Can We Be FRANDs?:
TCL Commc'n Tech. Holdings, Ltd. v. Telefonaktiebolaget LM Ericsson

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In *TCL Commc'n Tech. Holdings, Ltd., et al. v. Telefonaktiebolaget LM Ericsson, et al.*,[3] the United States District Court for the Central District of California issued a decision addressing so-called FRAND terms in connection with the enforcement of certain Standard Essential Patents (SEPs). Owners of SEPs, which include claims determined to be technically "essential" to practice certain industry standards, often make voluntary statements regarding a commitment to license such intellectual property to third parties on terms that are fair, reasonable, and non-discriminatory (i.e., "FRAND"). However, the meaning of those same terms—and particularly "non-discriminatory" in connection with the instant case—is open to interpretation. Moreover, the benchmark for determining a "reasonable" royalty for a FRAND-encumbered patent has not yet been clearly defined. In *TCL v. Ericsson*, the Court set forth a royalty rate calculation for the essential patents at issue—a rare undertaking by a federal court, and perhaps the first instance of a district court doing so for an entire patent portfolio.

I. Case Background

Chinese smartphone manufacturer TCL Communication Technology Holdings, Ltd. ("TCL") filed its complaint on March 5, 2014, alleging that Telefonaktiebolaget LM Ericsson and Ericsson Inc. ("Ericsson") had committed a breach of contract for failing to license a wireless patent portfolio on FRAND terms. The Court noted that "the precise contours of the FRAND obligation were never crystalized in a definitive formulation,"[4] despite efforts by the standard-setting institution, European Telecommunications Standards Institute ("ETSI"), in this case. TCL argued that Ericsson had violated its contractual commitments by, for example, demanding

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[3] *See* Memorandum of Findings of Fact and Conclusions of Law, 14-cv-00341, Document 1802 (Dec. 21, 2017). *See also* Ryan Davis, *4 Things to Know About the Latest FRAND Rate-Setting Case*, LAW360 (Jan. 4, 2018, 9:36 PM), https://www.law360.com/ip/articles/998063/4-things-to-know-about-the-latest-frand-rate-setting-case?nl_pk=685fe0f1-f356-4ee6-b481-1c9a6721d116&utm_source=newsletter&utm_medium=email&utm_campaign=ip.

[4] Memorandum of Findings of Fact and Conclusion of Law, at 12.

rates in excess of market rates and bundling 2G, 3G and 4G patents for additional revenue.

II. The District Court Decision with Respect to FRAND

To determine whether the non-discriminatory part of FRAND is met, some courts have assessed whether a patentee who makes or sells standard-compliant products is charging a higher royalty to an implementer against whom the patentee competes directly than to another party who sells very distinct compliant products.[5] In prior decisions, courts have held that FRAND obligations are not violated unless such discrimination disrupts or unbalances competition in the market—a model resting on an antitrust approach. The Court in *TCL v. Ericsson* took an arguably narrower approach, finding that a discriminatory distortion could occur if a single company was harmed. In fact, the Court stated that antitrust laws "provide no guide to understanding" what is non-discriminatory in the context of FRAND.[6]

In assessing whether Ericsson's terms were non-discriminatory, the Court examined licenses offered globally, including to big players such as Apple and Samsung, whose products sell for much higher prices than TCL products. The Court explained that "the analysis should include all firms reasonably well-established in the world market," which results in a "necessarily wide spectrum."[7] In support of its analysis, the Court noted that excluding the largest firms in the market would have the effect of "insulating them, and further contributing to their dominant positions, by imposing a barrier in the form of higher rates for those not at the top end of the market."[8] Thus, the Court broadened the meaning of "similarly situated," reasoning that the mobile phone market "has been extremely dynamic over the last decade."[9]

Similar to the identification of the relevant market in an antitrust analysis, the Court noted that factors relevant to finding firms "similarly situated" depended on the geographic scope of the firm, licenses required by the firm, and a reasonable sales volume.[10] The Court also clarified that factors such as a firm's overall financial success or risk, brand recognition, operating system of devices, or the existence of retail stores did not bear on its determination of whether royalty rates for its SEPs were discriminatory.[11] By declining to group large companies into a separate category, the Court found that the royalty rates offered by Ericsson to TCL were different from those

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[5] Lemley & Shapiro, 28 Berkeley Tech. L.J. 1135, 1149 n.42.

[6] Memorandum of Findings of Fact and Conclusion of Law, at 91.

[7] *Id.* at 56.

[8] *Id.* at 57.

[9] *Id.*

[10] *Id.*

[11] *Id.*

offered to other smartphone makers, and were therefore not FRAND. Ericsson has filed a notice of appeal to the Federal Circuit.

III. In the Spirit of FRANDship: Implications

The *TCL v. Ericsson* decision could have significant implications in future FRAND cases. For one, the Court departed from assessing a market and focused on an SEP owner's licenses to companies. According to the logic of the Court, this could promote competition by allowing smaller companies to remain competitive against larger companies, without losing revenue towards royalty rates owed to an SEP owner.

Further, the alternative approach of looking at market distortion requires assessing "the market" and defining the companies and products that are attributable to such a market. By contrast, when the non-discriminatory query is focused on the effect of licenses on companies rather than "the market," the calculus avoids the need to assess the relevant market and the key companies. Which approach is ultimately more favored will be determined by future FRAND cases.

TCL v. Ericsson also touches upon the role of economics in determining FRAND rates. Economic theory, bargaining power, and hypothetical negotiations are often implicated when calculating royalty rates to compensate a patentee for infringement,[12] aside and in addition to the *Georgia-Pacific* factors.[13] These

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[12] *See* Marianne Ley Hayek, *The Misunderstood Nash Solution for Reasonable Rates*, LAW360 (Apr. 4, 2018, 12:07 PM), https://www.law360.com/articles/1029242/the-misunderstood-nash-solution-for-reasonable-royalties.

[13] In *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1119-20 (S.D.N.Y. 1970), *modified and aff'd*, 446 F.2d 295 (2d Cir), fifteen factors were identified to determining reasonable royalty rates:

1) Royalties patentee receives for licensing the patent in suit.
2) Rates licensee pays for use of other comparable to the patent in suit.
3) Nature and scope of license in terms of exclusivity and territory / customer restrictions.
4) Licensor's established policy and marketing program to maintain patent monopoly by not licensing others to use the invention.
5) Commercial relationship between licensor and licensee, such as whether they are competitors or inventor and promoter.
6) Effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.

considerations may similarly be useful in determining the meaning of FRAND.

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7) Duration of patent and term of license.
8) Established profitability of the products made under the patent, its commercial success and its current popularity.
9) Utility and advantages of patent property over old modes and devices.
10) The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefit of those who have used the invention.
11) The extent to which the infringer has made use of the invention and the value of such use.
12) The portion of profit or selling price customarily allowed for the use of the invention.
13) The portion of realizable profit attributable to the invention as distinguished from non-patented elements, significant features / improvements added by the infringer, the manufacturing process or business risks.
14) Opinion testimony of qualified experts.
15) Outcome from hypothetical arm's length negotiation at the time of infringement began.