disagree with Judge Robart's conclusion to the contrary. *See* Microsoft Corp. v. Motorola, Inc., 864 F. Supp. 2d 1023, 1038

welfare gains from the creation and consumption of the innovative products that the new standard enables. A delay in licensing SEPs on FRAND terms irretrievably attenuates those welfare gains. Therefore, the SEP holder's making even an initial offer above the FRAND range would waste time and reduce economic welfare; it therefore should be understood to violate the SEP holder's duty of good faith. The SEP holder would also violate this duty by giving the implementer a commercially insufficient amount of time to accept the offer.

The SEP holder's duty to offer to license its SEPs on FRAND terms is typically conditional upon the essentiality of the specific patents to practice the standard. An SEP holder that submits a FRAND declaration to ETSI, for example, agrees that, "[t]o the extent that the IPR(s) disclosed in the attached *IPR Information Statement Annex* are or become, and remain ESSENTIAL," the SEP holder will offer an irrevocable license on FRAND terms.[26] By signing a declaration with ETSI, the SEP holder thus agrees to offer to license its SEPs on FRAND terms, subject to the condition that its patents "are or become, and remain" essential to practice ETSI's standard.[27] In legal terms, the essentiality of the SEP holder's patent is a condition precedent to the SEP holder's duty to offer to license that patent on FRAND terms. If a patent is not (or is no longer) essential to practice ETSI's standard, then the patent holder no longer has a contractual duty to offer to license that patent on FRAND terms.[28]

In sum, a FRAND contract imposes on the SEP holder a duty to offer to license its SEPs on FRAND terms. To comply with that obligation, the SEP holder needs to make an offer that is sufficiently certain, such that it confers on the implementer the power to accept. If the SEP holder fails to discharge that duty, an implementer of an industry standard may sue the SEP holder for breach of contract.

II. When Does the Implementer Exhaust Its Rights as a Third-Party Beneficiary?

The SEP holder's offer to license its SEPs on FRAND terms empowers the implementer to accept the offer and execute a binding license agreement with the SEP holder. However, the implementer terminates that power of

(W.D. Wash. 2012) ("Because the IEEE and the ITU agreements anticipate that the parties will negotiate towards a RAND license, it logically does not follow that initial offers must be on RAND terms.").

26 ETSI, Ericsson's IPR Information Statement and Licensing Declaration, ISLD-201509-007, at 1 (Oct. 1, 2015) [hereinafter Ericsson's Licensing Declaration to ETSI] (emphasis in original), https://ipr.etsi.org/IPRDetails.aspx?IPRD_ID=2211&IPRD_TYPE_ID=2&MODE=2.

27 *Id.*

28 I do not address, in this article, the question of whether an implementer of an industry standard can rely on equitable doctrines to enforce the patent holder's compliance with a FRAND commitment in cases in which such a commitment does not constitute a binding contract.

acceptance by rejecting the offer of a FRAND license or by making a counteroffer. That power of acceptance might also expire by operation of law if the implementer fails to accept the SEP holder's FRAND offer within a commercially reasonable amount of time. Once the implementer's power of acceptance has terminated, the implementer has no rights as an intended third-party beneficiary of the SEP holder's FRAND commitment to the SSO.

A. Rejection of the FRAND Offer by Explicit Refusal or Counteroffer

The primary way in which an implementer can terminate its power of acceptance is by explicitly rejecting a FRAND offer. It is basic contract law that the offeree's rejection terminates its power of acceptance.[29] The Restatement (Second) of Contracts says that "[a] manifestation of intention not to accept an offer is a rejection unless the offeree manifests an intention to take it under further advisement."[30] Thus, after the implementer explicitly rejects a FRAND offer, the implementer may no longer accept the offer, even if the implementer later signals its desire to do so.[31]

An implementer might also terminate its power of acceptance by making a counteroffer. The Restatement (Second) of Contracts defines a counteroffer as "an offer made by an offeree to his offeror relating to the same matter as the original offer and proposing a substituted bargain differing from that proposed by the original offer."[32] By making a counteroffer, the offeree terminates its power to accept the original offer.[33] Thus, by making a counteroffer to the SEP holder, even if that counteroffer is for a lower royalty still within the FRAND range, the implementer rejects the SEP holder's original FRAND offer and terminates the implementer's power of acceptance. The implementer's termination by counteroffer of its power of acceptance is even more unambiguous if its counteroffer is *below* the FRAND range. The Department of Justice and the U.S. Patent and Trademark Office, for example, have said that an implementer's "insist[ence] on [licensing] terms clearly outside the bounds of what could reasonably be considered to be F/RAND terms in an attempt to evade the . . . obligation to fairly compensate the patent holder" should be considered "a constructive refusal to negotiate."[34] A counterof-

[29] Restatement (Second) of Contracts § 36(1)(a) (Am. Law Inst. 1981); *see also* Great Lakes Commc'n Corp. v. AT&T Corp., No. C 13-4117-MWB, 2015 WL 5021693, at *7–8 (N.D. Iowa Aug. 21, 2015).

[30] Restatement (Second) of Contracts § 38 (Am. Law Inst. 1981).

[31] *See* Legal Sec. Life Ins. Co. v. Ward, 373 S.W.2d 693, 698 (Tex. Civ. App. 1963).

[32] Restatement (Second) of Contracts § 39(1) (Am. Law Inst. 1981).

[33] *Id.* § 39(2); *see also* Butler v. Smithfield Foods, Inc., 179 F.R.D. 173, 175 (E.D.N.C. 1998) ("Ordinarily a counteroffer operates as an outright rejection of the initial offer because it manifests the offeree's intention not to accept the offer and thereby terminates the offeree's power of acceptance."); Davis v. Texas Farm Bureau Ins., 470 S.W.3d 97, 104–05 (Tex. Ct. App. 2015).

[34] U.S. Department of Justice & U.S. Patent & Trademark Office, Policy Statement on Remedies for Standard-Essential Patents Subject to Voluntary F/RAND Commitments 7 (2013),

fer is thus a rejection of the SEP holder's offer, regardless of whether that counteroffer is within the FRAND range.

It bears emphasis that an implementer may *request* a different offer without terminating its power of acceptance of the SEP holder's initial offer. The Restatement (Second) of Contracts says that "[a] mere inquiry regarding the possibility of different terms, a request for a better offer, or a comment upon the terms of the offer, is ordinarily not a counter-offer."[35] Therefore, the implementer may negotiate with the SEP holder in the sense of requesting different terms without terminating its power to accept the original FRAND offer. However, the SEP holder has no duty to accept the implementer's requested terms or to give another FRAND offer. After an SEP holder has made a legitimately FRAND offer, it has discharged its duty to the third-party beneficiary and has no further obligations arising from the FRAND contract. Nothing in a typical FRAND contract entitles the implementer to receive multiple offers within the FRAND range.

In sum, an implementer terminates its power of acceptance directly by rejecting the SEP holder's legitimately FRAND offer or indirectly by making a counteroffer. After its power of acceptance has terminated, the implementer may no longer accept the SEP holder's FRAND offer. As the Restatement (Second) of Contracts says, "[a] contract cannot be created by acceptance of an offer after the power of acceptance has been terminated."[36] Thus, an implementer that rejects a FRAND offer extinguishes its rights as a third-party beneficiary and may claim no further rights from the SEP holder's FRAND contract.

B. Rejection of the FRAND Offer by Operation of Law

An implementer's power of acceptance might terminate by operation of law, which is "[t]he means by which a right or a liability is created for a party regardless of the party's actual intent."[37] An SEP holder might condition the implementer's power of acceptance upon the implementer's fulfillment of a specific requirement. For example, ETSI provides that the SEP holder may declare that its FRAND commitment "is made subject to the condition that those who seek licences agree to reciprocate."[38] Similarly, in a declaration to the ITU, the SEP holder may declare that its "willingness to license is conditioned on Reciprocity," which "means that the Patent Holder shall only be

http://www.uspto.gov/about/offices/ogc/Final_DOJ-PTO_Policy_Statement_on_FRAND_SEPs_1-8-13.pdf.

[35] Restatement (Second) of Contracts § 39 cmt. b (Am. Law Inst. 1981); *see also* Carle v. Lebeau, No. CV990496801S, 2002 WL 1573417, at *2 (Conn. Super. Ct. June 13, 2002).

[36] Restatement (Second) of Contracts § 35(2) (Am. Law Inst. 1981).

[37] *Operation of Law*, Black's Law Dictionary (West 10th ed. 2014).

[38] ETSI Rules of Procedure, *supra* note 11, Annex 6, § 6.1, at 37.

required to license any prospective licensee if such prospective licensee will commit to license its Patent(s) for implementation of the same [standard] Free of Charge or under reasonable terms and conditions."[39] In the case of patents contributed to either the ITU's standard or ETSI's standard, the SEP holder may therefore condition the implementer's power of acceptance on its fulfillment of the condition precedent that the implementer agree to cross-license its own SEPs on FRAND terms. Under U.S. law, the implementer's power of acceptance terminates by operation of law if the implementer fails to satisfy that condition.[40]

An SEP holder's offer to license its SEPs on FRAND terms might also impose a deadline to accept the offer. The Restatement (Second) of Contracts says that "an offeree's power of acceptance is terminated at the time specified in the offer."[41] Thus, the prospective licensee's failure to accept the offer by the stated deadline terminates its power of acceptance. After the deadline specified in the offer has passed, the implementer may no longer accept the FRAND offer and transform that offer into a binding contract.

Even if the SEP holder's FRAND offer to license does not specify a deadline, the implementer's power of acceptance is still finite. The Restatement (Second) of Contracts says that, if an offer does not specify a deadline, the offeree's power of acceptance terminates if the offeree fails to accept the offer within a "reasonable time,"[42] the length of which is a question of fact that depends on the circumstances of the offer and the subject matter of the prospective contract.[43] Hence, the implementer's failure to accept a FRAND offer within a reasonable time terminates the implementer's power of acceptance, regardless of whether the SEP holder's offer expressly included a deadline to accept and regardless of why the implementer allowed the deadline to lapse.

Half a century before the controversies over FRAND licensing of SEPs arose, one distinguished federal judge recognized that a requirement that a patent holder license its patents on reasonable terms does not grant potential licensees the perpetual right to obtain access to those patents. In *Rudenberg v. Clark*, Judge Charles Wyzanski, Jr. of the U.S. District Court for the District of Massachusetts decided whether a potential licensee extinguishes its right to obtain access to patents by failing to accept the licensor's offer

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[39] Patent Statement and Licensing Declaration for ITU-T or ITU-R Recommendation—ISO or IEC Deliverable 2 (June 26, 2015) [hereinafter ITU Licensing Declaration] (emphasis suppressed), http://www.itu.int/dms_pub/itu-t/oth/04/04/T04040000020004PDFE.pdf.

[40] Restatement (Second) of Contracts § 36(2) (Am. Law Inst. 1981) ("[A]n offeree's power of acceptance is terminated by the non-occurrence of any condition of acceptance under the terms of the offer.").

[41] *Id.* § 41(1).

[42] *Id.* § 41(1)–(2); *see, e.g.*, Pepsi-Cola Bottling Co. v. N.L.R.B., 659 F.2d 67, 90 (8th Cir. 1981) (requiring that an offeree accept an offer "within a reasonable time").

[43] Restatement (Second) of Contracts § 41(1) cmt. b (Am. Law Inst. 1981).

(or by failing to request the court's intervention) within a reasonable period of time.[44] In 1942, when the United States was at war with Germany, the U.S. government seized as suspected enemy property two U.S. patents related to electron microscope technology belonging to Siemens-Schuckerwerke, A.G., a German electrical manufacturing firm.[45] Professor Reinhold Rudenberg, a German scientist and a former Siemens employee, sued the Attorney General of the United States to claim ownership of the two patents and prevailed. Although the Attorney General appealed the decision, the parties ultimately settled the lawsuit through a consent decree that the court entered in 1947.[46] The decree ordered the Attorney General to transfer the patents to Rudenberg and obligated Rudenberg to "grant to any applicant . . . a non-exclusive unlimited license [for use of his patented technology] . . . on a nondiscriminatory basis."[47] To comply with the consent decree, Rudenberg offered several potential licensees a running-royalty rate of 5 percent of the net sales price of each patent-practicing product.[48] However, one potential licensee, the Radio Corporation of America (RCA), refused the license and allegedly continued to infringe Rudenberg's patents.[49] Rudenberg thereupon petitioned the court to modify the consent decree to add an explicit time limit on the decree's applicability to any infringer that refused to accept a license on reasonable terms.[50]

Judge Wyzanski agreed that a potential licensee might extinguish its rights to obtain access to the patents that Rudenberg had a duty to license on reasonable and nondiscriminatory terms. Although *Rudenberg* was not an antitrust case, Judge Wyzanski compared the duties that the consent decree imposed on Rudenberg to the compulsory licensing requirements to which "the Department of Justice and certain others ha[d] for a long time been seeking to subject . . . patentees who ha[d] violated the anti-trust laws."[51] He emphasized that, even though those (antitrust) compulsory licensing requirements imposed on the patent holder a duty to license its patents in exchange for a reasonable royalty and on a nondiscriminatory basis, that obligation did not "enure forever to the advantage of a persistent infringer who had continuously refused offers of a license at a reasonable royalty and on a non-discriminatory basis."[52] He said that, because "it has never been proposed to require

44 81 F. Supp. 42 (D. Mass. 1948).
45 *See* Rudenberg v. Clark, 72 F. Supp. 381, 382 (D. Mass. 1947).
46 *Rudenberg*, 81 F. Supp. at 43.
47 *Id.*
48 *Id.*
49 *Id.*
50 *Id.* at 44.
51 *Id.* (citing Hartford-Empire Co. v. United States, 323 U.S. 386, 417 nn.17–20 (1945)). Several years later, Judge Wyzanski presided over a leading monopolization case, United States v. United States Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).
52 *Rudenberg*, 81 F. Supp. at 44 (citing Note, *Compulsory Patent Licensing by Antitrust Decree*, 56 Yale L.J. 77 (1946)).

a patentee who has been adjudged a violator of law to hold himself open forever to the obligation to license infringers who have refused reasonable licenses," it would be improper to suppose that the consent decree imposed such an obligation on Rudenberg (who had broken no law).[53] Judge Wyzanski added that the consent decree was intended to ensure "equality of opportunity to all who might have use for inventions disclosed in patents," but that the decree

> was not intended to place the individual holder of patents at the mercy of large corporate enterprises which could use the invention, decline to accept the inventor's reasonable offers, allow him to sue for infringement and in the end, if beaten in the infringement suit, pay him not even a royalty high enough to cover the expenses of the litigation but the lowest royalty rate the inventor is receiving from anyone whatsoever.[54]

He concluded that a potential licensee enjoyed rights under the consent decree only insofar as the party "promptly" sought a license.[55] Consequently, Judge Wyzanski granted Rudenberg's proposed modification to the consent decree, which provided: "If the offeree fails within 120 days . . . either to accept plaintiff's offer or to apply to this Court[,] . . . [the] plaintiff may apply to the Court for an order requiring the offeree to show cause why all rights of the offeree under [the licensing requirement of the consent decree] should not terminate."[56]

It would be similarly absurd to construe the FRAND commitment as requiring the SEP holder to keep a FRAND offer open indefinitely while the implementer declines to accept that offer and continues to use the SEP holder's patented technology without paying for its use. By making a FRAND commitment, the SEP holder agrees to offer access to its SEPs to the implementer, provided that the implementer promptly pay fair compensation for its use of those SEPs. The "fair" and "reasonable" prongs of a FRAND commitment require not only that the implementer pay a fair and reasonable royalty for its use of the SEPs, but also that it pay that royalty within a commercially reasonable period of time. Nothing in the FRAND contract suggests that it extends the implementer's power of acceptance beyond the commercially reasonable length of time that general principles of contract law require.

When examining what constitutes a commercially reasonable period of time within which to accept the SEP holder's offer, a court should recognize that a timely conclusion of a license agreement for SEPs is crucial to ensuring

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53 *Id.* at 45.
54 *Id.*
55 *Id.*
56 *Id.*

the implementer's access to the SEPs, as well as the SEP holder's fair compensation. In FRAND licensing negotiations, time is of the essence. Expeditious and widespread adoption of a standard is critical to its commercial success. Timely formation of a FRAND license agreement enables the implementer to begin the prompt production of standard-compliant devices. In turn, the benefits of standardization can more quickly accrue to consumers. In practice, a manufacturer of a standard-compliant product often implements SEPs before obtaining a license to use them. In other words, a delay in the negotiation for a license does not necessarily preclude the implementer from producing standard-compliant goods. However, any legal rule that is predicated on the assumption that an implementer will routinely infringe SEPs, and thus use the SEPs before executing a license agreement, would punish those implementers that wait to use SEPs until they have agreed to a license. Richard Epstein and David Kappos argue that the law should protect against the "willful dispossession of property," including intellectual property.[57] The law should not create a competitive disadvantage for the implementer that refrains from using the SEPs until it has executed a license agreement.

The expeditious formation of a license agreement also ensures that the SEP holder will receive prompt compensation for its invention, which strengthens the SEP holder's incentive to invest in technologies to contribute to future standards. Conversely, failure to compensate the SEP holder promptly could decrease its access to capital and thus harm its ability to invest in additional research and innovation. Melchior Wathelet, Advocate General of the European Court of Justice, emphasized, in *Huawei Technology Co. v. ZTE Corp.*, the principle that, regarding SEPs, "[t]he time frame for the exchange of offers and counteroffers and the duration of the negotiations must be assessed in the light of the 'commercial window of opportunity' available to the SEP-holder for securing a return on its patent in the sector in question."[58] The Court of Justice of the European Union (CJEU) confirmed that principle in 2015, when it said that the potential licensee must "diligently to respond to [the SEP holder's] offer, . . . which implies, in particular, that there are no delaying tactics."[59] Dragging out a negotiation for years is unreasonable in the commercial context of FRAND-committed patents.

In short, even if the implementer does not expressly reject a FRAND offer, the implementer's power to accept a FRAND offer ends by operation

57 Richard A. Epstein & David J. Kappos, *Legal Remedies for Patent Infringement: From General Principles to FRAND Obligations for Standard Essential Patents*, 9 Competition Pol'y Int'l, no. 2, Autumn 2013, at 69, 70.

58 Opinion of Advocate General ¶ 89, Case C-170/13, Huawei Tech. Co. v. ZTE Corp. (Nov. 20, 2014), http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62013CC0170.

59 Case C-170/13, Huawei Tech. Co. v. ZTE Corp., ¶ 65 (July 17, 2015), http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1437080250973&uri=CELEX:62013CJ0170.

of law if the implementer fails to accept a FRAND offer either subject to the SEP holder's conditions or within a commercially reasonable period of time.

C. *The Legal Consequences of the Implementer's Exhaustion of Its Rights as a Third-Party Beneficiary*

Following the termination of the implementer's power to accept the FRAND offer, the SEP holder, having no further duty to the implementer pursuant to the FRAND contract, then may, among other things, (1) seek and receive injunctive relief against the implementer, (2) charge the implementer a higher, non-FRAND royalty, or (3) decline to license the implementer altogether.[60] The opposing view—that the SEP holder lacks the right as a matter of contract law to take any of those three actions—contradicts the most plausible interpretation of the intended scope of the SEP holder's grant of rights to intended third-party beneficiaries at the time of the SEP holder's contracting with the SSO.

III. Defining the Scope of the Implementer's Rights as a Third-Party Beneficiary: The Example of *À la Carte* Licensing

It is basic contract law that the promisor and the promisee define the scope of the rights of a third-party beneficiary.[61] It necessarily follows that the scope of the rights conveyed to the third-party beneficiary results from a voluntary exchange between the SEP holder and the SSO. In other words, the SSO cannot unilaterally define the scope of those rights. The SEP holder's assent is essential. Consequently, the implementer may not invoke the

[60] For example, the Düsseldorf regional court issued an injunction against Haier Deutchland GmbH, which infringed Sisvel's SEPs. *See* Press Release, Sisvel, Injunctive Relief for Infringement of Standard-Essential Patents—First German Judgements After CJEU Decision on FRAND, http://www.sisvel.com/index.php/sisvel-news/414; Dietrich Kamlah, *Düsseldorf Regional Court Discusses Requirements for FRAND Defence and Grants Injunction Based on SEP in Sisvel vs. Haier (Case 4a 144/14)*, Lexology (Nov. 16, 2015), http://www.lexology.com/library/detail.aspx?g=1e6f2bda-6ada-4c70-a04b-14c43a7e5819. The court found that the SEP holder made several license offers, and that the infringer did not accept any of them. The infringer made a counteroffer only after Sisvel initiated legal action for patent infringement. Further, the infringer provided an account of the infringing sales and provided a security for the royalty payment only during the oral hearing. The court "left open whether Haier was . . . . excluded from the FRAND defense as it had not reacted in a timely manner" to the SEP holder's offer. Press Release, Sisvel, *supra*. The court rejected the infringer's FRAND defense, because it found that the infringer failed to "render account and provide security for the payment of royalties" in a timely manner. *Id.* The court said that a potential licensee should render the account and provide a security within a month after the SEP holder's rejection of the potential licensee's counteroffer, which implies that an infringer that fails to act within a reasonable time can no longer raise a FRAND defense and might even be subject to an injunction. *See* Press Release, Sisvel, *supra*; Kamlah, *supra*.

[61] *See* Restatement (Second) of Contracts § 309 cmt. b (Am. Law Inst. 1981); *see also* 9 Joseph M. Perillo, Corbin on Contracts § 44.7 (Matthew Bender & Co. rev. ed. 2013).

FRAND contract to claim rights that the SEP holder never agreed with the SSO to grant to an intended third-party beneficiary.

A. The Implementer's Demand for an à la Carte *Offer*

An SEP holder and an implementer might disagree about the precise rights that a FRAND contract grants the implementer. For example, the implementer might contend that it may demand a FRAND offer on an *à la carte* basis, and the SEP holder might maintain that the FRAND contract does not grant the implementer that right. How does one resolve this disagreement? To determine the scope of the implementer's rights as an intended third-party beneficiary of the FRAND contract, a court will examine the exact terms of the FRAND contract between the SEP holder and the SSO.

For every term of the FRAND contract that is unambiguous—and thus susceptible to only one reasonable interpretation—the court will apply that interpretation.[62] A typical FRAND contract does not grant an implementer the explicit right to obtain a FRAND offer for an individual SEP or for any subset of an SEP portfolio. None of the three major standard-setting organizations that promulgate mobile communication standards—ETSI, the IEEE, and the ITU—include in their intellectual property policies any provision stating that, by making a FRAND commitment, an SEP holder agrees to offer to license its SEPs on a subportfolio basis.[63] Because basic principles of contract law establish that a third-party beneficiary may not enforce any rights against the promisor beyond the rights that the promisor conferred under the contract,[64] a court would conclude that there is no ambiguity in the FRAND contract and that the implementer has no right to obtain from the SEP holder an offer to license its SEPs on a subportfolio basis.

In the unlikely event that a court were to find a FRAND contract to be ambiguous with respect to the availability of an implementer's asserted right to demand *à la carte* licenses for SEPs, the court would choose the most reasonable of the conflicting interpretations.[65] A court interpreting an ambiguous contract term considers whether the adoption of a particular interpretation would produce a nonsensical, or absurd, outcome given the relevant industry's commercial characteristics and the general purpose of

[62] *See, e.g.*, Bohler-Uddeholm Am., Inc. v. Ellwood Grp., 247 F.3d 79, 95 (3d Cir. 2001); Weddington Prods., Inc. v. Flick, 60 Cal. App. 4th 793, 811 (1998); Embry v. Hargadine-McKittrick Dry Goods Co., 105 S.W. 777, 779 (Mo. Ct. App. 1907).

[63] ETSI Rules of Procedure, *supra* note 11, Annex 6, at 36–47; Institute of Electrical and Electronics Engineers [IEEE], IEEE-SA Standards Board Bylaws § 6, at 15–18 (Mar. 2015) [hereinafter IEEE-SA Standards Board Bylaws], http://standards.ieee.org/develop/policies/bylaws/sb_bylaws.pdf; Guidelines for Implementation of the Common Patent Policy for ITU-T/ITU-R/ISO/IEC, *supra* note 17, at 2–4, Annex 1, at 1–2.

[64] *See* Restatement (Second) of Contracts § 309 cmt. b (Am. Law Inst. 1981).

[65] *See, e.g.*, *Bohler-Uddeholm*, 247 F.3d at 95; *see also Weddington*, 60 Cal. App. 4th at 811; *Embry*, 105 S.W. at 779.

the contract in question. A court might also consider the custom or usage of trade, which is understood to be "a practice or method of dealing having such regular observance in a region, vocation, or trade that it justifies an expectation that it will be observed in a given transaction"[66] Both approaches to contract interpretation support the conclusion that the SEP holder never intended to grant an implementer the right as a third-party beneficiary to demand *à la carte* licenses to SEPs.

B. Avoiding Commercially Unreasonable Results

Courts disfavor interpretations of ambiguous contractual provisions that would produce commercially unreasonable results.[67] In *Axis Reinsurance Co. v. HLTH Corp.*, for example, the Supreme Court of Delaware emphasized that, "where a contract provision lends itself to two interpretations, a court will not adopt the interpretation that leads to unreasonable results, but instead will adopt the construction that is reasonable and that harmonizes the affected contract provisions."[68] Interpreting a FRAND contract to require that the SEP holder offer *à la carte* licenses for SEPs would create a commercially absurd outcome that would frustrate the contract's essential purpose.

The motivating economic rationale for a FRAND contract is to ensure that implementers of the standard have access to its essential technology, thereby to increase the probability of the standard's widespread adoption and commercial success. For example, ETSI's Intellectual Property Rights Policy specifies three policy objectives: (1) "reduc[ing] the risk to ETSI, members, and others applying" its standards that "investment in the preparation, adoption and application of [ETSI] standards could be wasted" because an essential patent is unavailable for license;[69] (2) ensuring that SEP holders are "adequately and fairly rewarded for the use of their [intellectual property rights] in the implementation of standards and technical specifications;"[70] and (3) ensuring that standards are "available to potential users in accordance with the general principles of standardization."[71] Requiring the SEP holder to

[66] *Usage*, Black's Law Dictionary (West 10th ed. 2014); *see also* Restatement (Second) of Contracts § 222(1) (Am. Law Inst. 1981).

[67] *See, e.g.*, Dubinsky v. Mermart, LLC, 595 F.3d 812, 818 (8th Cir. 2010) (citation omitted); XCO Int'l Inc. v. Pac. Sci. Co., 369 F.3d 998, 1005 (7th Cir. 2004) (Posner, J.) ("Contract interpretations that produce commercially unreasonable results are disfavored, not as a matter of policy but simply because they are implausible to impute to the parties."); Gol TV, Inc. v. EchoStar Satellite Corp., 692 F.3d 1052, 1055 (10th Cir. 2012).

[68] 993 A.2d 1057, 1063 (Del. 2010) (citing Restatement (Second) of Contracts § 203 (Am. Law Inst. 1981)), *cited in* Convergent Wealth Advisors LLC v. Lydian Holding Co., No. 12 Civ. 1199, 2012 WL 2148221, at *4 (S.D.N.Y. June 13, 2012).

[69] *See* ETSI Rules of Procedure, *supra* note 11, Annex 6, at 35.

[70] *Id.*

[71] *Id.*; *see also* Guidelines for Implementation of the Common Patent Policy for ITU-T/ITU-R/ISO/IEC, *supra* note 17, at 1 ("The Patent Policy encourages the early disclosure and identification of [SEPs] . . . . In

license its SEPs on a subportfolio basis would undermine all three objectives of ETSI's policy.

First, interpreting a FRAND commitment as requiring the SEP holder to license its SEPs on a subportfolio basis would frustrate the implementer's ability to obtain access to *all* SEPs and therefore lawfully practice the standard. Assume that an SEP holder refuses to grant a portfolio license, but instead requires an implementer to negotiate an individual license for each SEP. One could reasonably argue that the SEP holder's insistence on negotiating a royalty for a subportfolio of SEPs, or perhaps for each individual SEP, would constitute a constructive refusal to licenses its SEPs that would violate the very purpose of a FRAND commitment.

Second, imposing on the SEP holder a duty to license its SEPs on a subportfolio basis would frustrate the second goal of a FRAND commitment—that is, ensuring the SEP holder's adequate and fair compensation. Negotiating a royalty on a subportfolio basis would significantly increase the cost of transacting for each individual SEP. Particularly when the SEP holder owns thousands of SEPs, it would be impractical to negotiate the conditions for the use of each SEP in a timely manner. For example, Dina Kallay, the Director for IP & Competition for Ericsson, has observed that it would be "practically impossible for a significant contributor of standardized technology to timely and cost-effectively litigate its entire global Essential Patents portfolio."[72] It would be commercially absurd to believe that, *ex ante*, a sophisticated company that holds a large portfolio of SEPs would agree to license individual SEPs on a subportfolio basis and thus subject itself to the prospect of defending its portfolio against multiple validity challenges filed sequentially across a portfolio containing many families of SEPs.[73]

Third, expeditious and widespread adoption of the standard is critical to its commercial success. A delay in contract formation is counterproductive to the timely exploitation of standard-essential technology, and a protracted license negotiation robs consumers of the full benefits of the standard by postponing their ability to consume products that practice the standard. Therefore, because the SEP holder and the SSO intended, by executing the FRAND contract, to ensure that implementers have access to the standard's essential technologies, to provide fair and adequate compensation to the SEP holder, and to promote the commercial success and widespread adoption of a standard, it would be implausible to conclude that either the SSO or the SEP

doing so, greater efficiency in standards development is possible and potential patent rights problems can be avoided.").

72 Dina Kallay, *The ECJ* Huawei-ZTE *Decision: En Route to Ending Hold-Out?*, CPI Antitrust Chron., Oct. 2015, at 1, 5.

73 *Cf.* J. Gregory Sidak, *Evading Portfolio Royalties for Standard-Essential Patents Through Validity Challenges*, 39 World Competition 191 (2016) [hereinafter Sidak, *Evading Portfolio Royalties*].

holder intended the FRAND contract to obligate the SEP holder to offer to license its SEPs on a subportfolio or individual basis.

A potential licensee might in good faith wish to license only a subset of an SEP portfolio to use in some application *outside* the standard. However, as I explained in Part I.B, a nonparty may enforce a contract only if it is the contract's *intended* beneficiary.[74] An implementer of a standard may enforce the FRAND contract as a third-party beneficiary only if it thereby would effectuate the intentions of the SSO and the SEP holders for the FRAND contract—that is, only if such third-party enforcement promote the full implementation, commercial success, and widespread adoption of the standard. An implementer wanting to license only individual SEPs could not prove that such licensing would be "appropriate to effectuate the intention of the [contracting] parties."[75] In short, standard tools of contract interpretation indicate that, to the extent that a given implementer demands *à la carte* SEP licenses, it is not an intended third-party beneficiary of the FRAND contract.

C. *Usage of Trade*

A court may use the custom or usage of trade to "ascertain and explain the meaning and intention of the parties to a contract, whether written or in parol, which could not be done without the aid of this extrinsic evidence."[76] According to this line of analysis, whether it is reasonable to interpret the FRAND contract to permit the SEP holder to offer to license its SEPs only on a portfolio basis depends on whether portfolio licensing of SEPs constitutes a usage of trade.[77] At least with respect to equipment and devices for mobile communications, public statements by owners of large SEP portfolios (such as Ericsson, Nokia, and Qualcomm) and by industry commentators confirm that it is the usage of trade to license SEPs on a portfolio basis—or even in bundles of portfolios.[78] That practice is not surprising. An individ-

[74] *See* Guy v. Liederbach, 459 A.2d 744, 751 (Pa. 1983) ("[T]he recognition of the beneficiary's right must be 'appropriate to effectuate the intention of the parties.'" (quoting Restatement (Second) of Contracts § 302 (Am. Law Inst. 1979))); *see also* Scarpitti v. Weborg, 609 A.2d 147, 150 (Pa. 1992) (citing *Guy*, 501 A.2d at 751); Vogan v. Hayes Appraisal Assocs., Inc., 588 N.W.2d 420 (Iowa 1999) (citing Tredrea v. Anesthesia & Analgesia, P.C., 584 N.W.2d 276, 281 (Iowa 1998)); Golden v. Cook, 293 F. Supp. 2d 546, 554 (W.D. Pa. 2003).

[75] Restatement (Second) of Contracts § 302 (Am. Law Inst. 1981).

[76] Barnard v. Kellogg, 77 U.S. (10 Wall.) 383, 390 (1870). However, the Supreme Court has also cautioned against interpreting the contract on the basis of usage of trade if such an interpretation is "inconsistent with the contract, or expressly or by necessary implication contradicts it." *Id.*

[77] Economist Armen Alchian explained that the norms that evolve in an industry are those that best suit the business environment. Those industry norms tacitly incorporate vast amounts of knowledge and information. *See* Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. Pol. Econ. 211, 215–17 (1950).

[78] *See* Roger G. Brooks, *SSO Rules, Standardization, and SEP Licensing: Economic Questions from the Trenches*, 9 J. Competition L. & Econ. 859, 878 (2013) ("[I]ndividualized evaluations and negotiations simply are not done. Instead, the important negotiations are for undifferentiated rights to large portfolios, each portfolio

ual SEP holder might own hundreds or thousands of SEPs.[79] It is more efficient for the parties to a license agreement to negotiate terms on the basis of incomplete information and to estimate the aggregate value of the entire portfolio, than to negotiate terms on the basis of the value of each individual SEP. The parties' transactions-cost savings from portfolio licensing surely outweigh the cost of the increased risk (if any) that the parties will bear due to uncertainty over the quality of individual SEPs.[80] In sum, the benefits of portfolio licensing (and the high costs associated with negotiating licenses for individual SEPs) imply that participants in standardized industries will typically negotiate SEP licenses on a portfolio basis. To the extent that a court must consider the usage of trade to resolve ambiguity or incompleteness in the FRAND contract, the existing industry practice of licensing at the portfolio level is evidence that the FRAND contract does not require the SEP holder offer to license its SEPs on a subportfolio basis.[81]

implicating a diverse array of specific technologies, and including patents ranging from the very strong to the very weak."); *see also* Original Complaint ¶ 3, Ericsson Inc. v. Apple Inc., No. 2:15-cv-17, 2015 WL 196125 (E.D. Tex. Jan. 14, 2015) ("Ericsson has widely licensed its portfolio of Essential Patents on a global basis in over one hundred agreements with members of the telecommunications industry."); Qualcomm Technologies, Inc., LTE/WiMax Patent Licensing Statement 1 (Dec. 2008) [hereinafter Qualcomm LTE/WiMax Patent Licensing Statement], https://www.qualcomm.com/documents/ltewimax-patent-licensing-statement ("Qualcomm has established a fair and reasonable value for its essential 3G CDMA . . . portfolio by bilaterally negotiating licenses for such portfolio with more than 155 companies."); Press Release, Nokia Corp., Nokia Reaffirms Licensing Commitments for Standard Essential Patents (Apr. 8, 2014), http://company.nokia.com/en/news/statements/licensing-statement.

79 For example, more than 23,500 declared-essential patents read on the Global System for Mobile Communication (GSM) and Universal Mobile Telecommunications System (UMTS) standards. *See* Rudi Bekkers & Arianna Martinelli, *Knowledge Positions in High-Tech Markets: Trajectories, Standards, Strategies, and True Innovators*, 79 Tech. Forecasting & Soc. Change 1192, 1205 (2012).

80 Judge Richard Posner argues that the most reasonable interpretation of ambiguity or incompleteness in a contract is the interpretation that the parties most likely would have chosen, had transactions costs not been prohibitive. *See* Richard A. Posner, Economic Analysis of Law § 4.15 (Wolters Kluwer 9th ed. 2014). This same economic reasoning invites one to ask the following question in the context of FRAND licensing: When an implementer's product (such as a bestselling smartphone) fully implements the standard, is it vexatious for that implementer to demand in litigation that the SEP holder quote a FRAND royalties to license only an individual SEP from its portfolio? *See, e.g.*, Apple Inc. v. Telefonaktiebolaget LM Ericsson, Inc., No. 15-cv-00145-JD, 2015 WL 1802467, at *1 (N.D. Cal. Apr. 20, 2015) ("Ericsson's main contention in its briefs and at oral argument is that Apple's complaint is an inconsequential drop in the ocean that divides the parties. . . . The essence of Ericsson's argument is that the parties' actual controversy concerns not just these seven patents [in suit] but rather Ericsson's *entire* portfolio of patents essential to the 2G, 3G, and 4G/LTE standards." (alteration added) (internal quotation marks omitted)).

81 This reasoning should guide the analysis of other cases in which an implementer claims broader rights than what the SEP holder says it conveyed to an intended third-party beneficiary of the FRAND contract. For example, an implementer might argue that the FRAND contract requires the SEP holder to make a license offer that does not include a clause that allows the SEP holder to terminate the agreement if the licensee challenges the validity of the licensed SEPs after having executed the license. *See, e.g.*, Communication from the Commission, Guidelines on the Application of Article 101 of the Treaty on the Functioning of the European Union to Technology Transfer Agreements ¶ 136, 2014 O.J. (C 89) 28 (defining a termination clause as "the right, in the context of non-exclusive licenses, for the licensor to terminate the agreement in the event that the licensee challenges the validity of any of the [licensed] intellectual property rights"); Sidak, *Evading Portfolio Royalties, supra* note 73.

Conclusion

The FRAND contract gives an implementer the right to obtain an offer to license a portfolio of SEPs on FRAND terms. By making a FRAND offer, the SEP holder gives the implementer the power to accept and execute that offer in a binding license agreement on FRAND terms. If the implementer rejects the SEP holder's FRAND offer, either explicitly or by operation of law, the implementer extinguishes its rights as an intended third-party beneficiary of the FRAND contract and thereafter has no rights under the FRAND contract. After the unlicensed implementer has extinguished its rights as a third-party beneficiary, the SEP holder may request and obtain an injunction against the implementer, charge the implementer more than a FRAND royalty, or refuse to license its SEPs to the implementer.

The implementer also may not invoke the FRAND contract to demand extraneous license terms. The FRAND contract gives the implementer no more rights to SEPs than what the SEP holder *intends* to convey to a third-party beneficiary. In particular, there is no evidence that the SEP holder intended to give the implementer the right to demand *à la carte* licensing of individual SEPs. For a court to construe the FRAND contract otherwise—so as to compel the SEP holder to license its SEPs individually on demand—is to assume that the SEP holder and the SSO would not have cared about the absurdly high transactions costs of licensing that such a contractual provision would cause. The SEP holder, of course, never would have found it commercially reasonable to agree to make that duty part of its FRAND commitment to the SSO. For the same economic reason, the observed norm within a standardized industry such as mobile telecommunications—the usage of trade, in the parlance of contract interpretation—is that SEP holders license their SEPs in portfolios.