

# Japan: Guidelines on the 'Fair Value Calculation of SEP for Multi-Component Products'

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A Study Group appointed by the Japanese Ministry of Economy, Trade and Industry has recently published Guidelines on Fair Value Calculation of Standard Essential Patents for Multi-Component Products. The Group was composed of high-profile Japanese lawyers and academics.

The guidelines represent an important intervention into the ongoing debate concerning the tension between standard essential patents (SEPs) (which offer their owners R&D incentives/rewards in the form of monopolistic rights) and technology standards (which should be widely used by all players in the market to ensure interoperability). Without a framework to promote harmonious licensing, SEPs owners could, if they wished, use the patent enforcement system to 'hold up' or prevent their competitors from launching rival products that use the same standards. There is a related risk that the exercise of monopoly power by SEP owners could lead to the need for implementers to obtain multiple licences – this is known as the problem of 'royalty-stacking'.

The need to obtain multiple licences is particularly evident when it comes to multi-component products that contain many parts, such as game machines, construction machines, personal computers, and automobiles. In these circumstances a variety of manufacturers are involved in the production process, thus forming a hierarchical supply chain. The risk of 'hold-up' is therefore very high in these industries. To minimise risks SEP owners typically must commit to licensing their SEPs on 'FRAND' terms (fair, reasonable, and non-discriminatory). At times the parties cannot agree on what the FRAND terms should be, which can lead to acrimonious disputes and costly litigation. Guidelines on FRAND from independent policy-makers or courts can be useful to provide a measure of clarity to negotiating parties.

Against this background, the Japanese Study Group proposes three general principles, which could be useful for determining the FRAND royalty for multi-component products to be paid to SEP owners.

The first principle is that the parties to a licensing agreement should be decided based on a 'license to all' approach. This would entail that SEP owners have to give licences to all those companies that seek them, regardless of their position within the supply chain, including the manufacturers of the final product and the suppliers of parts, such as primary subcontractors, secondary subcontractors, etc. The main reason for this is that SEP owners' licensing strategies should be 'non-discriminatory' (the 'ND' of FRAND), i.e. they should not treat implementers differently based on their manufacture stage.

The second principle highlighted by the Study Group is that royalties should be quantified relying on a 'top-down' approach. This method aims at finding out what the aggregate royalty should be for all SEP owners in relation to a specific standard, and subsequently apportioning that aggregate royalty amongst said owners. In other words, the aggregate royalty attributable to a standard ought to be based on the value of the standard to the final product where it is implemented, and the portion of that aggregate royalty attributable to the SEP holder is quantified based on its share of the SEPs related to that standard. A type of 'top-down' approach was relied on in the 2013 US case *In re Innovatio IP Ventures, LLC* and the 2014 Japanese case *Samsung v Apple Japan* (Apple Japan Godo Kaisha v Samsung Electronics Co). This method is to be distinguished from the 'bottom-up' approach which instead takes into account the relevance and value of each individual SEP patent without looking at other SEP patents in the field.

The Group then considers the so-called EMVR method (Entire Market Value Rule), which quantifies the value of the royalty based on sales and profits of the entire product and not just the patented part or features of the product itself. The so-called SSPPU (Smallest Saleable Patent Practicing Unit) method is also discussed: this is a method for calculating royalties that is based on the smallest unit - module, unit or component - that employs the patented technology. Yet, after mentioning the above alternative methods, the Study Group proposes a different method: to determine the royalties based on the portion to which the SEP technology contributes in the value of the main product in which the SEP technology is implemented. This is akin to a 'contribution rate' approach.

The Study Group Guidelines also note that, as opposed to big corporations, small and medium-sized enterprises (SMEs) are at a greater risk of striking licensing terms on unfavourable conditions since they do not have large resources to deal with negotiations over SEPs, including professional human resources and relevant information necessary to conduct lengthy and difficult negotiations. They are therefore at a greater risk of being hit by exorbitant licence fees or, if negotiations fail, potentially devastating injunctions.

Attention to the needs of SMEs is not unusual when it comes to SEPs. The EU institutions have also paid heed to these companies. For example, concerns were expressed by the Commission in its Communication of 29 November 2017 on the EU approach to SEPs. One of the burning issues highlighted in that document is the lack of transparency in the context of SEP licensing frameworks managed by standard setting organisations (SSOs). Indeed, the Commission states that being able to access accurate information on the scale of exposure to SEPs is vital to the users of standards, especially SMEs that have little experience of licensing practices and seek to enter the relevant markets looking for connectivity. However, this information is not always easy to access. The Communication notes, in particular, that '... currently the only information on SEPs accessible to users can be found in declaration databases maintained by SSOs which may lack transparency' – a scenario that leaves companies, particularly SMEs and start-ups, in a difficult situation with respect to licensing negotiations and risk management.

Overall, the Guidelines produced by the Japanese Group Study are a positive intervention in this field. They should assist implementers of standardised and patented technology to strike favourable licensing deals, thus counter-balancing the strong monopolistic position SEP owners often find themselves in. This in turn **can benefit final consumers via better value products capable of interoperability**.

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