Litigating FRAND Rates After Fed. Circ. Ericsson Decision

By **Larry Sandell** (January 17, 2020)

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Notwithstanding that fair, reasonable and nondiscriminatory patent licenses are the standard way to deal with standard-essential patents, case law provides little clarity on how FRAND rates should be determined.

Given this — and the inherent difficultly in apportioning inventive value among the potentially thousands of SEPs that may encumber a given technological standard — litigants on both sides of FRAND cases understandably struggle with preparing and trying their respective damages cases.

But in this evolving legal area, certain best practices stand out for FRAND cases involving a retrospective “release payment” claim for past unlicensed sales: Litigants should focus on distilling a compelling, simplified story for the jury and adopt a mantra of “substantial evidence” — ensuring that damages experts’ opinions are tied to the specific facts of the case and paying heed the U.S. Court of Appeals for the Federal Circuit’s limited black letter law FRAND holdings on what comprises reliable evidence.

Last month, in TCL Communication Technology Holdings Ltd. v. Telefonaktiebolaget LM Ericsson,[1] the Federal Circuit vacated the U.S. District Court for the Central District of California’s bench judgment on a FRAND license dispute, holding that the Seventh Amendment relegates the ultimate, factual determination of retrospective FRAND release payments — and, inherently, any constituent FRAND rate calculation therein—to lay juries.

Below, U.S. District Judge James Selna had determined FRAND licensing rates with a top-down methodology: He adopted percentage-based cumulative royalty rates that TCL should be expected to collectively pay on its mobile devices to all SEP holders; used a “simple patent counting system” that ostensibly divided the number of Ericsson’s SEPs by the total SEPs in corresponding technological standards to arrive at an apportionment fraction; and then he determined final retrospective and prospective FRAND licensing rates by multiplying them together.

Although Judge Selna’s detailed 115-page memorandum was widely viewed as potentially illuminating fact pattern through which the Federal Circuit might clarify appropriate FRAND determination methods, the appellate tribunal declined to address these substantive issues in view of its holding that Ericsson’s right to a trial by jury was denied.

With jurors now unquestionably at the helm where retrospective FRAND damages are involved, FRAND litigators’ primary objective comes into focus: They should focus on preparing a simplified and emotionally persuasive story for lay jury consumption. Indeed, judges can be expected to almost invariably defer to a jury’s retrospective FRAND rate when equitably determining a prospective FRAND rate.[2]

But a litigator should also be wary of what evidentiary support might be legally necessary to support a favorable jury verdict on appeal. Notably, the appropriate FRAND rate and resulting damages are questions of fact reviewed by the Federal Circuit for substantial evidence. Thus, counsel should vigilantly ensure that the record contains substantial evidence to inoculate friendly verdicts against reversal. Conversely, opposing counsel should be ready to lodge objections at appropriate junctures, lest waiver preclude potential meritorious appellate arguments.

Beyond this, substantial uncertainty as to how FRAND licensing rates should be calculated remains — as exemplified in over a dozen amicus curie briefs received by the Federal Circuit in TCL v. Ericsson. Still, a few principles are clear — and litigators would be wise to ensure that the record includes substantial evidence that (1) is akin to typical reasonable royalty patent damages evidence; (2) fits into a modified Georgia-Pacific analysis; (3) ties favorable FRAND concepts to the specific facts of the case; and (4) reliably supports apportionment by SEP patents' inventive value, even if with "a degree of uncertainty."

As an initial matter, the Federal Circuit's TCL v. Ericsson decision established that contract-based FRAND release payments for past patent use "functions as a substitute for patent infringement damages."[3] Although the court's holding was directed to the legal (vis-à-vis equitable) nature of both forms of compensatory damages, the close equivalence of these twin remedies powerfully counsels that the Federal Circuit's copious reasonable royalty damages' jurisprudence will generally govern FRAND rate issues.

Second, both the Federal Circuit and the U.S. Court of Appeals for the Ninth Circuit have expressly found a modified Georgia-Pacific factor analysis to be a permissible (but not the exclusive) methodology to determine a FRAND rate. In Ericsson v. D-Link Systems Inc., the Federal Circuit sanctioned the practice, but explained that at least certain factors "simply are not relevant" or "are even contrary to RAND principles."[4]

Factor 4 — a policy of preserving monopoly and avoiding licensing — is incompatible with a promise to license; factor 5 — the "commercial relationship between the licensor and licensee" — is irrelevant because licensing must be offered at a nondiscriminatory rate; and factor 10 — "commercial embodiment of the licensor" — is irrelevant because a standard requires use of its SEPs.

The Federal Circuit also explained that factor 8 — "current popularity" — and factor 9 — "utility and advantages of the patented invention over the old modes or devices" — should be modified or discounted in the FRAND context to account for skewing that results from standard adoption.

The Ninth Circuit, in Microsoft Corp. v. Motorola Inc., agreed with the Federal Circuit's approach, but also held that factor 15, which "directs courts to set the hypothetical negotiation at 'the time the infringement began'" "is another factor that merits modification in some RAND contract contexts."[5]

Third, the concepts of "patent hold-up" and "royalty stacking" cannot be properly presented to a jury unless the record includes case-specific evidence indicating that hold-up or stacking actually transpired.[6] The U.S. District Court for the Northern District of California recently illustrated what type of linking evidence might be sufficient.

In Core Wireless Licensing SARL. v. Apple, Inc. Apple, as the would-be FRAND licensee, was permitted to tell the jury about royalty stacking because it had evidence (1) of cumulative royalty demands that would have exceeded the profit margin of chip at issue and (2) that it "considers royalty stacking in real-world licensing negotiations."[7] Other would-be FRAND licensees may do well to marshal similar evidence early in litigation.

The vacated TCL district court opinion substantially grounded its top-down FRAND royalty calculation approach on hold-up and royalty stacking concepts. Several notable amici and at least one district court have favored this top-down approach.[8] However, it remains unclear whether case-specific evidence of hold-up or royalty stacking is needed for a top-down approach to pass muster.

The prudent course of action for a proponent of a top-down methodology at the trial court is to provide this evidence; top-down opponents should watch for and object to the lack of or weaknesses in such evidence.

Fourth, as with calculating traditional patent damages, apportionment is required when determining a FRAND royalty rate. In the FRAND context:

the patented feature must be apportioned from all of the unpatented features reflected in the standard. … [And] the patentee's royalty must be premised on the value of the patented feature, not any value added by the standard's adoption of the patented technology.[9]

Beyond this requirement, assessing the reliability of FRAND royalty rates apportionment theories becomes murky. The number of SEPs implicated in any given standard is virtually always far too large to permit the scrutiny of claims, specifications and file histories that is customary and required in typical patent cases. Indeed, the Federal Circuit has even instructed that "the jury should be told of its obligation to approximate the value added by the patented invention and that a degree of uncertainty in setting that value is permissible."[10]

Thus, in view of the inherent impracticality of apportionment by conventional means, FRAND litigants have attempted several methods of proxy apportionment. In TCL v. Ericsson, the district court utilized a "simple counting method" that, with certain adjustments, apportioned the top-down royalty rate by dividing the number of unexpired SEPs owned by Ericsson by the total number of SEPs in the standard. In essence, the proxy apportionment theory presumed that all SEPs were, on average, of equal approximate value.

Many amici took issue with this simple assumption, arguing that it would distort innovation incentives and encourage over-designation of SEPs during the standardization process. Unfortunately, the Seventh Amendment defect in the bench ruling deprived the Federal Circuit the opportunity to substantively address this form of proxy apportionment.

In In re Innovatio IP Ventures LLC, the U.S. District Court for the Northern District of Illinois used a top-down method and apportioned for the value of the patentee's SEPs based on statistical studies that found the top 10% of SEPs in a portfolio to hold 84% of the portfolio's total value.[11] After finding the patentee's SEPs to be in the top 10% of the overall SEP portfolio, it apportioned by the number of the patentee's SEPs (similar to TCL) with an adjustment for their relative high value (i.e., multiplied by 0.84/0.10).

In Apple Inc. v. Motorola, Inc.,[12] the patentee's expert opined that, in general, the first few patents licensed in a portfolio would command 40-50% of the entire portfolio rate. The Federal Circuit agreed with the district court's finding that this "'non-linear' valuation theory" — which was untethered to the facts of the case — was inherently unreliable and could not be relied upon for apportionment. The Federal Circuit noted, however, "that the general theory that … the first patent from a larger portfolio may, in practice, garner a larger royalty than later patents from the same portfolio, is not inherently unreliable."[13]

Most recently, in Intellectual Ventures II LLC v. Sprint Spectrum LP,[14] the patentee's expert relied on "proud lists" — "representative lists of patents that each company believes are particularly applicable to its negotiating partner's business and products"—from existing licenses as "the best evidence of the technology covered" instead of counting or independently assessing the relative value of SEPs at issue. The U.S. District Court for the Eastern District of Texas denied the would-be FRAND licensee's motion to exclude such testimony for an alleged failure to apportion.

After the Federal Circuit's TCL v. Ericsson ruling, determining FRAND patent license rates for SEPs remains a challenging and complicated process for litigators, damages experts and judges — and even more so for the lay juries who are constitutionally tasked with calculating retrospective FRAND release payment damages.

Ultimately, litigated FRAND license rates are likely to be driven by case-specific proclivities and the whims of lay jurors. But litigators with appellate foresight should hold the mantra of substantial evidence close to their hearts and ensure that their FRAND evidence of record is sufficiently tied to the facts of the case.

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[1] Appeal No. 18-1363 (Fed. Cir., Dec. 5, 2019).

[2] E.g., Ericsson, Inc., v. D-Link Sys., Inc., 773 F.3d 1201, 1214 (Fed. Cir. 2014); Realtek Semiconductor, Corp. v. LSI Corp., No. C–12–3451, 2014 U.S. Dist. LEXIS 81673, at *6, *23 (N.D. Cal. June 16, 2014).

[3] Slip op. at 23 n.9.

[4] 773 F.3d at 1230-32.

[5] 795 F.3d 1024, 1041 (9th Cir. 2015).

[6] Ericsson, 773 F.3d at 1233-34; CSIRO v. Cisco Sys., Inc., 809 F.3d 1295, 1302 (Fed. Cir. 2015).

[7] 2016 U.S. Dist. LEXIS 186674, at *6 (N.D. Cal. Nov. 18, 2016).

[8] See Innovatio IP Ventures, LLC, 2013 U.S. Dist. LEXIS 144061 (N.D. Ill. Oct. 3 2013).

[9] Ericsson, 773 F.3d at 1232-1233.

[10] Id. at 1232 n.9.

[11] 2013 U.S. Dist. LEXIS 144061 at *180-83.

[12] 757 F.3d 1286, 1323-25 (Fed. Cir. 2014).

[13] Id. at 1325.

[14] Case No. 2:17-CV-0662-JRG-RSP (E.D. Tex. Apr. 26, 2019).