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Automakers need to be ready when licensors come knocking

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As the telecommunications and automotive industries begin to overlap with the surge of connected vehicles, a costly intellectual property issue is on the horizon.

During the creation of connected technologies, such as LTE, WiFi and Bluetooth, standards were developed for the software and hardware to bolster advancements. These inventions are protected through the creation of standard essential patents, which encourage widespread adoption of the standards. The users of these technologies are required to pay licensing fees.

As connectivity brings value to the automotive sector, it also opens the door to claims of patent infringement by the holders of the years-old standard essential patents, such as those used in over-the-air updates or even computer chips in connected devices built into the vehicles.

Each microchip and connected offering holds upwards of 15,000 patents. For automakers and their suppliers, that means the threat of thousands of patent holders seeking costly licenses for each vehicle or part sold. Legal experts say the practice of standard patents and licensing fees are on the verge of plaguing the auto industry and are predicting millions of dollars in unexpected fees to be extracted in coming years.

"This is a huge issue that's coming to a head in short order," said Vishnu Ramaswamy, partner and IP attorney for Detroit-based Dickinson Wright PLLC. "Automotive, in the last three or four years, has had an increasing desire to embrace the internet of things, connectivity and autonomous driving. It's becoming an extension of the telecommunications network. Now these holders of standard essential patents are aggressively going after various stakeholders to buy a license."

The issue of standard patent licensing has been litigated heavily in other sectors, with the most notorious case stemming from Microsoft's use of a Motorola-owned WiFi standard for use in the Xbox 360 gaming console. Motorola demanded Microsoft pay them 2.25 percent of the \$399 retail price of the system, which translated to between \$8 and \$9 per console sold.

When the parties couldn't reach an agreement, Microsoft sued Motorola in 2010 for breach of contract tied to the patent under requirement that standard patent holders must negotiate with a fair, reasonable and non-discriminatory pricing for the license. Three years later, a federal judge ruled that Motorola violated the pricing requirement and determined Microsoft pay Motorola 3.471 cents per unit sold. Microsoft sold 84 million Xbox 360s, paying Motorola roughly \$2.9 million for the WiFi license, as opposed to the nearly \$700 million they would have owed under Motorola's initial demand. However, the litigation became so nasty, and international, that Microsoft ended up paying \$400 million to move a manufacturing facility out of Germany.

Michael Huget, partner and leader of the IP litigation practice at Detroit-based Honigman Miller Schwartz and Cohn LLP, said the licensing of standard patents is completely new territory for the auto industry, which has traditionally relied on its own supply base to provide parts and technology for a pre-determined price laid out in a contract. Licensing fees have never been part of the equation.

"The way the industry is structured, it's never dealt with this before," Huget said. "That model isn't going to work as more and more connectivity enters the vehicle. (Automakers) will be dealing with tons of different players they didn't even know they were in business with and it's coming faster than any of them realize."

John LeRoy, partner and chair of the open source compliance practice at Brooks Kushman PC in Southfield, warns that in most cases automakers won't even understand they are using a standard essential patent requiring a license until a patent holder contacts them.

"These patents are not written in a way that a mere mortal can determine its use," LeRoy said. "The major challenge, in some cases, is that there is no analysis provided to the automaker; they didn't develop the chip, they didn't manufacture it. The chips come into the auto supply chain somewhere in the fourth tier. Yet the automaker is expected to pay the license for something they likely didn't even know they were using."

Standard essential patent licensing has become big business for early developers of wireless technologies. San Diego-based Qualcomm Inc., for instance, reported \$6.5 billion of its pre-tax profit in 2016 from patent licensing, compared to just \$1.8 billion from its chip-making business, Fortune reported in June.

However, Qualcomm's licensing practices have landed it as the defendant in several cases, including an antitrust case brought forth by the U.S. Federal Trade Commission, who alleges Qualcomm's license fees violate fair and reasonable negotiating to a point that it drives out competition. Apple also sued the company over patent-licensing terms, and the Korea Fair Trade Commission fined Qualcomm \$853 million for antitrust violations in the South Korean market.

But Qualcomm is just one of the major players. Standard patent licensing will continue, and the automotive industry has little to defend itself with, Ramaswamy said.

"There's very few proactive measures a company can take; they mostly have to sit and wait for a licensor to come knocking," Ramaswamy said. "With as many as 15,000 patents for each standard and thousands of standards, it's impossible for any single party to find its liability."

LeRoy said the first step toward tackling the issue is for the auto industry to begin to take it seriously and develop a strategy for negotiating with patent holders.

"The strategy is to understand your own data and how you may negotiate," LeRoy said. "When a licensor comes to your door, figure out where they fit in the portfolio of that standard and what you're willing to pay if everyone with a patent in that standard comes to you. Then divide it up among who has what share of the pie. But you really never know how much they are going to demand and how it may end in litigation."

Huget said as the practice takes hold of the auto industry, the industry will rely more and more on its own internal engineering to find ways around the standards.

"You're going to see more patents coming out of the automakers," he said. "The costliness of these licenses will force them to start writing more patents themselves as this is hitting the radar."