

# FRAND or foe

Telecoms and electronics giants can throw their weight around in negotiations over patent cross-licences. And it is right that they should extract significant licence fees in respect of their relevant and valuable intellectual property. But, asks **William Cook**, is it credible to claim to have hundreds of patents that are “essential” to industry standards?

**T**he Electronic Telecommunications Standards Institute (ETSI) has been in the spotlight recently. It has been under attack from the European Commission and network providers within its own membership. It is also at the centre of a dispute in the English courts, with global significance, between Nokia and wireless technology developer InterDigital.

At the heart of these problems lies the role of standards in the technology sector generally. Faced with the increasing complexity of technology products, formal technology standards have been established in several industries to ensure interoperability, innovation and reduce the barriers to market entry for new entrants. But the conflict between the interests of those involved in setting standards and those who hold patents in the associated technical area is obvious – as English judge Mr Justice Pumfrey has said: “Nothing would be pleasanter for a patentee than to participate in the setting of a standard compliance with which would inevitably involve infringement of his patent.”

To address this problem, under the rules of any standards-setting body, its members are typically required to disclose any of their patented technology which is (or, rather, is claimed to be) essential for compliance with a particular proposed standard, and at the same time agree to grant licences to allcomers at reasonable rates. Any companies that conceal their “essential” patented technology and then use it to prevent other companies entering the market or for demanding high licence fees can be accused of patent ambush, which may well breach European competition laws.

Several points flow from this:

In particular, companies who disclose a patent as “essential” are typically expected to agree to license that technology to all others on a fair, reasonable and non-discriminatory (FRAND) basis.

At least in theory, if companies do not agree to these FRAND terms, the standards-setting body can guide the standard to be finally adopted away from that technology.

In reality, companies tend to neither (1) conceal their patents, nor (2) disclose them but refuse to license on FRAND terms. That is, companies typically both disclose their patents and agree to license on FRAND terms. This is because of the difficulty in defining what is FRAND: given that every major cross-licensing negotiation is different, involving a different selection of patents on both sides, what is fair and reasonable to one counterparty may be extortionate to another. One person’s FRAND could be another’s enemy. Everything depends on context.

The end result is that there is little to stop a first party asserting in the courts an “essential” patent against another, notwithstanding its continuing obligation to license on

FRAND terms, by claiming that the other refused to take a licence on what the first considered unilaterally to be FRAND.

So standard-setting bodies such as ETSI have been confronted by a major land grab for patents in areas identified as critical for growth such as mobile technology. The result is patent stacking: patent holders take out many patents for different aspects of a single product. The more patents a company declares as essential for compliance with a particular standard, the stronger its negotiating position. All other things being equal, 100 patents licensed on FRAND terms may arguably produce licence fees of 100 times the fees for one patent. The concern is that the result has been the wholesale over-declaration of “essential” patents.

Increasingly, standard-setting bodies such as ETSI are being called upon to police the conduct of their members in the face of patent ambush and patent stacking, refusals to license or to license on FRAND terms, and over-declaring “essential” patents. These activities are blamed for distorting the market, reducing innovation and restricting competition.

The failure of ETSI to take a more active role in the regulation of its standards has led the European Commission to take the lead in clamping down on patent ambush and licence abuse. The European Competition Commissioner Neelie Kroes has stated that it is crucial “that standard-setting bodies establish rules which ensure fair, transparent procedures and the early disclosure of relevant intellectual property”.

In addition, in the recent dispute between Nokia and InterDigital, the English courts have claimed jurisdiction as self-appointed arbiters of patent essentiality under the ETSI standards. The international potential of the English courts has never been greater.

## Licensing problems

Generally, the rules of standards-setting bodies do not set out clear policies on the licensing of technologies essential to a standard. In fact, standards-setting bodies have rigidly enforced the separation of licensing issues from the standard-setting process. As ETSI states in its Guide on Intellectual Property Rights: “Specific licensing terms and negotiations are commercial issues between the companies and shall not be addressed within ETSI.”

This situation has resulted in a recent call by some of Europe’s largest network providers for changes to the ETSI rules requiring patent holders to license essential patents on a FRAND basis. The problem faced by ETSI was that under its rules a patent holder is not mandated to license its technology at all. In fact, even if the essential patent belongs to an ETSI member, the only sanction available to ETSI is to threaten the

member with non-participation in the standard, or guide the standard away from that technology.

In their proposal to ETSI's November 2005 General Assembly, network providers including Orange, T-Mobile and Vodafone called for new ETSI rules to require the agreement of licensing terms *before* the setting of a new standard and the imposition of a limit capping excessive royalty payments. ETSI's failure to deal with licence fees was, the providers argued, limiting competition through the negative impact on pricing and by handicapping the industry's ability to drive down costs.

This complaint followed a separate protest to the European Commission in October 2005, by six equipment manufacturers, alleging anti-competitive behaviour by Qualcomm over the licensing of its "essential" 3G technology patents. Qualcomm was accused of violating EU competition law, renegeing on commitments made during negotiations and failing to meet its commitments to international standard bodies to license its technology on FRAND terms.

The providers – Broadcom, Ericsson, NEC, Nokia, Panasonic Mobile Communications and Texas Instruments – pointed to Qualcomm's refusal to license essential patents to potential chipset competitors on FRAND terms, charging excessive and disproportionate royalties for its Wideband Code Division Multiple Access (WCDMA) patents and to offering lower licence royalty rates to handset customers who bought chipsets exclusively from Qualcomm. Qualcomm has rebutted the allegations, suggesting that the providers are simply using the European Commission investigation as a means of renegotiating better licensing terms and pointing out that the allegations come from 2G suppliers who have the most to lose from the enhanced and expanded 3G competition spawned by Qualcomm's licensing of its enabling 3G technology, chipsets and software.

In turn, the European Commission has threatened to investigate ETSI. As a result of this, ETSI has agreed to set up an IP group to make changes to its standard-setting rules. The industry awaits with interest but not bated breath: ETSI must serve the interests of its members, who are clearly divided in terms of interest. Network providers would like to see the lowest cost licensing regime possible, to minimize the prices of the equipment they buy. But the big industry suppliers have an obvious interest in retaining as much autonomy in their licensing program as possible: they want (1) to maximize licensing income and (2) to drive competitors' prices higher by charging them large licence fees. The European Commission has promised to continue to monitor the situation.

In reality, however, it is unlikely that any rule change will alter fundamentally the current position. Patent owners will stack their patents high, declare many as "essential" to a standard, then seek to negotiate the highest licence fees possible. This is simply good business. So what checks on patentees are being put in place?

### **Nokia versus InterDigital**

The recent dispute in the English courts between Nokia and InterDigital has opened a new front in the struggle between patentees and their prospective licensees under "essential" patents, and has provided a weapon for licensees in global negotiations.

Licensing its technology is a lucrative business for InterDigital. It is public knowledge that it signed a licensing deal with LG Electronics in January 2006 in which LG agreed to pay \$95 million in royalty payments each year from 2006 to 2008 for the use of InterDigital's 2G and 3G handset technologies. Further, Nokia has been ordered to pay up to \$252 million to InterDigital, as a final award in an ICC arbitration covering roy-

alty rates applicable to Nokia's sales of relevant 2G and 2.5G infrastructure and handsets from 2002 to 2006. Following that, Nokia and InterDigital settled their global 2G and 2.5G disputes, with Nokia taking a perpetual licence for \$253 million.

Before the settlement, Nokia had commenced legal action in the English courts in which Nokia challenged the "essentiality" to the 2G standards of three InterDigital patents. It appears that this may have been too late to affect the ICC arbitration, and so the global 2G and 2.5G settlement, but future 3G royalties are still in dispute. It therefore comes as no surprise that Nokia has, in a separate action, also challenged in the English courts the essentiality to the 3G standards of some 30 InterDigital patents.

#### **2G action**

In the 2G action in December 2004 (*Nokia Corporation v InterDigital Technology Corporation* [2004] EWHC 2920, appealed in April 2005 at [2005] EWCA Civ 614), Nokia sought the invalidity of three patents asserted by InterDigital as essential to the ETSI's 2G standard, and then tried to add to that action an (unprecedented) declaration of "non-essentiality" in respect of those patents. Nokia chose to seek the non-essentiality declaration, rather than follow the traditional route of seeking a declaration of non-infringement of the contested patents, apparently in an attempt to strike at the heart of InterDigital's patent policy of multiple declarations of essentiality.

In short, despite InterDigital's protests, the English court allowed the matter of non-essentiality declaratory relief to proceed to a full hearing before the court (it agreed that there was a reasonable argument that it should hear declarations of non-essentiality). In its decision, the court demonstrated a willingness in principle to resolve the commercial issue between Nokia and InterDigital on terms understood by the parties, by looking at whether the patents were essential for the standard rather than whether Nokia infringed InterDigital's patents.

The matter therefore proceeded to full trial on the issues of (at least) validity and non-essentiality, with the final confirmation that the court has power to hear declarations of non-essentiality being postponed to a later date. However, the case settled before any of these issues were decided.

#### **3G action**

In March 2006, the parties were back in court (*Nokia Corporation v InterDigital Technology Corporation* [2006] EWHC 802 (Pat)). This time the subject matter concerned 30 of InterDigital's 3G frequency division duplex (FDD) patents that InterDigital had notified to ETSI as essential under the Third Generation Partnership Project (3GPP) 3G standard. 3GPP brings together a number of telecommunications standard-setting bodies, including ETSI.

This time Nokia did not seek a revocation of the contested 3G patents. It simply claimed that these 30 InterDigital patents were not essential for its equipment to comply with the 3G standard and sought declarations of non-essentiality. InterDigital sought to strike out Nokia's claim.

The Patents Court found little of material difference between the facts of the 3G case and the 2G action. The Court affirmed that it had the discretion to grant a declaration of non-essentiality where it felt that the aims of justice would be achieved and where the underlying issue was sufficiently clearly defined to enable a proper determination.

The reasons behind these decisions are illuminating. The court follows three basic principles when considering whether to grant negative declaratory relief under its "inherent jurisdiction":

- 1) the question is decided as a matter of discretion, giving the first instance judge significant power in any particular case;
- 2) negative declarations are only suitable where they will serve a useful purpose; and
- 3) they are also only possible where the underlying issues can be clearly defined.

Underlying all these is that, for the court to have the power to hear a declaration of non-liability brought by a party, there must have already been some formulation of a claim of liability against that party (a formulated claim “as of right”). In the 2G action, the court found it easy to hold that there had been such a claim, because InterDigital had formally stated, *within the court action*, that two of the patents were essential. But, knowing this, in the 3G action InterDigital refused to indicate *to the court* whether or not it considered any of the 30 patents to be essential, even though it had of course already notified them to ETSI as essential or potentially essential.

However, the court found that InterDigital’s identification of the patents merely to ETSI as being essential or “potentially” essential was sufficient to amount to a claim “as of right”. As Mr Justice Pumfrey said: “In my judgment, to approach an international standards body and suggest that the use of a particular invention is essential ... necessarily involves a formulated claim against potential users of the standard.”

He further considered that the term “potential” applies only when either or both of (1) the form of claims and (2) the scope of the standard were uncertain. As soon as they are both fixed (eg patent granted and standard finalized), the logical consequence is that the court views an assertion of “potential essentiality” as amounting to an implicit assertion of “essentiality”, unless and until it is withdrawn.

Put simply, the Court was unimpressed that a member of ETSI would make a declaration of essentiality and then be unprepared or unwilling to have the substance of that declaration tested. InterDigital certainly could not paint itself as the unwilling claimant with an unformulated case, dragged into costly litigation against its will.

### Conflict will remain

The *Nokia* cases show consistently that the English courts are willing to hear disputes about essentiality. The English court’s willingness to tread where ETSI will not will be welcomed by newer industry players (the natural licensees), who find themselves under pressure in licensing negotiations due to the weight of “essential” patent numbers claimed against them. The threat of litigation on essentiality should keep patentees honest.

These newer players often include Japanese, Korean and Chinese companies, but in any event it is worth saying that the

## Applying the English judgment

### Discretion

The judge in the 3G case was unimpressed by InterDigital’s refusal to confirm to the court that the patents were essential to the standard, even though it had notified them as essential to ETSI. One cannot imagine that the judge was favourably disposed to InterDigital’s position as a result.

More significantly on discretion, InterDigital’s arguments that a declaration would “open the floodgates” to litigation, that it is inappropriate because the UK is only a small percentage of the market, or that it does nothing to assist the licence negotiations, were rejected at this stage.

### Useful purpose

The best view of the judgments in the 2G and 3G cases is that, as a matter of policy, the court clearly considers that industry participants should have a forum to challenge assertions to standards bodies that patents are essential. That the English court is willing to blaze a trail by adopting the jurisdiction itself should be unsurprising: the Patents Court and Court of Appeal have several highly experienced and confident specialist patent judges who would be delighted (and easily able) to hear such challenges. It has been suggested that, as the English market may represent only 5% of relevant global telecoms or electronics markets, the judgment of the English court is irrelevant to global disputes. However, this is unduly negative – the court’s view represents the impartial view of an experienced tribunal unconnected with either party, which will inevitably have weight in global licensing negotiations. As such, it is extremely valuable: a finding that a particular patent is, or is not, essential will have significant persuasive value in negotiations.

Connected with this, the court rejected the argument that, even if the patents are declared non-essential, Nokia could still be found to infringe them and therefore that the declaration would be a waste of time. In the court’s view, this was simply not realistic – to be notified as essential, a patent must necessarily describe and claim its invention in terms which relate to the definition of the standard itself. If they do not, the patent claims will relate to specific implementations which cannot be part of the standard. As the court said: “Nothing can be notified as technically essential if it relates to implementation-specific features.”

The unwritten message is clear here. If patentees are notifying (even arguable) implementation-specific patents as being essential to standards, these can be challenged in the English courts relatively quickly and removed from the negotiation table. The balance of power in negotiations, still heavily oriented towards patentees of course, has shifted slightly towards licensees.

### Are the issues clearly defined?

By the time of the 3G hearing in March 2006, the judge had already presided over the full five-week trial in the 2G action. Having seen ETSI standards and the patent claims in that action, he was in no doubt that the issues associated with deciding whether compliance with a standard would require infringement of a patent were sufficiently clearly defined for him to make a decision. But this may vary from case to case.

major players there are running big patent filing programmes themselves – the biggest are each filing hundreds of applications each year already.

In addition, particularly in Europe, there is increased interest in using European competition law to redress the negotiation balance. But one thing is for sure – the fundamental policy conflict between the setting of standards and protection of intellectual property will last as long as will exist the desire for new technology.



William Cook

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