



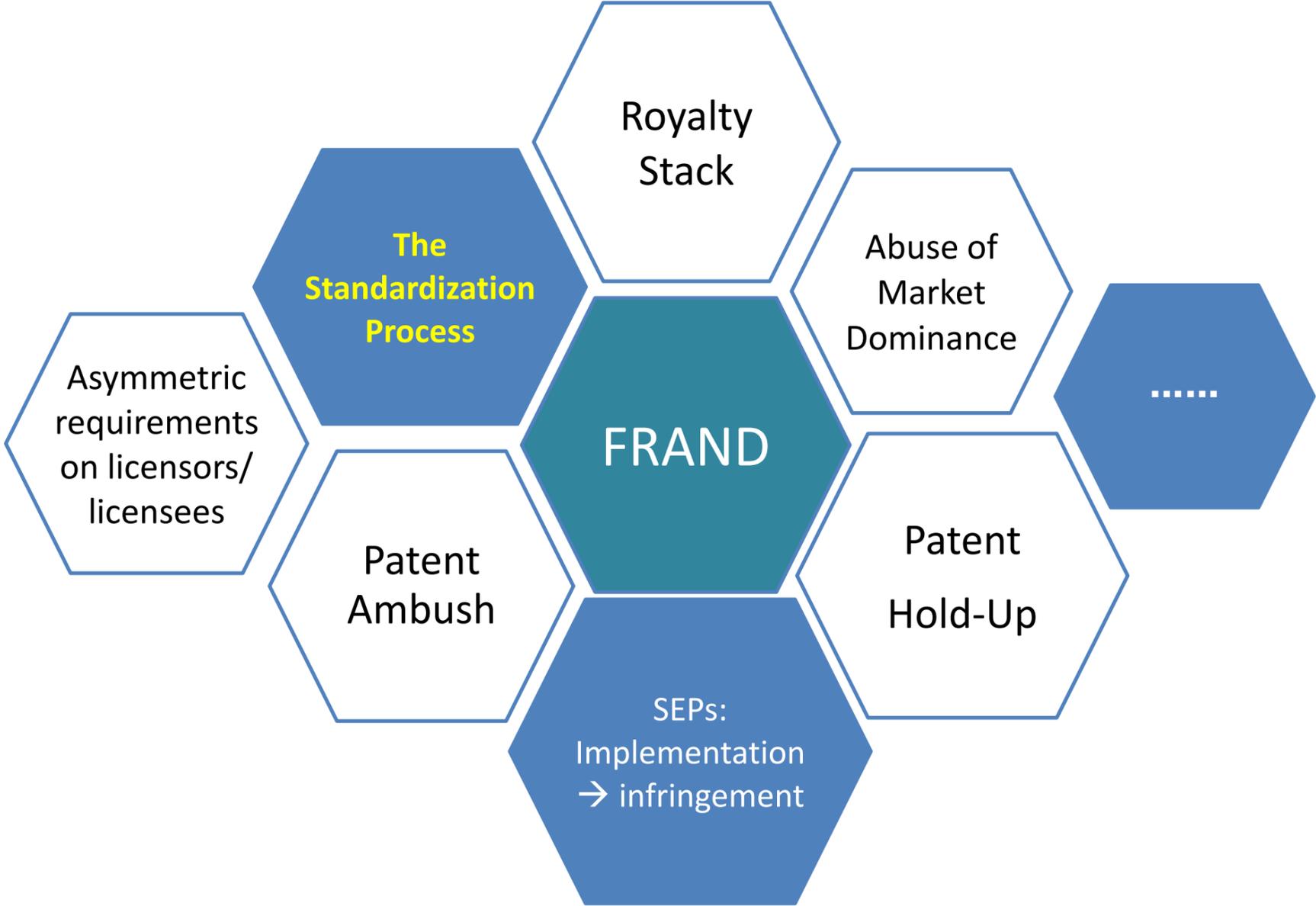
THE MEANING OF FRAND OBLIGATIONS AND HOW IT AFFECTS INNOVATION AND INDUSTRY DEVELOPMENT

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A General introduction of FRAND Obligations



FRAND principle imposes restrictions on SEP owner's pursuit of injunctions in litigation

1. A SEP holder may take advantage of its IP rights, using litigation as a tactic, to coerce the implementer to accept its licensing terms

Motorola v. Apple (a 2014 US case)

- The US court dismissed Motorola's request for the injunction, and held that *“the negotiation of royalties under **the threat of an injunction would give the patentee an excessive advantage**, which enable the patentee to gain the unreasonable (not compliant with the FRAND commitment) license conditions. This problem is particularly prominent when the patent only covers a small component of a complex product.”*



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Case AT. 39985 – Motorola – Enforcement of GPRS Standard Essential Patents, European Commission, Decision (2014)

- Motorola also sought and obtained an injunction against Apple Inc. in a German court through its SEPs, and the injunction lasted for several hours, forcing Apple to remove some of its products from online sales in Germany, and to accept the unfavorable license conditions on the day the injunction was enforced.
- The European Commission was of the opinion that **a temporary injunction on online sales of some of Apple products in Germany excluded the products that might be the most innovative and up-to-date into the market, limited consumers' choices and partially restricted downstream competition.** Because of the fast moving nature of the mobile device market and the short product cycle, even a short time period of exclusion can cause huge damages for Apple Inc.
- The European Commission concluded that Motorola has given an irrevocable commitment to license on fair, reasonable and non-discriminatory (FRAND) terms and conditions to the European Telecommunications Institute (ETSI). The pursuit of injunction by Motorola who is an owner of SEPs is an abuse of market dominance culpable under the EU competition Law.



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Huawei v IDC, Guangdong High People's Court (2013)

- “By initiating the injunction suit for essential patents against Huawei during negotiation, IDC was, in essence, compelling Huawei to accept the excessively stringent patent licensing conditions, instead of refusing to trade.”
- “On the surface, it is to exercise its legitimate litigation rights, but with the real purpose of compelling Huawei to accept the excessively high licensing conditions and to pay consideration for factors other than the essential patents. Therefore, such behaviors are not justifiable and shall not be allowed.”



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2. Dominant companies have a “**special responsibility**” toward the competitive process

Richard Whish and David Bailey, *Competition Law (8th edition)*

- “[T]he Court of Justice in *Michelin v Commission* Stated that a firm in a dominant position has a ‘special responsibility’ not to allow its conduct to impair undistorted competition on the internal market.”

Alison Jones and Brenda Sufrin, *EU Competition Law*

- “The EU Courts have consistently stressed that although the finding that an undertaking is in a dominant position is not a reproach, dominant firms have a ‘special responsibility’ towards the competitive process.”



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3. In the context of competition law, the dominant position, the abuse and the effects of the abuse do not have to be in the same market.

China :

- *The Announcement No. 22 of 2009 on Prohibition of Coca-Cola Company's Acquisition of Huiyuan Company*

The European Union :

- *British Gypsum v Commission*
The market for plaster (dominant), and the market for plasterboard (not dominance but conducted abusive act in this market)
- *Tetra Pak II*
The market for aseptic machinery and cartons (dominant), and the market for non-aseptic liquid repacking machinery and non-aseptic cartons on which Tetra Pak does not hold dominance is also an abuse of market dominance.
- *COMP/C-3/37.792 Microsoft*
Citing Tetra Par II, the European Commission concluded "Microsoft's dominance over the client PC operating system market has a significant impact on the adjacent market for operating systems for work group servers."
- [Factors considered]
The specific circumstances of the case



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4. In the context of Standard Essential Patents licensing, this *special responsibility* imposed on the SEP owners implies that the FRAND obligation not only restricts the activities taken based on the SEPs, but also the overall licensing practice. Threat of injunction to force the licensee to take the SEP owner's non-FRAND offers may be established based on non-SEPs

Existing legal framework

- Injunction may not be allowed in consideration of national interest and public interest, *Article 26 of Interpretation (II) of the Supreme People's Court on Several Issues concerning the Application of Law in the Trial of Patent Infringement Dispute Cases*.
- In cases of SEPs, injunction may not be allowed if the SEP owner intentionally violated the FRAND obligations and the implementer has no obvious fault, *Article 24 of Interpretation (II) of the Supreme People's Court on Several Issues concerning the Application of Law in the Trial of Patent Infringement Dispute Cases*.



Patent hold-up is a real and serious threat that has been proved by empirical studies and court decision



The holdup problem has been recognized by courts and standard setting organizations

- Holdup “is a substantial problem that [F]RAND [fair, reasonable, and nondiscriminatory licensing] is designed to prevent.” *Innovatio*
- It has been shown in the past cases that SEP holders tend to offer excessive royalties.

The court in *Microsoft v. Motorola* awarded patentees only **1/150** of the royalties the patent holder sought.

The originally offered rate was 2.25% per end product, \$6-8 per console for the use of patents reading on the 802.11 and H.264 standards. For the 802.11 standard, the court decided rate was 3.471 cents per console and 0.555 cents per unit for the H.264 standard.



Legal principles of patent law should be taken into consideration in the determination of FRAND rate

1. Patent exhaustion

The right of the patents reading into the component should be exhausted through the first sale of the component.

A patent holder should be entitled to just one reward

- To ensure the free flow of goods in the market
 - i. China: Beijing High Court, *To Understand and Apply Patent Infringement Determination Guidelines*
 - ii. US: *Lexmark*
- To avoid double dipping of patentees



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2. Royalty base: SSPPU

Devices integrated with numerous functions/technologies: the value of the specific component

- It was estimated that a 2016 smart phone already incorporated over 250,000 patents, which are 7 times higher than 2000.

Problems caused by using the end product prices as the royalty base

1) Royalty inflation

Allows a single SEP holder to extract excessive extra value from irrelevant components of the products.

2) Royalty discrimination

Allows a SEP holder to discriminate against different branded/priced products.

In industry practices, SSPPU provides a proper benchmark which may to the largest extent avoid the above mentioned problems.

- Some suggested that a low enough rate may resolve the royalty inflation problem. However, this is not true.
- Once a license agreement with royalty fee based on end product price is entered, any change of the end product price would affect the share of value the licensors may be able to extract. These license agreements usually last 3 to 10 year or even longer, it is unfair to the implementers.



Necessity of FRAND obligations



Downstream implementers

- Related component manufacturers
 - opportunity to obtain license
 - may make sure that its customers have no concern of being sued patent infringement to participate the market competition fairly.
- End product manufacturers
 - no longer face the threat of injunction
 - not take IP royalty as a heavy burden



Other SEP owners

- While the final goal is to secure the illegal licensing scheme offered by the patentee, it would extrude the share of the licensing fee belonging to other good faith SEP owners.
- Rewarded with a fair share for its technical contribution.





Thank you.

