Interdigital v Lenovo: a win for SMEs

UK policymakers should build on the High Court judgment by adding more transparency to the FRAND licensing process, argues Jim Beveridge

March 2023 was a busy month for followers of the standard essential patent (SEP) scene in Europe. On March 16, the England and Wales High Court published its decision in *Interdigital v Lenovo*.

The impact of this ruling was much wider than the traditional mobile phone marketplace because SMEs increasingly use communication SEPs in vertical IoT applications.

This is only the second-ever determination of fair, reasonably, and non-discriminatory (FRAND) licence terms in the UK courts. Mr Justice James Mellor took this opportunity to examine and clarify the key principles applicable in global FRAND disputes.

The court-determined rate of 17.5 cents per unit was close to Lenovo's offer of 16 cents and some distance from Interdigital's (supra-FRAND) offer of 49.8 cents. The court ruled that neither Interdigital's 5G extended offer, nor Lenovo's so-called lump sum offer, were FRAND.

This ruling, following on from the *Unwired Planet* judgment, provides an additional point of reference for companies seeking to navigate a global patent system that remains in flux. Helpfully, the court identified principles (transparency, willingness, valuation, etc) that are important for a balanced FRAND determination. The court also acknowledged the discrimination in this process towards SMEs.

Five key takeaways

1. The court set a FRAND rate for InterDigital's portfolio of $0.175 per device, amounting to a total of $138.7million, which was 65% lower than the rate being sought by InterDigital.

2. The court held that, "by consistently seeking supra-FRAND rates, InterDigital did not act as a willing licensor" whereas "for the most part, Lenovo did conduct themselves as a willing licensee".

3. The court carried out a comparable licence analysis. It rejected InterDigital's 20 proposed comparable licences and top-down analysis. It relied upon the seven licences offered by Lenovo (principally the LG 2017 license).

4. The court held the FRAND determination was not time-limited, as would be the case for a damages determination. Lenovo therefore had to pay full (no discounts applied) royalties on sales from 2007 until the end of 2023.

5. The court emphasised the need for transparency in this market: "the SEP universe would be able to converge on and agree FRAND terms very much more quickly if the

basics of each SEP licence were made public (by ‘basics’ I mean the number of units covered, the royalty rates or total sum paid/payable and which standards are involved). In other words, the market for mobile telephony SEP licences would work very much more smoothly with transparency of what terms had been agreed in the past” and this “has implications for how the SEP licensor should conduct itself as a willing licensor”.

The court identified necessary principles of FRAND in its judgement (outlined below). Justice Mellor’s rationale was that, as more clarity is brought to the FRAND principles by courts, the application of the European Telecommunications Standards Institute’s (ETSI) FRAND obligation will become clearer. Below are extracts and analysis of the most significant parts of the judgment.

Transparency

The court emphasised the need for transparency in the SEP market. The court found that, if the basic elements of each SEP licence were made public, it would be much easier for SEP holders and implementers to agree on FRAND terms.

The court explained that transparency would help ensure that SEP holders are not able to extract excessive royalties from implementers. It would also ensure that implementers are not able to avoid paying royalties altogether.

Transparency is essential for ensuring that SEP holders and implementers can reach fair and reasonable terms.

¶200: “The SEP universe would be able to converge on and agree FRAND terms very much more quickly if the basics of each SEP licence were made public (by ‘basics’ I mean the number of units covered, the royalty rates or total sum paid/payable and which standards are involved).”

Volume Discounting = SME discrimination.

In particular, the court found that InterDigital's volume discounts were not FRAND and risked discriminating against smaller licensees who would end up paying much more on a unit basis than the larger companies.

The court's reasoning was as follows:

- Volume discounts are typically used in manufacturing to offset the costs of production. However, there are no such costs associated with IP licensing. As a result, volume discounts in IP licensing can only serve to increase the profits of the patent holder, while disproportionately burdening smaller licensees.
- Smaller licensees are often the ones who are most likely to bring new products and services to market. However, they may be reluctant to do so if they know that they will be at a disadvantage in terms of licensing costs.
- Volume discounts can therefore discourage innovation and competition in the market.

The court's decision is a positive development for competition and innovation. It sends a clear message to patent holders that they cannot use volume discounts to discriminate against smaller licensees.

¶495:"Having considered all the evidence on the issue of volume discounts I have reached the clear conclusion that the volume discounts said to have been applied to the largest InterDigital licensees (i.e., in the range of 60%-80%) do not have any economic or other justification. Instead, their primary purpose is to attempt to shore up InterDigital's chosen 'program rates'. Their primary effect is discrimination against smaller licensees."

¶499: "most importantly of all, the sizes of the volume discounts said to be used by InterDigital plainly discriminate against smaller licensees, which is exactly what FRAND is supposed to avoid."

¶507: "I emphasise that I am not deciding that volume discounts of any magnitude are not FRAND. One of Mr Meyer's final answers on this topic indicated that relatively small volume discounts might not take a rate outside the FRAND range."

1. **Comparable licences**

Mr Justice Mellor considered 27 licenses and, of these, found that only one was truly comparable to the one at issue.

This licence, an agreement between InterDigital and LG in 2017, was the most relevant because it involved the same technologies, products, and markets as the Lenovo case.

The court found that the LG licence supported a royalty rate of $0.175 per unit. This rate was significantly lower than the rate that InterDigital had demanded from Lenovo. The court found that InterDigital's other licenses were not comparable because they were either too old, too narrow in scope, or too favourable to InterDigital.

The court's decision to rely on the LG license is significant because it provides guidance to other courts in future FRAND licensing disputes. It shows that courts will consider a variety of factors when determining the FRAND rate, which may include the value of the patents, the costs of licensing, and the competitive landscape.

Royalties

FRAND royalties should be independent of the price and use of the end product. This is because the value of a patent should not be based on the price or use of the product that it is used in. Instead, the value of a patent should be based on the contribution that it makes to the overall innovation process. This is good news for SMEs producing modules targeting a variety of use cases.

Furthermore, if FRAND royalties were based on the price or use of the end product, then patent holders would have an incentive to design their patents in a way that maximises the price or use of the end product. This would lead to a situation where patent holders would be rewarded for designing their patents in a way that is harmful to competition and innovation.

Instead, FRAND royalties should be based on the value of the patent itself. This would ensure that patent holders are rewarded for their innovation, while also preventing them from using their patents to stifle competition and innovation.

¶199: "Each unit should be viewed as a functional unit, functioning using the relevant generation(s) of the technology. I consider this approach is consistent with, indeed dictated by, the FRAND obligation so that the royalties paid and payable for each functional unit should be the same. I observe that in the ETSI materials there is no hint at all that FRAND licensing should be on a 'profits available' approach (cf. the old 'Licenses of Right' caselaw)."

291:"The same royalty is payable whether the device is very heavily used over mobile networks, or data is predominantly conveyed over Wi-Fi networks, or the device is put in a drawer and never used."

Injunctions

Mr Justice Mellor reinforced that if patent liability is established for a valid essential patent setup then the licensee has to accept the UK FRAND licence or face an FRAND injunction. He noted that, in this case, Lenovo were justified in saying no to the offers from InterDigital.

¶ 11:"I also found the notion that InterDigital might be entitled to an unqualified injunction against an implementer like Lenovo to be unreal, unless Lenovo had unequivocally refused to take a FRAND licence. I shall explain my view in greater detail below, but there is a very simple reason for it. InterDigital's undertaking to ETSI is 'irrevocable'. InterDigital cannot revoke its undertaking to license on FRAND terms, whether generally or in respect of any particular implementer."

He went further to clarify as to what that means.

¶ 532: "If a Defendant to this type of action does not want to invoke the Claimant's undertaking to ETSI, then, assuming one or more SEPs have been found to be valid and essential, the Defendant is highly likely to be subject to an injunction to restrain further infringement in the future and to have to pay damages in respect of past infringements. Assuming also that the Defendant has pleaded limitation as a defence, damages will only be recoverable for infringements committed within 6 years of the date of the claim form. Limitation is applicable in those circumstances because the Defendant has turned its back on entering into the relationship of willing licensor and willing licensee."

¶533: "By contrast, if the Defendant does wish to invoke the Claimant's undertaking to ETSI, then, howsoever the action is characterised, the relationship invoked (that of willing licensor and willing licensee) is central. It is that relationship, in my view, which takes this type of action outside the normal realms of actions in tort or contract where limitation applies. It is that relationship [that] is inconsistent with one party in these circumstances being able to rely on limitation defences."

Past sales

The judge said that a willing licensee would not seek to benefit from delay in agreeing FRAND terms or payment of FRAND royalties. Instead, a willing licensee would pay in respect of all past units as soon as the appropriate rates have been agreed or set.

This is because a willing licensee understands that FRAND is a process, and that it is in their best interest to cooperate with the patent holder to reach an agreement as quickly as possible. If a licensee delays the process, they run the risk of being ordered to pay back royalties for past units.

This is a significant development in FRAND licensing law. It sends a message to implementers that they cannot delay the licensing process to avoid paying royalties for past units. Instead, implementers must be willing to cooperate with patent holders to reach an agreement as quickly as possible. The court noted that, in this case, a FRAND offer was not provided so the delay was not necessarily the licensee-implementer's fault and acknowledged that this point will be subject to appeal.

¶529: "In my view, a willing licensee would not seek to benefit from delay in agreeing FRAND terms or payment of FRAND royalties. Thus, I have concluded that a willing licensee will pay in respect of all past units. Specifically, I do not consider that a willing licensee would seek to avoid making payments of FRAND royalties by taking advantage of one or more national limitation periods. The willing licensee would say: 'I have set these monies aside to pay to the SEP licensor(s) and I will pay them over just as soon as the appropriate rates have been agreed or set'. If the position was otherwise, that would automatically insert into the process (and FRAND is a process) an on- going perverse incentive to delay the agreement or setting of FRAND terms for as long as possible i.e. the longer the delay, the less the licensee has to pay. This cannot be FRAND."

¶728: " …SEP licensors now have the ability to litigate to determine global FRAND terms and, if my ruling regarding limitation is upheld on appeal, there will be much less incentive for implementers to engage in hold out …"

Reasonable royalty offers

FRAND means that royalty offers must be reasonable. Mr Justice Mellor found that InterDigital's royalty offer was significantly higher than what was reasonable and fair. The judge also found that InterDigital had gone for the jackpot in its negotiations with Lenovo, and that it had done so to extract the maximum possible amount of money from Lenovo.

The court's finding that InterDigital's royalty offer was not reasonable is significant because it sends a clear message to patent holders that they cannot use their patents to extract excessive royalties from prospective licensees.

The court found that InterDigital had been seeking supra-FRAND rates, which is evidence of its unwillingness to license its patents on FRAND terms. Therefore, the court found that Lenovo was not an unwilling licensee.

On the other hand, licensees also need to be willing to take the license that is being set by the court. If they are not willing to take the license, they face an injunction.

Arbitration

The judge noted that FRAND principles were still being worked out, and that he could not definitively say whether Lenovo's refusal to agree to arbitration was FRAND-unreasonable.

¶ 920: "I have also not ignored InterDigital's argument that in 2018-2019 Lenovo should have agreed to InterDigital's proposals for arbitration. However, an arbitration to settle FRAND terms has to be by way of agreement and is but one method of dispute resolution. Suffice to say that whilst FRAND principles are still being worked out, I cannot say that Lenovo's refusal to agree to an arbitration was the act of an unwilling licensee".

Royalty rates cannot be justified using internal costs or profits.

This is an important point because it clarifies the focus of FRAND negotiations. FRAND is not about trying to justify a particular royalty rate based on the internal costs or profits of either party. Instead, it is about finding a rate that is fair, reasonable, and non-discriminatory in the context of the relationship between the licensor and the licensee.

¶ 812: "FRAND is concerned with the relationship between the licensor and the licensee. Therefore, FRAND rates should focus on the money (and other benefits) that pass between the parties. Other benefits should be translated into monetary terms as part of the analysis. FRAND is not concerned with either party's internal justification for the sum paid or received, nor with the way in which one party seeks to deal with those sums in its accounts."

Future of FRAND in UK Courts

Is Mr Justice Mellor on a mission to make the, arguably broken, FRAND process fit for purpose? He believes that courts have an important role to play, and he notes that past FRAND judgments have been flawed because of a lack of legal processes and access to data. However, he believes that the UK court system now has the necessary tools to make FRAND more effective.

These tools include confidentiality, disclosure, and pre-action disclosure. These mechanisms can be used by parties to get the information they need to resolve disputes before going to trial. Courts are also in a privileged position relative to negotiating parties, as they have access to confidential contracts, expert data, and the ability to cross-examine experts.

Mr Justice Mellor was not fazed by the complexities of other jurisdictions opining on the meaning of FRAND and setting global FRAND rates. He believes that as FRAND determinations are made in different jurisdictions, the differences between them will converge and eventually disappear. This, if his forecast is realised, will make it easier for parties to determine FRAND terms between themselves.

This UK judgment, sitting alongside the *Unwired Planet* ruling, is a positive step towards a future where the global legal system provides a more robust, predictable, and interoperable legal framework for FRAND licensing. This increased certainty will allow innovative SME communities to feel relaxed about adopting open standards, without the shadow of potential litigation hanging over them. This notwithstanding work remains to be done to simplify the process of obtaining the necessary licenses for the SME community. The court suggested that willing licensees would undertake the necessary due diligence and seek out the required licenses. This is a difficult enough task for a well-resourced multinational, impossible for a regional SME. The judgment is a win for the SME community as at the heart of the judgement is the call for more transparency. For too long the setting of FRAND rates has been a black art clothed in secrecy and obfuscation.

Mr Justice Mellor's views are shared by many in the IP community, who believe that the FRAND process needs reform. The UK courts could have a significant impact on future license negotiations. The UKIPO has an opportunity to build on the Mr Justice Mellor's ruling and address the imbalance of power in negotiations.

Final word on the UK case to Mr Justice Mellor:

¶753: "If the data is available which supports a more refined analysis, I consider the Court should adopt the more refined analysis. Each such step should lead to a more precise estimation of FRAND terms. If that means that the Court's decision modifies the approach in future licensing negotiations, so be it."

Jim Beveridge has been working in the field of IP, international technology standards and policy issues for over 20 years.