JIRICO
Jindal Initiative on Research in IP and Competition

JAPANESE AND THE EUROPEAN APPROACH IN FACILITATING FUTURE SEP LICENSING

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JIRICO Brief

INTRODUCTION

The debate on licensing of Standard Essential Patents (SEPs) on what are termed as Fair, Reasonable and Non-Discriminatory (FRAND) terms, has been on for over a decade and across the globe. Typically the issues surrounding such licensing have focused on methodologies for calculation of royalties (top down v bottom up approaches), appropriate base for determination of royalty (smallest saleable patent practicing unit v end price of device), availability of injunctive relief to SEP holders, hold-up and royalty stacking abuses etc.

Last few years have seen how the policy has evolved through changes in ex ante and ex post regulation. The patent policies of Standard Setting Bodies have seen some revisions and both the judicial rulings as well as antitrust interventions have evolved with recent decisions seeing attempts by courts to actually undertake intensive econometric exercises involved in calculation of FRAND royalties. As a result, the existing framework of FRAND policy and rules has seen significant developments in a relatively short span of time.

In times to come, FRAND is expected to be faced with greater action. This is predicted as the Internet of Things (IoT) is expected to become the next patent war zone.

IoT which involves adoption and convergence of diverse technologies and standards is likely to encompass thousands of patents. Many of which are likely to be essential. IoT, which will connect billions of devices in coming years, may offer incredible opportunities for businesses and consumers. However, with the coming together of so many technologies across various verticals in the IoT ecosystem, one key question is whether patenting and licensing strategies will have to change to adapt to the myriad standards being developed and patents being sought for IoT products and services, and for the coming rollout of 5G technologies.

While the standardization of 5G technologies are currently underway, deliberations have already begun on what licensing of 5G would entail. Furthermore, how FRAND litigations involving these new technologies that spread across industries are likely to shape up within the existing framework, is a pertinent question.

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Governments, standard setting bodies, industry groups and others have been exploring ways to address questions on how to value patents that appropriate the maximum rent in the IoT ecosystem, what is the appropriate licensing model/platform for such negotiations and other issues that are likely to arise with the rollout of IoT and 5G.

Recent attempts to clarify rules on FRAND and add to the existing framework in order to accommodate complex future issues were made by the European Commission Communication and the Japan Patent Office.

JAPAN PATENT OFFICE (JPO): GUIDE TO LICENSING NEGOTIATIONS INVOLVING SEPS

On March 9, 2018, JPO presented its draft Guide to Licensing Negotiations involving SEPs[1], seeking response from stakeholders around the world. The draft drew up instructions on SEP licensing. It also drew attention to the different methods of patent valuation that may come to play in the IoT context and gain even more relevance than before. It stated that in the age of the IoT, companies in diverse type of industries will use technology for the same standard in the ICT field. Under these circumstances, rights holders may insist that royalty rates and amounts for the same standard technology should be different according to different uses, if the end products that use the technology are different. On the other hand, implementers may claim that the same royalty rates and amounts should be applied regardless of the use for the same standard technology, and that it is discriminatory and contrary to FRAND terms if rights holders employ different royalty rates and amounts. Based on the principle that royalties are determined in accordance with the extent of contribution of the patent, even when the same standard technology is used, if the extent of contribution of the patent for the product differs due to the different way of using the standard technology, the appropriate FRAND royalties may be different. The JPO acknowledged the debate over patent valuation. And notes that in the age of IoT, in the ICT field, there are views that it is not discriminatory for a rights holder to apply different royalties for products that enjoy the capacity of the technology either wholly (e.g. self-driving car, remote surgery) or partially (e.g. smart meter) even if they use the same standard technology.

The draft was prepared in order to meet the demands of the rapidly evolving communication and technology industry. It discusses in detail a list of negotiation practices that could help the parties involved in reaching an agreement based on FRAND terms. The draft paper deals with important issues of hold-outs and fixing the royalty rates. Japanese market faces peculiar problems with the fixing of royalty rate. Currently, Japanese companies acts as licensees to the American and European companies while at the same time it also acts as a licensor to the Asian market. This complicates any attempt to fix the rates. Better results could be found if case to case negotiations were to decide these terms.

This draft was based on the information and consultation received by the JPO in 2017. It lays down good faith principles that can help parties avoid disputes through effective negotiation amongst themselves. Currently, a patent is granted for a term of 20 years. However, the shelf life of the products might not be the

same. In such a scenario, any dispute could further depreciate the market life of the product and reduce the commercial viability of the businesses involved. Any dispute on licensing of standard essential patents necessarily involves questions of patentability and essentiality. It subsequently deals with the issue of licensing terms. Most of the licensing disputes have ended not with a court decision but a mutual agreement between the interested parties. This calls for introduction and promotion of Alternate Dispute Resolution (ADR) procedures that could allow the parties to indulge in a flexible procedure that save both time and cost. Taking a step ahead in this path, JPO presented its draft attempting to introduce array of ADR practices that can potentially offer an efficient licensing mechanism.

Lemley and Shapiro argue in favour of ADR and against the cumbersome legal procedures in matter pertaining to FRAND disputes. According to them, these problems require a flexible approach with limited participation of the Standard Setting Organisation (SSO). They propose a baseball style arbitration where both the parties get to submit their final offers to the arbitrators who then decide on the price.[2] This baseball style arbitration has also been discussed by Larouche.[3] By entering into a binding arbitration agreement the patent owner can discharge its FRAND commitment. In such cases results are certain and transparency is significantly increased.[4]

The document lays down the importance of negotiation practices in deciding the course of SEP licenses. It recognises five stages of a license negotiation practice and discusses in detail acts of the parties involved throughout these stages that they could take at each of these stages. The five steps include – 1) Offer by Rights Holder of Licensing Negotiation, 2) Expression of Willingness by Implementer to Obtain a License, 3) Specific Offer by Rights Holder on FRAND Terms, 4) Specific Counteroffer by Implementer on FRAND Terms and 5) Rejection by Rights Holder of Counteroffer / Settlement of Disputes in Courts or through ADR. These stages are drawn from the framework suggested in ECJ decision on *Huawei v ZTE*[5], where the court emphasized on the need to balance the interest of the right holder as oppose to a willing licensee.

They point out elements of a good faith negotiation in order to improve the commercial gain accrued to both the parties and reduce the cost of time. Parties need to be careful with the methods they use to approach their negotiation. The right holder might be required to prove the ownership and essentiality of the concerned patent. The onus is on the right holder to be transparent while limiting the information they release. In order to act in good faith, they should send a warning letter before seeking an injunctive relief. The implementer on the other hand also needs to show its willingness to obtain the license. Without undue delay the implementer need to respond to the offer made by the right holder even if they disagree with the term of that offer. The implementer is free to challenge the validity of the patent but any such claim needs to be backed by requisite technical and factual information. The right holder will be responsible to provide the specifics proving that the offer presented is in compliance with FRAND terms. This involves details about the methods used to calculate the royalty rates and other comparable licenses and their terms and conditions. If the implementer is in disagreement with the right holder, they may send a counter offer with a similar information sheet explaining the calculations of the FRAND terms that they offer and the list of comparable licenses that they are relying on. If the aforementioned steps do not lead

to an agreement, the parties may consider the option of litigation. However, the draft guide offers ADR as a better approach to the same. It calls for mediation and arbitration as a suggested mode of dispute resolution. It emphasizes on time and cost reducing abilities of these procedures.

While the aforementioned points discuss the factors of a good faith negotiation, it is also important to ensure that the entire process is efficient. The draft also discusses various other factors that affect the efficiency of a license negotiation. Generally, the right holder gets to decide the party it wants to enter into an agreement with. There is a longstanding debate on the involvement of different players of the supply chain in these negotiations as it could significantly affect the efficiency of the entire system. The end product manufacturer might not have the sufficient technical details of each component involved in making of the product. In such cases the supplier would be an appropriate party. Apart from this confidentiality agreement and the contents of such agreements requires special attention. It is important to ascertain the extent of information revealed and a potential use of such information in litigation.

Finally, it discusses the issue of setting of royalty rates. The popular formula of calculating royalty rate reflects the contribution of the patent to the end product (Royalty base (Calculation base) x (2) Royalty ratio (Rate)). There are differing views on valuation of patent on the basis of its contribution to the product. Since the parties might have to use the said patent out of necessity in order to meet the market standards. Another, factor that poses similar problems is the decision on the use of smallest saleable patent practicing unit (SSPPU) and the entire market value (EMV). Other ways of fixing of royalty rates would include an evaluation of all the comparable licenses.

The JPO also announced the introduction of the new policy with regard to an advisory opinion (Hantei) whereby it allows the essentiality check of the SEPs in the case of any dispute. To avoid the misuse of the advisory opinion system, the draft manual of 'Hantei' mentions that petitioners needs to be involved in litigation where the essentiality of SEP are issues.[6] According to a newspaper report, with this advisory opinion system, the petition would be concluded within three months of filing.[7]

Appropriateness of use based licensing model has been a matter of much debate globally now. It is likely to draw even more attention in the context of IoT and implementation of 5G Patents across industries. The US is also considering how to move forward on IoT. In 2017, the National Telecommunications and Information Administration (NTIA), the Department of Commerce Internet Policy Task Force and Digital Economy Leadership Team published a green paper[8] and noted that, "as with any technological field, patents can be expected to play a key role in IoT development" by giving inventors incentive to develop better devices, manufacturing processes and infrastructure. Meanwhile case law jurisprudence is likely to play an important role in grappling with potential problems of 5G SEP licensing. In December 2017, US district judge James Selena of the Central District of California published a "Memorandum of Findings of Fact and Conclusions of Law" from the *TCL v Ericsson* case.[9] This is the first time a US court has determined FRAND rates for SEPs.

EC COMMUNICATION PAPER: SETTING OUT EU APPROACH TO PATENT LICENSING

The EC Communication published at the end of last year also touched on this albeit briefly. The EC communication 'Setting out the EU approach to Patent Licensing'[10] published on November 29, 2017, emphasized that there will be thousands of patents essential to the operation of the standards developed. As the IoT grows and 5G is rolled out, the issue of how these patents are licensed will become increasingly important. SEPs have to be licensed on a FRAND basis, but determining a FRAND royalty rate is a challenging task. The Communication stresses that "there is no one-size-fit-all solution to what FRAND is," and that "what can be considered fair and reasonable differs from sector to sector and over time."

The Communication has stated in relevant parts:

"Both parties must be willing to engage in good faith negotiations, with the view to establishing licensing conditions that are fair, reasonable and non-discriminatory. Parties to a SEP licensing agreement, negotiating in good faith, are in the best position to determine the FRAND terms most appropriate to their specific situation.

Efficiency considerations, reasonable license fee expectations on both sides, the facilitation of the uptake by implementers to promote wide diffusion of the standard should be taken into account. It should be stressed in this respect that there is no one-size-fit-all solution to what FRAND is: what can be considered fair and reasonable differs from sector to sector and over time. For this reason, the Commission encourages stakeholders to pursue sectoral discussions with a view to establishing common licensing practices, based on the principles reflected in this Communication. The following IP valuation principles should be taken into account:

Determining a FRAND value should require taking into account the present value added of the patented technology. That value should be irrespective of the market success of the product which is unrelated to the value of the patented technology.

In defining a FRAND value, parties need to take account of a reasonable aggregate rate for the standard.

The non-discrimination element of FRAND indicates that right holders cannot discriminate between implementers that are 'similarly situated'.

For products with a global circulation, SEP licences granted on a worldwide basis may contribute to a more efficient approach and therefore can be compatible with FRAND."[11]

The Commission called on Standard Development Organisations (SDO) and SEP holders to develop effective solutions to facilitate the licensing of a large number of implementers in the IoT environment (especially SMEs), via patent pools or other licensing platforms, while offering sufficient transparency and predictability. The Commission stated that it will monitor licensing practices, in particular in the IoT sector. It will also set up an expert group with the view to deepening expertise on industry licensing practices, sound IP valuation and FRAND determination. The Communication lacked any substantial discussion on "use based and chip set licensing". In avoiding to do so, the Commission's Communication has been less than prescriptive.

CONCLUSION

Industry is divided on the appropriateness of these methodologies for calculation of the base for royalty determination and have formed alliances amongst themselves. Use based licensing model requires the use of the underlying technology to be taken into account in determining the royalty. The question of the extent to which royalties should account for the value the technology brings to the product began with the rolling out of previous standard generations and is likely to have more significant ramifications with 5G which is likely to be implemented across sectors.

1 Japan Patent Office, 'Guide to Licensing Negotiations involving Standard Essential Patents' (2018) < http://www.jpo.go.jp/iken/pdf/180308_hyoujun/sep_guide_draft_en.pdf> accessed 20 March 2018.

2 Mark Lemley and Carl Shapiro, 'A Simple Approach to Setting Reasonable Royalties for Standard-Essential Patents' (2013) 28 Berkeley Technology Law Journal 1135.

3 Pierre Larouche, Jorge Padilla and Richard Taffet, 'Settling FRAND Disputes: Is Mandatory Arbitration a Reasonable and Non-Discriminatory Alternative?' (2013) Tilburg Law School Legal Studies Research Paper Series No. 023/2013 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346892> accessed 20 March 2018.

4 Jorge Contreras, 'Essentiality and Standards Essential Patents', *The Cambridge Handbook of Technical Standardization Law Competition, Antitrust and Patents* (Cambridge University Press, 2017).

5 Case C-170/13 *Huawei Technologies Co. Ltd v ZTE Corp.*, EU:C:2015:477.

6 Japan Patent Office, 'Manual of "Hantei" (Advisory Opinion) for Essentiality Check' (2018) < https://www.jpo.go.jp/torikumi_e/t_torikumi_e/files/hantei_hyojun_e/01_e.pdf> accessed 20 March 2018.

7 'Zyuyou tokkyo 3 kagetsu de hantei: Tokkyo chou shinseido saiban nashi de [And advisory opinion for influential patents within 3 months: JPO's new policy]' *Nikkei Shinbun* (21 February 2018) (In Japanese).

8 The Department of Commerce, Internet Policy Task Force & Digital Economy Leadership Team, 'Green Paper: Fostering the Advancement of the Internet of Things' (January 2017) <https://www.ntia.doc.gov/files/ntia/publications/iot_green_paper_01122017.pdf> accessed March 20 2018.

9 *TCL Communication Technology Holdings, Ltd., Et Al v Telefonaktiebolaget LM Ericsson, Et Al*. (2017) United States District Court, Case 8:14-cv-00341-JVS-DFM.

10 European Commission, 'Setting out the EU approach to Standard Essential Patents' COM (2017) 712 final <https://ec.europa.eu/docsroom/documents/26583> accessed 10 January 2018.

11 ibid.

ABOUT O.P. JINDAL GLOBAL UNIVERSITY

O.P. Jindal Global University (JGU) is a non-profit global university established by the Government of Haryana and recognised by the University Grants Commission (UGC). JGU was established as a philanthropic initiative of its Founding Chancellor, Mr. Naveen Jindal in memory of his father, Mr. O.P. Jindal. JGU has been awarded the highest grade 'A' by the National Accreditation & Assessment Council (NAAC). JGU is one of the few universities in Asia that maintains a 1:13 faculty-student ratio and appoints faculty members from India and different parts of the world with outstanding academic qualifications and experience.

The vision of JGU is to promote global courses, global programmes, global curriculum, global research, global collaborations, and global interaction through a global faculty. JGU is situated on an 80-acre state-of-the-art residential campus. JGU is a research-intensive university, which has established several research centres. JGU has established eight schools: Jindal Global Law School (JGLS), Jindal Global Business School (JGBS), Jindal School of International Affairs (JSIA), Jindal School of Government and Public Policy (JSGP), Jindal School of Liberal Arts & Humanities (JSLH), Jindal School of Journalism & Communication (JSJC), Jindal School of Art & Architecture (JSAA), and Jindal School of Banking & Finance (JSBF).

ABOUT JIRICO

Jindal Initiative on Research in IP and Competition (JIRICO) is an initiative of JGU. It focuses on initiating and complementing well-informed policy related deliberations that can result in concrete reforms. Towards this end, JIRICO seeks to become a leading think-tank that engages in interdisciplinary and high-impact work. This involves contributions from experts in the fields of intellectual property law, competition law, economics and management. Further, JIRICO focuses on global developments, with a special emphasis on the Indian policy environment, which inform stakeholders about the issues in this niche area. JIRICO provides a unique platform to facilitate dialogue amongst industry partners, policymakers, regulators, practitioners and academicians.

O.P. Jindal Global University at a Glance

People

3500+ *Students*

FEMALE 42% | MALE 58%

300 *Faculty*

FEMALE 45% | MALE 55%

300 *Non-teaching staff*

FEMALE 26% | MALE 74%

1:13 *Faculty-Student ratio*

37 *Average age of faculty members*

1400 *Alumni*

Faculty

3 *Rhodes Scholars*

53% *Alumni from the top 200 global universities*

20% *International faculty from 20 countries*

Students

UNDERGRADUATE 90% | MASTERS / DOCTORAL 10%

70% *Students on scholarships*

29 *Indian States & Union Territories represented by students*

20 *Countries represented by students*

Schools

22 *Programmes*

14 Undergraduate Programmes
7 Postgraduate Programmes
Doctoral Programme

8 *Schools*

- Jindal Global Law School — India's First Global Law School
- Jindal School of International Affairs — India's First Global Policy School
- JINDAL GLOBAL BUSINESS SCHOOL
- Jindal School of Liberal Arts & Humanities — India's First Transnational Humanities School
- Jindal School of Government and Public Policy — India's First Public Policy School
- Jindal School of Journalism & Communication — India's First Global Media School
- JINDAL SCHOOL OF ART & ARCHITECTURE — India's First Interdisciplinary School of Built Environment
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Research

2000+ *Publications*

50+ *Interdisciplinary research centres*

3 *Research & capacity building institutes*

JILDEE — Jindal Institute of Leadership Development and Executive Education

JINDAL INSTITUTE OF BEHAVIOURAL SCIENCES

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87 *Student exchange collaborations*

66 *Faculty exchange & development programmes*

25 *Joint research collaborations*

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QS I-GAUGE — Indian University Rating — DIAMOND

2018

- Recognised & Granted Autonomy by University Grants Commission
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- Member of Association of American Colleges and Universities
- Member of Association to Advance Collegiate Schools of Business
- Member of International Development and Public Policy Alliance
- Member of Association of Indian Universities