Kluwer Patent Blog

To Be or Not To BE SEPs

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Introduction

It used to be an excellent strategy to obtain patents on industry standards. The idea was rather simple: a patent covering an industry standard would mean that such a patent could be enforced against the entire industry. However, recent developments in the law on standard essential patents ("SEPs") have called this strategy into question.

An SEP generally refers to a patent that claims an invention that must be used to comply with a technical standard. To illustrate this, let's take a look at the IPR policy of the European Telecommunications Standards Institute ("ETSI"). ETSI is a large standard-setting organisation prominent in commercially significant standards, such as wireless communications standards. Due to the inter-operability requirements, certain ETSI standards are adopted in China and elsewhere in the world.

ETSI generally does not determine whether a particular patent is essential to a standard. Rather, it typically provides some mechanism by which the patent owner itself can make a declaration of essentiality, coupled with **a commitment to license any SEPs on fair, reasonable, and non-discriminatory ("FRAND") terms.**

ETSI standards and related SEPs were at the heart of patent licensing disputes between Huawei Technologies and InterDigital in China and the U.S. In April 2014, the Guangdong High Court published its October 2013 judgments in two related cases. One held that InterDigital abused its dominant market position by refusing to license its SEPs for 3G wireless communication devices on FRAND terms. In the other case, the court capped a FRAND rate at 0.019% of the actual product sales price for InterDigital to license its SEPs to Huawei.

In the Jiangus province, an alleged SEP for the USB 3.0 Specification took centre stage in litigation between Hon Hai Precision Industry, a Taiwanese company and a Chinese retailer of products with USB 3.0 connectors. In December 2014, the Jiangsu High Court affirmed the Jiangsu IP Bureau's ruling that the alleged SEP was not an essential patent, thus the grant of a permanent injunction against the sales of such products was also affirmed.

These two cases are the first to decide FRAND and essentiality in the context of SEPs in China and therefore warrant some analysis.

Huawei v. InterDigital

InterDigital, Inc. is a mid-sized U.S. wireless research and development company. On July 26, 2011, it filed a complaint with the U.S. ITC against Nokia Corporation and Nokia Inc., Huawei Technologies Co., Ltd and its affiliates, and ZTE Corporation and its affiliate, alleging patent infringement of certain 3G wireless devices, such as WCDMA- and CDMA 2000-capable mobile phones, USB sticks, mobile hotspots and tablets and components of such devices.

On December 5, 2011, Huawei filed two suits against InterDigital in the Shenzhen Intermediate Court in China. The first suit alleged that InterDigital had a dominant market position in China and the United States in the market for the licensing of essential patents owned by InterDigital and abused its market power by engaging in unlawful practices, including differentiated pricing, tying, and refusal to deal. The second suit alleged that InterDigital failed to negotiate on FRAND terms with Huawei. It asked the court to determine the FRAND rate for licensing essential Chinese patents to Huawei and also sought compensation for its costs associated with this matter.

On February 4, 2013, the Shenzhen Intermediate Court ruled that the royalties to be paid by Huawei for InterDigital's 2G, 3G, and 4G standard-essential patents should not exceed 0.019% of the actual sales price of each Huawei product. This appears to be the first time that any judicial authority has ruled on the appropriate royalty rate for a FRAND encumbered SEP.

With respect to the first suit, the court held that InterDigital violated China's Anti-Monopoly Law by (1) making proposals for royalties from Huawei that the court believed were excessive, (2) tying the licensing of essential patents to the licensing of non-essential patents, (3) requesting as part of its licensing proposals that Huawei provide a grant-back of certain patent rights to InterDigital, and (4) commencing a USITC action against Huawei while still in discussions with Huawei for a license. The court ordered InterDigital to cease the alleged excessive pricing and bundling of InterDigital's Chinese essential and non-essential patents, and to pay Huawei approximately USD 3.2 million in damages. The court dismissed Huawei's remaining allegations, including Huawei's claim that InterDigital improperly sought a worldwide license and improperly sought to bundle the licensing of essential patents on multiple generations of technologies.

With respect to the second suit, the court determined that, despite the fact that the FRAND requirement originated from ETSI's Intellectual Property Rights policy, which refers to French law, InterDigital's license offers to Huawei should be evaluated under Chinese law. Under Chinese law, the court concluded that the offers did not comply with FRAND.

InterDigital appealed both cases to the Guangdong High Court, which affirmed the lower court's rulings.

Hon Hai v. Ge Fang

USB 3.0 is the third major version of the Universal Serial Bus (USB) standard for interfacing computers and electronic devices. USB 3.0 can transfer data at up to 5

Gbit/s, which is more than ten times faster than the USB 2.0 standard. USB 3.0 connectors (see below) are usually distinguished from their USB 2.0 counterparts by blue colour-coding of the receptacles and plugs, and the initials SS.

USB 3.0 Specification is a non-mandatory industrial standard set by the USB Implementation Forum, Inc. ("USB-IF"). The USB 3.0 Contributors Agreement sets forth the conditions for licensing a contributor's SEPs. Article 3.4 of the USB 3.0 Contributors Agreement provides that

> Contributor, on behalf of itself and its Affiliates, hereby agrees that it will grant to any Promoter, other Contributor or Adopter, and their respective Affiliates, a non-exclusive, world-wide license under its Necessary Claims.

An SEP is defined in terms of "Necessary Claims", which refers to

> claims of a patent or patent application that (a) are owned or controlled by a party or its Affiliates now or at any future time during the term of this agreement; and (b) are necessarily infringed by implementing those portions of the Final Specification within the bounds of the Scope, wherein a claim is necessarily infringed only when it is not possible to avoid infringing it *because there is no commercial reasonable non-infringing alternative for implementing such portions of the Final Specification within the bounds of the Scope.* (Emphasis added.)

However, Necessary Claims do not include

> any claims (x) other than those set forth above even if contained in the same patent or patent application as Necessary Claims; (y) *that read solely on any implementations of any portion of the Final Specification that are not within the bounds of the Scope;* or (z) that, if licensed, would require consent from, and/or a payment of royalties by the licensor to unaffiliated third parties. (Emphasis added.)

The USB 3.0 Specification incorporates certain patented technologies of two Taiwan companies (among others): Hon Hai Precision Industry Co. Ltd ("Hon Hai") and Lotes Co., Ltd ("Lotes"). Under the USB 3.0 Contributors Agreement, both companies have agreed to grant a worldwide license to their contributed technologies. The two companies also engaged in negotiations with each other for a potential patent license.

In July 2012, Hon Hai and Foxconn (Kunshan) brought an administrative enforcement

action with the Jiangsu Intellectual Property Bureau ("Jiangsu IP Bureau"), accusing the Jianghonghan Trade Centre of infringing its Chinese utility model patent, ZL 200820138608.0. The accused products sold by the defendant included a USB 3.0 connector that is covered by the patent in suit. The Jiangsu IP Bureau found infringement and issued an injunction. The defendant appealed the Jiangsu IP Bureau's decision to the Nanjing Intermediate court and eventually to the Jiangsu High Court.

The High Court was asked to decide two main issues: first, whether the asserted patent claims are Necessary Claims covered by the USB 3.0 Specification; second, whether Lotes obtained a license to the patent in suit.

The parties did not dispute these facts: (1) the accused USB 3.0 connectors fall within the scope of the asserted patent claims; (2) USB 3.0 Specification does not disclose the "first recesses" limitation recited in the asserted patent claims. But the defendant contended that the "first recesses" limitation is a known technical feature and that any combination of a known technical feature with the standards must fall within the scope of Necessary Claims.

Relying on the definition of "Necessary Claims" in the USB 3.0 Contributors Agreement, the High Court flatly rejected the defendant's argument. First, the USB 3.0 Specification does not explicitly require/disclose such a technical feature. Second, the defendant failed to show that there are no reasonable, non-infringing alternatives. The High Court further noted that the mere fact that a non-infringing alternative does not have commercially competitive advantages does not make it unreasonable. Therefore, the asserted claims are not Necessary Claims.

Turning to the issue of license, the High Court noted that USB 3.0 specification itself does not provide any license, express or implied, by estoppel or otherwise, to any intellectual property rights. Article 3.4 of the USB 3.0 Contributors Agreement provides for the potential licensing of Necessary Claims. While the licensing terms should be royalty-free, reasonable and non-discriminatory, other means are also allowed. Therefore, the Specification and the Agreement do not create automatic licensing. Moreover, the asserted patent claims are not Necessary Claims. And the defendant did not produce any evidence to prove a licensing agreement has been consummated among the parties. For these reasons, the High Court rejected the defendant's license argument. Therefore, the defendant lost on appeal.

Concluding Thoughts

Now Chinese courts have spoken on FRAND – such royalty rates rather low. This is not surprising because courts in other parts of the world have arrived at similar low rates. What has not been decided is whether an SEP owner can obtain an injunction, especially if a FRAND offer was made but refused. There is a possibility that Chinese courts may refuse requests for any form of injunction based on SEPs encumbered with an irrevocable obligation to license. Therefore, SEPs seem to have limited value in China.

In contrast, implementation patents continue to have significant value. Implementation patents refer to patents that are not incorporated into a standard but

facilitate the implementation of the standard. Because implementation patents are not SEPs, they are not encumbered by FRAND obligations. Therefore, ordinary infringement damages and injunctive relief are available to these patents.

The Hon Hai patent is such an implementation patent. Interestingly, it is a utility model patent. This again proves that utility model patents continue to have vitality in China (see my prior blog on this subject at http://kluwerpatentblog.com/2014/12/30/continued-vitality-of-utility-model-patents-in-china/).

Finally, essentiality largely hinges upon the scope of the relevant standards. As shown by the Hon Hai case, essentiality is a fact-intensive inquiry. Expect vigorous litigation over this issue in the future. This will make the difference between SEPs and implementation patents.

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