Avenue des Arts 56 - 1000 Brussels - Belgium
T. +32 46 020 1811
information@fair-standards.org
www.fair-standards.org

24 June 2021

Timely licensing for SEPs – how to avoid opportunities for hold-up and royalty stacking

Synopsis

Holders of standards essential patents (SEPs) contribute their intellectual property towards standards for a variety of reasons. In some cases, SEP holders are content to offer royalty- free terms. In other sectors where commercial drivers are different, SEP holders choose to monetize their SEPs by way of licensing fees.

In business environments in which SEPs are used to generate revenue streams, securing early certainty over licensing costs will make the business plans of standards adopters less risky and encourage them to launch more innovative products and services. In such an environment, SEP holders can benefit from earlier and better adoption rates of the standards on which their licensing revenue is dependent.

The Fair Standards Alliance's position is that, to minimize the potential for hold-up and royalty stacking, SEP holders seeking to actively license their patents to collect royalties 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 actual, valid SEPs. They should provide a base level of information without requiring the prospective licensee to sign a non-disclosure agreement (NDA).[1]

This approach is especially needed when it comes to patent pools licensing FRAND-encumbered SEPs. They are subject to the same requirements and obligations to license under

[1] See Fair Standards Alliance, *Transparently FRAND: The Use (and Misuse) of Confidentiality Obligations in FRAND Licensing Negotiations* (13 Nov 2017), available at https://fair-standards.org/wp-content/uploads/2020/07/170213_FSA-Position-PaperTransparency-FRAND-1.pdf. Transparency in licensing terms and conditions is further described in the Fair Standard Alliance's Key Principles for FRAND Licensing, Principle #3 in *Fair Standards Alliance: An Introduction* (12 Nov 2015), available at https://fair-standards.org/wpcontent/uploads/2016/08/FSA-POSITION-PAPER-June2016.pdf.

FRAND terms and conditions as exist for SEP licensors licensing directly.[2] If patent pools are created, it is beneficial to announce them on a timely basis following the creation of a standard. Like individual SEP licensors, patent pools should also be transparent as to the license(s) offered by publishing the information about the relevant SEPs and proposed licensing terms and conditions. That information should be made available as early as possible. Additionally, SEP licensors should aim to minimize the number of pools licensing patents for a particular standard in order to achieve the greatest efficiency for licensors and licensees alike and promote innovation of products supporting a standard.

I. Introduction

This paper is intended to help organizations understand the effect of unnecessary delays in a) making SEP declarations, b) providing supporting evidence and c) issuing proposed licensing terms, and how to avoid such delays.

Standardization occurs in standards setting organizations (SSOs) pursuant to each SSO's IPR policy. Generally, SSOs ask their members to agree to license any patented invention they contribute to specifications available on FRAND terms. Most SSOs make inclusion of the patents in the standard contingent upon the patent-holder making this voluntary FRAND commitment. In some business sectors, SEP holders make their intellectual property available on a royalty free basis. In other sectors SEP holders seek to monetize their SEPs.

In general, it is less risky for companies to develop and offer products and services built on standards that potentially require the use of SEPs to know the licensing terms in advance. But FRAND declarations as established by SSOs do not provide sufficient certainty about the nature of the terms on which the SEPs will be licensable. Similarly, SSOs do not independently verify whether a patent that has been declared essential is in fact essential or valid.

The problem is particularly acute when a SEP holder does not declare a claim until after the standard on which the SEP is predicated has been adopted and later the SEP holder demands higher or "excess" royalties in the knowledge that implementers may not be able to design out the standard from their product or service without large expense. Additionally, once a standard has been adopted, SEP holders can then attempt to leverage this enhanced bargaining power over innovative companies making devices that incorporate standardized technology. These problems are known as "hold-up". A related problem is "royalty stacking" – when a standard implicates so many patents that, in the aggregate, royalties demanded by SEP-holders "stack" on top of each other.

If companies that adopt a standard by creating innovative products that incorporate the standardized technology are not prepared to accept the risk of being "held up" with royalty demands that exceed the value of the patented invention, adoption of standards is slowed or

[2] See Fair Standards Alliance, *Competitive and Industry Harms Related to Refusals to License SEPs and Other Forms of "Level Discrimination" in SEP Licensing* (2 Dec 2020), available at https://fair-standards.org/wp-content/uploads/2020/12/FSA-Position-Paper-Competitive-and-Industry-Harms-Related-to-Refusals-to-License-SEPs.pdf.

inhibited altogether with a consequent reduction in revenues for those who aim to assert their SEPs. The same problems arise when royalty stacking goes unchecked.

This paper explores some sectors and markets that are more susceptible to "hold-up", the international guidelines and regulations that have some relevance, and what SEP holders could do to avoid accusations of "hold-up".

II. Sector and market applicability

The motives and behavior of those entities which innovate to acquire SEPs varies according to a number of factors. Standards developed to support internet traffic tend to be royalty free because competition in this market is largely product focused. In ICT market sectors, many entities benefit from market expansion for their own products and therefore many reserve use of their SEPs for defensive purposes. In the telecommunications and consumer electronics sectors, volumes are a contributory factor for different organizational drivers and behavior in that royalties are often sought by those asserting SEPs or their representatives, for example, pools. This position paper is aimed specifically at actors in these latter market sectors and any others that may have similar characteristics.

III. National and international guidelines and regulation

In many jurisdictions there are no official guidelines on SEP licensing from the relevant enforcement bodies, but decisions derived from private litigation are a source of guidance. Below are some prominent initiatives for guidance by public authorities.

For example, a 2017 Communication from the European Commission (EC) signposted a more stable and predictable regime for SEP licensing within the EU.[3] Among other provisions, this document calls for actions by SSOs on "Increasing Transparency and SEPs exposure".

The EC's Communication also states, "to avoid royalty stacking, in defining a FRAND value, an individual SEP cannot be considered in isolation". The Fair Standards Alliance believes that to avoid royalty stacking, those claiming to hold SEPs will need to be cognizant of others with similar claims and ensure that the overall royalty burden does not exceed FRAND terms. If a patent pool is created, ideally having a single pool per standard will be helpful towards achieving this aim.

The EC has also undertaken other work in the field of SEPs to try to improve transparency. For example, the EC commissioned a "Pilot study for essentiality assessment of Standards Essential Patents" in which the authors concluded that it is "both technically and institutionally feasible" to develop such a system that may improve the transparency of data relating to patent essentiality. Its usefulness and success, however, will significantly depend on how it is

[3] Communication from the Commission to the Institutions on Setting out the EU approach to Standard Essential Patents (Communication), available at https://ec.europa.eu/docsroom/documents/26583.

structured in practice. Moreover, however helpful essentiality checks may be, the ultimate determination of essentiality and validity must rest with the courts.

The High People's Court in Guangdong Province, home to many of China's high-tech companies, issued its own guidelines in the Chinese language in April 2018. The full title is "Working Guidelines on the Trial of Standard Essential Patent Disputes (Trial Implementation)". This document has been interpreted in similar ways by legal specialists[4] who confirm a "fault-based" approach to injunctive relief, where the availability of an injunction depends on which party is "at fault". SEP holders may be "at fault" if they do not a) send a negotiation notice with the scope of patent rights, b) provide relevant patent information (illustrative patent lists or patent claim comparisons) to a SEP implementer that is entering into license negotiations, c) propose specific licensing terms or royalty calculation methods which must be reasonable, and d) act in a reasonable and timely manner and not lead negotiations into deadlock. The general principle that a SEP holder's FRAND obligation limits its availably to seek injunctive relief – and requires the SEP holder provide certain information during licensing negotiations – is consistent with the approach of other jurisdictions, including the Court of Justice's of the European Union *Huawei v. ZTE* decision.[5]

The Japanese Patent Office (JPO) has provided a "Guide to Licensing Negotiation Involving Standard Essential Patents".[6] It draws on experience from Japanese, US, European and Chinese court cases. Although not legally binding, it has the aims of enhancing transparency and predictability in SEP licensing.

This guidance by national and supra-national bodies to SEP holders and SEP adopters on good practices in SEP licensing, shares a commitment to improving transparency and certainty, two of the key aims of this position paper. Policymakers, courts, and other interested parties should additionally consider the licensing principles developed under the auspices of CEN CENELEC and supported by over 50 organizations, *Core Principles and Approaches for Licensing of Standard Essential Patents*.[7]

IV. SEP licensing

Delay in announcing SEP licensing terms gives the potential for:

- Royalty stacking, particularly
  - when multiple licensors seek to license patents claimed to be essential for the same standard; or

[4] For example: http://competitionlawblog.kluwercompetitionlaw.com/2018/06/01/new-sep-guidelines-guangdong/ and https://www.omm.com/resources/alerts-and-publications/alerts/chinese-court-releases-guidelines-for-sep-related-disputes/.
[5] Case C-170/13, *Huawei Techs. Co. v. ZTE Corp*., ECLI:EU:C:2015:477.
[6] https://www.jpo.go.jp/e/support/general/sep_portal/document/index/guide-seps-en.pdf.
[7] CEN CENELEC CWA 95000 (12 Jun 2019), available at ftp://ftp.cencenelec.eu/EN/News/WS/2019/CWA_SEP/CWA95000.pdf.

- when multiple patent pools are formed sequentially to seek to license patents claimed to be essential for the same standard.

- Hold-up – more expensive royalty cost because adopters have already committed themselves to the standardized technology through substantial investment in product development and SEP holders take advantage of that lock-in of the adopters. The risk of hold-up and royalty stacking is greater where there are multiple pools for the same standardized technology and companies face multiple demands for excess royalties from several SEP-holders and pools.
- Lower rates of adoption – because adopters are discouraged from choosing new technology with uncertain royalty arrangements – and hence smaller returns for SEP holders.

The Fair Standards Alliance recommends that where SEP holders intend to seek royalty income by licensing their SEPs, they should abide by the following guidance:

- SEP holders 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 actual, valid SEPs.[8]
- Requiring an NDA to be signed before a base level of information is made available is neither open nor transparent and should therefore not be requested.[9] NDAs which prevent a potential licensee from determining whether a SEP holder is complying with the FRAND obligation because the NDAs forbid companies from discussing the proposed or existing financial terms of the licenses (such as upfront payments or royalty rates) with, for example, suppliers of components or customers that may have been separately approached to take a license by the same patentee, should also not be requested.[10]
- Patent pools representing SEP holder interests must accept and comply with the FRAND commitments made by those SEP holders.[11]
- Individual SEP holders and pools should announce their claims and make all relevant information – the SEPs involved, the basis for the essentiality and validity, and proposed licensing terms – as early as practically possible. This will assist potential adopters to plan their business cases and, in turn, encourage early adoption of a standard to the benefit of SEP holders.[12] Ideally, only one pool per standard should be created.

[8] See CEN CENELEC CWA 95000, page 39 Section 5.5, which emphasises the need for, and benefits of transparency and predictability in SEP licensing.

[9] See CEN CENELEC CWA 95000, page 13 Section 3.2, concerning the very limited role that NDAs should have in SEP licensing negotiations.

[10] Fair Standard Alliance's Key Principles for FRAND Licensing, Principle #3 in *Fair Standards Alliance: An Introduction* (12 Nov 2015), available at https://fair-standards.org/wpcontent/uploads/2016/08/FSA-POSITION-PAPER-June2016.pdf.

[11] See CEN CENELEC CWA 95000, page 18 Section 3.10, concerning patent pool administrators being bound by the same FRAND obligations as licensors of the SEPs that they represent.

[12] See Fair Standards Alliance, *Patent Pools and Licensing Platforms in SEP Licensing*, available at https://fair-standards.org/wp-content/uploads/2019/11/191104_FSA_Position_Patent_Pools.pdf, which provides more exhaustive information about how pools should be administered.

V. Patent Pools

As discussed above, all the recommendations with respect to SEP holders acting in ways to encourage timely SEP licensing apply with equal force to patent pools. One of the potential benefits of having a patent pool for licensing standardized technology is increased efficiency through a reduction in transactions costs associated with reaching a licensing agreement because the number of investigations, negotiations, agreements, and financial transactions are minimized.

However, when there are multiple patent pools, there is less efficiency because the transaction cost of licensing is multiplied by the number of pools. Enforcing secrecy through NDAs also adds to the cost of transactions. Multiple pools can also lead to an excessive royalty stack because potential licensees may feel compelled to obtain a license from each individual pool. An illustrative example involving the H.265/ High Efficiency Video Coding (HEVC) Standard appears in the Annex to this paper.

Conclusions

By following an approach of early announcements of FRAND licensing terms for royalty bearing SEPs, there will be benefits to both standards adopters and SEP holders. Adopters will have more certainty about their business plans because claims for royalties can be assessed earlier and licensing costs established sooner; there will be less risk involved in launching products thus lowering barriers to innovation in the whole value chain. SEP holders will consequently benefit from higher adoption rates on the standards on which their claims are founded, and their royalties earned.

Annex: Case study - HEVC

The issues arising with having multiple pools for the same standard are illustrated by the H.265/HEVC Standard, for which there are three patent pools: (1) the MPEG LA pool; (2) the HEVC Advance pool; and (3) the Velos Media pool.[13] A publicly available document setting out the SEP licensing landscape for this specific technology—the HEVC video compression standard published in 2013—can be found here.[14]

The licensing complexity and consequential business uncertainty that this has created suggests that adoption has been discouraged as a result.[15] One of the HEVC pools – HEVC Advance (now Access Advance) – revised its licensing terms twice to try to encourage better adoption.[16] Today, some eight years after HEVC was published, it is only supported in a small number of browsers whereas its predecessor AVC is universally supported.[17]

Some potential adopters began designing the HEVC technology into silicon and products in 2014,[18] just a year after the standard was published. The sequential declaration of the three pools, in 2014, mid 2015 and early 2017 had the potential to lead to royalty stacking and hold-up for those adopters already locked into deployment.

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

---

[13] See John "Jay" Jurata, Jr. & Emily N. Luken, *Glory Days: Do the Anticompetitive Risks of Standards-Essential Patent Pools Outweigh Their Procompetitive Benefits?,* 58 SAN DIEGO L. REV. (2021) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3622615.

[14] Gaurav Agnihotri, *High Efficiency Video Encoding: How the video ecosystem is evolving*, IPWatchdog (11 July 2018), available at https://www.ipwatchdog.com/2018/07/11/high-efficiency-video-coding-video-ecosystem-evolving/id=99094/.

[15] *Id.*

[16] See *HEVC Advance Revises Royalties to Remove Most Broadcaster Licensing Fees*, Pilot Blog (21 Dec 2015), available at https://nabpilot.org/hevc-advance-revises-royalties-to-remove-most-broadcaster-licensing-fees/.

[17] See Jan Ozer, *The Streaming Codec Landscape in 2021*, WOZA media systems (12 Jan 2021), available at https://www.wowza.com/blog/streaming-codec-landscape-2021.

[18] Blu-ray Disk Association, https://web.archive.org/web/20140906223337/http://www.homemediamagazine.com/high-def/bda-updates-blu-ray-4k-timeline-34108; Apple iPhone6 family, https://appleinsider.com/articles/14/09/12/apples-iphone-6-iphone-6-plus-use-h265-codec-for-facetime-over-cellular.