RIETI Policy Seminar

Standards and Intellectual Property: Strategies Japan should adopt in light of current global trends

Handout

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Standards and IP – From the Viewpoint of Economics

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Negotiation vs. Litigation

Arm’s Length Negotiations and Litigation FRAND Determinations are very different exercises

• Bilateral negotiations
  – Typically involve NDAs
    • Licensees ask for these to protect business information revealed in negotiation and in the concluded license
  – Royalties center on the value the patents bring to the implementer and its customers, not the patent’s essentiality to a standard
  – Valuation relies on a relatively small number of patents representative of the full portfolio
Common Arm’s Length License Terms

• In high tech sectors, the following terms and conditions are the norm
  – Full portfolio rights, combining SEPs and non-SEPs for efficiency reasons
  – A single rate or volume-tiered rate table for global rights
    • Many SDOs mandate worldwide rights (e.g., ISO, IEEE)
    • A blended rate accounts for differential patent strength across jurisdictions
    • Occasional carve out rates for developing nations
  – Discounts
    • Volume and lump sum payments
Litigation Is Different than Negotiation

• While many litigation FRAND determinations rely on a “hypothetical negotiation scenario”, this “but-for” world does not mirror real world negotiations
  – Litigation ignores most non-pecuniary terms of a license, setting only rates or damages based on rates
Legal Limitations

• SEP Portfolios tend to be global
  – But patents are national rights
  – Efficient and fair court treatment of FRAND requires careful balance of jurisdictional issues

• SEP Portfolios are often very large
  – But patent infringement litigation typically involves in-depth review for just a few patents
  – Fitting FRAND cases into legal frameworks requires new approaches
Apportionment is Still the Same

- FRAND, like patent damages, must reflect the value conveyed to the licensee (and its customers), but NOT more
  - This means apportionment is an important element of FRAND determination
But, Standards are Joint Ventures

• Apportionment does NOT mean SEP holders receive no value due to standardization
  – Adoption of a standard will reflect the joint value contributed by all active participants
  – So created value must be shared among all participants

• *Unwired Planet v Huawei* (UK)
  – “it is not necessary to deprive the patentee of its fair share of those two sources of value [inclusion in the standard and contribution to the product] in order to eliminate hold up and fulfil the purpose of FRAND.”
Patent Counting in FRAND Determination and Apportionment

• In litigation FRAND determination, patent counting is often a necessary evil
  – Well accepted that the number of patents licensed, by single SEP holder or in the aggregate, is a very poor proxy for patent value
  – However, accurate patent valuation in relation to other SEPs requires time consuming and costly analysis (~$10k per patent) => hard for portfolios
  – Thus, patent counting is often used in court decisions for apportionment

• Unwired Planet v Huawei (UK):
  – “[I]f another SEP holder charges 5% but has contributed twice as many SEPs to the standard than the SEP holder of interest, then absent any reliable value weighting, this fact would suggest a rate of 2.5% for the current case.”
  – “Indeed when one thinks about it some sort of patent counting is the only practical approach at least for a portfolio of any size. Trying to evaluate the importance of individual inventions becomes disproportionate very quickly.”
Patent Counting Cautions

- Patent counts cannot be used to estimate a “royalty stack”
  - Using a single rate to extrapolate the aggregate royalty burden leads to both false positives and false negatives
  - Specific evidence is required
    - *Ericsson v. D-Link (US) and CISCO v. CSIRO (US)*: “Certainly something more than a general argument that these phenomena are possibilities is necessary.”

- Do best to account for different values across patents
Balance Is Important

Courts Around the World Confirm FRAND Obligations for Both Parties
• ECJ in Huawei v. ZTE; UK Chancery Court in Unwired Planet v Huawei; Delhi High Court in Telefonaktiebolaget LM Ericsson v. Mercury Elecs., CS(OS) No. 442/2013; Beijing Intellectual Property Court in IWNCOMM v. Sony

- SEP holders must disclose patents, explain how implementers infringe, and must make a FRAND license offer
- Implementers must “diligently respond” to the SEP holder’s offer in writing with a good faith counter-offer and must avoid delay tactics
FRAND Determination Methods

• Using comparable licenses as FRAND benchmarks is the most common method because they can reflect fair market value:
  – *CSIRO* v *Cisco* (US) : “[C]omparable license valuations […] may be the most effective method of estimating the asserted patent’s value.”
  – *Unwired Planet* v *Huawei* (UK) : “The relevance of comparables is that they are evidence of what real parties in real negotiations have agreed upon.”

• Most comparables will be global
  – *Microsoft* v *Motorola* (US), *St. Lawrence* vs. *Vodafone* (Germany), and *Unwired Planet* v *Huawei* (UK) upheld the use of worldwide portfolio licensing because it is efficient and avoids evasion of “nondiscriminatory” prong of FRAND
FRAND Comparable Cautions

• Pay attention to non-pecuniary terms
  – License scope, both geographical and product
  – Patent coverage and capture periods
  – License duration

• Lump sum payments are difficult to convert to effective running royalty rates
  – Cannot use ex post actual sales - will bias royalty (up or down)
  – Need contemporaneous sales forecasts
  – Back out likely discounts for upfront payment

• Market conditions matter as well
  – May indicate either higher or lower royalties
Patent Pools as Comparables

• Patent pool licenses can be informative, but tend to fall on lower end of the FRAND spectrum
  – *Microsoft v Motorola* (US): “patent pools tend to produce lower rates than those that could be achieved through bilateral negotiation”
  – *In Re Innovatio* (US): “pool rates may be considerably depressed”

• Must assess commercial success first
  – Too few SEP contributors can signal sub-FRAND rates
  – Too few licensees can signal supra-FRAND rates
Incremental Value Method

• Heavily discussed by policymakers, but not yet seen in court decisions
  – Attempts to measure the additional value a SEP contributes

• Problems:
  – *Microsoft v Motorola* (US): The incremental value approach lacks “real-world applicability.”
    • Measured at what point in time? How to deal with technology trade-offs?

• But it can be a reference point
  – *Microsoft v Motorola* (US): “[C]omparison of the patented technology to the alternatives that the SSO could have written into the standard is a consideration in determining a RAND royalty.”
“Bottom Up” Method

• Similar to Incremental Value
  – Determine the costs of implementing reasonable alternatives that could have been adopted into the standard

• The method is only relevant when viable alternatives exist and sufficient information about them is available
  – Existence not enough, must show alternative is equally valuable

• Cautions
  – Must pay close attention to why alternatives not chosen
  – Trade-offs differ across alternatives

  *Microsoft v. Motorola (US):*
  “[P]erformance of the standard is multidimensional, different people value different aspects.”
“Top Down” Method

- Theoretically easy to understand:
  - Starts with “reasonable” total royalty burden for a standard compliant product
  - Divides that amount among relevant SEP holders based on share of contributions
    - NOTE: The number of SEPs can be misleading due to complementarity; it is generally the number of SEP holders that matters given that each SEP holder licenses on a portfolio basis
- Cautions here too
  - Without detailed information on the value all IP contributes to a standard, any aggregate royalty figure will be an arbitrary guess
  - If product prices or profit margins are used as starting point
    - Can be a disconnect between the physical location vs value of technology
    - Must account for infringement depressing prices and profits
Litigation Deterrence

- Important policy goal for FRAND is reducing litigation
- Must consider incentives to negotiate in good faith
  - If courts require implementers pay no more than ex ante FRAND rate, why would implementers ever take a FRAND license?
  - Licensee hold out is a low cost option:
    - Zero royalties owed if the SEP holder does not sue; or
    - Even if lose litigation, get deferred and lower net present value payment
- *St. Lawrence v. Vodafone* (Germany):
  - A SEP holder has a “legitimate interest to settle all acts of use” by a single license agreement rather than on a patent-by-patent basis around the world
  - Patentees would “incur high costs,” including transaction and monitoring costs, if forced to license its portfolio “in diverse agreements (for a plurality of patents and a plurality of countries).”
Concluding Thoughts

• Consensus is emerging around the world slowly as cases reach decisions
  – Global portfolio licenses are most consistent with FRAND
  – Both licensee and patentee have good faith obligations under FRAND

• Courts and regulators need to keep incentives on both sides of the table in mind
  – Want to encourage good faith negotiations and limit litigation
  – Balance between the sides is crucial
References


