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FAIR STANDARDS ALLIANCE AN INTRODUCTION

The Fair Standards Alliance is a European based association that has been incorporated to promote in the European Union and beyond a number of Key Principles regarding the licensing of standards-essential patents (SEP's) on a fair and reasonable, and non-discriminatory (FRAND) basis.

Our membership is broad and diverse, ranging in size from multinationals to SME's, and coming from different levels of the value chain across a diversity of industry sectors. Our members significantly contribute to European innovation and the European economy. For 2014, the aggregate turnover of the Alliance founding members was more than 430 Billion Euros, and in aggregate our members spent more than 32 Billion Euros on R&D and innovation. Alliance members directly employ more than 390,000 people within the EU alone, and have more than 164,000 patents that are either granted or pending.

Standards are important enablers for a competitive and dynamic European market where innovation and interoperability go hand in hand. In order for standards to be successful and widely taken up by the market, the Alliance believes that it is crucially important to ensure not only that SEP holders are appropriately compensated for their contributions to innovation, but also that there are fair, balanced, and rational practices in the licensing of standards-essential patents.

FRAND – which is a commitment to license on Fair, Reasonable and Non-Discriminatory terms – must have a clearer meaning in order for standards to promote innovation, economic growth, competition, and consumer choice. The Alliance believes that FRAND should, for example, mean the following (but not in any order of importance):

- (1) A license for a SEP should be available at any point in the value chain where the standard is implemented, and the important terms of those licenses should be transparent to other companies implementing the same standards;
- (2) A FRAND royalty should reflect the value of the invention. In most cases that means that it should be based on the smallest device that implements those patents, and additionally it should take into account the overall royalty that could be reasonably charged for all patents that are essential to that standard;
- (3) Injunctions and similar legal threats should be a last resort;
- (4) A FRAND commitment made in respect of a SEP should not fall away simply because the SEP is sold to another company.

Our members are united in the view that unfair and unreasonable SEP licensing practices pose a significant risk to the innovation eco-system, create barriers to entry for new market



players, threaten to stifle the full potential for economic growth across major industry sectors, and ultimately harm consumer choice.

This paper further outlines the importance of these issues and the views of the Alliance.

A Background – Why FRAND matters

In today's connected ecosystems, different products made by different companies must be able to work together. Without standards creating that interoperability, the ability of companies to provide meaningful innovative products to consumers is limited. Standards provide common, interoperable platforms which companies can use as the basis for competitive differentiation. Such platforms not only generate competitive mass markets, but also enable the supply chain efficiencies needed for industry to provide leading-edge innovation to consumers at affordable prices.

Successful standards provide market players with the confidence required to invest in implementing those standards (for example, by making the necessary investments in developing, manufacturing and marketing standard-implementing products) and to add their own unique, product-differentiating technologies to standardised features. Consumers benefit from the availability of such distinctive, yet interoperable, products at reasonable costs.

Policy makers have long recognized the importance of standards for innovation and competitiveness and have put regulatory and legislative frameworks in place to foster successful standardisation. The European Commission's recently published Digital Single Market and Single Market Strategies both emphasize the importance of a strategic approach to standardisation for boosting the European Union's further economic growth, and elevates the recognition of the importance of standards to a matter of primary concern.

However, it is equally broadly recognised that only *fair* standards practices can deliver on the potential for enabling innovation and growth. There are a number of aspects that make a standard fair. The majority of successful standards-setting organisations today have adopted such fair standards in their by-laws. However, common adherence to one important attribute of fairness in standards has failed to keep pace with developments in competitive market ecosystems – namely fairness in the licensing of standards-essential patents. Standards-essential patents, or SEPs, are patents that cover inventions that are required to practice the standard, so that one cannot build a standards compliant device without implementing the invention covered by a SEP.

Because the core objective of standardisation is the wide-spread adoption of the technologies it describes, participants in most standards-setting organisations voluntarily agree to grant licenses to their SEPs on "Fair, Reasonable and Non-Discriminatory" (FRAND) terms. These FRAND commitments accomplish two goals: Firstly, implementers of a standard can feel secure that they can get licenses on fair and reasonable terms, and secondly, the SEP holders can receive appropriate remuneration for their patented inventions.

Abuses of commitments to license standards-essential patents on fair, reasonable and non-discriminatory terms are the Fair Standards Alliance's primary concern. Where such abuses occur, or where the possibility for them to occur is tolerated, the ability of standards to contribute to innovation and economic growth at large is at risk.



B. Key Principles for FRAND licensing

1 FRAND should mean Fair and Reasonable and Non-Discriminatory to All

Many standards setting organisations provide in their intellectual property rights policy (IPR Policy) that SEP's shall be available for license by any company wanting to manufacture and sell equipment.

However, some SEP holders say they will only grant licenses at the end-product level, presumably in the hope that they can tax a much larger royalty base than just the price of the component supplying the patented functionality. Some SEP holders even seek royalties from **users** of such end products; this has gone as far as demanding royalties from coffee shops, restaurants, or hotels that offer WiFi-based wireless connectivity to their customers. When inappropriately seeking royalties only from parties at the higher end of the value chain, SEP owners are potentially rewarded for innovations that have nothing to do with their SEPs.

The SEP holder seeking FRAND compensation for its valid and infringed SEPs should receive the same royalty regardless of where it licenses in the supply chain. For example, if the SEP's value is €X, that value remains the same even if the component incorporating the SEP is bundled in a complex multifunction device or if applied in an end-user application.

The Alliance believes that SEP holders breach their FRAND commitment when they refuse to license implementers simply because of their position in the product supply chain. Such refusals violate the basic commitment to license on a non-discriminatory basis. Tolerating discriminatory refusals to license threatens to undermine incentives for a wide variety of standard-setting participants, who will be prevented from licensing the standard they helped to develop.

Therefore, the Alliance believes that holders of FRAND-encumbered SEPs should offer licenses on fair and reasonable and non-discriminatory terms to all companies, organisations, and individuals at all levels of the supply chain of an end product who implement, or wish to implement, the relevant standard, in accordance with the terms of the applicable IPR Policy of the relevant standards setting organisation.

2 Injunctions Should Be Available Only in Limited Circumstances

Nobody can implement a standard without implementing the SEPs associated with that standard. If a product is to meet the requirements of the standard, it is not possible to design around it, the implementer therefore being 'locked-in'. This puts SEP holders in powerful positions because, if the patent is valid and infringed, the SEP holder has the right under patent law to apply at Court for an injunction to stop the product being sold.

The ability of a SEP holder to threaten a good-faith implementer with an injunction distorts licensing negotiations to the detriment of that implementer. A rational implementer can be coerced into accepting to pay higher-than-reasonable royalties just to avoid the risk of being barred from selling its product.

An owner of a SEP who has voluntarily committed to provide licenses to its SEP is acting unfairly, and is reneging on its FRAND commitment, when threatening such an implementer with an injunction. Good-faith implementers who are willing to license the SEP they use should not be faced with that risk. Simply asserting defences, questioning the validity or



essentiality of SEPs, or asserting counterclaims should not mean that a potential licensee is acting in bad faith or is an 'unwilling' licensee.

The Fair Standards Alliance welcomes the fact that the Court of Justice of the European Union reviewed some of the issues relating to SEP injunctions in the case of *Huawei Technologies Co. Ltd v. ZTE Corp., ZTE Deutschland GmbH* and the Alliance hopes that SEP holders and national Courts will interpret and implement the decision in accordance with the Alliance's Key Principles.

The Alliance's view is that a SEP holder must not be allowed to seek or enforce an injunction or other exclusionary remedies in relation to that SEP except in extremely limited circumstances.

3 Enhanced transparency regarding FRAND-encumbered SEP licensing

Many SEP holders operate their licensing programs under cloaks of secrecy, requiring potential licensees to enter into confidentiality agreements. These confidentiality agreements prevent companies from discussing the proposed or existing financial terms of the licenses (such as upfront payments or royalty rates) with any other companies. At the same time, during negotiations of licenses, SEP holders represent to potential licensees that other companies have accepted the financial terms of the proposed license. Because of the confidentiality restrictions imposed on the prospective licensee (and other licensees) the prospective licensee is unable to verify if what the SEP holder has represented is true.

By making SEP licensing information transparently available, a level playing field will be created and companies will benefit from enhanced cost predictability for their products, irrespective of size or negotiating power, and end-users will be able to make more informed purchase choices.

The Alliance therefore wishes to encourage SEP holders to be open and transparent regarding, amongst other things, which companies in the supply chain are licensed, the FRAND royalties that are charged, how they are calculated and other licensing conditions.

4 A FRAND promise should extend to a transferee if the SEP is sold

In recent years a practice has developed where some SEP holders divide up or 'fragment' their portfolios of patents. Transferring ownership of SEPs in principle should not present a problem in the context of SEP and FRAND licensing, and parties generally should be free to transfer patents as they see fit - provided the recipient respects the previously committed licensing obligations.

Problems can arise if SEPs are transferred to new owners that do not abide by the FRAND commitments made by the former owner. If the licensing commitments do not transfer with SEPs, SEP acquirers may refuse to offer FRAND terms to implementers of the relevant standards. Furthermore, the diffusion of SEP portfolios over more and more independent owners can exacerbate the problem of royalty stacking – namely that the royalties independently demanded by multiple holders of SEPs on the same standard do not account for the presence of other SEPs on the same standard and thereby lead to an inappropriately high overall royalty.



The Alliance believes that if a FRAND-encumbered SEP is transferred, the initial transferee and all subsequent transferees must remain bound by the FRAND commitment. The Alliance would like standards-setting organisations, policy makers and regulators to remain vigilant in addressing such circumstances, and to ensure that patent assertion entities are not utilized as mere proxies to obscure behaviour that seeks to get around FRAND commitments and that would be more obviously abusive if pursued directly.

5 No Patent Tying - Only Relevant Patents should be Required to be Licensed

Portfolio licensing (whether for SEPs to a particular standard, all patents relevant to a particular type of device, or to a company's entire patent portfolio) can be an attractive choice for companies because it can reduce costs and administrative burdens. Rather than having to license patents piecemeal, a portfolio-wide license can provide stability and predictability and can promote "patent peace" between companies for a number of years. .

However, these business incentives for entering into portfolio licenses should not mean that a licensee must be *required* to license a SEP holder's entire patent portfolio if it does not practice all of the inventions.

It is important to maintain the right of a potential licensee to only license the patents it needs from a SEP holder, including taking a license to less than a full portfolio. For example, a provider of cellular phones or components likely will have no need for a license for network infrastructure SEPs. Likewise, a company that operates only in a particular country or geographic region should not be required to pay for worldwide rights that it does not need.

While some parties may voluntarily and mutually agree to broader licenses, a holder of a FRAND-encumbered SEP should not be able, as a condition of granting a FRAND license to the SEP, to require implementers to (i) take licenses to patents that are not essential to the standard, or that are invalid or not infringed by the implementer; or (ii) grant a license to the implementer's patents that are not essential to the standard.

6 Fair and Reasonable Royalties

The calculation of a FRAND royalty in any specific case can be complex and may reflect many case-specific factors. Nevertheless, there are also many generic factors that should always be considered when determining what constitutes a fair and reasonable royalty or licensing fee. Taking such generic factors into account will aid the efficiency of licensing negotiations between SEP licensors and licensees, and could reduce the need for parties to resort to litigation to establish a FRAND royalty.

Owners of SEPs should receive fair and reasonable compensation for the contributions they make to innovation by making their inventions available to a standard. However, they should not receive compensation based on anything beyond the inventive value of the patented invention itself.

Royalty rates for SEPs that do not take into account the value of innovation and investment added by implementers of standards unjustly enrich SEP owners based on the contributions made by others. This artificial burden on innovation will ultimately stifle industry's ability to offer value-for-money to consumers.



In order to implement this principle, the following (non-exhaustive) list of considerations should be taken into account, and appropriately applied to each specific case:

(a) Fair and reasonable royalties for a SEP must not tax features of a product that are unrelated to the patented invention

Some SEP holders suggest that licensing rates should be based on downstream uses of standardised technology. Licensing policies that seek to charge such rates are unfair – they violate the FRAND commitment because they seek compensation for unpatented technologies or technologies that the patent holder did not invent or create. For example, when a smartphone has an innovative user interface that helps drive consumer demand for that device, the owner of a patent essential to a cellular standard should not be permitted to use that patent to appropriate any portion of the value of the user interface. Instead, in most circumstances, FRAND licensing rates should be determined with reference to the device, or the part of the device, that implements the patented invention; this ensures that the patent holder obtains fair compensation for what it actually invented, and *not* compensation for the value of others' work or contributions. In other words, the price of a brick should be independent of whether that brick is used for building a garage or a mansion – and the royalty for a SEP associated with a standard that enables an Internet of Things (IoT) device to be wirelessly connected to other IoT devices (or the cloud) should be independent of whether that first IoT device is a smart watch, a refrigerator or a car.

That is why it is so important to not blindly base royalty rates for SEPs on the overall value of an end device that makes use of the SEP's invention, but to rather carefully consider the actual value that the SEP contributes to that end device. Often, that assessment can greatly be aided by considering the smallest component that actually implements the patented invention. When that part can be isolated as a separately saleable unit (a brick for building various types of buildings), a fair royalty rate will typically bear a relation to the price of that unit.

(b) Fair and reasonable royalties for a SEP must not exploit the fact that the standard cannot be implemented without licensing the SEP

A FRAND royalty must reflect only the value of the SEP, not the additional value conferred on it by its inclusion in the standard. The value of the standard reflects contributions from the entire community that developed the standard, and from the ecosystem having adopted the standard, rather than by the SEP holder alone.

Standards have inherent value attributable to the common agreement for all to use the same technology to ensure interoperability between manufacturers' products. SEP owners greatly benefit from having their patents included in a standard because adoption of their invention is no longer driven only by the merit of that invention in itself, but by the commercial imperative for market players to make their products interoperate with the ecosystem of all other products using the same standard. Market players will therefore implement the SEP, even when it only covers a small detail of the standard's functionality that does not present a significant technical challenge, but where the technical specification simply required choosing one of several possible solutions for completeness. Standardisation can transform the



potential licensing revenue of a patent dramatically if each and every device complying with the standard will necessarily use it.

Standardisation can also significantly lower the patent holder's cost involved in finding out who is using their patent and can be approached for compensation.

In choosing to make a FRAND commitment, a SEP holder willingly makes a trade-off in return for these benefits. Unlike the more general patent holder, the SEP holder has voluntarily accepted as part of the quid pro quo of standardisation that the per-unit royalties it may earn will be constrained by the "fair, reasonable, and non-discriminatory" commitment.

A FRAND license must not reward SEP holders for the value associated with the standard itself but for only the technical contribution of the SEP to the standard. Seeking value attributable to standardisation would be unjust and an attempt to co-opt the work of others and of the standardisation process.

(c) Fair and reasonable royalties for a SEP must take into account the actual and potential aggregate royalty demands for other SEP's

A FRAND rate must consider royalties for other patents required to implement the standard. The goal of widespread adoption of a standard cannot be achieved if these aggregate demands are not considered when determining a FRAND rate, or else a "royalty stack" will be created that makes implementing the standard uneconomical.

Some SEP licensors have suggested that royalty stacking is merely theoretical. But as a practical matter, no rational SEP licensee views a single SEP licensing negotiation in isolation; rather, the licensee necessarily views the current negotiation in the context of past and future negotiations for all SEPs needed to practice the standard (or at least those for which it is reasonably foreseeable that will be demanded).

Accordingly, the rational willing licensee will not agree to pay royalties for a single license that would make it uneconomical to sell a product that implements the standard. It follows that the licensee necessarily will need to take into account the potential royalty stack, even in its first negotiation.

Moreover, taking action to address royalty stacking only *after* a prohibitively expensive royalty stack has been created necessarily will not prevent harmful effects from royalty stacking. If the first royalty is not set in light of the potential aggregate demands to come, a disproportionate share of royalties would go to those SEP holders first in line, without regard to the relative value of their SEP, simply because they acted quickly and aggressively to demand higher than appropriate royalties.

(d) Fair and reasonable royalties for a SEP must take into account the fact that prices come down over time and that SEP holders may be remunerated for use of their technology in other parts of the value chain

Many licensors seek to charge fixed prices per unit, or provide fixed monetary caps or minimums, as part of their licensing programmes. These programmes often do not sufficiently take into account the fact that the prices of products reduce over time.



Similarly, SEP licensing programmes should take account of the fact that the SEP holder may also be financially benefiting in other parts of the eco-system and value chain from use of standardised technology.

12th November 2015

Notes

The list of issues and points raised in this note is not exhaustive. The Alliance will be preparing further Papers with more detailed positions on these and other issues in the SEP/FRAND debate. The positions and statements in this paper do not necessarily reflect the detailed individual corporate positions of each member.