Determining FRAND Licensing Terms for SEPs – Review of Recent Developments

Damien Geradin

Intertic Conference

Rome, 16 June 2013

Agenda

- The FRAND concept
- Hold up and royalty stacking
- Injunctions and the risk of hold up
- Google consent decree
- Düsseldorf court’s reference to the CJEU
- Proposed methods to determine FRANDness of licensing terms
- Conclusions

The FRAND concept

- As per SSO's IPR policies, firms that disclose SEPs are asked to give a FRAND commitment.
- The FRAND commitment is contractual in nature.
- There is no such thing as an abstract FRAND rate:
  - FRAND depends on the specifics of every licensing negotiation.
  - The FRAND commitment contemplates a *range* of reasonableness.
- FRAND has worked. For instance, since the adoption by ETSI's IPR policy in 1994, the mobile device industry has evolved from a tight cartel to a very competitive market with significant entries.

Hold up and royalty stacking

- Standard implementers have complained that a FRAND commitment is not sufficient to prevent risks of abusive licensing:
  - **Patent hold-up**: Risk that once a standard has been adopted, essential patent holders will seek to exploit the additional market power allegedly conferred by standardization to charge “excessive” royalties in breach of their FRAND commitment.
  - **Royalty stacking**: Risk that when SEP holding is highly fragmented, the cumulative rates that have to be paid to patent holders will reach unsustainable levels.
- While hold-up and royalty stacking may occur, the practical importance of these problems has been exaggerated.
- The activities of certain NPEs (e.g., InterDigital) may nevertheless be problematic.

Injunctions and the risk of hold up

- It has been argued that the risk of hold-up would be compounded by the ability of SEP holders to seek injunctions against would be licensees.
- See, e.g., the Commission's *Google/MMI merger* decision:

  > "Depending on the circumstances, it may be that the threat of injunction, the seeking of an injunction or indeed the actual enforcement of an injunction granted against a <u>good faith potential licensee</u>, may significantly impede effective competition by, for example, <u>forcing the potential licensee into agreeing to potentially onerous licensing terms which it would otherwise not have agreed to</u>." (§ 107)

- But what is a "<u>good faith</u>" or "<u>willing</u>" potential licensee?

Google consent decree

- Google is permitted to seek injunctive relief only in the following four narrowly-defined circumstances:
  - “(1) the potential licensee is not subject to United States jurisdiction;
  - (2) the potential licensee has stated in writing or in sworn testimony that it will not accept a license for Google’s FRAND-encumbered SEPs on any terms;
  - (3) the potential licensee refuses to enter a license agreement for Google’s FRAND-encumbered SEPs on terms set for the parties by a court or through binding arbitration; or
  - (4) the potential licensee fails to assure Google that it is willing to accept a license on FRAND terms.”

Düsseldorf court's reference to the CJEU

- Huawei sues ZTE for infringement of its SEPs in various courts, including the Düsseldorf patent court and seeks an injunction.
- ZTE is clearly an unwilling licensee having dragged its feet in the license negotiations.
- In order to claim benefit of the *Orange Book* defence, ZTE make an absurdly low licensing offer to Huawei.
- Perceiving differences between the position of the German courts and the position of the Commission with respect to the compatibility of injunctions for the enforcement of SEPs with Article 102 TFEU, the Düsseldorf court refers five questions to the CJEU.

Proposed methods to determine FRANDness of licensing terms

- Benchmarking:
  - Comparison of the rate requested with rates charged by licensor in earlier agreements, in other jurisdictions, etc.
  - Royalties considered fair and reasonable in earlier patent cases.
  - Comparison of *ex post* with *ex ante* rates
- Numerical proportionality
- Incremental value
- Comparison with patent pool rates when pool exists
- Combination of factors as per *Georgia Pacific*

Judge Robart's decision

- Motorola asserts its patents essential to the H.264 and 802.11 standards against Microsoft.
- The royalty rate requested by Motorola is 2.25% of the relevant Microsoft products' selling price.
- Microsoft sues Motorola before the US District Court of the Western District of Washington at Seattle for breach of contract.
- To decide whether Motorola's opening offers were in good faith, Judge Robart held a bench trial to determine: (1) a RAND royalty range for Motorola's SEP; and (2) a specific RAND royalty rate for Motorola's SEPs.
- Judge Robart adopts rates infinitely smaller than those asked by Motorola: (i) 0.555 cents per unit for Motorola's H.264 standard portfolio; and (ii) 3.471 cents per unit Motorola's 802.11 SEP portfolio.

Methodology used by Judge Robart

- “RAND terms and conditions can be determined by stimulating a hypothetical negotiation under a RAND obligation.” (§ 83)
- “The Georgia-Pacific factors must be adjusted to account for the purpose of the RAND commitment.” (§ 99)
- Based on this framework, “the court conducts a hypothetical negotiation for Motorola’s 802.11 and H.264 SEPs.
  - First, the court examines Motorola’s H.264 and 802.11 patent portfolios to determine each portfolio’s importance to its respective standard as well as the importance to Microsoft’s products.
  - Second, the court fashions a royalty rate and range for Motorola’s H.264 and 802.11 patent portfolios ... In determining a royalty rate and range, the court considers possible comparable licensing agreements and patent pools, which could provide indications of a reasonable royalty rate for Motorola’s patent portfolios. The court also applies the principles behind the RAND commitment in finding the appropriate royalty rate and range.” (§113)

Is Judge Robart's decision a victory for standard implementers?

- It is certainly a victory for Microsoft.
- But one should not lose sight of the circumstances of the case:
  - Motorola's demand appeared unreasonable on its face ($ 4 billion per year).
  - The importance of Motorola's SEPs to both the relevant standards and to Microsoft products appeared to be limited and Motorola did not produce evidence to the contrary.
  - Motorola had not been very consistent in its FRAND policy.
  - Judge Robart could rely on several benchmarks under which Motorola's demand did not fare well.
- Nothing in Judge Robart's decision suggests that royalties for SEPs should necessarily be low. It all depends on the evidence presented.

Is it a setback for SEP holders ? No

It is a clear setback for Motorola, but the judgment contains a number of statements that should reassure SEP holders.

- “more than one rate could conceivably be RAND” (p. 5)
- SEP licensing negotiations “might include layers of complexity beyond the monetary royalty rates” (p. 6)
- “To induce the creation of valuable standards, the RAND commitment must guarantee that holders of valuable intellectual property will receive reasonable royalties on that property.” (§ 73)
- “Incremental value” rule’s flaws:
  - “lack of real world applicability” (§ 77)
  - “impracticability with respect to implementation by courts.” (§ 79)

Is it a setback for SEP holders ? (2)

- “a reasonable royalty rate for an SEP committed to a RAND obligation must value the patented technology itself, which necessarily requires considering the importance and contribution of the patent to the standard. …” (§ 80)
- “patent pools tend to produce lower rates than those that could be achieved through bi-lateral negotiations. … a rate higher than a pool rate could still be RAND.” (§ 499)
- “… the patent-counting royalty allocation structure of pools does not consider the importance of a particular SEP to the standard. … it is entirely reasonable for the owner of a patent that is extremely important and central to the standard to seek a higher royalty rate than the owner of a less important patent.” (§ 500)
- “since licensing …, at least for some entities, an important component of profitability, reducing that component would reduce the incentive to innovate and thereby slow the pace of innovation in the economy.” (§ 502)

Criticism of the Robart decision

- Takes "hold up" and "royalty stacking" theories as a given. However:
  - While "hold up" may occur (e.g., InterDigital), it is by no means prevalent.
  - Royalty stacking is more a "theoretical" than a "practical" problem as cross-licensing between SEP holders deflates the potential stack.
- Judicial determination of a FRAND rate necessarily implies some simplifications. Judge Robart has done a relatively thorough job, but other judges may not be so cautious and this may lead to problematic decisions.
- Yet, judicial determinations of FRAND rate is probably the best way forward when parties are unable to agree on licensing terms.

Conclusions

- Licensing of SEPs remains a highly contentious area.
- 2013 has seen some important developments:
  - The Google consent decree
  - Judge Robart's decision
- Further guidance will likely emerge from:
  - DG COMP's investigations of Samsung and Motorola's licensing conduct
  - The questions referred by the Düsseldorf patent court to the CJEU
- Most extreme positions on FRAND are being rejected, which is a positive development as the interests of both SEP holders and implementers need to be preserved.

COVINGTON

COVINGTON & BURLING LLP

Damien Geradin - dgeradin@cov.com