

**Comments of the Fraunhofer-Gesellschaft on the United Kingdom
Intellectual Property Office's Industrial Strategy: Intellectual Property Call
for Views dated 11 October 2017 (UK IPO Call for Views)**

The Fraunhofer Gesellschaft (Fraunhofer) thanks the UK IPO for its national and international engagement with a broad range of stakeholders regarding appropriate measures to help 'find ways to stimulate collaborative innovation and increase licensing opportunities for intellectual property (IP) rights'¹.

Fraunhofer's comments are respectfully submitted with the following structure:

1. Required Information
2. Overall Comments
3. Specific Considerations, as outlined in the JPO's Invitation to Contribute

1. Required Information

a. Are you responding as an individual, business, intermediary, representative body?

- i. The Fraunhofer-Gesellschaft is Europe's and Germany's largest applied research organisation. It is non-profit.

b. What does your business do / in what sectors do you operate?

- i. The organization's mandate is to undertake applied research which focuses government, industry and society across the areas of healthcare, security, communication, mobility, energy and the environment.

c. How large is your business, and what proportion of your assets are IP-based?

- i. The Fraunhofer-Gesellschaft has a workforce of over 24,000 and an annual research budget of €2,2 billion. It currently operates a total of 69 institutes and research units.
- ii. The present value of future payments relating to the sale of patent rights amounts to 7.7% of current assets. Financial assets based on IP amount to 12.77 % of total assets of the Fraunhofer Gesellschaft.

d. In what UK regions do you operate?

- i. In 2012, Fraunhofer created a platform "Fraunhofer UK". Its first UK-based Centre is the Fraunhofer Centre for Applied Photonics at the University of Strathclyde, Glasgow.²

e. In what international territories do you operate?

- i. Fraunhofer is globally present with offices and research centres in the United States, India, Japan and further contact points worldwide.³

¹ UK IPO Call for Views, at page 4.

² <https://www.fraunhofer.co.uk/>

³ See

<http://www.standortkarte.fraunhofer.de/main.jsp?lang=en&debug=false&topic=institut&topicvalue=null&focus=world&focusvalue=>

f. Is there more the IPO could do to help UK companies operating overseas?

- i. Not applicable

g. What do you spend on IP?

- i. Fraunhofer is a not-for-profit organisation which has IP as its bread and butter. All revenues are reinvested into applied research and critical science infrastructure – without output being one or more forms of IP.

h. Which aspects of the IP system do you use?

- i. Fraunhofer uses the full breadth of IP Rights with focus on patent rights and trade secrets, as well as use of trademarks.

i. What do you particularly value about the UK's IP system?

- i. The rule of law.

j. Do you face barriers when using the UK IP system?

- i. Should the UK IPO adopt the following false premise as one underlying any recommendations arising from the report, it is anticipated that market dynamics and fundamental rights existing in relation to IP will be disrupted and curtailed. Furthermore, the innovation system will become unsustainable.

Page 8, UK IPO Report, 'Industrial Strategy: Intellectual Property Call for Views': 'We are aware that IP trading can present some companies with barriers to innovation, notably in the area of Standard Essential patents (SEPs), where we are told that the issue of portfolio fragmentation can lead to spiralling costs to innovators operating in standards-reliant sectors.' **There is no empirical evidence supporting this statement.**

- ii. Should the UK IPO adopt the following approach of compulsory licensing, this would be in breach of the UK Government's obligations under the TRIPS Agreement and will likely make the innovation system unsustainable.

Page 8, UK IPO Report, 'Industrial Strategy: Intellectual Property Call for Views': 'It has been suggested that over-use of patents can stifle innovation in burgeoning markets. [...] It has been suggested that the UK could build [compulsory free licensing of patents] capability into its patent system, for example by declaring on the face of the patent that it may be used free of charge. This could serve to stimulate investment in new markets and rapidly grow infrastructure around innovative technologies.' **It takes all types of IP and business models to create an internationally competitive market. It is further noted that business and property rights are enshrined as**

fundamental rights in the European Charter of Fundamental Rights⁴ and the UN Human Rights Convention.

- iii. Should the UK IPO adopt this unsubstantiated approach, it would be at odds with international law, norms and case law regarding standard essential patents.

Page 8, UK IPO Report, 'Industrial Strategy: Intellectual Property Call for Views': 'some [jurisdictions] have arrived at commonly accepted, government regulated standard valuation methods, and we would be keen to hear views on whether and how the UK should consider similar activities, and what the benefits would be.' **There is not one method of IP valuation, and to suggest otherwise is untenable. It is not the role of UK IPO to become involved in the implementation or licensing of standard essential patents.**

2. Overall Comments

Fraunhofer welcomes the UK IPO's explicit acknowledgement that the UK IP system works well. Fraunhofer respectfully requests that the matters focussed on in the UK IPO Report do not result in a debasing of the established, tested and proven legal mechanisms, commercial practices, economic policies and innovation systems, which support technological advancement.

In particular, Fraunhofer encourages UK IPO to engage in cross-departmental or –ministerial discussions, so that the United Kingdom Government's initiatives regarding innovation are consolidated in a synergistic manner, and with a long-term horizon.

Fraunhofer respectfully urges the UK IPO to acknowledge that any impact assessment (including a cost-benefit analysis) associated with any proposed policy shift needs to be addressed within the whole innovation cycle, and the impact on all initiatives collectively. Failing to do so, the UK IPO could be at risk of introducing isolated initiatives which would devalue the UK government's investment in IP, R&D, and the innovation system - making the innovation system unsustainable.

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Article 17 of the Charter of Fundamental Rights of the European Union.

3. Specific considerations

IP Licensing resolution

A. UK legal framework works well

Fraunhofer urges the UK IPO to recognise that, in terms of the legal and governance ecosystem, the United Kingdom's framework is appropriately addressing any matters arising in relation to licensing and the conduct of parties involved in such negotiations.⁵

Any government interference with an international market will likely have a direct negative impact on foreign direct investment, and decrease opportunities for UK researchers and companies to cooperate in international technical projects, and international business.

Key to this, is that all foundations relating to international technical cooperation, and international trade, remain intact within the domestic setting. Experience of the Fraunhofer-Gesellschaft (Fraunhofer), and interdisciplinary studies in law and economics of innovation, strongly point to a fundamental proposition: to support an innovation cycle, a government must recognise the specific components of the said cycle and support their good development by providing a conducive legal and economic framework.

To the extent that the legal framework is considered, supporting innovation involves considering international technological progress, and international treaties which provide the broad yet robust framework. These in turn translate through to national laws and jurisprudence, important for the preservation of fundamental rights and obligations for government, industry and consumers.

B. FRAND licensing successfully contributes to technology progress

A FRAND undertaking is an undertaking to make certain IP accessible through a negotiated license on fair, reasonable and non-discriminatory terms. The IP takes the form of standard essential patents, with the licence's field of use being implementation of a particular technology standard. FRAND requires good faith negotiation between the negotiating parties to promptly conclude a license⁶.

⁵ For Europe, see *Huawei Technologies Co. Ltd v ZTE Corp.*, ZTE Deutschland GmbH (Case C-170/13, 2015) (*Huawei v. ZTE*). For European Member State court decisions interpreting *Huawei v. ZTE*, see German decisions such as *One-Red v ASUS and Acer* LG Mannheim 29.01.2016, *St Lawrence v. Vodafone* LG Düsseldorf, 31.03.2016, *Sisvel v. Haier* LG Düsseldorf 03.11.2015 and 13.01. 2016, *St Lawrence v. Deutsche Telekom and HTC*, LG Mannheim 27.11. 2015, *NTT DoCoMo v. HTC* LG Mannheim 29.01.2016, or the English decision of *Unwired Planet International Ltd v Huawei Technologies Co Ltd & Anor* [2017] EWHC 1304 (Pat) (07 June 2017). For the USA, see *Ericsson Inc. v. D-Link Systems Inc.* (773 F. 3d 1201 Fed Circ 2014); *CSIRO v. Cisco Systems* (809 F.3d 1295 Fed Cir 2015); *Core Wireless Licensing S.a.r.l v. LG Electronics, Inc. and LG Electronics Mobilecomm U.S.A., Inc.* (31 August 2015) Case No. 2:14-cv-912-JRG; and *SRI International Inc. v. Cisco Systems Inc.* (9 May, 2016) Civ. No. 13-1534-SLR. See Indian High Court decisions of *Ericsson v. iBall* I.A. No.17351/2015 in CS (OS) 2501/2015, *Ericsson v. Intex* I.A. No. 6735/2014 in CS(OS) No.1045/ 2014.

⁶ See, for example, *Huawei v. ZTE*; *Ericsson v. iBall*.

The FRAND licensing model has been successfully operating, contributing to great technological progress in the ICT sector and achieving high interoperability levels. This is demonstrated through the 2G, 3G, 4G and now 5G connectivity standards, as well as standards for video compression (HEVC) and many other technologies enabling the digital transformation.

Within FRAND, it is expected that both the licensor and licensee will sit at the negotiation table and participate in finalising any required licenses in good faith. These have been the guiding touchstones to trade, whether it be domestic, regional or international, for generations and were confirmed by the Court of Justice of the European Union in *Huawei v. ZTE*.⁷

Given the importance of this issue, we would urge the UK IPO to adopt an approach consistent with the following:

- 1) The availability of injunctive relief is recognized as being enshrined in WTO member obligations through TRIPs, and also human rights conventions;
- 2) In terms of trade, there is often a mutual obligation of good faith behaviour either expressly or impliedly operating at law;
- 3) Good faith is the relevant legal concept to apply to both an IPR owner and a potential licensee/IPR infringer;
- 4) Acting reasonably and within a reasonable time (promptly) to provide information regarding licensable patents, and to respond to an offer of a license, are further legal touchstones;
- 5) The meaning of reasonable time or promptly set out in 4) above are also found in other international conventions.
- 6) The seeking of injunctive relief to protect property is not *per se* contrary to competition law, and the burden of proof rests with the party alleging breach of competition law to prove this through cogent evidence, taking into account all the circumstances of the case;
- 7) A standard essential patent is a patent, and therefore is also to be treated as normal property;
- 8) Every application for an injunction must be assessed on its own merits, with the court assessing the facts of the case before it and applying the doctrine of proportionality. As an element of this assessment, the court generally takes into account the impact of a change in the status quo which existed before the infringing conduct complained of commenced;
- 9) The infringing party should at the very least place money in escrow until such time as an appropriate license is put in place.

It is further noted that there is no presumption at law of patent hold up or patent hold out, and that the party alleging this in a particular case must demonstrate this with cogent evidence relevant to the fact of the case before a court. For example, a presumption that the owner of a standard essential patent owner who applies for injunctive relief will definitely threaten to demand an excessive rate of payment for the use of its IP, would be an unfair assumption against that IP owner in a specific case.

Furthermore, there is no express or implied commitment generally undertaken by owners of standard essential patents regarding injunctions.

⁷ Huawei Technologies Co. Ltd v ZTE Corp., ZTE Deutschland GmbH (Case C-170/13, 2015) (*Huawei v. ZTE*)

Without the ability to protect IP assets, those IP assets have no value.

We strongly urge caution about interfering with this fundamental right. The current legal landscape already rightfully takes into account: the interests of both parties, the conduct of both parties and an expectation that each shall act in good faith, the requirement for action within a reasonable time frame, the option of placing money on escrow, and as assessment whether damages are an appropriate alternate remedy to an injunction.

In conclusion, for conducting negotiations effectively and efficiently, the UK IPO must consider the general framework for FRAND licensing negotiations, recently confirmed by the CJEU in *Huawei v. ZTE*.⁸ Most importantly, the CJEU stressed that both parties: the licensor of standard essential patents and the potential licensee bear responsibility for the process. This also applies to the manner of driving the licensing negotiations: both parties are held responsible for moving the process and both will be held accountable for bad-faith delays.

Fraunhofer considers that the CJEU confirms established international practice and has been recognised as valid and relevant for the UK.⁹

C. Dispute settling mechanism

Fraunhofer respectfully considers that the UK IPO has no role to play in any arbitration or mediation mechanism relating to patents or the licensing of patents (including standard essential patents).

Regarding alternate dispute resolution, it is noted that all forms of alternate dispute resolution are both voluntary, and rely on party autonomy.

Arbitration is infrequently used for disputes relating to patent licensing negotiation or patent licensing. It is assumed that this is for two main reasons: (i) patent disputes in this context usually arise when the parties are not in a contractual relationship, and so there is no pre-agreed means of resolving pre-contractual disputes (including challenges to the validity of patents); and (ii) very few arbitration rules provide that the arbitral tribunal has jurisdiction to determine validity of patents along with issues regarding pre-contractual negotiation. There thus remains the exposure of court proceedings where the validity of patents is challenged.

It is further noted that there is no ability for a court to review an arbitration award on the basis that there is an error of law appearing on the face of the award, nor can a court refuse to

⁸ For European Member State court decisions interpreting *Huawei v. ZTE*, see German decisions such as *One-Red v ASUS and Acer* LG Mannheim 29.01.2016, *St Lawrence v. Vodafone* LG Düsseldorf, 31.03.2016, *Sisvel v. Haier* LG Düsseldorf 03.11.2015 and 13.01. 2016, *St Lawrence v. Deutsche Telekom and HTC*, LG Mannheim 27.11. 2015, *NTT DoCoMo v. HTC* LG Mannheim 29.01.2016, or the English decision of *Unwired Planet International Ltd v Huawei Technologies Co Ltd & Anor* [2017] EWHC 1304 (Pat) (07 June 2017).

⁹ *Unwired Planet International Ltd v Huawei Technologies Co Ltd & Anor* [2017] EWHC, 1304 (Pat) (07 June 2017).

enforce such an award on that basis.¹⁰ The parties are thus at the mercy of an arbitrator who may or may not be qualified in the area of technology or the overall market, or the relevant proposed governing law for an agreement. It would be an odd consequence of any arbitration if the governing law for a resulting contract is imposed on the parties, merely by virtue of holding a patent in a particular jurisdiction as part of a global patent portfolio and business.

While arbitration does have a role in particular circumstances, it is not considered a generally appropriate tool for parties negotiating a licensing agreement. This is particularly the case for SMEs who might own standard essential patents, who would not be aware of the details of arbitration, choice of arbitration rules, choice of arbitrators, choice of language, choice of counsel, how to manage costs so that it is not more expensive than litigation, or what it means to have no right to access to the courts to assert legitimate rights. As noted above, there will always be the exposure of court action in any event, if the validity of the patents is challenged.

The important role of the courts and the fundamental rights of access to justice and the right to protect property should remain at the fore and not be diminished. Fraunhofer respectfully observes that the rule of law is fundamental to business investment and societal advancement. Further, given the highly technical and legally complex matters involved in patent grant, licensing and litigation (combined normally giving rise to international trade as the context for and arrangement regarding standard essential patents), it is considered fundamentally necessary that any disputes relating to such matters should be addressed by the courts.

Fraunhofer considers the United Kingdom's courts to be expertly competent in handling highly complex patent litigation matters, which typically involve multifaceted technical and legal issues. This recognition is shared by the global legal academic and practice communities, which ever-so-often use the UK patent jurisprudence as a comparator or point of reference.

D. New entrants into the SEP licensing space

In addition, it is observed that there are new entrants in the area of licensing of standard essential patents, as stated in the introduction to the Invitation to Contribute. For the most part, these new entrants, have little or no previous experience with the FRAND licensing model, the standardisation work, and international markets for ICT technology. It is their natural economic and market behaviour to claim that the established "rules of the game" do not fit them. However, the rules of the game require obligations on the part of users – from undertaking due diligence prior to product launch to concluding relevant business dealings in good faith.

It is necessary to acknowledge that the FRAND licensing model has been successfully implemented and has contributed to the great technological progress in the ICT and interoperability, as demonstrated by the 2G, 3G, 4G and now 5G connectivity standards, as well as standards for video compression (HEVC) and many other technologies enabling the digital transformation.

¹⁰ *TCL Air Conditioners v. Judges of the Federal Court of Australia* [2013] . French CJ and Gageler J held, at paragraph 34, that '[e]nforcement of an arbitral award is enforcement of the binding result of the agreement of the parties to submit their dispute to arbitration, not enforcement of any disputed right submitted to arbitration'.

Fraunhofer strongly suggests that awareness raising targeting new entrants into the SEP licensing would be very valuable. Education could be the key to informing new market participants and users of technology alike about rights and responsibilities regarding intellectual property and products and services which derive therefrom. In relation to both new entrants and long-existing market participants who have adopted a litigious approach, competition law and other court-related actions are available to ensure 'bad faith' conduct is not the norm.

E. Royalty free patents

As noted above, equally important to support for R&D investment is the coherent and robust legal framework, which enables inventors and innovators to commercially benefit from their innovation outputs.

It acknowledges that standard essential patents are patents, which are a type of intangible property. This is recognised by jurisdictions all over the world. The US decision of *eBay*¹¹ (2006) determined that a patent is property, and subject to the normal laws of property. This is also recognized in Europe, where the European Court of Justice in *Huawei Technologies Co. Ltd v ZTE Corp., ZTE Deutschland GmbH*¹² recognizes the rights of IP owners to protect property and at the international and European fundamental rights level¹³.

Government policy should not dictate an attach point for royalties, and should not prescribe which entity is to seek a licence. To do so would interfere with market dynamics and the conduct of international business. It is well-established that FRAND is fact-dependent and determined on a case-by-case basis.

A royalty-free declaration does not exclude all charges for the use of the patent. There are many auxiliary compensation mechanisms, which parties use when negotiating technology licensing contracts, such as R&D partnerships, product co-development and exchange of trade secrets.

F. IP Valuation standards

The suggestion that there needs to be a government-sanctioned methodology for valuing IP is rejected. As in the case of standard essential patents licensed on FRAND, courts have held that there is no one method of determining licence fees or damages for infringement, and there is and can never be such a rule: *CSIRO v. Cisco*¹⁴, which held that the adoption of a rule proposed by Cisco (in particular one which would require parties to adopt the smallest saleable practicing unit) is **untenable**; see also *Ericsson Inc. v. D-Link Inc. et al*¹⁵.

¹¹ *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006)

¹² *Huawei v. ZTE*, (Case C-170/13, 2015)

¹³ See TRIPs, and Article 17 of the Charter of Fundamental Rights of the European Union, for example.

¹⁴ *CSIRO v. Cisco Systems* (809 F.3d 1295 Fed Cir 2015), at 1303.

¹⁵ *Ericsson Inc. v. D-Link Inc. et al*, (773 F. 3d 1201 Fed Circ 2014), at 1226.

European and Member State law also reflects this position: The European TTBER¹⁶ states that it is legitimate to calculate royalties based on a final product base where licensed technology relates to an input incorporated into a final product. The EU Guidelines on the application of Article 101¹⁷ provide that parties are able to take into account a number of elements for determining license fees including the incentive to innovate, sunk investments and R&D costs¹⁸. The latest economic report from Germany has specific mention of investment in R&D and the need for return on investment in order to have a sustainable, competitive and growing economy.¹⁹

It is also noted that IP owners are considered to be best placed to determine licence fees (particularly where other licences are in place) and courts are best placed to determine damages, based on each case, evidence presented and based on commercial norms. An interference with the role of accepted commercial norms and the courts could have grave and unintended consequences on innovation for Indian society and markets.

The majority of licences in relation to standard essential patents are concluded through negotiation between the parties. There is no reason to disturb commercial relations, many of which run for many years due to the life of patents.

If one has regard to jurisdictions around the world, it has been consistently stated that there is no one methodology to be employed to calculate royalties, and thus assess the value of patents.

In the US, it has been expressly stated that there is no set of factors that serve as a talisman for royalty rate calculations.²⁰ To the extent that one court should mirror the analysis of other cases such as *Innovatio* or *Microsoft*, the US Court of Appeals for the Federal Circuit has specifically rejected that argument.²¹ It has further noted that factors for consideration 'may also need to be adapted on a case-by-case basis depending on the technology at issue.'²²

¹⁶ Commission Regulation (EU) No 316/2014 of 21 March 2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements (TTBER) Official Journal L93, 28.03.2014, p.17-23

¹⁷ Communication from the Commission — Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements (Guidelines) Official Journal C89, 28.03.2014, at pp 3-50.

¹⁸ See the Guidelines to Article 101, at paragraphs 8-9.

¹⁹ 'Strong investment in R&D noted by this report is a sign that we are not only concerned with the current bottom line, but also future ones': see <https://www.gtai.de/GTAI/Navigation/EN/Meta/Press/press-releases,t=germanys-growing-future,did=1814346.html>

²⁰ *Ericsson Inc. v. D-Link Inc. et al*, at *47 - 50.

²¹ *Ericsson Inc. v. D-Link Inc. et al*, at *49.

²² *Ericsson Inc. v. D-Link Inc. et al*, at *48.

The Court expressed 'no opinion on the methodologies employed in these district court cases (when determining a royalty award) – which may yet come before this court – or in their applications to the facts at issue there. The facts in those cases, and the decision-makers involved, differ from those at issue here (in *Ericsson Inc. v. D-Link Inc. et al*). We address only the record before us and what a jury must be instructed when RAND-encumbered patents are at issue and the jury is asked to set a RAND royalty rate.' See *Ericsson Inc. v. D-Link Inc. et al*, footnote 8 at *50.

Concluding on the issue of RAND in *Ericsson Inc. v. D-Link Inc. et al*, the US Court of Appeals for the Federal Circuit held:

*We believe it is unwise to create a new set of [...] factors for all cases involving RAND-encumbered patents. Although we recognize the desire for bright line rules and the need for district courts to start somewhere, courts must consider the record [...] and should avoid rote reference to any particular damages formula.*²³

In Europe, the UK Court of Appeals recognised in *Unwired Planet v. Huawei*²⁴ the same principle – there is no prescribed way of calculating royalties and parties are free to negotiate the rate, in good faith.

In addition, a recent study demonstrates that patent holders in the smartphone value chain do not exercise any meaningful monopoly power to raise prices.²⁵

Fraunhofer strongly urges the UK IPO to acknowledge the norms and principles of contract negotiation reinforced by the Courts in the United States and Europe, and to refrain from providing guidance on or introducing a prescribed methodology of IP valuation. To do so could very well distort sectors contributing to technological progress and next-generation developments.

Should the UK IPO adopt this unsubstantiated approach, it would be at odds with international law, norms and case law regarding standard essential patents.

Fraunhofer kindly requests that the UK IPO identify the jurisdictions to which it refers in making the following statement at page 8 of the UK IPO Report, 'Industrial Strategy: Intellectual Property Call for Views', being: 'some [jurisdicions] have arrived at commonly accepted, government regulated standard valuation methods, and we would be keen to hear views on whether and how the UK should consider similar activities, and what the benefits would be.'

It is not the role of UK IPO or government to become involved in the implementation or licensing of standard essential patents.

²³ *Ericsson Inc. v. D-Link Inc. et al*, at *50.

²⁴ *Unwired Planet International Ltd v Huawei Technologies Co Ltd & Anor* [2017] EWHC 1304 (Pat) (07 June 2017)

²⁵ Galetovic, A., Haber, S., Zaretski, L., 'Is there an anti-commons tragedy in the smartphone industry?', Hoover IP2, Working paper series No. 17005, revised 1 August 2017. Available at: <http://hooverip2.org/working-paper/wp16011/>.