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INPUT IN RESPONSE TO EU COMMISSION WORKSHOP ON STANDARD ESSENTIAL PATENTS IN THE CONTEXT OF NEW ICT STANDARDIZATION DEVELOPMENTS, HELD ON 25 JANUARY 2017

Introduction

The Fair Standards Alliance (FSA) thanks the European Commission for organizing on 25 January 2017 the workshop on Standard Essential Patents in the Context of New ICT Standardization Developments, and for inviting further input and recommendations.

A proper framework for fair licensing of standards-essential patents is key for the European Union to stay at the forefront of innovation and economic growth. While the research papers discussed at the workshop were an excellent start, the FSA cautions that the development of guidelines on FRAND requires further research and input from affected parties. The plan to issue such guidance by the summer of this year does in our view not leave sufficient time for stakeholders to digest the various studies, evaluate the implications, and provide feedback on the topics the Commission has identified. Protecting Europe's innovation ecosystem requires careful consideration. It is essential to get this right. If not, any guidance risks to do more harm than good to European consumers and the European economy, as innovations like Internet of Things and 5G emerge.

The FSA wishes to contribute to further progressing the substantive assessment. Therefore, we offer in this document our insights, perspectives and recommendations on the matters discussed at the workshop, and highlight those principles we consider important in the framework of the licensing of SEPs for which a FRAND commitment has been provided.

1. "Improving access, transparency and quality of SEPs declarations and databases"

The FSA supports the Commission's objective to improve transparency and quality of SEP declarations.

Where specific disclosures are part of an SDO's IPR policy, such disclosures should be made early on in the SEP declaration process. We understand that, to reduce over-disclosure, the Commission is considering advocating for rules that would require participants in standards development to declare at least one section of the standard to which the declared patent family applies. The FSA supports

such efforts.¹ Furthermore, in order to maintain the value of information provided during the disclosure process, it also seems reasonable - and necessary - to require reasonable effort to correct erroneous information that is provided in such declarations as a draft standard develops and at the latest as the standard is adopted.

The Report for the European Commission on “Transparency, Predictability, and Efficiency of SSO-based Standardization and SEP Licensing” also suggests to establish “*random testing of a portion of each portfolio of declared SEPs*”, “*to determine the share of the patents which are indeed essential to the standard*”.² While this is an interesting and well-intended suggestion, we believe that its implementation would entail many practical hurdles. It could ultimately fail to deliver the hoped-for improvement, as it may be difficult to obtain a truly objective analysis, while the outcome would not be definitive until determined by a court.

2. “Clarifying core elements of an equitable, effective and enforceable licensing methodology around FRAND principles”

Fundamentally, we believe that the core principles of “an equitable, effective and enforceable licensing methodology” for SEPs for which a FRAND commitment has been provided should be designed to facilitate good-faith negotiations and to reduce the need for parties to seek recourse to courts or arbitrators.

The notion that “*FRAND is a range, and FRAND royalties will be achieved as the result of appropriate behavior of parties during negotiation*” is incomplete without introducing guiding principles that set signposts as to what licensing terms are consistent with the FRAND obligation. Some important cornerstones for what constitutes good-faith negotiation behavior on SEP licensing have been established with the CJEU’s Huawei-ZTE ruling, but when seeking to implement that ruling, SEP holders and standards implementers are faced with the significant hurdle of designing FRAND offers/FRAND counter-offers with very little guidance on what actually constitutes a FRAND offer/counter-offer. The lack of an umbrella of common expectations of what FRAND means will not only hamper good-faith negotiations, but also puts good-faith patent holders and implementers at risk of losing out on legitimate claims and defenses against bad-faith behavior.

While it would not be appropriate for the Commission to set a single pre-defined methodology to calculate the value of a FRAND royalty, or to determine a closed set of FRAND terms, the Commission needs to establish the criteria and guidelines for licensors and licensees to consider when designing and reviewing licensing offers under a FRAND commitment.

Such guidelines should reflect at minimum the following points:³

- *FRAND should mean Fair and Reasonable and Non-Discriminatory to ALL.* Holders of FRAND-encumbered SEPs should offer licenses on fair and reasonable and non-discriminatory terms to all companies, organizations, and individuals at all levels of the supply chain of an end

¹ As this information seems already to be provided by declarations in the majority of declarations before ETSI, it seems that such a requirement, when applied to ETSI, could provide useful information without unduly burdening companies making such declarations.

² Report for the European Commission on “Transparency, Predictability, and Efficiency of SSO-based Standardization and SEP Licensing” (also referred to as “CRA Report”), available at <http://ec.europa.eu/DocsRoom/documents/20506/attachments/1/translations/en/renditions/native>, page 86.

³ See in particular the FSA position paper “Key Principles” (12 November 2015), available at <http://www.fair-standards.org/wp-content/uploads/2016/08/FSA-POSITION-PAPER-June2016.pdf>.

product who implement, or wish to implement, the relevant standard or respective portions of the standard. Refusing to license implementers of a SEP simply because of its position in the product supply chain, or under the pretext of more efficient licensing or under an alleged necessity to track and identify final usage amounts to a breach of a FRAND commitment, and violates the basic commitment to license on a non-discriminatory basis.^{4/5} Tolerating discriminatory refusals to license SEPs threatens to undermine incentives for a wide variety of standard-setting participants, who will be prevented from licensing the standard they helped to develop. This principle has also been recognized in the Commission's Guidelines on the applicability of Article 101 TFEU to horizontal co-operation agreements.⁶ Deviating from this principle or allowing for exceptions will create confusion, and simply be wrong. We also refer to the FSA's position paper on the topic for further details.⁷

- *Fair and reasonable royalties for a SEP must not be a 'tax on innovation'*. Licensing policies that seek to charge licensing rates based on downstream uses of standardized technology are unfair and violate the FRAND commitment because they seek compensation for unpatented technologies or technologies that the patent holder did not invent or create. We take issue with the idea discussed at the workshop that "FRAND implies use-case based licensing". We recognize that there may be situations where use-cased based licensing could be appropriate, as a voluntary mutually agreeable alternative. It would however be wrong to establish it as a general paradigm or mandated solution. If generally licensing SEPs at different royalty rates based on the application the licensee develops, a patent owner may seek compensation for value that it did not create, for technologies that it did not invent, and for innovations for which it cannot rightfully claim credit.

This is not a new or surprising perspective: Patents are valued based on the claimed invention – not on the value added by others who make specific application of the patented invention. Furthermore, a paradigm of use-case based licensing of SEPs would be of increasing concern in a digitized world where Information Communications Technology (ICT) has become an integral part of our economies and societies. It is critical that input costs, such as the royalty expense of licensing SEPs, be reasonable, so that creators and manufacturers of products that define the Internet of Things (IoT) can make the investments necessary to bring innovative products to market. Lack of clarity regarding SEP licensing

⁴ It also disturbs the supply of products in the established value chain. In practice, there are contractual obligations in the value chain for the supplier to deliver products free of legal faults, so that they can be used without infringing patents. Suppliers will not be able to fulfill their responsibilities in case SEP holders have no legal obligation to provide a FRAND license to any user in the value chain. Unclear licensing behavior of SEP holder and lack of rules result in interferences of the synergy between supplier and implementer. The unpredictable warranty risks bears the risk of delivery stops of the suppliers and increased product prices.

⁵ Such licensing approach may be considered "effective" and "convenient" to a SEP licensor, but such "convenience" is only marginal when compared to the efficiencies created by making FRAND licenses available throughout the supply chain.

⁶ "In order to ensure effective access to the standard, the IPR policy would need to require participants wishing to have their IPR included in the standard to provide an irrevocable commitment in writing to offer to license their essential IPR to all third parties on fair, reasonable and non-discriminatory terms ('FRAND commitment')" (para 285) – Commission's Guidelines on the applicability of Article 101 TFEU to horizontal co-operation agreements OJ [2011] C11/1 (also referred to as "Horizontal Cooperation Guidelines"), available at

[http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011XC0114\(04\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52011XC0114(04)&from=EN).

⁷ The FSA position paper "SEP licenses available to all" (24 June 2016), available at <http://www.fair-standards.org/wp-content/uploads/2016/09/160624-FSA-Position-Paper-SEP-licenses-available-to-all.pdf>.

practices will hinder – rather than enable – the take-up of these digital technologies. We refer to the FSA’s position paper on this topic for further details.⁸

Furthermore, as patents should be valued based on the claimed invention, 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. It is 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 SEPs contribute to the technology addressed by the invention. 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 (e.g., a brick for building various types of buildings), a fair royalty rate will typically bear a relation to the price of that unit.

- *Linking FRAND royalties to a reasonable return on R&D would incentivize inefficient innovation.* According to the JRC report, “*the royalty rate must at least correspond to the cost of R&D to be socially efficient*”.⁹ Care must be taken to not misinterpret this by falsely seeking to balance out individual investments. On the individual level, patents can be no more and no less than an *incentive* for innovation. They provide an opportunity for creating profit from an invention, but not a guarantee for compensating R&D investments, especially for previously failed inventions that were never implemented and therefore add no value themselves. The value of a SEP is independent of hours spent in contributing to standards development. This is also recognized in the Commission’s Horizontal Cooperation Guidelines, which state that “*In principle, cost-based methods are not well adapted to this context because of the difficulty in assessing the costs attributable to the development of a particular patent or groups of patents*” (para 289).

Indeed, we are not aware of any competitive market economy where particular companies are guaranteed a return on investment. SEP owners with licensing-based business models participate in standards development in the hope that they will be able to monetize their innovation by licensing patents to a significantly broadened base of implementers on FRAND terms. Linking FRAND royalties to a reasonable return on R&D would incentivize inefficient innovation by eliminating the need for technology developers with licensing models to focus on future market requirements.

- *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.

⁸ See the FSA position paper “Application-dependent SEP licensing” (30 August 2016), available at <http://www.fair-standards.org/wp-content/uploads/2016/09/FSA-Application-Dependent-Licensing-Paper.pdf>.

⁹ JRC Science for Policy Report: “Licensing Terms of Standard Essential Patent – A Comprehensive Analysis of Cases” (2017), p. 138, available at <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC104068/jrc104068%20online.pdf>.

- *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. As indicated in the CRA Report, “*patent ownership dispersion and thus royalty stacking matters and should therefore be taken seriously when discussing SEP licensing rules*”.¹⁰
- *Enhanced transparency regarding FRAND-encumbered SEP licensing.* SEP holders that are willing to provide demonstrably non-discriminatory rates should be open and transparent about the rates they seek to charge for their SEPs, what patents are being licensed, and their basis for believing that the patents are essential, valid SEPs. By requiring extensive secrecy from all licensees, some SEP holders seek to prevent prospective licensees from knowing the terms that have been offered to others, and thereby from reliably evaluating whether the terms they are negotiating are FRAND. The FSA supports transparency in FRAND licensing, similar to the conclusions reached in the CRA Report.¹¹ While voluntary provisions regarding confidentiality certainly are permissible, the use of SEP leverage to *force* potential licensees to accept excessive secrecy is improper. In addition to harming the particular licensees involved, such practices harm the public interest in ensuring a robust and fair SEP licensing ecosystem. We refer to the FSA’s position paper on the topic for further details.¹²
- *Injunctions Should Be Available Only in Limited Circumstances, and requests be reviewed in accordance with the principles of equity and proportionality.* The ability of a SEP holder to threaten a good-faith implementer with an injunction distorts licensing negotiations to the detriment of that implementer. Therefore, when deciding on the appropriateness of injunctive relief in respect of one or more SEPs, factors such as the market participation of the patent holder, proportionality, and the interests of the general public should be taken into consideration. We refer to the FSA’s position paper on the topic for further details.¹³
- *A FRAND promise should extend to a transferee if the SEP is sold.* If a FRAND-encumbered SEP is transferred, the initial transferee and all subsequent transferees must remain bound by the FRAND commitment.
- *No Patent Tying – Only Relevant Patents should be Required to be Licensed.* 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.

¹⁰ CRA Report, page 19.

¹¹ As stated in the CRA Report, “[t]ransparency would be further enhanced if royalty rates determined through arbitration were made public and if confidentiality clauses could not be unilaterally imposed by one of the contracting parties” (page 89).

¹² See the FSA position paper “Transparently FRAND: The Use (and Misuse) of Confidentiality Obligations in FRAND Licensing Negotiations” (15 February 2017), available at <http://www.fair-standards.org/wp-content/uploads/2017/02/170213-FSA-Position-PaperTransparency-FRAND-1.pdf>.

¹³ The FSA position paper “Injunction in accordance with the principles of equity and proportionality” (23 January 2017), available at <http://www.fair-standards.org/wp-content/uploads/2017/01/FSA-Injunction-Position-Paper-23-January-1.pdf>.

3. “Facilitating the efficient and balanced settlement of disputes”

Negotiation is the favored way to reach a license agreement. However, when parties disagree, recourse may be needed to courts or Alternative Dispute Resolution (ADR) mechanisms, such as mediation or arbitration. Neither the choice to resolve a dispute in court nor the choice to use ADR should imply that a potential licensee is “not willing”.

Conflicts over SEP licenses under FRAND terms cannot be resolved by simply setting a FRAND rate based on an automatic assumption of essentiality, infringement, or validity of the SEPs the prospective licensor has asserted. Rather, as with any other infringement dispute, a SEP holder must prove its claims of validity, essentiality, and infringement if challenged by a prospective licensee. Such potential licensee must always have the right to employ the patent systems’ traditional mechanisms for challenging validity or infringement, and to raise any other relevant defenses. Permitting challenges to the merits of a given patent is pro-competitive, and ensures that only true innovators are rewarded with patent rights.¹⁴

Alternative Dispute Resolution

As set out in the FSA’s position paper on this topic,¹⁵ it is essential to provide incentives to both licensors and licensees to negotiate in good faith on FRAND terms rather than to litigate. However, in case parties do not come to an agreement, and need to resort to other means in order to solve their disputes, it is important that measures are in place to facilitate the fair and balanced settlement of SEP licensing disputes. The fact that those disputes occur on the basis of a specific FRAND commitment means that those measures may be different than those applicable to other litigation cases.

In instances where parties pursue ADR mechanisms for resolving SEP licensing disputes, the parties should each be entitled to employ at least the following FRAND principles in the procedural rules of the mediation/arbitration procedure:

- *Voluntary nature*: Both parties must be able to freely agree whether to arbitrate/mediate the FRAND dispute (including on the rules of those proceedings) instead of litigating in courts;
- *Consideration of the merits under the traditional rules concerning the burden of proof*: The potential licensee’s rights under patent laws to challenge the validity, essentiality, or infringement of the alleged SEP cannot be compromised in the name of licensing efficiency. The SEP holder should have the burden of proving its entitlement to FRAND royalties through a showing that it owns infringed patents actually essential to the standard (and whether the used features of the standard are mandatory or optional) and withstanding any challenges to validity, enforceability, or any other defenses. ADR should not simply be a matter of setting a rate if the licensee contests the SEP holder’s claims. A party should not be considered “unwilling” to reach an agreement or to enter into mediation or arbitration proceedings

¹⁴ As stated in the European Commission’s Guidelines on Technology Transfer Agreements, „*In the interest of undistorted competition and in accordance with the principles underlying the protection of intellectual property, invalid intellectual property rights should be eliminated. Invalid intellectual property stifles innovation rather than promoting it*” (Guidelines on the application of Article 101 TFEU to technology transfer agreements, [2014] OJ C89/03, para 134).

¹⁵ The FSA position paper “Facilitating the Fair and Balanced Settlement of Disputes on SEPs” (15 February 2016), available at <http://www.fair-standards.org/wp-content/uploads/2017/02/170213-FSA-Position-Paper-Facilitating-the-Fair-and-Balanced-Settlement-of-Disputed-on-SEPs.pdf>.

because it does not agree to the proposed procedural rules governing such mediation or arbitration, or to a proposed mediator or arbitration tribunal;

- *Ability to appeal*: All aspects of arbitral findings are appealable to a court, in accordance with the relevant review standards;
- *Appropriate Openness*: While there are certainly aspects of an arbitration that should be confidential, or that parties should be able to keep private, in order to provide transparency and allow potential licensees to verify claims of fairness and non-discrimination, some aspects of a FRAND arbitration should be made public, including findings of validity, infringement, and the FRAND terms and conditions. The more data points regarding FRAND terms that are publicly available, the less often parties need to resort to litigation as both will have a better understanding of the likely outcomes; and
- *Balanced Composition and Process*: The composition of the panel should favor neither the SEP holder nor the potential licensee.

Regarding proceedings at court or similar tribunals, measures to reinforce the principles of fairness, equity, and proportionality by law, as well as harmonizing the law and its application, will facilitate fairness and balance of dispute resolution. Lawmakers and courts should make sure that these principles are applied in any decision concerning injunctive relief, provisional remedies, potential alternative measures, damages and rights of information as addressed e.g. in Articles 8, 9, 11, 12 and 13 of the European IPR Enforcement Directive.^{16, 17}

Conclusion

The FSA strongly supports the Commission’s intention to provide further clarity around the concept of FRAND licensing, as part of its overall agenda of promoting innovation and growth in Europe. Any such guidelines need to carefully reflect the interests of all stakeholders, and provide clarity on principles of what fair licensing entails. Not getting this right may have severe consequences on European business and consumers.

The FSA and its members thank the Commission for considering our views, and we look forward to continuing our constructive dialogue.

Note: the positions and statements in this paper do not necessarily reflect the detailed individual corporate positions of each member.

¹⁶ See also the FSA position paper “Injunction in accordance with the principles of equity and proportionality” (23 January 2017), available at http://www.fair-standards.org/wp-content/uploads/2016/09/FSA_Position_Paper_IPR_Enforcement_Directive.pdf.

¹⁷ Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights.

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About the Fair Standards Alliance

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.

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.

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. Annually, the aggregate turnover of the Alliance members is close to 2 trillion Euros, and in aggregate our members spend more than 100 Billion Euros on R&D and innovation. Alliance members directly employ just over 1 million people within Europe alone, and have more than 300,000 patents that are either granted or pending.

For further information, see <http://www.fair-standards.org/>.