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## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

Partners Abraham Kasdan and Michael Kasdan have co-authored an article titled, "Recent Developments in the Licensing of Standards Essential Patents," which was published in the January 2020 issue of *The Licensing Journal*.

### INTRODUCTION

Technologies that operate across many different devices and geographical regions are all around us. As one example, today's mobile telephones can connect to 3G/4G/LTE and WiFi networks and communicate with other devices virtually anywhere in the world. This is made possible because all of these devices comply with highly specific technical standards that are promulgated by national and/or international standards setting organizations (SSOs), made up of companies involved in developing and building these global technologies. When aspects of technical standards are protected by patents, the patent owners are generally obligated by the pertinent SSO to offer licenses to their patented technology under "fair, reasonable, and nondiscriminatory" (FRAND) terms, as the quid pro quo for having their patented technology included in the standard. The purpose behind the FRAND requirement is to prevent patent owners from gaining an unfair advantage over companies who must make devices that practice the standard in order to participate in the

market; and are therefore necessarily "locked in" to standard-compliant designs. Over the past several years, the licensing and litigation landscape involving standard essential patents (SEPs) and FRAND has become a matter of intense focus. Numerous technology industries, as well as courts around the world have begun to grapple with key issues such as "How do you determine what a FRAND licensing rate should be?" and whether a licensor's offer is FRAND or not. This article summarizes several recent developments in the transnational licensing of SEP portfolios.

### THE OVERALL LANDSCAPE

Not surprisingly, most of the recent licensing disputes over SEPs involve the worldwide telecommunications industry. A host of multinational companies have been involved in developing the 2G, 3G, 4G, and soon-to-be-commercialized 5G standards (aspects of which are also described by a bewildering array of acronyms, such as "LTE" and "LTE Advanced"). These standards specify the technical features included in mobile phones and their networks. The European Telecommunications Standards Institute (ETSI) is an SSO charged with developing worldwide standards for these technologies. Early on, SSOs recognized that the incorporation of patented technology

CONTINUED

## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

into a standard could give the patent holder significant leverage when negotiating licenses. SSOs therefore required the patent holder to agree to make its SEPs available on FRAND licensing terms. ETSI, like other SSOs, however, does not provide guidance on how to structure licensing terms that meet the FRAND requirement. Indeed, doing so or setting price or royalty rates among entities in a given industry may raise antitrust issues. This leaves it to others to work out the specifics of how SEP owners can comply with the FRAND requirement. Of course, what is fair, reasonable, and nondiscriminatory to one party (e.g., a licensor), may not be viewed as such by another (e.g., a licensee). This has led to a spate of recent litigation worldwide in which courts have been asked to make the determination of what constitutes an appropriate FRAND royalty. These cases are somewhat of a new breed. The determination of what specific royalty rate is fair, reasonable, and nondiscriminatory on a worldwide basis requires courts to perform an economic analysis that is quite foreign to them. Setting a FRAND royalty rate for a large worldwide patent portfolio is quite different from determining a "reasonable royalty rate" for patent infringement, which US courts typically do to assess patent damages.

### RECENT CASES

Assessing what constitutes FRAND licensing terms involves many controversial factors. For example, some courts have concluded that the value ascribed to a SEP patent should not include any gain attributable to the mere fact that it

covers an aspect of the standard. (*Ericsson, Inc., v. D Link Systems, Inc.*, 773 F.3d 1201 (Fed. Cir. 2014); *CSIRO v. CISCO Systems, Inc.*, 809 F.3d 1295 (Fed. Cir. 2015)) Some economists have referred to such a calculation as reflecting the prestandardization or "ex ante" value of a SEP patent. Others have argued that a more appropriate valuation of a FRAND royalty should also take into account the costs incurred by the SEP owner in contributing to the standard, e.g., R&D costs and other expenditures, so as to incentivize companies to continue to collectively participate in standards setting activities. This and other issues are and continue to be hotly contested among economists and lawyers. Courts likewise have dealt with the question of determining FRAND terms in different ways, as the following cases demonstrate:

#### TCL v. Ericsson

This US case of *TCL Comm'n v. Ericsson, C.A.*, No. 14-CV-341 (C.D. Cal. December 21, 2017), which is currently on appeal to the Federal Circuit, arose from a long-standing licensing dispute over Ericsson's assertion of its large portfolio of SEP patents covering 2G, 3G, and 4G cellular technologies against TCL, a Chinese telecommunications company. Briefly, Ericsson's technology had played a key role in the development of these technologies; and when the relevant standards were being defined by ETSI, Ericsson committed to license its patents on FRAND terms. TCL had been negotiating various licenses from Ericsson for some time. When negotiations ultimately

CONTINUED

## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

broke down, Ericsson filed a series of litigations against TCL in various jurisdictions. This case, filed by TCL in California, resulted in a 10-day bench trial before Judge Selna to determine if Ericsson had met its FRAND obligation during its negotiations with TCL.

In December of 2017, Judge Selna issued his Final Judgment, supported by an extensive 100-plus page Memorandum of Facts and Law. The Court found that while Ericsson had negotiated in good faith, its offers to TCL did not meet its FRAND obligation under ETSI. Judge Selna went on to determine what the worldwide FRAND royalty rates should be for Ericsson's SEPs, using primarily a "top-down" approach, as generally advocated by TCL, and a "check" based on an analysis of comparable licenses (as generally advocated by Ericsson).<sup>1</sup>

At the outset, Judge Selna acknowledged the complexity of this undertaking by stating that "the search for precision and absolute certainty is a doomed undertaking." This complexity was in no small measure due to the difficulties of assessing the fair and reasonable licensing value attributable to large numbers of SEPs. For example, there were almost 1500 SEPs covering the 4G standard of which Ericsson's proportional share was either 7.25% (if one accredited the

testimony of Ericsson's expert) or 4.8% (if one believed TCL's expert).

The Court followed the "top-down" approach to first determine a total aggregate royalty under the respective 2G, 3G, and 4G standards, justifying this methodology based on Ericsson's prior statements, including some made during litigation, that a singledigit aggregate royalty rate would be appropriate in this field. This led Judge Selna to conclude that aggregate total royalties of 5% of handset sales for 2G and 3G, and 6-10% of handset sales for 4G, were appropriate.<sup>2</sup>

Judge Selna considered, but ultimately rejected an "ex-ante" bottom-up type of analysis (advocated by Ericsson) as being too unreliable to measure the value that Ericsson's SEPs added to the subject products. Instead, the Court assumed that each Ericsson SEP patent had the same value, and simply counted the number of Ericsson SEP patents covering each standard in relation to the total number of SEP patents involved in the standard, to determine Ericsson's royalty share of each of the 2G, 3G, and 4G standards.

Judge Selna then made various calculations based on the proffered evidence to determine the relative strength of Ericsson's SEPs in the United States,

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<sup>1</sup> Basically, a top-down approach seeks to first determine what the aggregate royalty should be for all SEP patents covering a particular standard, and then apportion that aggregate royalty in some rational way among all SEP patent holders. This is in contrast to a "bottom-up approach" which seeks to determine the importance and value of each individual SEP patent without considering other SEP patents in the field. Both of these approaches, and indeed all other proposed methods of valuing SEPs, have their critics.

<sup>2</sup> It is interesting to note that Unwired Planet (discussed below), involved some of the same Ericsson patents at issue in TCL that Ericsson had sold to the plaintiff. There, however, the UK courts took a rather different approach, relying heavily on comparative licenses to determine a FRAND rate.

## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

Europe, and the rest of the world and ultimately concluded that the relative strength of Ericsson SEPs was stronger in the United States than elsewhere, based on evidence introduced by TCL's expert. These considerations resulted in a chart of potential FRAND royalties for each of the different standards and geographical regions, based on his previously determined total aggregate royalties.

As a reasonableness check on his top-down analysis, Judge Selna considered what had been paid under comparable licenses reached by others in the industry. Judge Selna used these prior licenses to calculate the royalty rates that Ericsson might have received under such licenses for its 2G, 3G, and 4G SEP portfolios. He ultimately determined final FRAND rates for the United States, Europe, and the rest of the world that were arguably consistent with both approaches.

Significantly, and perhaps in recognition of the many factors that can impact on a FRAND determination, Judge Selna concluded that "there is no single rate that is necessarily FRAND, and different rates offered to different licensees may well be FRAND given the economics of the specific license." He also noted that his approach overlapped with the *Georgia Pacific* factors typically used by US courts to determine reasonable royalty damages in patent cases. Judge Selna concluded, however, without further explanation, that a full-blown *Georgia Pacific* analysis was not useful in the unique context of a FRAND dispute. To those in the industry,

Judge Selna's methodology and calculations provided an important data point in assessing FRAND royalty rates. That likely will remain the case, to some degree.

However, Ericsson appealed Judge Selna's decision to the Court of Appeals for the Federal Circuit, which recently issued its decision in the beginning of December, 2019. On appeal, Ericsson argued that the decision suffered from both procedural and substantive flaws. First, Ericsson argued that the dispute included issues that required a jury trial and that Judge Selna's decision to hold a bench trial violated its Seventh Amendment right to a jury trial. In addition, Ericsson argued that Judge Selna's methodology for determining a FRAND royalty was inconsistent with both legal precedent and commercial practices.

The Federal Circuit never reached Ericsson's second argument and therefore did not comment on or provide any substantive guidance on the appropriate methodology for determining a FRAND royalty rate. Rather, the Federal Circuit agreed with Ericsson on its procedural argument that it had been deprived of a jury trial. Notably, the Court's rationale in deciding that there were legal issues for a jury to decide was rooted in the fact that the issues in the TLC/Ericsson case included determining compensation for a release, which is – in substance – compensation for past infringement. The Court did not reach the issue of whether setting a prospective FRAND rate would

CONTINUED

## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

be an equitable and not “legal” issue, and thus an issue that a Court can decide (without a jury).

### **Unwired Planet v Huawei**

In *Unwired Planet* ([2018] EWCA Civ 2344), Unwired Planet, a US patent licensing entity, had acquired certain SEPs from Ericsson’s worldwide portfolio pertaining to 2G, 3G, and 4G standards. These SEPs included UK patents as well as patents in many other countries. It sued Huawei, a large Chinese mobile handset provider, in the UK for infringement of certain UK patents, two of which were found to be valid and standard essential by the English High Court. Unwired Planet sought an injunction against Huawei in the UK, if Huawei would not agree to take a global FRAND license. In contrast to *TCL v. Ericsson*, where both sides were interested in reaching a global license, Huawei only was seeking a license in the UK. Huawei argued that the Court should determine a FRAND royalty based only the two UK patents it found to be standard essential, rather than under Unwired Planet’s worldwide patent portfolio. The English High Court, however, ruled that a FRAND license necessarily had to be global, went on to define its terms, and issued an injunction against Huawei in the UK that would be lifted only if Huawei agreed to a global license under the terms set by the Court. Last October, the London Court of Appeal rendered its judgment which, for the most part, upheld the decision of the English High Court. Among the issues on appeal were whether the Court below was correct in

ruling that only a global license could be FRAND. As to this issue, Huawei had argued that the UK court only had jurisdiction to determine a FRAND royalty under the UK patents, and that the imposition of a global license by the UK Court was contrary to the principles of comity and was manifestly unjust. The Court of Appeal, however, rejected Huawei’s argument and sided with the lower court on this issue. Specifically, the Court of Appeal agreed with the lower Court’s reasoning that because Unwired Planet’s SEP portfolio was sufficiently large and geographically diverse, reasonably acting licensees would seek to agree on a worldwide license, albeit one with possibly different rates in different regions, noting that a licensee would still be free to challenge the validity of a licensed SEP in any jurisdiction. Therefore, it sided with the lower Court and agreed that only a global license could satisfy the FRAND commitment. While accepting without question that the jurisdiction of a UK court with respect to disputes concerning patent infringement and validity only extends to UK patents, the Court of Appeal took the position that a FRAND undertaking is different, reasoning that since standards have an international effect, so does the FRAND commitment. The Court of Appeal further noted that it would be impractical and prohibitively expensive for a patent owner with a worldwide SEP portfolio to have to negotiate a license or bring infringement proceedings in many different jurisdictions.

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## RECENT DEVELOPMENTS IN THE LICENSING OF STANDARDS ESSENTIAL PATENTS

*This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.*

In considering the obligation of Unwired Planet to ETSI under its FRAND requirement, the Court of Appeal therefore also agreed with the decision below that this obligation was met by Unwired Planet's offer of a global license, and that this did not usurp the right of foreign courts to decide issues of infringement and validity of their local patent rights. The Court of Appeal only differed with the lower Court in one minor respect, taking a broader view on the question of whether there was only one set of FRAND terms in any one case. Because of the very large number of complex issues that arise in these types of cases, the Court of Appeal noted, in substantially affirming the decision below, that depending on the particular set of facts and circumstances, different sets of terms may all be compliant with FRAND. In this case, the Court of Appeal left standing the particular global FRAND rate determinations made by the lower court. The *Unwired Planet v. Huawei* case, however, isn't over yet. In April 2019, the Supreme Court of the UK granted Huawei's petition for review of its jurisdictional challenge (i.e., whether an English Court has the jurisdiction to grant relief in the form of a global patent license

in regard to a claim for infringement of UK patents). It is expected that the UK Supreme Court will render its decision on this interesting and highly significant legal issue in an expedited manner. For the time being, however, the UK Courts are being viewed by SEP owners as a very attractive forum for FRAND litigation, particularly when the defendant has sufficient UK sales that could be threatened by a potential injunction.

### CONCLUSIONS

Determining what constitutes fair, reasonable, and nondiscriminatory licensing terms for international patent portfolios that may include hundreds or thousands of standard essential patents covering complex technologies is extremely challenging, and the methodologies that courts and companies use to make this determination are all fraught with uncertainties. The law in this area is evolving as SEP holders and their lawyers grapple with these issues. As courts in various countries are being asked to make these complex decisions, parties on both sides of these licensing disputes are encountering novel legal and practical challenges.