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Valuation and Licensing of Standard Essential Patents in a British Context

Roya Ghafele (OxFirst) · Thursday, April 8th, 2021

In the aftermath of the landmark decision 'Unwired Planet vs Huawei', a series of other FRAND litigations have followed suit. Cases such as Conversant vs ZTE/Huawei, Philips vs TCL, TQ Delta v ZyXel or Optis v Apple pertain equally to the licensing of standard essential patents.

From an economic perspective this raises the question as to how the British Courts may want to continue addressing the valuation of standard essential patents. To shed further light on this question, this article offers a short overview of key valuation and principles. These reflect the state of play of English law and also found their application in the Unwired Planet vs Huawei Court.

In Unwired Planet vs Huawei two principal methods were applied to determine the FRAND royalty rate. The Top Down Approach and the Comparable licenses approach served as the toolkits to come to grips with the FRAND value of standard essential patents. The Top Down Approach seeks to determine the aggregate royalty rate for patents that read on a given standard. As such, the method lends itself well to understand the value of given standard essential patents (SEPs) in relation to the entire standard. The advantage of the method is that it helps mitigate the peril of royalty stacking. Royalty stacking describes the risks associated with a potential cumulative royalty rate a licensee may have to bear if it were to pay respective licensing rates also to all other holders of patents that read on a given standard. In Unwired Planet vs Huawei the Court recognized that even the hypothetical risk of a royalty stack can jeopardize the FRAND-ness of a licensing rate.

The method also has the appeal to offer further transparency and clarity. As it offers an estimate of the value of the standard as a whole, licensees may be better placed to price standard compliant products from the outset. The way that the Unwired Planet vs Huawei court went along in doing so, was to count the number of patents on a given standard.

On the other hand side, the application of the Top Down approach can disincentive patentees to sell or otherwise trade their standard essential patents to professional licensing entities. Because one aggregate rate is determined, the patentee cannot expect to get paid more by splitting its portfolio and licensing it through different entities.

The other key method the Court recognized was the Comparable licenses approach. The approach is quite easy to understand. It seeks to determine a licensing rate with reference to what other licensees have been willing to pay. The method hence establishes a FRAND rate with reference to

a comparison and determines a FRAND rate by seeking to track ‘real world’ scenarios. As such, the advantage of the method is that it is anchored in the reality. To furthermore establish the comparability of licensing transactions, it can be necessary to make use of additional econometric assessments. Licensing transactions may for example need to be brought to a ‘common denominator’ so that their comparability may be somewhat established. The Unwired Planet Court called this the ‘Unpacking of FRAND licensing rates.’; a terminology it borrowed from Ericsson.

The art is to find comparable licensing rates in the first instance and here reform of existing disclosure requirements for licensing transactions could help. Also, licensors and licensees may not have the same level of access to comparable rates. A licensor will have full records of its licensing transactions. An insight, a licensee will not possess.

Other than that, the Unwired Planet vs Huawei Court also recognized the so called ‘Ex-Ante Approach.’ This approach seeks to determine the value of the patents before or at the time they were adopted in the standard. Since the parties to the case did however not elaborate on this method, it was not further established.

With this baseline, the Unwired Planet vs Huawei Court felt well equipped to establish the FRAND rates of Unwired Planet’s patents.

But where does this leave all the other FRAND disputes currently pending in the UK?

Under English law, a simple ‘cut and paste’ of an existing valuation approach is not permitted. The valuation needs to be established on the merits of this specific case. This does however not mean that either the Top Down Approach or the Comparable licenses approach cannot be used to gain insights on the FRAND value of the SEPs under dispute. In Unwired Planet vs Huawei, the Court used a combination of both methods. While the Court started off with the Comparable licenses approach and used the Top Down approach as a cross check, it is also possible to start off with the Top Down Approach and use the Comparable licenses approach as a sensitivity check. Equally, such an Approach has found recognition in the Court room.

English law furthermore recognizes the need to assess the value of a license within the context of a hypothetical negotiation. The hypothetical negotiation is more a framework of thought than a concrete prescription as to how to determine a licensing rate for a patent. As a valuation toolkit it has been recognized for IP in general and is not reserved to the FRAND debate.

The hypothetical licensing negotiation describes an idealized scenario whereby a licensor and licensee would have discussed the adequacy of a licensing rate before the infringement incurred. In an English context, this approach seeks to establish the value of the license as if infringement had never occurred. The thought framework of the hypothetical negotiation leaves scope for a range of different methods that can be applied. After all, parties to a hypothetical negotiation could have applied a range of different methods they found useful to state their case.

So, where does this leave the current state of play of the valuation of standard essential patents in the UK?

With Unwired Planet vs Huawei the UK has recognized the need for an economic determination of FRAND royalty rates. The way the FRAND rate was determined is far from perfect, but may be a starting point for further thought.

In light of the many pending FRAND cases the UK Courts are currently hearing, it would be important to advance current thinking on the valuation of FRAND rates. Doing otherwise risks exposing these cases to the payment of an insufficiently well grounded FRAND licensing rate.

To further enhance the applicability of the comparable licensing rate, it may be helpful to insist on further disclosure requirements for licensing transaction and introduce policy reform in that respect. In both Canada and the United States, financial authorities require the disclosure of licensing transactions of significant size. In the UK and Europe no such requirements exist, to my knowledge. This can make the identification of comparable rates a challenge and should be changed.

Clearly, going forward, it is obvious that there is a need to further establish thinking on the value of FRAND licensing rates and IP in general.

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