**PATENT ROUNDTABLE**

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**SEP litigation and (F)RAND licensing commitments**

**Patent Wars or Business as Usual? - Putting smartphone patent litigation into context**

Patent litigation in the communications sector, and especially smartphones, has recently attracted a lot of media and public attention. The impression to a casual observer may be that these circumstances would be extraordinary, and that such litigation, especially when it involves SEPs (standard essential patents), must reflect serious problems in the industry, requiring fundamental adjustments of SSO’s IPR policies or even broad regulatory intervention. In reality, it is our view that nothing would be further from the truth.

There is no compelling evidence that the current (F)RAND licensing regime would have generally hindered market entry. On the contrary, the (F)RAND regime has successfully been the basis for hundreds of licensing agreements agreed bilaterally in an amicable way and, accordingly, has clearly enabled market entry by facilitating broad distribution of technology. Open standards have brought significant benefits for the consumer and society generally, enabling seamless interoperability and bringing more competition and choice to the mobile communications market than ever before.

Some companies have recently provided public comments on SSO IPR policies and the working of (F)RAND licensing principles, calling for reform and changes to the interpretation of such policies. These commentators tend to be “interested parties” engaged in on-going litigation concerning the very issues they are seeking to change in the SSOs, and often these same companies have been the greatest beneficiaries of the IPR policies they now criticize, having successfully entered the market despite making only recent incremental contributions to the underlying technology themselves.

The reality is that technical progress over the past 15 years, underpinned by truly open standards and their associated IPR policies, has enabled easy access to advanced communications technologies even by companies who have not previously invested in research and development in this field. Some such companies now seem to be trying to avoid, circumvent, or at least minimize compensating their fair share for the investment in research and development by the early entrants for the intellectual property that provides the very basis for their success. At the same time, some late entrants have tried to position their own incremental inventions in adjacent fields as magical engineering feats or great leaps forward, no matter how mundane their patented improvements over the prior art really are. It is not surprising that this has created friction between some companies, and that sometimes the resulting disputes have to be resolved through litigation. In many such disputes SEPs have not been the initial reason for such litigation, and SEPs actually represent only a minority of the patents in suit in the smartphone industry today.

Patent litigation as such is not a sign of market failure – rather it represents the only available remedy ultimately for IP holders to enforce their right to exclusivity or to compensation from unwilling licensees. As open standards are publicly available, developers of the technology cannot withhold their contributions from non-paying customers, like a box-maker could simply stop shipments. Litigation is an integral part of the IP system, and the use of courts to resolve disputes between competitors is simply a sign of a vibrant and functioning market[[1]](#footnote-1). Contrary to a view commonly expressed in the media, the vast majority of license negotiations in the communications sector result in agreements without recourse to litigation, and the transaction costs of IP litigation represent a relatively small fraction of the value of IP licenses that are transacted in the smartphone industry, and these costs are minuscule compared to the hundreds of billions of euros in revenues in smartphones, tablets, communications services, and network infrastructure. The reality is that innovation is not being hindered by patent disputes, rather the increasing realization of value in IPR is spurring further investment in research and development.

While prevalence of patent litigation overall, and SEP patent litigation in particular, does not indicate the presence of any systemic problem, we certainly do acknowledge that there are from time to time isolated instances of abuse by individual patent holders. This is nothing new, as there have in our experience always been instances of bad behavior by some actors. However, we have not seen any general increase in such behavior over recent years. Further, it would be risky and dangerous for any outsider to evaluate the basis of allegations of abuse in licensing and enforcing of SEPs without knowing all the details pertaining to the behavior of each party in such licensing negotiations. The courts and competition authorities are perfectly competent to resolve any actual abuses without needing to resort to any general reform of the (F)RAND regime.

**Need to maintain the careful balance of the (F)RAND bargain**

Contributing to the creation of a complex standard is a huge endeavor and a massive investment over a period of very many years. Companies not only send representatives to contribute in technical working groups, but the proposed technology concepts are researched, tested, simulated, and in some cases even piloted before they are brought to discussion in standardization. Companies who develop standardized technologies have often invested heavily in development work for more than ten years before a standard is finally completed and adopted. It is therefore a huge competitive advantage for a third party to be able to simply implement a ready-made standard or to buy commercial chipsets or software that implements such technology. The competitive situation was very different only 20 years ago, when such complete implementations of communications standards were often not commercially available, and each market participant generally had to invest comparable amounts in development costs. Now almost any company is able to access and utilize the fruits of the investments behind open standards, without having to make a contribution of their own.

It is by no means a forgone conclusion that technologies and standards will continue to be developed in an open fashion. The motivation for technology developers to contribute to open standards is the assumption that later licensing opportunities will provide fair and reasonable rewards for such early investments. There is little incentive for companies to contribute to standardization without having a reasonable expectation of return. Without continued collective efforts in standardization, we would likely see a limited number of ‘proprietary’ technologies developed by increasingly vertically integrated firms and as a consequence significantly higher entry barriers for new companies. This would lead to less competition and less consumer choice.

The fact is that the well-established (F)RAND bargain has enabled companies to contribute to open standards development. Any modification of this carefully balanced regime risks modifying the very principles of open standardization, with potentially unforeseen consequences. This should be done with enormous care and understanding the principles and incentives influencing open standardization.

**Risk of over-regulation driven by private interests**

Companies that have contributed significant amounts of technology to open standards have done so under the applicable IPR policies in each SSO, and such past contributions and licensing of related SEPs are governed by the specific legal commitments that have been made under such policies at the time. Some of the recent calls for reform of the (F)RAND regime appear to be thinly veiled efforts by litigants to obtain favorable interpretations of IPR policies and past licensing commitments outside the courtroom, based on popular opinion rather than legal review of the facts and behavior of the parties in each situation.

SSOs and regulators should resist such pressure to intervene on a general level: any generic guidance on interpretation of (F)RAND commitments responsive to a few vocal interests would not be likely to reduce patent litigation, rather it may only shift the focus in pending disputes (and possibly influence the outcome) , while potentially risking the balance of the (F)RAND bargain and proper functioning of standardization processes more generally. High level intervention with generic all-purpose guidance for licensing of SEPs, without the possibility to weigh the specific facts and circumstances in each particular case, would be dangerous and lead to unforeseen consequences and might be likened to drawing territorial borders across continents using a ruler– While some parties may be very happy with the result in the short term, such solutions run the risk of creating imbalances and tensions that could endanger functioning of the entire standardization system. This would truly risk holding back innovation. It is important, therefore, that any policy or regulatory initiatives which may modify the (F)RAND regime should focus solely on future standards. Interpretation of existing IPR policies and past commitments must be left to competent courts in accordance with the applicable legislation.

Two areas where specific (F)RAND clarifications have been proposed are (1) availability of injunctions with SEPs, and (2) determination of a common royalty base for licenses. Neither of these is really suitable for more prescriptive regulation, which would only involve significant risks for the delicate balance of the (F)RAND bargain.

First, while injunctions with SEPs should certainly not be available against a genuinely willing licensee, there are situations where injunctions against unwilling licensees are a necessary remedy for IPR holders, such as a total refusal to negotiate a license, or refusal to pay compensation determined by a competent court. Any general guideline over and above the applicable SSO IPR policies would likely fail to fully address all possible behaviors of licensors and licensees. While regulatory authorities should definitely intervene in cases of clear abuse by IPR holders, the fact that commercial disputes about (F)RAND licensing terms are being resolved in courts is simply a sign of a normal, effective IPR market, not a sign of failure.

Second, some companies have suggested SSOs should define certain commercial terms for license agreements, such as a common royalty base, based on the cost of some minimal implementation of the technology. It is not appropriate for SSOs to define business models for licensors or implementers, or to favor particular business models over others. Not only could such over-regulation by SSOs lead to a breach of competition rules, but it would inevitably also distort the market, leading to less choice for consumers. For example, the value of intellectual property cannot always be defined as a fraction of the cost of some physical building blocks required for its implementation, as this would be analogous to forcing prices of software on a disk to be set as a percentage of the cost of the blank media carrying such software. When suppliers of such building blocks are not taking full responsibility for the cost of such IPR, its value is not reflected in the cost of such components either. Further, as 1% of a base of 100 leads to the same result as 10% of a base of 10, which royalty structure is actually used has no economic relevance, as long as the result reflects the appropriate value for a license. It should be left to market participants to implement royalty terms that are most efficient to agree and administer, rather than SSOs imposing particular solutions or limitations.

**Conclusion**

Competition and innovation in the communications sector has never been more intense, and open standards and associated IPR policies continue to play a critical enabling role. The (F)RAND licensing regime is alive and well, and there is no need for broad regulatory intervention either by SSOs or the regulator in the functioning of technology licensing markets in the communications sector. SSOs should focus on developing their IPR policies and approaches with an eye only to the future, not on re-interpreting past commitments or taking positions which may influence the outcome of private disputes. Regulators should focus on intervening only in cases of clear patent abuse, and let the markets and courts continue to function effectively and exercise their competence.

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1. For example, in the context of the current proposals for creating an EU unitary patent it is to be noted how much emphasis and importance is placed on establishing an effective and accessible litigation system (in the form of a new EU Unified Patent Court). [↑](#footnote-ref-1)