

# Implementing the FRAND Standard in China and its Relationship to Innovation

The 8th IP Seminar

Business Intellectual Property: Strategy and Innovation

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## ✓ Introduction

- Standard & SEPs
- Background of *Huawei v. IDC*
- Legal Base for FRAND Obligation
- Judicial Determination of FRAND Rate
- Conclusion



# Introduction

- Disputes in more than 10 jurisdictions:
  - *e.g.* U.S., U.K., China, Germany, Netherland, Korea, Japan...
- China and Standard-essential patents (SEP)
- Huawei v. ZTE (EU High Court, July 2015)
- National Development and Reform Commission (“NDRC”) decision in the Qualcomm case regarding SEPs licensing with \$975 million fine

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# SEPs & FRAND

- SEPs

- Patents which are essential to practice the standard
- It is not possible on technical grounds to make equipment that complies with the standard without infringing the patent

- FRAND

- Most SSOs require their members to commit to license any SEPs on fair, reasonable, and non-discriminatory (FRAND) terms in their IPR Policy

# Purpose of FRAND

- Balance between
  - Inventor’s incentive to develop new technologies
  - Implementers’ legal employment of SEP without legal risk of infringement, being locked-in, or losing standard-specific investment
- Avoid “Hold-Up Problem”
  - Where SEP holders withhold a license until an implementer agrees to pay unduly high royalty rate for the patent

# Problem of FRAND & SSO Policies

- The majority SSOs put FRAND in their IPR Policies
- None of them defines what is “fair” and “reasonable”

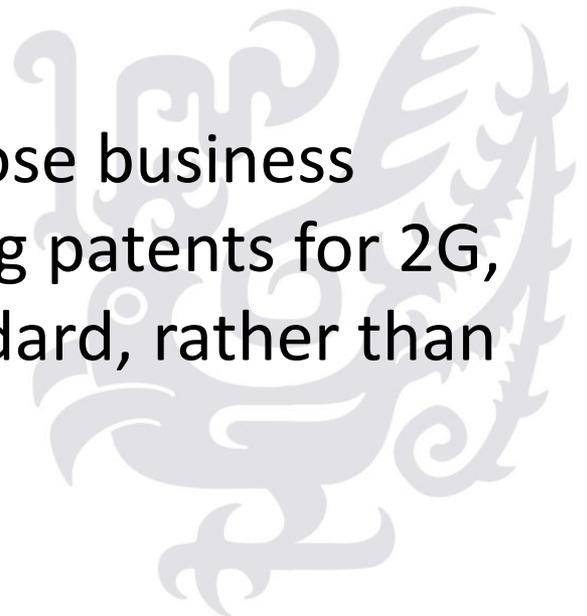


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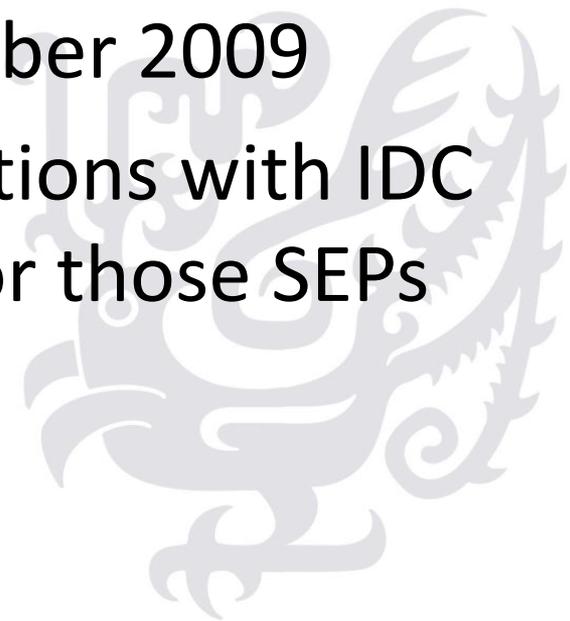
# Introduction to *Huawei v. IDC* (1)

- Huawei:
  - One of the largest telecom equipment and device manufacturer in the world
  - A Chinese company with headquarter in Shenzhen
- IDC:
  - a non-practicing entity (NPE), whose business model primarily based on licensing patents for 2G, 3G, 4G devices, and IEEE802 standard, rather than the manufacture of products



# Introduction to *Huawei v. IDC* (2)

- IDC owns SEPs in China's wireless communications standards (WCDMA, CDMA2000, and TD-SCDMA standards)
- IDC joined ETSI and committed to license its SEPs on FRAND terms in September 2009
- Huawei had had several negotiations with IDC regarding the license royalties for those SEPs since November 2008

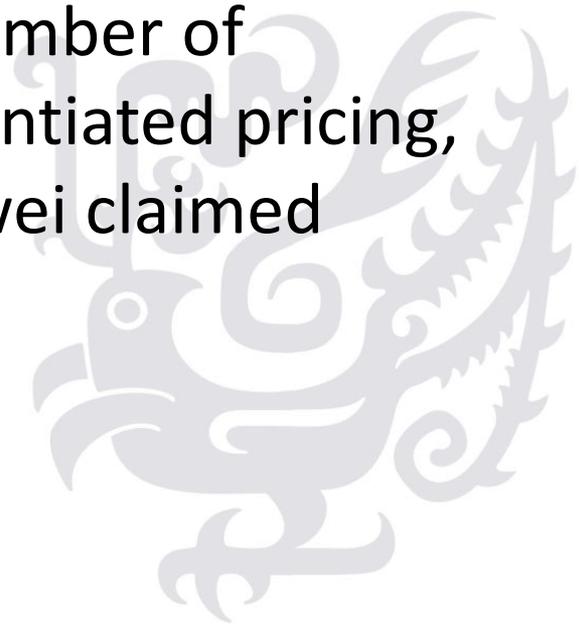


# Introduction to *Huawei v. IDC* (3)

- IDC first sued Huawei and other telecommunications companies, including Nokia and ZTE, in the United States federal district court and the International Trade Commission (ITC) in 2011 and 2012, claiming infringement of its 3G telecom patents (US patent numbers 7349540, 7502406, 7536013, 7616070, 7706332, 7706830, and 7970127)

# Introduction to *Huawei v. IDC* (4)

- In December 2011, Huawei in return filed two lawsuits against IDC in the Shenzhen Intermediate People's Court
  - 1<sup>st</sup>: Huawei alleged that IDC had been abusing its dominant market position by a number of unlawful practices, such as differentiated pricing, tying-in, and refusal to deal. Huawei claimed damage for RMB 20 million.



# Introduction to *Huawei v. IDC* (4)

- 2<sup>nd</sup>: Huawei sued IDC for violating its FRAND obligations and asked the court to determine the FRAND rate



# Introduction to *Huawei v. IDC* (5)

	Claims	
	Abuse of Dominant Market Positions	Violation of FRAND commitment and Determination of FRAND Rate
<b>First Instance: Shenzhen Intermediate People's Court</b>	Shen Zhong Fa Zhi Min Chu Zi No. 858 (2011)	Shen Zhong Fa Zhi Min Chu Zi No. 857 (2011)
<b>Second Instance: Guangdong High People's Court</b>	Yue Gao Fa Min San Zhong Zi No. 306 (2013)	Yue Gao Fa Min San Zhong Zi No. 305 (2013)

- Introduction
- Standard & SEPs
- Background of *Huawei v. IDC*
- ✓ Legal Base for FRAND Obligation
- Judicial Determination of FRAND Rate
- Injunction



# Legal Base for FRAND Obligation

- ✓ Contract Between SEPs Holders & Standard Implementers
- Contract with 3<sup>rd</sup>-Party Beneficiary
- Doctrine of Good Faith & Fairness
- Statutory Base for Essential Facilities & National Standard



# Contract Between SEP Holder & Implementers

- Widely accepted principle:
  - SEP holders' FRAND commitment to SSO is just a promise to license to other members, rather than a license itself.
- Dutch court
  - A SEP holder' FRAND commitment to SSOs does not constitute a license between the SEP holder and standard implementers (2012).

# Contract Between SEP Holder & Implementers

- *Huawei Courts*:
  - There was no contract between Huawei and IDC

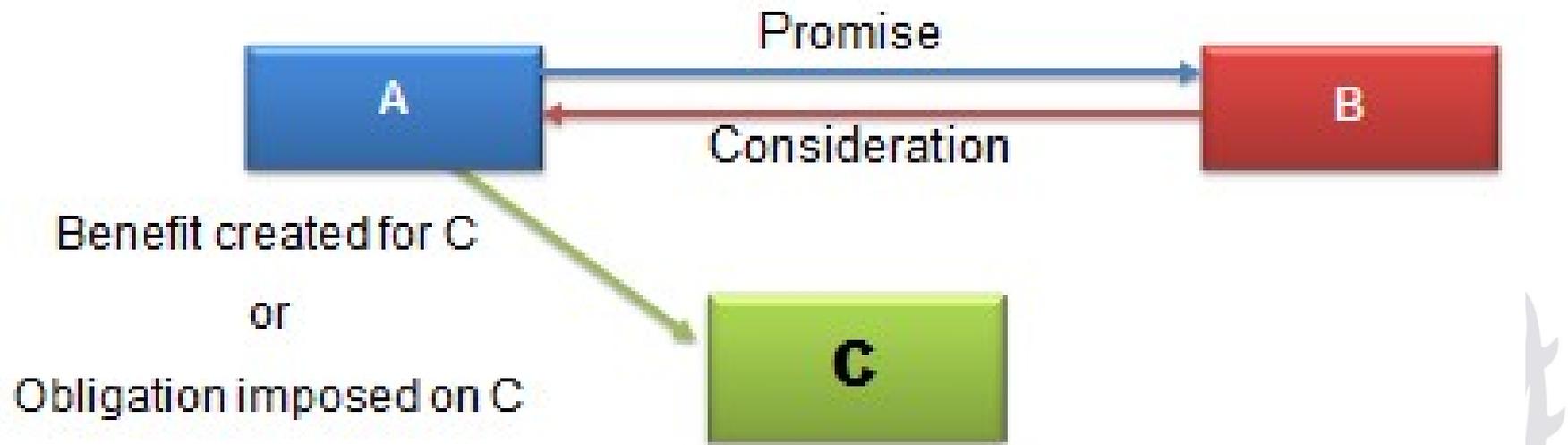


# Legal Base for FRAND Obligation

- Contract Between SEPs Holders & Standard Implementers
- ✓ Contract with 3<sup>rd</sup>-Party Beneficiary



# Contract with 3<sup>rd</sup>-Party Beneficiary



# Contract with 3<sup>rd</sup>-Party Beneficiary

- U.S. Approach

- *Microsoft v. Motorola*

- Motorola: IEEE and ITU commitments were merely unilateral offers to negotiate reasonable and non-discriminatory (RAND) licenses
    - Microsoft was a third-party beneficiary of Motorola's FRAND commitment to IEEE and ETSI, which was an enforceable contract
    - Motorola was obliged to grant Microsoft a RAND license, not only “to engage in bilateral, good-faith negotiations leading to RAND terms.”

# Contract with 3<sup>rd</sup>-Party Beneficiary

- *Apple, Inc. v. Motorola Mobility, Inc.*
  - By committing FRAND terms to ETSI and IEEE, Motorola had made a contractual commitment to license its SEPs on FRAND terms to third party beneficiaries, including Apple.



# Contract with 3<sup>rd</sup>-Party Beneficiary

- German courts
  - SEP holders' FRAND commitment does not grant other SSO members a right to obtain a license.
  - FRAND commitment is only an invitation for third parties to make offers.



# Legal Base for FRAND Obligation

- Contract Between SEPs Holders & Standard Implementers
- Contract with 3<sup>rd</sup>-Party Beneficiary
- ✓ Doctrine of Good Faith & Fairness



# Doctrine of Good Faith & Fairness

- General Principles of Civil Law:
  - Art. 4: “In civil activities, the principles of voluntariness, fairness, consideration for equal value, and good faith shall be observed.”
- Chinese Contract Law
  - Art. 5: “The parties shall observe the principle of fairness in defining each other’s rights and obligations.”
  - Art. 6: of the Chinese Contract Law: “The parties shall observe the principle of good faith in exercising their rights and fulfilling their obligations.”

# Doctrine of Good Faith

- Royal principle, overriding principle, catchall doctrine
- Duty to keep promises during negotiation, abuse of right?
- Comparative perspective:
  - Common law: equity, equitable estoppel
  - Microsoft v. Motorola, Court of Appeals for the 9<sup>th</sup> Circuit (July 30, 2015)
    - Common-law obligation of fair dealing and good faith

# Doctrine of Good Faith

- Promise at the Pre-Contract Phase
  - U.S.: Promissory/equitable estoppel (patent holders' promise or statement + standard implementers' reliance)
- Abuse of Legal Right
  - injunction



# Doctrine of Good Faith

- Comparative Law

- Japan:

- Tokyo District Court

- U.S.

- Microsoft:

- Good faith from contract
      - Violation of good faith: excessive offer or injunction



# Legal Base for FRAND Obligation

- Contract Between SEPs Holders & Standard Implementers
- Contract with 3<sup>rd</sup>-Party Beneficiary
- Doctrine of Good Faith & Fairness
- ✓ Statutory Base for Essential Facilities



# Statutory Base

- *“Provisions of the State Administration for Industry and Commerce on Prohibiting the Abuse of Intellectual Property Rights to Preclude or Restrict Competition” (Provisions)*  
《关于禁止滥用知识产权排除、限制竞争行为的规定》
  - Issued by the State Administration for Industry and Commerce (SAIC, 国家工商行政管理总局) on Apr. 7, 2015, been into effect since Aug. 1, 2015

# Provisions

- Art. 13
  - “Businesses with dominant market position shall not, without justification, engage in the acts below to exclude or restrict competition in the process of setting and implementing standards:
    - ...
    - after the patent has become a standard-essential patent, [the patent holder] violate the fair, reasonable and non-discriminatory (FRAND) principle, by precluding or restricting competition, such as refusal to license, tying products, or imposing other unreasonable terms.”

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- ✓ **Judicial Determination of FRAND Rate**
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# Fair and reasonable rate

- the profits generated from practicing the subject SEPs or similar patents, and the proportion of such profits in licensee's overall profits and revenue;
- patentee can only profit from its patent, not the standard;
- the amount of valid patents in the standard held by the patentee; and
- royalty should just account for part of, not all, the licensee's profits from the product

# Non-Discriminatory Rate

- SEP holders should charge the standard implementers the same royalty rate in other transactions with the same fundamental conditions
- Apple and Samsung
  - IDC/Apple:0.0187%
  - IDC/Samsung:0.19%



# Microsoft v. Motorola (9<sup>th</sup> Cir. 2015)

- Not reliable indicators:
  - Motorola/Symbol agreements
    - They were made under litigation
    - Patents expired before the hypothetical agreement between Motorola and Microsoft
- Motorola/Vtech & Motorola
  - The agreement was entered into to solve an ongoing infringement dispute between the parties
  - Vtech took the license to avoid a potential lawsuit

# Problem with the *Huawei* Decision

- Methods of Royalty Calculation
  - Different Approaches
    - Fixed fee
    - Percentage of sales/revenue
    - Royalties on number of units produced
  - Motorola-RIM License
    - Lump sum, plus
    - % of net sales price of any mobile device it sold
    - subject to an annual royalty cap



	Apple	Samsung
Time	2007~2014	2007~2012
Term	Non-exclusive, non-transferrable, global license	
Royalty Amount	USD \$56 Million	USD\$ 400 Million
Licensee's Revenue from Mobile Products	USD\$ 300 Billion	USD\$ 209.751 Billion
Royalty Rate	0.0187%	0.19 %

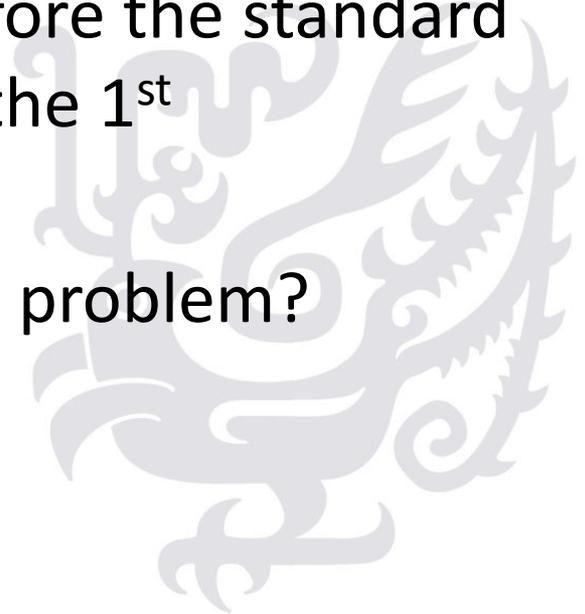


# Problem with the *Huawei* Decision

- Methods of Royalty Calculation (cont'd)
  - IDC-Apple Transaction: 56 Million
    - Fixed fee
    - 0.0187% was calculated by the court, not written in the agreement
  - IDC argued in this case that the success of Apple iPhone is a commercial exception, implying that the company should have charged Apple a much higher licensing fee if it could predict iPhone's market share.

# Problem with the *Huawei* Decision

- Timing of the Hypothetical Negotiations
  - The royalty rate should not be different for implementers that adopt the standard at different times.
  - IDC/Apple Transaction in 2007 before the standard was adopted and Apple released the 1<sup>st</sup> generation of iPhone
  - Ideal reference without “hold-up” problem?



# Problem with the *Huawei* Decision

- Timing of the Hypothetical Negotiations (cont'd)
  - To determine a FRAND rate, courts should replicate the bargain before a standard is adopted. (Thomas Cotter)
  - A reasonable royalty is be based a hypothetical negotiation between the SEPs holder and the standard implementer when the SSO is setting the standard (Mark A. Lemley & Carl Shapiro)
  - After the technology was adopted and the implementers made sunk costs (Damien Geradin)

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- Two Chinese characteristics
- Huawei identified key factors with insufficient reasoning and calculation
- Impact on the global high-tech industry



Thank you for your attention!!

