FRAND: beginning with a three-pronged approach

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Standard-essential patent owners should begin by considering three major questions when crafting a strategy for licensing patents on fair, reasonable and non-discriminatory terms, say Steven Pepe, Kevin Post and Samuel Brenner of Ropes & Gray.

The owner of a patent that is essential to an industry standard (a standard-essential patent, or SEP) may be tempted to abuse the market power afforded by that patent's inclusion into that standard to "hold up" implementers by demanding excessive royalties.

To address this danger, most standard-setting organisations require that SEP owners commit to licensing their SEPs on fair, reasonable, and non-discriminatory (FRAND) terms. Of course, determining exactly what FRAND terms are in any given case remains challenging.

Before starting a licensing campaign, SEP owners should carefully consider how to structure their licensing offers (and agreements) in light of their ultimate end goals. This consideration will likely be driven by, among other things, the market(s) or standard(s) at issue and concerns over complying with their FRAND obligations.

For example, among the questions SEP holders should address before starting a licensing programme are: whether to propose a specific rate or merely invite negotiations; whether and how to account for a prospective licensee's size, business model, and position in the supply chain; and whether and how to provide perspective licensees with evidence or proof that the patentee's SEPs are, in fact, essential to the relevant industry standard.

A patentee who makes the wrong decision about how to go about licensing a SEP could be opening itself up to a complaint alleging breach of the FRAND obligation. While there is no perfect, universal approach, one way to navigate these dangers is to develop and abide by a well-thought-out, comprehensive licensing playbook.

In particular, SEP holders should focus early on the following questions.

What is the appropriate scope of the proposed licence?

SEP owners should consider the appropriate scope of any proposed licence. In particular (although this is not an exhaustive list), they should decide if they will offer full-portfolio licences or individual SEP licences (eg, excluding patents covering "non-mandatory" features), and whether those licences will be country-specific, regional, or worldwide.

This decision turns on the nature of the standard and potential licensed products, where those products are sold, and industry norms. Although worldwide, full-portfolio licences are typical, there are circumstances where they may not be desirable (eg, if a product implements only a portion of a standard and/or is sold in a limited geography).

From the perspective of the courts, both in the US and abroad, worldwide full-portfolio licences in the cellular market have been considered FRAND, but courts do not always have the jurisdiction to enforce a worldwide demand or a full-portfolio SEP licence. It is largely agreed, however, that SEP owners violate FRAND if they require that, to license a SEP, implementers also take a licence to non-SEPs.

What form should the royalty take?

SEP owners also should consider the appropriate form of the royalty payments they are seeking. Generally, such payments are expressed either as per-unit payments or as a percentage of sales. A fixed payment brings certainty to both parties, whereas a percentage of sales has an element of risk—over the course of time, the sales price of the licensed product may rise or fall significantly. Again, there is no one answer to what an appropriate form is for a FRAND royalty, as both forms described here have been found to be FRAND.

The right royalty form instead depends on, eg, the patentee’s risk tolerance, the nature of the proposed market and the licensed products, and the importance of the standard to the product. For example, where all potential licensed products implement the same standard, but vary in price—eg, Bluetooth headphones compared with a car offering Bluetooth connectivity—a per-unit fixed payment might be appropriate.

Where, instead, the standardised feature directly relates to the total value of potential licensed products (as is often the case with cellular standards and mobile devices), a percentage royalty might be preferable.

What is the appropriate methodology for determining a FRAND rate?

SEP owners should decide what methodology they will employ in calculating their proposed FRAND rates. In doing so, they should apply a coherent methodology, so that in each licensing negotiation or litigation they can consistently calculate and justify the rate they are seeking.

There is currently no settled consensus on how to calculate FRAND rates. For example, some courts have applied a modified *Georgia-Pacific v US Plywood Corp* (1970) framework in a bench trial, checking the resulting rate using comparable licences.

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However, at least one court has presented the question of the FRAND rate to a jury, which was instructed on the unmodified *Georgia-Pacific* framework. (An unmodified framework applies all of the factors identified in *Georgia-Pacific* as relevant to calculating a reasonable royalty. A modified framework modifies or drops some factors to account for the context of SEPs. For example, in a modified *Georgia-Pacific* framework, the fact-finder does not consider the licensor's policy of maintaining a monopoly because a SEP holder cannot refuse to license its patents provided the licensee is willing to take a FRAND licence.)

Under some circumstances, SEP holders have proposed "bottom-up" approaches, in which the value of particular SEPs is assessed in isolation, without reference to other patents covering the same standard, including by evaluating *ex ante* alternatives to the patented technology that could have been incorporated into the standard.

Beginning in the UK and Japan in 2014 and in the US in 2017, a "top-down" approach, starting from an aggregate royalty attributable to the standard as a whole, which is then allocated to the SEP owner based on the SEP's proportional contributions to the standard, has been applied in US and in foreign courts.

This top-down approach, checked against comparable licences and other methodologies, has now been applied and accepted in the US, Europe, and China, and has been endorsed in the European Commission's recent FRAND guidelines (November 2017).

Ultimately, as with other aspects of FRAND, there is no perfect solution and the appropriate approach will depend upon the individual standard and the asserted patents.

Conclusion

FRAND remains a complicated legal issue, in which there is often no single correct approach. However, while there is a lack of absolute clarity, by thinking ahead and carefully considering the actions of other licensors in the marketplace, comparable licences, standards, and products, and the effects of the increasing number of FRAND court decisions, SEP owners should able to anticipate and overcome pitfalls and build successful, FRAND-compliant licensing programmes.

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