ALLEN & OVERY

IN *TCL V ERICSSON* THE CALIFORNIA COURT SETS A FRAND RATE FOR ERICSSON'S SEP PORTFOLIO SIGNIFICANTLY LOWER THAN THE RATE THE ENGLISH COURT DERIVED IN *UNWIRED PLANET V HUAWEI*

Same portfolio, different rates – how *TCL v Ericsson* compares with *Unwired Planet v Huawei*

On 21 December 2017 the U.S. District Court for the Central District of California released its judgment in *TCL Communications v Ericsson*[1] setting a Fair, Reasonable, and Non-Discriminatory (**FRAND**) rate for Ericsson's Standard Essential Patent (**SEP**) portfolio for licensing to Chinese handset manufacturer TCL Communications (**TCL**). This decision by Judge James Selna comes eight months after the High Court of England and Wales set a global FRAND rate in *Unwired Planet v Huawei*[2] for Unwired Planet's SEP portfolio purchased from Ericsson (which necessitated determining the rate for Ericsson's portfolio). Both courts utilised similar methodologies to establish FRAND rates, yet arrived at royalties that were quite different, with the California court establishing a FRAND rate for Ericsson's portfolio that is less than half the rate set by the English court. In this note we examine the courts' analyses and how the judgments differ.

Background

The dispute concerned the licencing of Ericsson's SEP portfolio, which contains a number of patents that Ericsson had declared essential to the 2G, 3G, and 4G standards of the European Telecommunications Standards Institute (**ETSI**). Under ETSI's policies, which are governed by French law, patent holders that declare their patents essential to ETSI standards are required to grant licences to manufacturers on FRAND terms: this is to ensure that the SEP owner is fairly compensated for use of its patent without abusing its superior bargaining position relative to the licensee.

After years of licencing negotiations (discussed below), TCL sued Ericsson in March 2014 in California for, *inter alia*, breach of the ETSI FRAND obligation in respect of its SEP portfolio and declarations that Ericsson's patents were invalid. Within three months, Ericsson initiated its own patent infringement suit against TCL in the Eastern District of Texas, which was transferred to California and subsequently consolidated with the main action. Ericsson had brought similar suits against TCL in France, the UK, Brazil, Russia, Argentina, and Germany; however in July 2015 the California District court granted TCL an anti-suit injunction requiring the parties to jointly request a stay of all claims and counterclaims in all worldwide litigation pending the judgment of the California court. TCL agreed to accept the worldwide portfolio licence rate the California court would set.

As in *Unwired Planet*, Judge Selna applied French law and concluded that the contract between a declarant patentee and ETSI includes an obligation on the patentee to licence its SEPs to third parties on FRAND terms. TCL is entitled to enforce the contract between ETSI and Ericsson by virtue of the doctrine of *stipulation pour autrui*, or stipulation on behalf of a third party.

[1] *TCL Communications v Ericsson*, Case No. 8:14-cv-00341-JVS-DFM (C.D. Cal. Dec. 21, 2017).
[2] *Unwired Planet v Huawei* [2017] EWHC 2988 (Pat).

The parties' negotiations

Negotiations between TCL and Ericsson had been on-going since 2011 for Ericsson's 3G portfolio and 2013 for Ericsson's 4G portfolio.[3] TCL filed its lawsuit while discussions were on-going, shortly after Ericsson had made an offer to TCL, to which TCL representatives had responded positively, saying "*it looks promising, we will form a team quickly to start the detail negotiation*". However, rather than continuing negotiations, TCL filed suit.

The judgment does not comment on TCL's approach during negotiations as the licensee. This is in contrast to *Unwired Planet*, where Mr Justice Birss found that "*although an implementer does not owe a FRAND obligation to ETSI, an implementer who wishes to take advantage of the patentee's FRAND obligation, must themselves negotiate in a FRAND manner*". The California and English courts may therefore differ as to whether the ETSI obligation carries with it any requirements on the implementer.

With respect to the patentee, Judge Selna found that Ericsson had acted in good faith and its licensing approach had not violated its obligations to ETSI. However, as discussed below, the judge also concluded that neither of the offers that Ericsson made to TCL (referred to as Offer A and Offer B) were FRAND. The court therefore set about to determine the FRAND rate for Ericsson's portfolio, although noting that "*the search for precision and absolute certainty is a doomed undertaking*".

Determining the FRAND rate

The California court relied on the "top-down" or "total aggregate royalty" approach to assess the appropriate FRAND rate for Ericsson's portfolio, which involves determining the aggregate SEP royalty applicable to a standard, and then allocating an appropriate proportion of the total royalties to each SEP holder, in accordance with their share of the standard. The court was therefore required to deduce the proportion of royalties Ericsson should receive for the 2G, 3G, and 4G standards, as compared with other SEP holders.

The court took the approach that, for each relevant standard, Ericsson was entitled to the proportion of royalties equivalent to the proportion of SEPs it owned in that standard. As such, the court calculated the number of truly essential SEPs Ericsson had (the numerator) compared to the number of truly essential patents in each relevant standard (the denominator), as the UK court did in *Unwired Planet*. The need to examine truly essential patents rather than simply counting how many patents have been declared essential to that standard results from over-declaration, whereby some patents are declared essential to ETSI standards when they are not, in fact, essential.

The total aggregate royalty approach takes into account all of the patents in a standard, rather than determining a FRAND rate by looking at the contribution of individual patents or comparable licences. The approach was recently endorsed by the European Commission in its 29 November 2017 communication on SEPs, which states that "*an individual SEP cannot be considered in isolation. Parties need to take into account a reasonable aggregate rate for the standard, assessing the overall added value of the technology*". We analyse the Commissions' communication here.

Total number of SEPs

To determine how many truly essential patents are in the 2G, 3G, and 4G standards, TCL presented evidence compiled by a team of engineers based in India and led by Dr Apostoles Kakaes, who had done a similar exercise for Huawei in the *Unwired Planet* litigation. The team started by gathering the 153,000 patents/applications that were declared

[3] TCL had also secured a licence to Ericsson's 2G portfolio in 2007 that was set to expire in 2014, and so needed renewal.

essential to ETSI's 2G, 3G, or 4G standards, and applying a series of steps to narrow down the pool. Patent families that were all expired, did not have an English language patent, or did not have claims directed at user equipment were excluded. This narrowed the pool to 7,106 patent families. The team then identified the 15 largest patent holders and examined one-third of each entity's patents remaining in the list, ultimately analysing the essentiality of about 2,600 patent families. The team concluded that there are 446 essential 2G patent families, 1,166 essential 3G patent families, and 1,796 essential 4G patent families; although after adjustments for geographic disparities in Ericsson's portfolio, TCL's final figures were 413 in 2G, 1,076 in 3G, and 1,673 in 4G.

Although Judge Selna approved of TCL's overall approach, he found that excluding expired patents from consideration was erroneous. This was because "*[t]he total aggregate royalty represents the value of all expired and unexpired inventions in the standard, also removing an expired SEP from the denominator treats the invention as no longer having value. The invention however still has value, that value has merely been transferred to the public domain. To remove expired patents from the denominator (without decreasing the total aggregate royalty) would result in transferring the value from expired inventions to the remaining patents in the standard instead of the public*." However, TCL had not put forward any figures which included the expired patents.

Ericsson did not propose any alternative figures for the number of patents in the standards. Ericsson however did criticise TCL's approach, arguing that its team of consultants could only have spent on average of 20 minutes per patent at a cost of around $100 "*and this is plainly insufficient*." A similar criticism of Huawei was put forward by Unwired Planet in its UK litigation, which argued that Huawei's team could only have spent 30 minutes per patent evaluating it for essentiality.

Ultimately, the court broadly accepted TCL's proposed approach and results with certain adjustments to account for a number of inconsistencies in TCL's own evaluation, which reduced the number of patents TCL put forth by 11.4%. As such, the court found that there were 365 truly essential patent families in the 2G standard, 953 in 3G, and 1,481 in 4G.

In the *Unwired Planet* FRAND determination, which we summarise here, Huawei used a similar process that involved starting out with all of the patents declared essential and narrowing down the pool, ultimately examining only the patent families that remained for essentiality. Unwired Planet put forth its own figures using a largely sampling-based approach, finding there were far fewer truly essential patents in each standard than Huawei's figures. Much of the trial involved an examination of each party's methodology and the opposing sides' criticisms of each. Mr Justice Birss found each process had certain merits but was not sufficiently precise, and ultimately split the difference between the figures proposed by each side, concluding there were 154 2G , 479 3G, and 800 4G essential patent families.

Ericsson's SEPs and proportional share

In *TCL v Ericsson*, the parties disagreed on the number of essential patents in Ericsson's portfolio. The parties agreed that Ericsson held 12 2G SEP families, but disagreed over 3G and 4G (TCL finding that Ericsson had roughly 20 3G SEP families and 70 4G SEP families, while Ericsson found it had roughly 25 3G SEP families and 112 4G SEP families). Any patents that would expire prior to the date of closing arguments (May 18, 2017) were eliminated from consideration in light of the holding in *Brulotte v. Thys*, 379 U.S. 29 (1964), which prohibits royalties on patents that have expired.

In *Unwired Planet v Huawei*, the English court also determined the number of essential patent families in Ericsson's portfolio (to derive the value for Unwired Planet's portfolio), and, adjusting those figures proposed by Huawei, concluded that Ericsson had 21 2G SEP families, 42 3G SEP families, and 67 4G SEP families.

As noted earlier, in *TCL* the court determined the strength of Ericsson's portfolio, and the proportion of royalties it would receive, by calculating the number of essential patents in Ericsson's portfolio (the numerator) divided by the total number of essential patents in the standard (the denominator). For example, for 2G, since the parties agreed that Ericsson had 12 SEP families, that ratio was 3.28% (12/365), meaning, Ericsson owned 3.28% of all 2G essential patent families. Had TCL not excluded the expired patents from the denominator, Ericsson's proportion of 2G SEP families would have been smaller.

In *TCL*, for 3G and 4G, the court examined each party's figures, finding that: (a) for 3G, Ericsson had either 2.061% of essential SEP families (using TCL's figures) or 2.58% of 3G SEP families (using Ericsson's figures), and (b) for 4G, Ericsson had either 4.761% (using TCL's figures) or 7.525% (using Ericsson's figures). These figures were then compared to rates found in comparable licences, leading the court to set a rate for each standard, as discussed below.

The court acknowledged that Ericsson's portfolio was strongest in the US, and therefore the rates outside the US should be lower. Although Ericsson does not have patents in every country, the court noted that patents can also be enforced where the products are manufactured, in this case China. Ericsson's portfolio was weaker in China, and so a lower rate for China was set, and that rate was used as the global floor which would be paid in the entire Rest of World region. The court found that Ericsson's 2G and 3G portfolios were stronger in Europe than China, and so set a Europe rate for 2G and 3G.

In *Unwired Planet*, the court found two separate rates: one rate for Major Markets (which, for all standards, consisted of the UK, the US, Japan, Korea, India, and France) and one rate for Other Markets (all other countries, including China). The FRAND rate for the Other Market countries was 50% of the Major Market rate. Although the court in *Unwired Planet* commented that the royalty rate in China is often lower than for the rest of the world, there was no suggestion that China should be used as any kind of global 'floor' as was done in *TCL*.

Total aggregate royalty rate

In *TCL*, the court used Ericsson's proportion of patents in each standard to derive the royalty rate Ericsson should receive, based on the total aggregate royalty rate for each standard. To determine the appropriate total aggregate royalty rate, the court relied on press releases by SEP holders, including Ericsson's own public statements, made during the period when manufacturers were announcing rates to induce adoption of standards covered by their patents.

The court found that 5% was an appropriate total aggregate royalty for 2G and 3G. This means that, for 2G or 3G, a manufacturer producing handsets would pay, in total, 5% of its selling price in patent royalties. Ericsson would receive 3.280% of that 5% total for 2G, given that it held 3.280% of all 2G patents. The royalty rate for Ericsson's 2G portfolio is therefore 0.164%.

For 4G, the court applied total aggregate royalty rates of both 6% and 10% and ultimately calculated Ericsson's royalty rate by taking both figures into account and comparing those to rates in other licences, as discussed below.

In *Unwired Planet*, the court calculated the total aggregate royalty as a cross-check, finding that the numbers derived from assessing portfolio strength and comparable licences indicate a total aggregate royalty of 5.6% for 2G and 3G and 8.8% for 4G.

Comparable licences

Although the court in *TCL* relied on the total aggregate royalty approach to determine a fair and reasonable rate for Ericsson's portfolio, Judge Selna noted that doing so does not help ascertain whether the discrimination element of FRAND has been violated. The court therefore analysed comparable licences to assess whether Ericsson's Offer A and Offer B to TCL were discriminatory, as well as taking the comparable licence rates into account in deriving the final rates for Ericsson's portfolio.

Geographic scope was found to be the most important factor in assessing which licences/parties were comparable. The court determined that TCL is a global firm (not a "local king") as were Huawei, LG, HTC and ZTE. Additionally, the court found that Apple and Samsung were relevant comparators, despite Ericsson's argument that Apple and Samsung are not similar to TCL given their greater market shares and brand recognition. The court rejected this argument and found that "*the prohibition on discrimination would mean very little if the largest, most profitable firms could always be a category unto themselves simply because they were the largest and most profitable firms*".

In *Unwired Planet*, prior to commencement of the FRAND trial, Unwired Planet had settled its case against Samsung. Huawei argued that the settlement between Unwired Planet and Samsung formed a useful comparable licence, and that Unwired Planet was discriminatory in not granting Huawei similar rates. Mr Justice Birss disagreed, finding that given the circumstances that led to the Unwired Planet/Samsung licence, it was not comparable for determining the FRAND rates to Unwired Planet's portfolio.

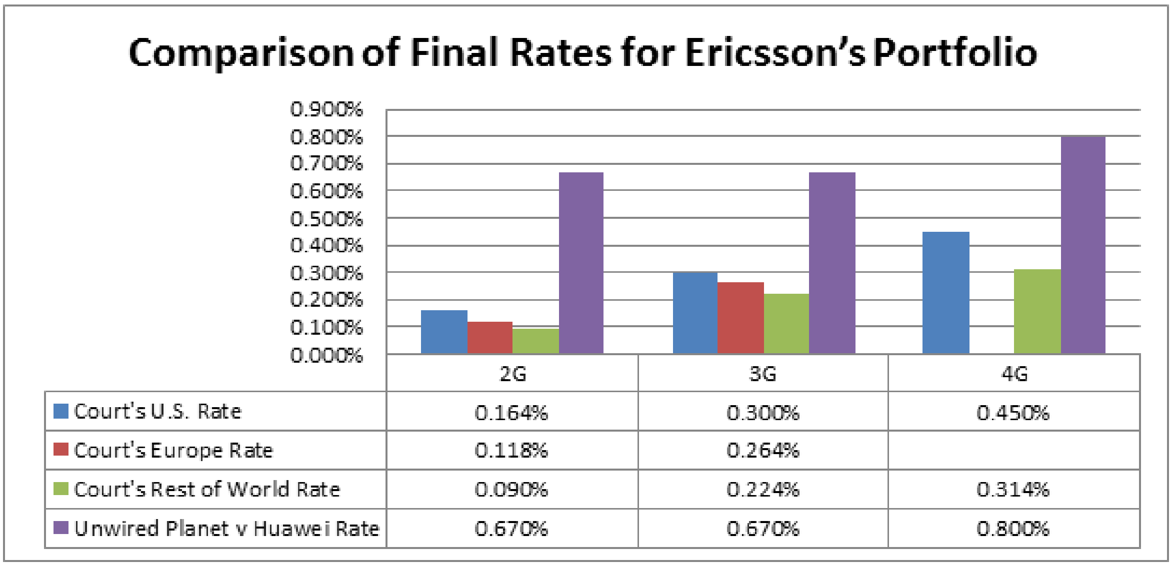
Discrimination

The court in *TCL* compared the rates Ericsson offered TCL with the rates Ericsson had given comparators, to assess whether Ericsson had been discriminatory. Ericsson argued that to be discriminatory the price has to be "*impairing the development of standards*", which is similar to the approach adopted by Mr Justice Birss in *Unwired Planet*. However, Judge Selna held that discrimination in violation of a FRAND commitment can be found so long as an individual company is harmed. He rejected applying a US antitrust law-based standard, which requires harm to competition rather than harm to a competitor, to the analysis of discrimination as part of the FRAND commitment.

By comparing Offer A, Offer B, and the rates in comparable licences, the court found that Ericsson had been discriminatory and noncompliant with its FRAND obligations. Although the figures in the comparable licences remain confidential (as with the rates in licences analysed in *Unwired Planet*), the *TCL* judgment illustrates that the rates in Ericsson's Offer A and Offer B were much higher than the rates Ericsson had charged similarly-situated entities.

The rates for Ericsson's portfolio

As mentioned, both the *TCL* and *Unwired Planet* courts derived FRAND rates for Ericsson's portfolio, although in *Unwired Planet*, that was done as part of the larger task of setting the rate for Unwired Planet's portfolio, a subset of Ericsson's portfolio. The chart below compares the royalty rates as determined by each court:



As shown by the chart, the rates derived in *TCL v Ericsson* are less than half of the rates found in *Unwired Planet*. The main reason for the difference is the value the court adopted for the denominator showing the total number of essential patents in each standard. In *Unwired Planet*, the court found there were 800 total 4G SEP families, 479 3G SEP families, and 154 2G SEP families. In *TCL*, the court found there were 1,481 4G SEP families, 953 3G SEP families, and 365 2G SEP families.

The court in *TCL* ordered that the parties enter into a 5-year licence agreement reflecting the determined FRAND rates, and that TCL must pay Ericsson approximately $16.5 million for past un-licenced sales. In *Unwired Planet*, Mr Justice Birss ordered a "FRAND injunction", meaning that Huawei must accept the FRAND licence as set by the court or be enjoined in the UK.

Conclusion

Future courts assessing FRAND rates have additional approaches to consider in light of *TCL v Ericsson* as compared to *Unwired Planet v Huawei*. SEP holders and licensees will watch with interest whether courts adopt the *TCL* court's determination that discrimination for the purposes of compliance with the ETSI FRAND undertaking can exist if a single entity is harmed. The approach taken by the US court implies that manufacturers selling their products at the lower end of the market can be considered "*similarly situated*" to the highest grossing firms, enabling them to benefit from rates negotiated by those market players.

Of course, neither *TCL v Ericsson* nor *Unwired Planet v Huawei* constitute settled law. Ericsson is expected to appeal *TCL*, while the *Unwired Planet* appeal will be heard in May 2018. We must wait and see what the next judgment brings.

Key contacts

Nicola Dagg
Partner – London
Intellectual Property

Contact
Tel +44 20 3088 3871
Mob +44 7 815 063 369
nicola.dagg@allenovery.com

Dominic Long
Partner – London and Brussels
Antitrust

Contact
Tel +44 20 3088 3626
Mob +44 7825 980 441
dominic.long@allenovery.com

Mark Heaney
Partner – London
Intellectual Property

Contact
Tel +44 20 3088 2914
Mob +447717 800526
mark.heaney@allenovery.com

Mark Ridgway
Partner – London
Intellectual Property

Contact
Tel +44 20 3088 3720
Mob +44 7767 674 294
mark.ridgway@allenovery.com

Taly Dvorkis
Senior Associate – London
Intellectual Property

Contact
Tel +44 20 3088 4995
taly.dvorkis@allenovery.com

