

FRAND From Business Perspective

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Part 1: Standards first, licensing second

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Describing the problem

Tension

- Interoperability standards: Uniformity of implementations (as needed for interoperability) by dictating particular implementation choice
- Patent: Monopoly over use of particular implementation choice

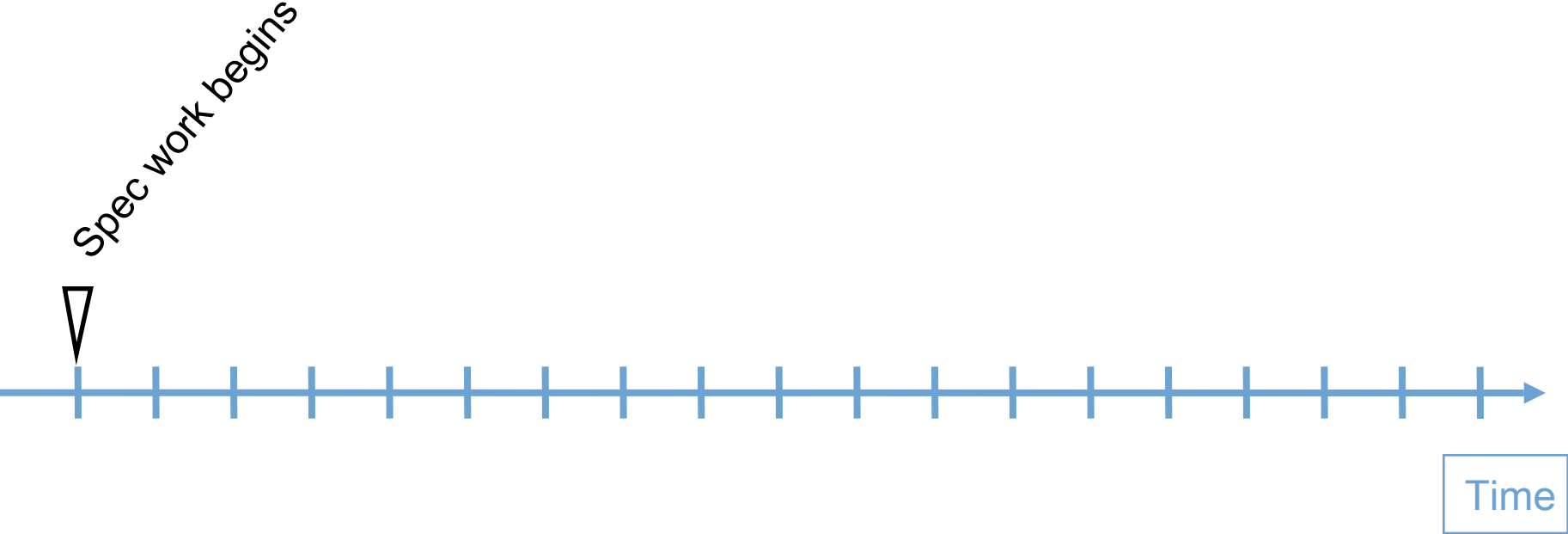
Standard-setting over time

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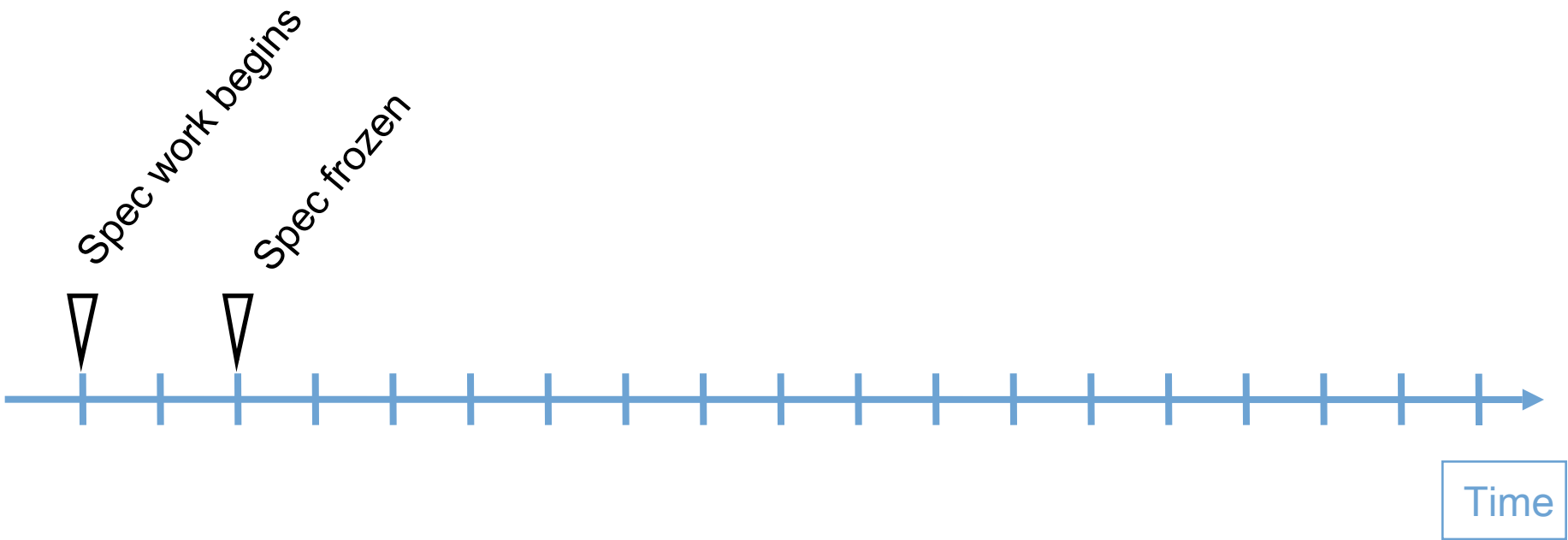


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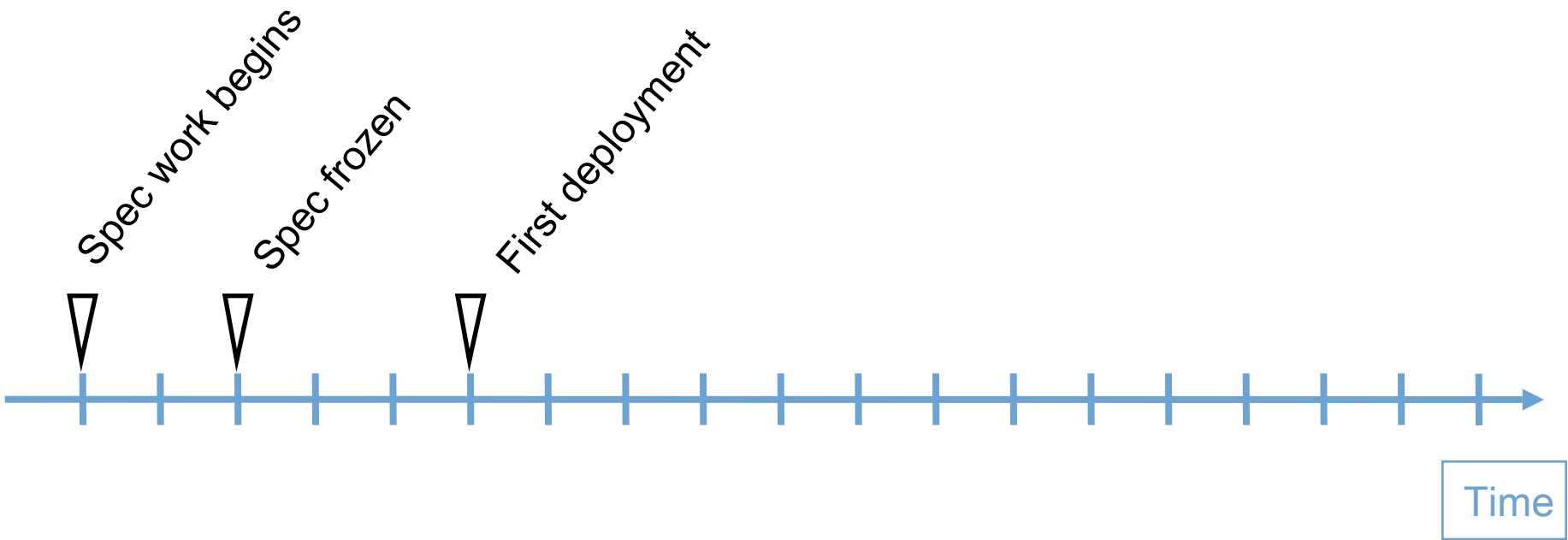
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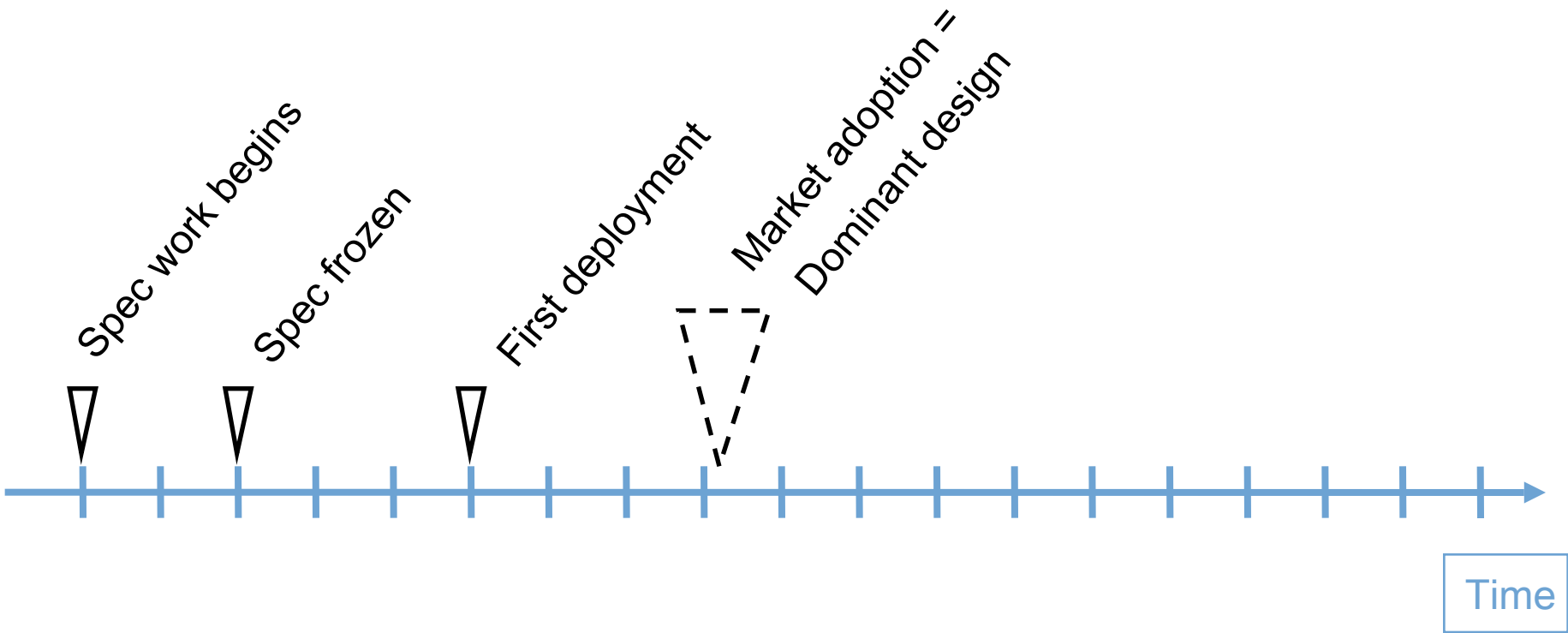


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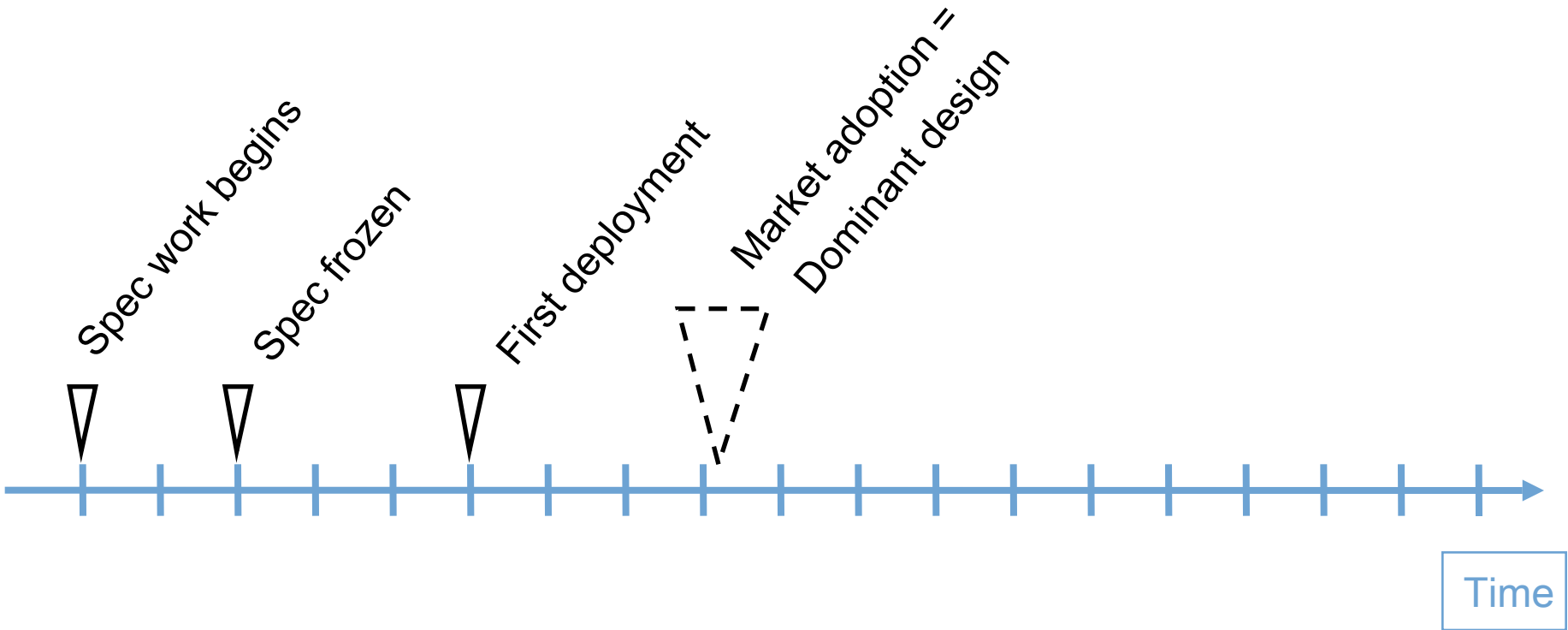
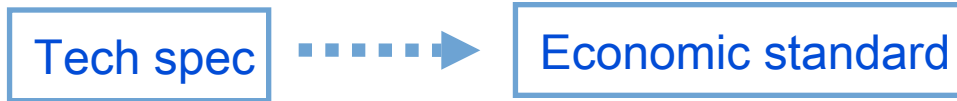


Indicative

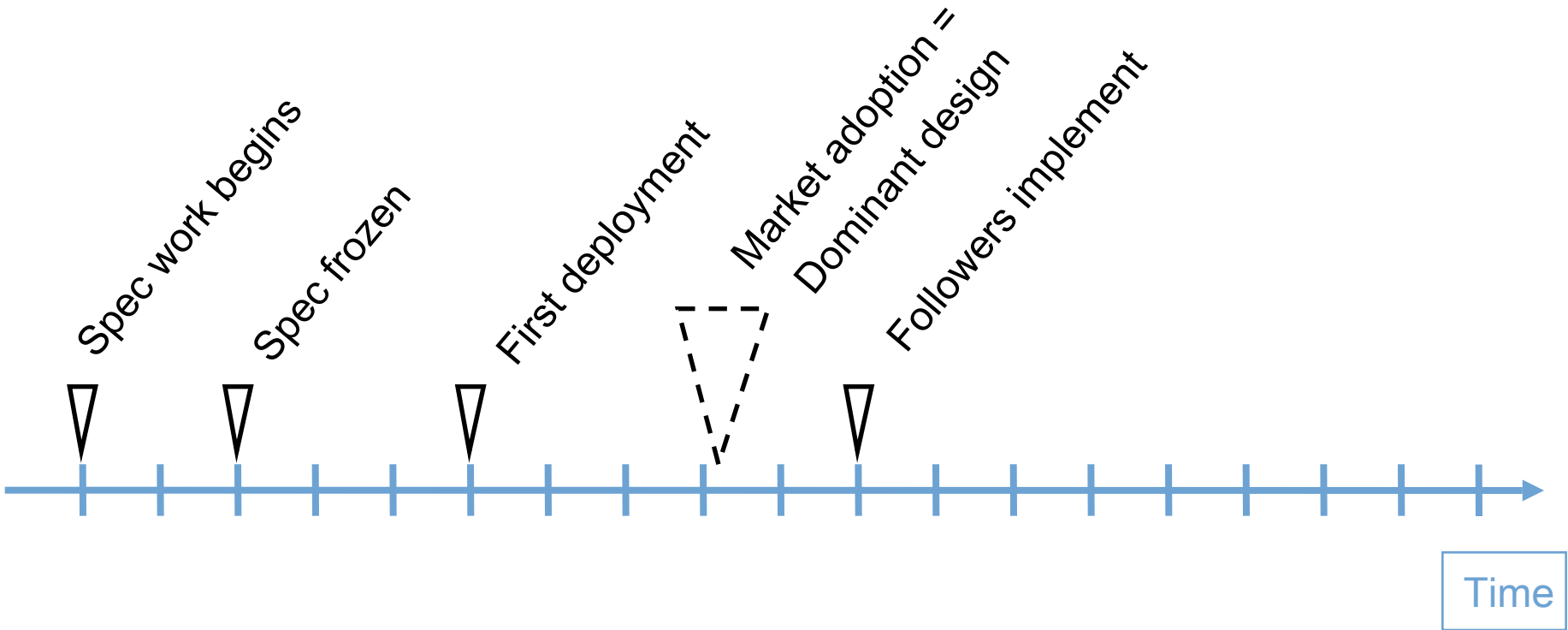
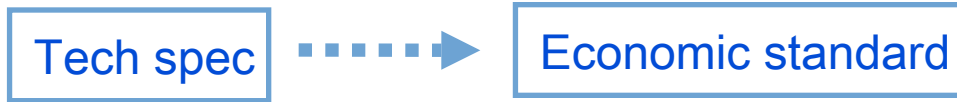
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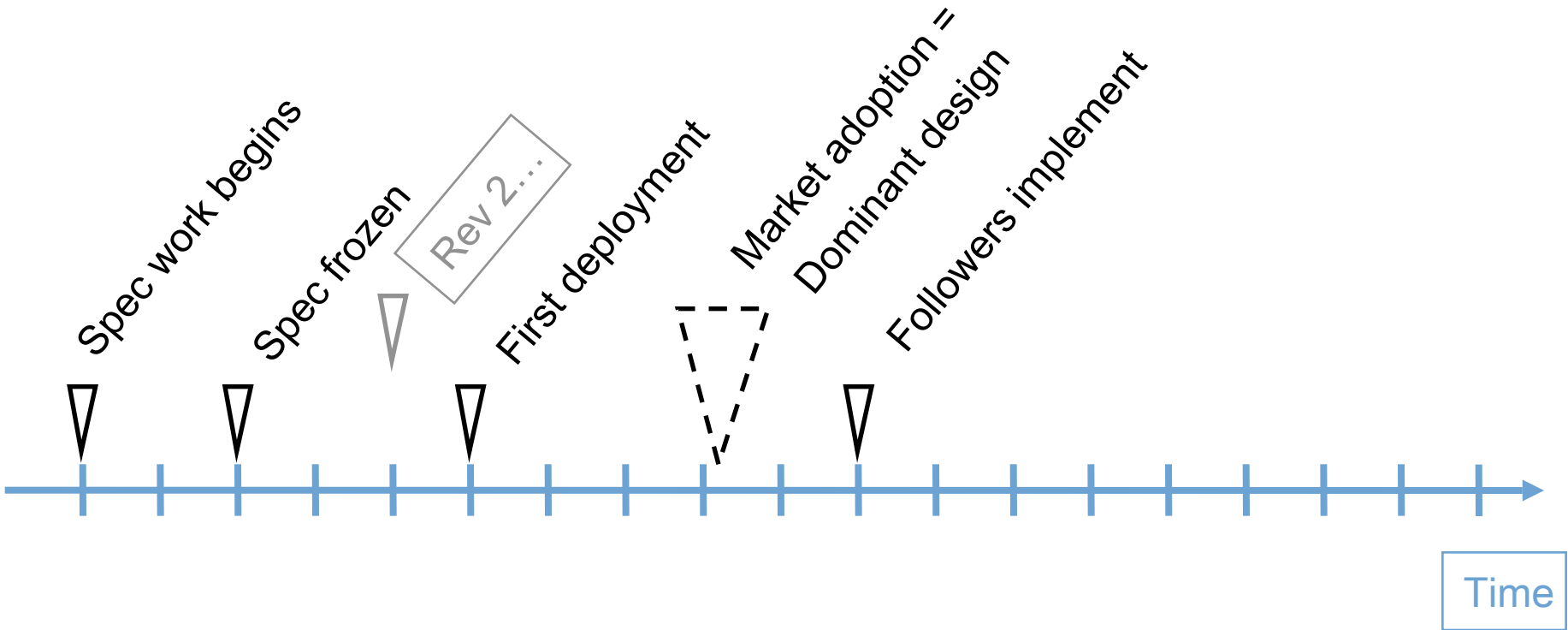
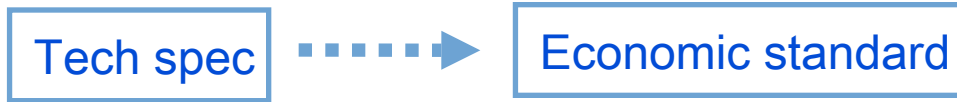
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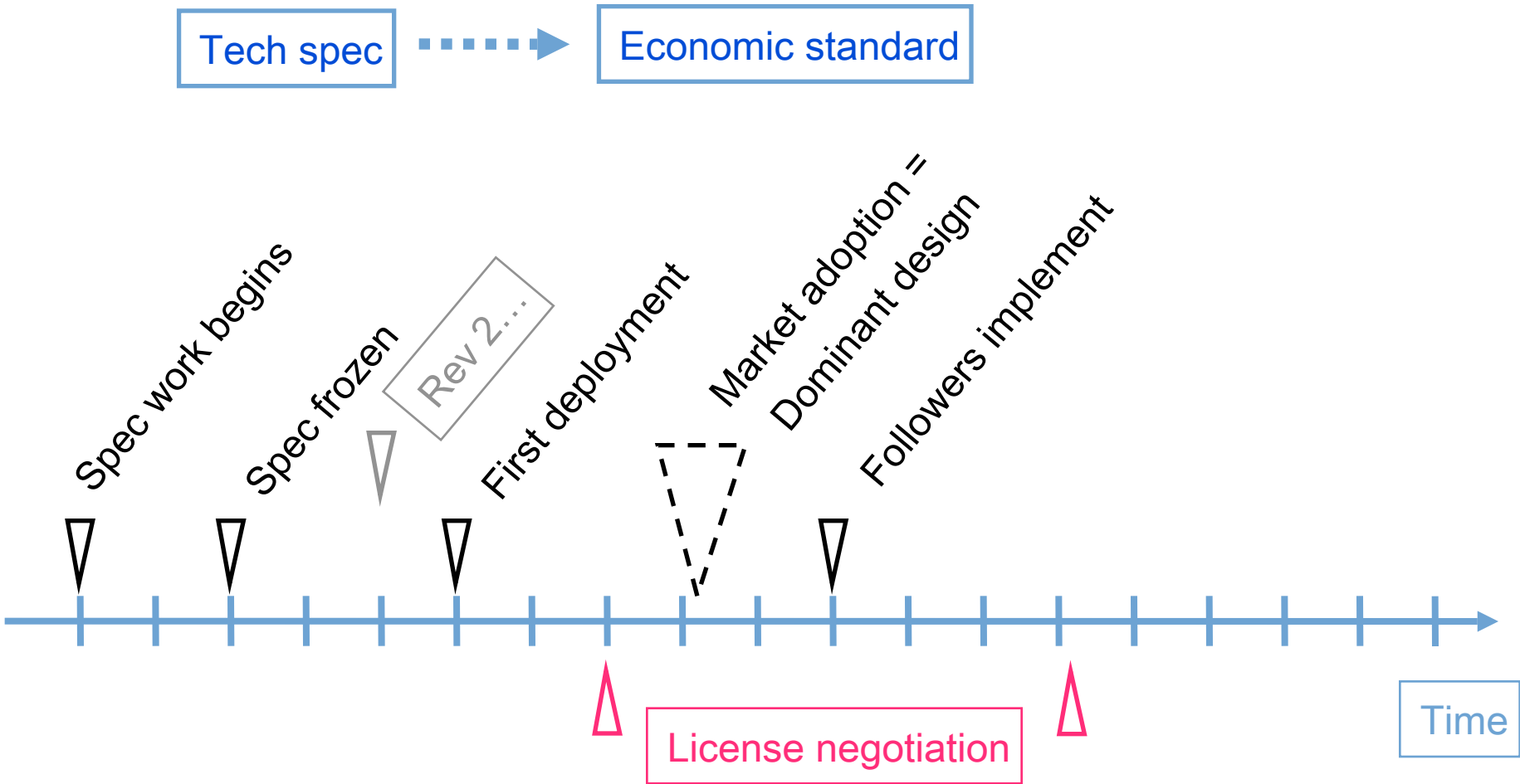


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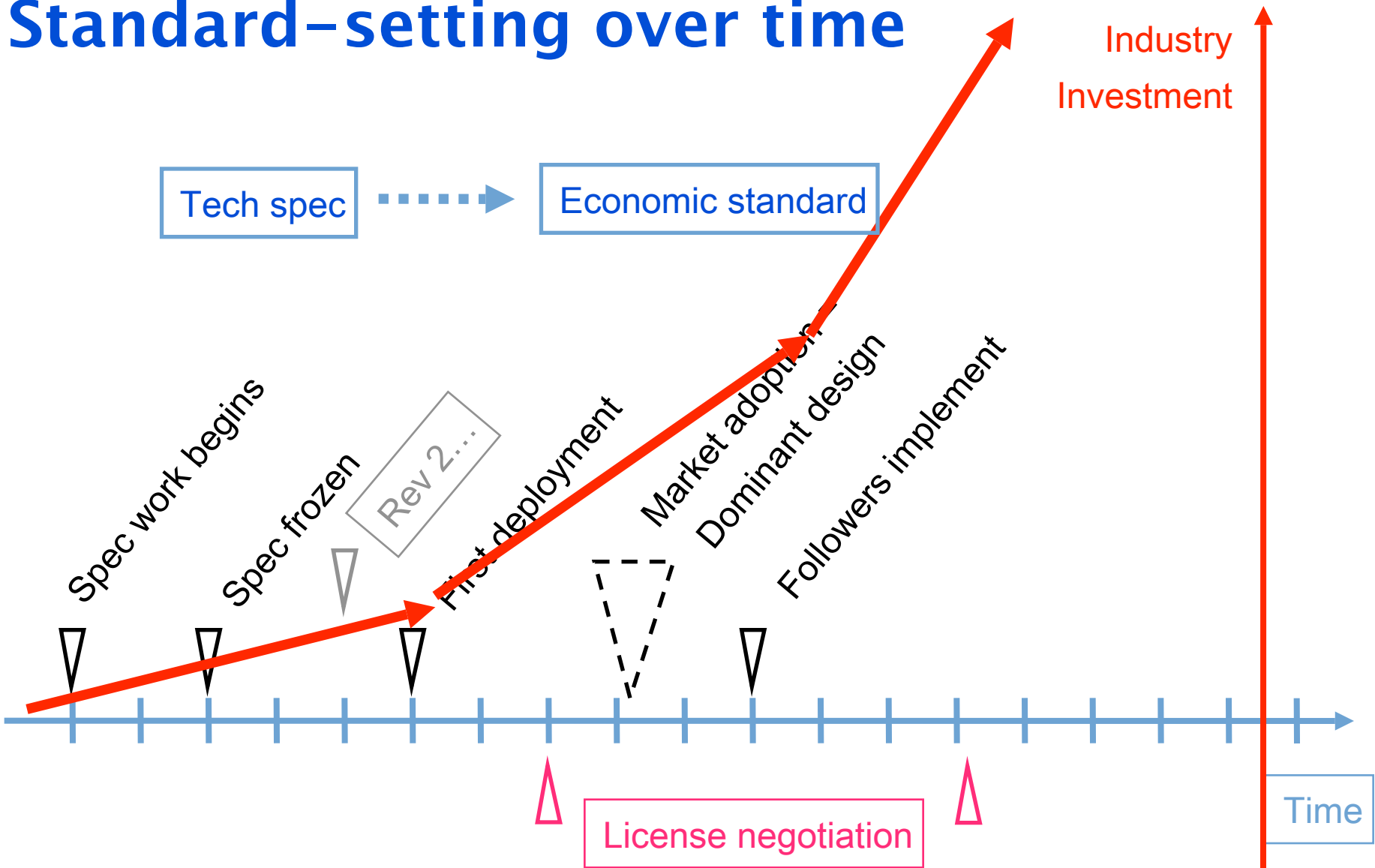
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Patent
Licensing
For
Standards
Occurs
Ex post
Implementer Investment

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Implementer Investment

Patent Holdup

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- Applies in ex post licensing: substantial investment has occurred
- In presence of market-defining standard, implementers face exceptionally large **holdup risk**
 - Essential patents are unavoidable
 - significant sunk cost
 - Circumvention, industry exit no longer feasible
- Risk: Patentee appropriates implementer sunk cost
 - higher royalty than implementer would have accepted ex ante
 - Significant negotiation leverage

Part 2: FRAND – or else

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**Contract context for requiring and
giving FRAND Undertakings**

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 - Patentee can have patent included in standard – but not on any terms

Standard practice (sic) under SDO rules

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Must get FRAND for Essential Patents

– or else: DROP THE STANDARD !

Giving FRAND undertakings – PART OF A DEAL

- THE DEAL: Participating in standards-making
 - Possible to get one's patents included: Big market, easy enforcement
 - Right to withhold individual patents, if done upfront
 - Requires licensing of included patents on terms compatible with standardization objectives
 - MUCH more than “not blocking the standard”
 - Giving FRAND undertakings signals acceptance of these ground rules
- Refusals of FRAND are extremely rare
- Compliance ?

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 - FRAND should be compatible with the implementer’s investment case

Part 3: The 25 Per Cent “Rule”

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One perspective for evaluating
investment compatibility

Implementer investment case

- Design, specific assets, market investments
 - Total capital requirements – capital at risk
- Earning potential: future cashflows
 - Operating margin
- Industry/business area characteristics
 - Business model – e.g. integrated manufacturer/OEM
 - Risks assumed
 - Maturity of product market
 - ⇒relatively consistent op margins among industry peers
- Total patent cost in relation to operating profit capability
 - Value of patent(s): earning power of licensed business

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- Suggestion: Royalty burden exceeding **25 % of industry-typical operating profits** will discourage implementer investment
 - Attainable profitability in line with industry experience
 - Implementer’s risk in investments
 - Implementer’s and patentee’s “shares” of possible returns
- Total cost of all patents, not relevant for any single patent
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“Typical” OP	Max. patent cost
40 % of sales	10 % of sales
16 % of sales	4 % of sales
6 % of sales	1.5 % of sales

FRAND in implementation context

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Essential patent royalty sought should be expressed

- in relation to a stated aggregate patent cost

- Acid test: 25 per cent rule

- justifying the proportion sought from that aggregate

- Quantitative and qualitative arguments

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- Standardization objectives require total cost to be compatible with investment in implementations
 - Experience suggests: 25 per cent “rule” as a benchmark

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- “FRAND or no standard” approach is based on business rationale
- FRAND has to be effective – or its absence would not be a showstopper
- Standardization objectives require total cost to be compatible with investment in implementations
 - Experience suggests: 25 per cent “rule” as a benchmark
- **Recommendation:** SDOs should require patent holders to express (in licensing offers)
 - what total Essential patent cost (estimate) they base their offer on
 - what justified proportion of such total cost they consider as their appropriate royalty

A close-up photograph of a fishing net. A wooden post is in the center, with a red rope tied around it. A red and white buoy is attached to the rope. The net is stretched across the frame, with a bright sun in the background creating a lens flare. The sea and a distant horizon are visible in the background.

Thank you

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