CPI Columns
Asia

April 2024

Chinese Standard Essential Patents Licensing Negotiations and Dispute Resolution in Practice

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By Dragon Wang, Bing Wu, Yannan Li & Xiaolin Wang[1]

The Supreme People's Court ("SPC") recently handed down a second-instance judgment in the case of Advanced Codec Technologies, LLC ("ACT") vs. OPPO Guangdong Mobile Communications Co., Ltd. (r "OPPO") for infringement of standard essential patents (SEPs),[2] marking a significant development in the legal landscape of SEP enforcement and licensing in China.

In this milestone case, the SPC provided approaches and guidelines for resolving several issues related to SEP licensing and other disputes that are of great interest to the industry. These include the determination of SEP infringement, setting of licensing rates, assessment of the degree of fault of the parties involved, and the calculation of compensation for SEP infringement.

This is a pioneering judgment in guiding SEP holders and technology implementers in conducting FRAND (Fair, Reasonable, and Non-Discriminatory) licensing negotiations and resolving related infringement disputes. It significantly enhances the predictability of outcomes in FRAND licensing negotiations and dispute resolutions in China. Moreover, this ruling is particularly important in the context of the evolving global technology landscape, where SEPs play a crucial role. By clarifying key aspects of SEP enforcement and licensing, the SPC has contributed to a more efficient and predictable environment for technological innovation and implementation in China.

I. Case Background

The six Chinese patents at issue are related to AMR-WB, which is an audio codec technology. Of these six patents, four patents expired in 2019, while the remaining two expired in 2020 and 2021, respectively.

Since 2014, numerous global smartphone manufacturers have recognized the market value of AMR-WB patent technology and successively reached licensing agreements with ACT or its affiliates. By early 2018, a significant portion of the global smartphone market had licensed this technology. At the end of 2018, and encountering protracted licensing negotiations, ACT filed lawsuits over the infringement of SEPs against OPPO, Vivo, and Xiaomi at the Nanjing Intermediate People's Court, and against TCL at Shanghai's Intellectual Property Court.

Despite nearly 20 rounds of challenges, all patents remained valid. Settlements with Xiaomi were finalized by the end of 2019, while disputes with OPPO and Vivo concluded after five years, including delays due to the COVID-19 pandemic. Eventually, ACT won both the first- and second-instance judgments, while additional lawsuits against OnePlus, Realme, and Meizu are ongoing.

II. Key Points of the Judgement

The SPC, in its judgment, responded to several issues related to FRAND licensing and dispute resolution that have long been of concern in the industry.

A. Non-infringement Argument for Standard Essential Patents

In SEP infringement cases, even if the rights holder has proven that the patent in question is an SEP and that the infringing product follows the relevant standard, concluding its technical solution falls within the scope of the patent protection, if the alleged infringer can prove that the patented technical solution is not itself implemented in the infringing product in the real world, t *Dragon Wang, Bing Wu, Yannan Li & Xiaolin Wang* hen infringement is not established.

[1] Dragon and Bing are partners and Yannan is licensing executive at Sitao IP. Xiaolin was senior associate with Sitao.

[2] The case numbers are (2022) Supreme People's Court Zhiminzhong No. 907, 910, 911, 916, 917, and 918.

In practice, alleged infringers often raise defenses against SEP infringement, such as the standard not being localized in the country; carriers not requiring the relevant functionality; network environments not supporting the relevant functionality; the relevant functionality only existing in chips; or it being disabled in the infringing products through software, resulting in end-users not actually using the patented technology in the infringing products, hence not constituting infringement.

However, such non-infringement defenses raised by implementers have not been supported in judicial practice. The Supreme People's Court ruled in this case that if the alleged infringer uses a chip capable of supporting the relevant functionality as a component in the assembly of the accused infringing product, then the product should be deemed as "implementing the patent." In other words, as long as the product contains the patented technology, the technology is objectively implemented in the product, and the "available but not used" of the relevant functionality in the accused infringing product does not constitute a valid defense, nor does it prevent a determination of infringement.

Therefore, in practice, if implementers wish to defend against infringement by proving that they have not objectively implemented the patented technology, they must fulfill the corresponding burden of proof. Merely proving that the relevant functionality is only present in the product, but is not actually used, i.e. it is in a state of "available but not used," cannot constitute a valid defense against infringement charges. Implementers must prove that the relevant functionality in their products is "not available, thus not used" to prove that their products do not constitute infringement.

B. Rate Determination – Adoption of the Comparable License Approach

Judicial authorities worldwide use various methods to set SEP royalty rates, tailored to each case's specifics and evidence. The "top-down approach" and the "comparable license approach" are the predominant methods for aiming to determine the patent's industry value and establish a fair market price for royalties.

When applying the "top-down approach" to determine rates, two key factors are the industry aggregate royalty rate, and the portfolio's patent value ratio within this aggregate rate. Despite some industry consensus on the aggregate royalty rate, many judicial cases show that with the continuous evolution of technical standards, the counting of standard-essential patents is fraught with uncertainty. Even though some courts determined an "industry aggregate royalty rate" and the patent value proportion based on the evidence from both parties in specific cases, such conclusions still lack universality.

The "top-down approach" assumes that each counted SEP has equal quality (market value). In specific cases, it is reasonable for judicial authorities to adopt or verify rates by using the "top-down approach" in combination with the evidence submitted by both parties. It is also understandable for rights holders to reference the "top-down approach" when constructing SEP licensing programs, or to use it in the context of cross-licensing to compare the strengths of both parties' patents. However, discussing the "top-down approach" beyond these specific contexts of judicial rate determination, license negotiation, or cross-licensing overlooks its practical limits, as equating all patents' values is unreasonable. That is, the theoretical premise or its variants is in moot when removed from above specific contexts.

ACT presented evidence of comparable licensing agreements involving seven licensees and evidence of patent stability to demonstrate that many leading global smartphone manufacturers fully recognize the market value of the AMR-WB patent technology. The SPC ultimately determined that OPPO initially favored the "top-down approach" but explicitly stated at the trial before the SPC that it no longer insisted on this calculation method. The evidence provided by the parties in the case regarding the determination of the licensing rate primarily consisted of standard-essential patent licensing agreements. Therefore, this case lacked the necessary conditions to adopt methods other than the "comparable license approach".

Regarding the "comparable license approach," the SPC elaborated in this case, *"The prominent advantage of the comparable license approach is that it can reflect market pricing. In a market with fair competition, the final licensing rates of patent licensing agreements are usually the result of genuine negotiations and voluntary consensus reached through business discussions, and the licensing rates determined through negotiation can relatively objectively, fairly, and reasonably reflect the market value of the licensed patent technology at the time of signing of the agreement."*

Considering the theoretical foundations and application scenarios of the "comparable license approach" and the "top-down approach," the "comparable license approach" has significant advantages over the " top-down approach" when investigating the value of specific patent technologies for specific licensees. The "comparable license approach" matches the market pricing of specific patent technologies, unlike the "top-down approach," which inaccurately treats all SEPs as having the same market value. In terms of closely approximating or confirming the "royalty rate" as a case fact, the "comparable license approach" is undoubtedly superior to the "top-down approach." The "top-down approach" can be used to cross check the conclusions of the "comparable license approach" when supported by evidence, but the "comparable license approach" should not be excluded in favor of the sole use of the "top-down approach." Only in the absence of comparable agreements and with evidence supporting basic facts like patent count statistics, is there room for the exclusive use of the "top-down approach" to determine royalty rates.

C. Key Considerations for Selecting Comparable Agreements

In this case, the Supreme People's Court of China clarified that when selecting comparable licensing agreements, factors such as the context of the licensing negotiations, the similarity of the licensing entities, the similarity of the licensed patents, and the similarity of the licensing terms should be given primary consideration. Specifically, in this case, considering the similarity in various aspects of the licensing agreements submitted as evidences, the SPC refined these considerations into five key factors: the subject matter of the comparable license (e.g. whether it includes only the six patents involved in the case); the situation of the licensee (e.g. whether it is a well-known enterprise in the Chinese telecommunications industry like OPPO); the geographic scope of the license (e.g. whether it is limited to China or it is a global license); the context of the licensing negotiations (e.g. whether there is related litigation between the parties during the negotiation); and the scale of patent implementation (e.g. whether the sales volume is similar to that of OPPO).

The SPC identified Agreement 1 signed with Chinese Company B as the most comparable agreement in this case, focusing on the following aspects: first, the license covered the same six patents in question. Second, Company B, like the defendant, is also a prominent player in China's telecommunications industry. Third, regarding the geographic scope of the license, Agreement 1 with Company B also pertained only to China. Fourth, both Company B and OPPO had implemented the six patents in question in over one hundred million mobile phones. Fifth, regarding the licensing negotiation context, the effect of related litigation on Agreement 1's negotiation was deemed minimal due to the time gap. In other words, it could be considered that Agreement 1 with Company B was reached in a normal licensing negotiation atmosphere and could objectively and reasonably reflect the market value of the six patents involved in the agreement.

The SPC did not consider Agreement 1 with Chinese Company C comparable due to its lower sales volume and the interference of patent infringement litigation abroad (existing foreign litigation at the time of signing Agreement 1 with Company C). Similarly, the Court also excluded the agreement with Chinese Company A, because of differences in the subject matter of the licensed patent (global AMR-WB patents, excluding the United States), the geographic scope of the license (global, excluding the United States), and interference from patent infringement litigation (involvement of Chinese judicial litigation).

Ultimately, based on the analysis of the royalty rate in Agreement 1 with Company B, the SPC determined a royalty rate of $0.008 per unit for calculating the damage compensation amount in this case.

The SPC exercised relative caution in selecting comparable agreements in this case, reflecting a conservative attitude towards determining licensing rates for standard essential patents (SEPs). Firstly, the criteria for determining the scope of comparable agreements were relatively strict. For example, the court limited the selection of potential comparable agreements to those signed with well-known enterprises in the Chinese telecommunications industry, without considering that all prior licensees were globally renowned smartphone manufacturers. Secondly, the court treated the specific terms of each of comparable agreement separately, severing the connections among related agreements signed by ACT and the same licensee. For instance, the SPC ignored the broader context of ACT's licensing aimed at achieving a global license to put the dispute to an end, and the relationship between various regional agreements that constitute the global license. This may result in judicial determinations deviating significantly from licensing practice. Thirdly, the Court did not account for common discount factors in its analysis of comparable agreements. Notably, the adoption of WACC, which is necessary and has been recognized in foreign judgments when unpacking agreements with a lump-sum payment of royalties, was not considered in this judgement.

It is important to note that, in selecting the most suitable comparable agreement in this case, the SPC considered all the above factors comprehensively, instead of using any single factor as the sole reason to exclude a specific prior agreement from the scope of comparable agreements. This method of selecting comparable agreements provides sufficient flexibility for determining comparable agreements in other similar cases, allowing the choice of comparable agreements to be adjusted according to the specific facts on a case-by-case basis.

Another issue worth discussing in this case is that both parties in the first-instance trial engaged third-party economists to produce economic reports, presenting their respective positions and viewpoints using the "comparable license approach" and the "top-down approach" for determining the royalty rate. In addition, ACT also engaged a top industry expert in the ICT area and an authoritative expert in audio codec standardization to testify in court. Regrettably, the first-instance court didn't fully utilize the expert resources provided by both parties, resulting in the lack of opportunities for these experts to assist the SPC in clarifying case facts related to licensing agreements and the value of the patents in question. SEP disputes involve complex legal and economic issues, and conducting a thorough trial of complex cases with assistance from experts is beneficial for judges to understand industry practices, clarify case facts, improve the quality of judgment, make the ruling more instructive, and ensure that the judgments are more in line with industry practices and market recognition, providing more guidance and predictability to the industry. We look forward to seeing the judiciary involve more professionals in future trials of SEP disputes that involve complex factors related to law, technology, standards, and business, conducting the trial in a more thorough and detailed manner.

D. Determination of Parties' Fault in Contracting

The SPC of China clarified that the negotiating behavior of the SEP holder and the implementer during the process of negotiating licensing terms, as well as whether there was fault and the degree of fault for not reaching an agreement on licensing terms, are not statutory factors to be considered when determining the reasonable multiplier for calculating damages based on royalty according to the patent law. However, after the determination of the amount of loss caused by infringement to the SEP holder, no matter if it's infringement liability or contractual liability in concern, it is necessary to further determine the apportionment of losses between the parties based on the degree and impact of fault caused by both parties.

The SPC emphasized that the SEP holders, within the legal system of the People's Republic of China, must comply with the provisions of the Civil Code of the People's Republic of China. This includes Article 7 concerning the good faith principle, Article 132 on the prohibition of abusing civil rights, and Article 500 on the liability for pre-contractual fault. Therefore, once an implementer seeks a license for SEPs, the rights holder, in principle, shall not refuse without justifiable reasons, shifting negotiation focus from the license grant itself to the terms under which it is granted. The licensing terms, especially the licensing fees, are the core issues in negotiating and concluding a SEP license contract between the rights holder (licensor) and the implementer (licensee). Negotiations for SEPs license must be conducted in good faith as stipulated in the Civil Code. This principle of good faith is primarily reflected in the widely recognized and followed FRAND (Fair, Reasonable, and Non-Discriminatory) principles of the industry.

The SPC holds that, according to the industry practice for negotiating SEP licenses, the process of reaching a SEP license agreement generally involves the following steps:

(1) The rights holder issues a written infringement notice to the implementer, informing them of the suspected infringement of the SEP, including details such as the patent number and the standard corresponding to the patent, and inquires whether the implementer is willing to negotiate licensing terms with the rights holder.

(2) Upon receiving the written notice from the rights holder, if the implementer wishes to obtain a license, they should promptly reply to the rights holder and inform them of their willingness to negotiate specific implementation license terms.

(3) After receiving the implementer's response, the rights holder may propose an offer of licensing terms to the implementer, including the licensing fee, type of licensing, geographic scope, and duration.

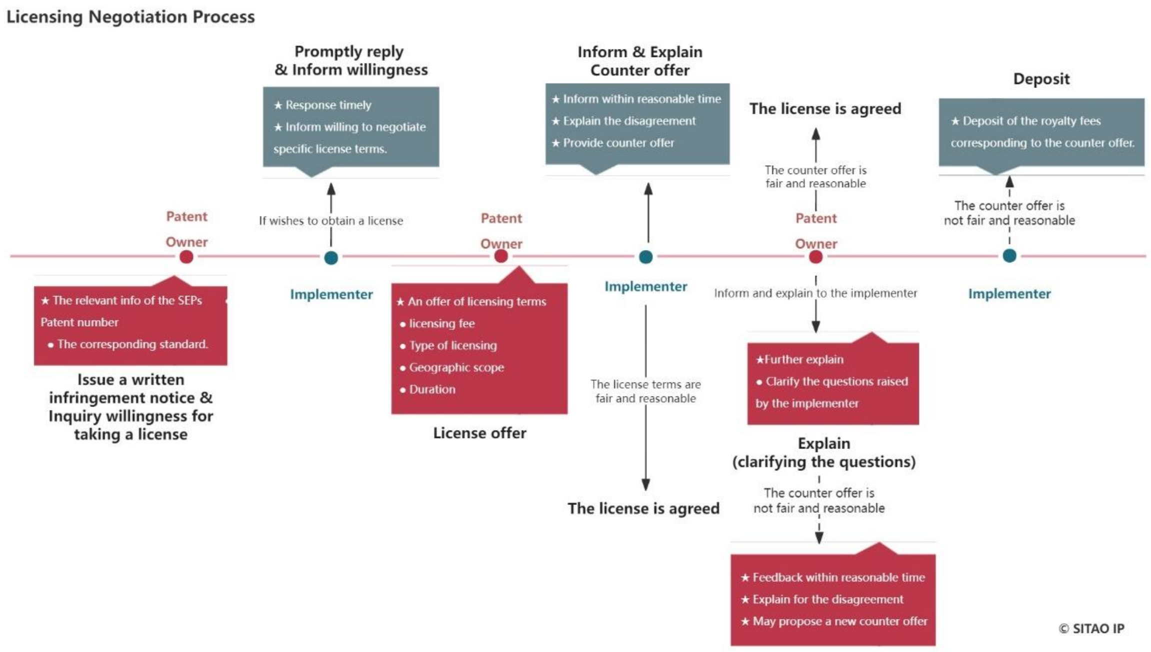
(4) Upon receiving the rights holder's offer, if the implementer considers the licensing terms to be fair and reasonable, both parties can reach a licensing agreement accordingly. If the implementer finds the proposed terms unreasonable, they should inform the rights holder within a reasonable timeframe and explain their reasons for rejection, while also possibly proposing a counteroffer to the rights holder.

(5) After receiving the implementer's reasons for not accepting the offer, the rights holder may provide further explanations to clarify any doubts raised by the implementer. If the rights holder receives a counteroffer from the implementer and considers it fair and reasonable, both parties can thus reach a licensing agreement.

(6) If the rights holder finds the implementer's counteroffer terms unreasonable, they should likewise respond to the implementer within a reasonable timeframe, explain why they do not accept the counteroffer, and propose a new offer depending on the situation.

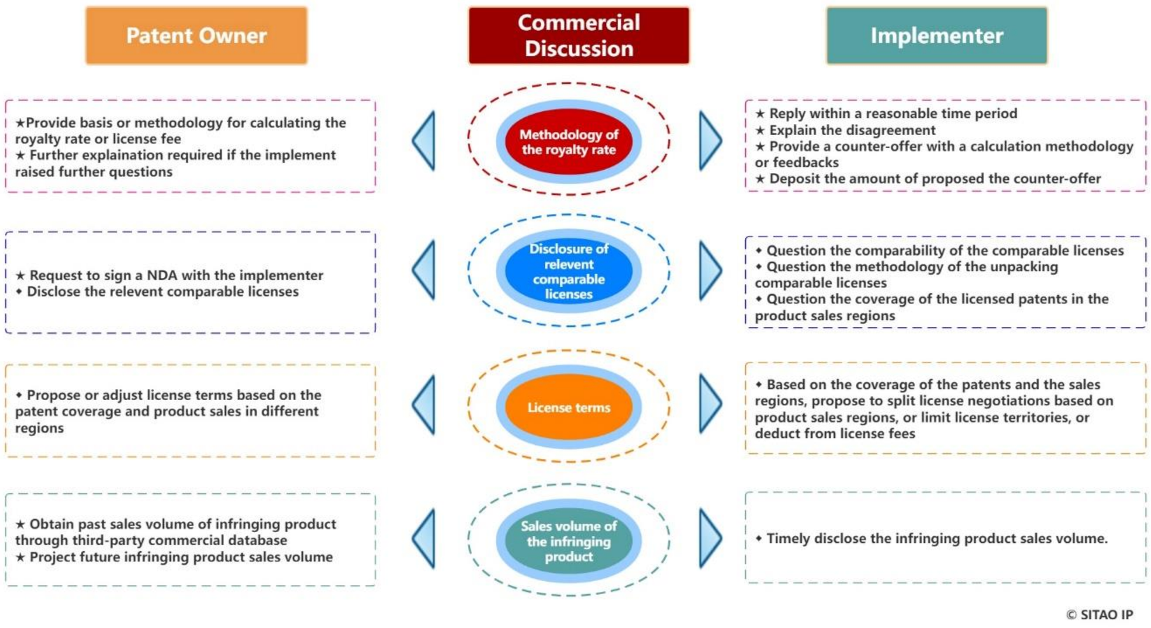
(7) If the rights holder considers the implementer's counteroffer to be unfair and unreasonable, then the implementer may deposit the corresponding licensing fee associated with their counteroffer in a timely manner.

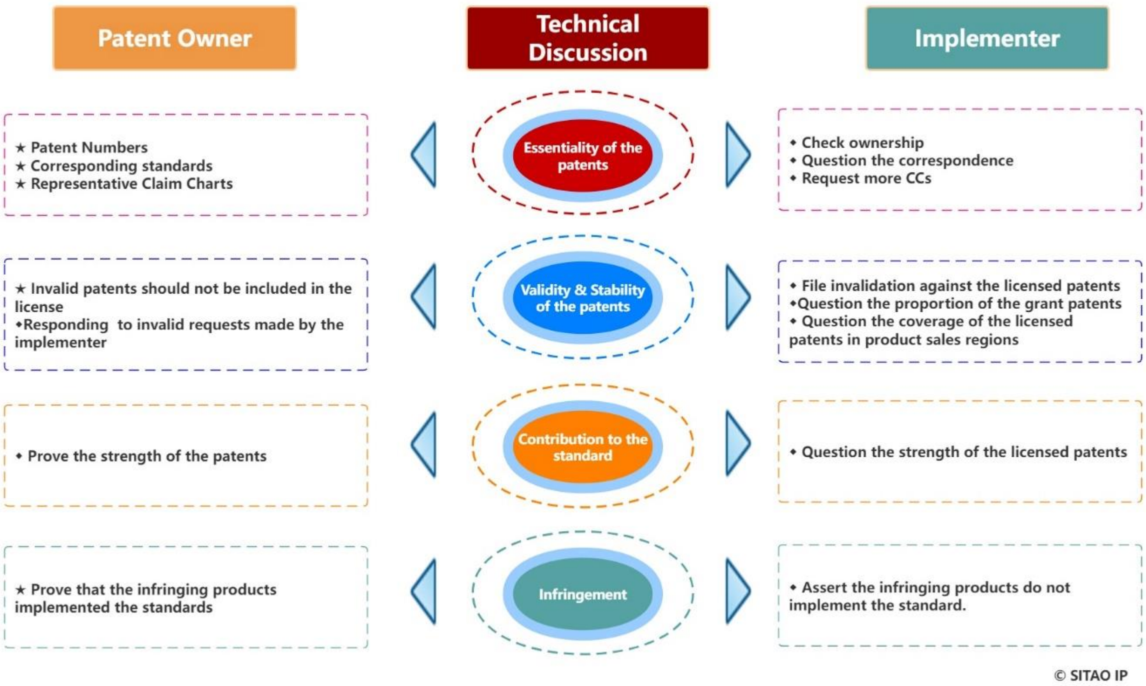
The above SEP license negotiation steps are summarized as shown in the following diagram:



The SPC further believes that negotiations for SEP licenses generally involve technical and business negotiations. Technical negotiations usually focus on the essentiality of the patents to the standards, the validity and stability of the patents intended to be licensed, the technical contribution of the patents, and whether the technical solutions of the products alleged to infringe fall within the scope of the patents. Business negotiations often cover the methodology of rate calculation, disclosure of relevant comparable agreements, the scope of the patents intended to be licensed, the type of the license, the duration and geographic scope of the license, and the annual sales volume of the products alleged to infringe.

The above matters of technical and business negotiations are summarized as shown in the following diagram:





In assessing the faults of both parties during the negotiation process, the SPC believes that despite the many details in the industry practices of SEP licensing negotiations, the core focus in determining whether there is fault in the negotiation process still lies in judging whether both parties havedemonstrated a sincere willingness to reach a license agreement. The following factors are typically considered:

(1) Initiating legal proceedings to determine royalty without first sending a written infringement notice to the implementer.

(2) Explicitly refusing the implementer's request for a license.

(3) Repeatedly threatening the implementer with filing of infringement lawsuit or applying for an injunction to stop infringement during negotiations, or actually implementing such actions.

(4) Unjustifiably interrupting negotiations.

(5) Refusing to disclose necessary patent information to the implementer (e.g. a certain number of standard essential patents, exemplary claim charts).

(6) Refusing to disclose to the implementer the claimed amount of royalties or the basis or method for calculating the royalty rate.

(7) Offering the implementer licensing terms that are significantly or unreasonably higher than those offered to the other similarly situated industry competitors, and refusing to explain the reasons.

(8) Failing to provide feedback to the implementer within a reasonable period after receiving their counteroffer.

(9) Unjustifiably refusing requests from the implementer to clarify relevant technical issues, etc.

Factors for determining whether the implementer is at fault in licensing negotiations:

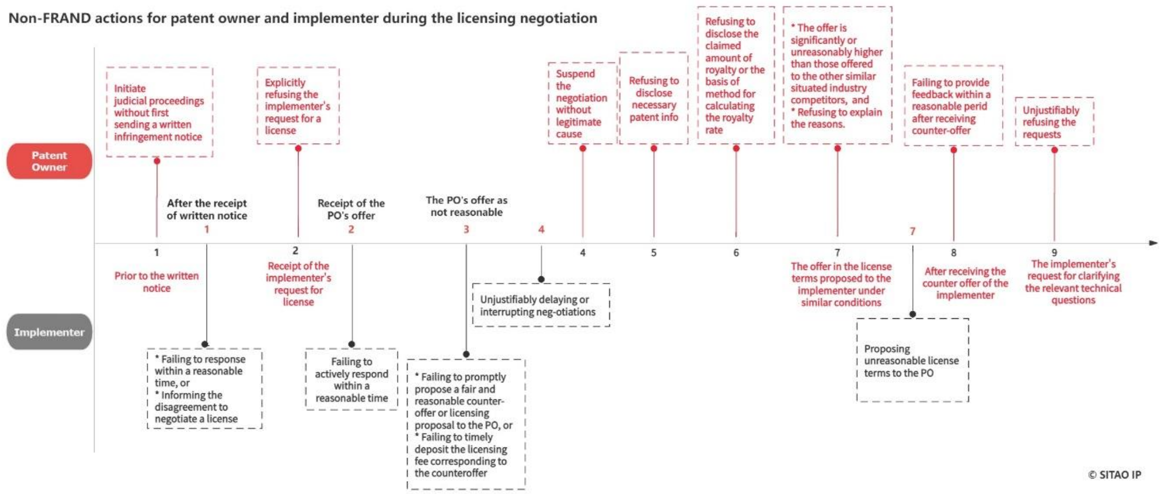
(1) Failing to respond within a reasonable time after receiving the rights holder's written infringement notice or failing to inform the rights holder of disagreement to negotiate a license.

(2) Failing to actively respond within a reasonable time to the terms offered by the rights holder.

(3) Failing to promptly propose a fair and reasonable counteroffer or licensing proposal to the rights holder if the offer is considered unreasonable, or failing to deposit the licensing fee corresponding to the counteroffer in a timely manner.

(4) Unjustifiably delaying or interrupting negotiations.

The factors for determining the faults of the rights holder and implementer are summarized as shown in the following diagram:



According to the SPC's judgment on the degree of pre-contracting faults of the parties in this case, it is evident that the SPC innovatively introduced the principle of good faith in the negotiations for concluding SEP license contracts between the rights holder (licensor) and implementer (licensee). The SPC regards the principle of good faith as mainly embodied in the widely recognized and followed FRAND (Fair, Reasonable, and Non-Discriminatory) principles in the industry. If a violation of the good faith principle leads to contracting faults, then the sharing of losses between the parties must be further determined based on the degree and impact of each party's faults. In this case, the SPC set clear obligations for both rights holders and implementers, requiring both parties to demonstrate a sincere willingness to reach a licensing agreement and actively facilitate the conclusion of such an agreement. For instance, as per the spirit of the judgment, an implementer who fails to provide sales data of the infringing products without just cause or refuses to provide a basis or method for calculating the counteroffer would be considered at fault.

The SPC's approach of setting clear obligations for both rights holders and implementers in this case helps to regulate the behavior of both parties in negotiating and concluding SEP license contracts, navigating them towards the goal of reaching a licensing agreement.

However, there are instances where certain willful infringers, under the guise of respecting intellectual property and friendly negotiations, take advantage of the limitations of judicial and administrative proceedings. They use public campaigns, negotiation tactics, and litigation strategies to increase the difficulty and cost for rights holders in negotiations and enforcing their rights, aiming to delay payment of royalties or bring down royalty rate. Such seemingly "friendly negotiations" that are actually “efficient infringement” behaviors aim not to reach a licensing agreement but to gain an undue competitive advantage over willing licensees in the same industry. If such “efficient infringement” is not regulated, it will inevitably erode the foundation of SEP licensing rules and harm the enthusiasm of innovators. Neglecting such behavior also runs counter to the intention of making China a preferred location for resolving international intellectual property disputes.

Unfortunately, the judgment in this case does not discuss how to evaluate the behavior of an unwilling licensee who seemingly complies with but substantially violates FRAND obligations. However, with more judgments arriving regarding SEP licensing dispute, we expect that the judiciary will conduct a further analysis of the parties' substantive behaviors and thereby determine whether they truly meet FRAND requirements. This will further regulate the behavior of licensors and licensees, creating a more predictable licensing environment.

E. Determination of Compensation Amount

The SPC believes that whether a SEP owner promptly receives royalties under ideal negotiation and transaction conditions, or later following a positive judgement, the principal amount of royalties obtained should be a constant. The additional loss suffered by the SEP owner due to the failure of both parties to conclude a contract is essentially the loss of interest that should have been obtained earlier, i.e. the foreseeable interest loss under normal circumstances. This interest loss should be shared by both parties according to their respective faults in failing to conclude the contract. The total compensation amount the SEP owner eventually obtains from the SEP implementer includes: 1) the principal of the royalty; 2) interest loss, calculated as the interest on the delayed principal amount multiplied by the implementer's fault ratio in contract negotiation.

The SPC further believes that, according to industry practice, a license agreement should be reached within a reasonable period of 12 to 18 months. The time for receipt of a lump-sum royalty payments can be reasonably determined from the date the implementer replies to the rights holder expressing their willingness to negotiate under FRAND terms, with a maximum negotiation duration of 18 months, plus 5 days for payment after the contract is concluded.

The SPC highlights the distinct nature of SEP licensing compared to non-SEP licensing, and believes that the SEP holders shall not, in principle, refuse to grant a license to implementers who indicate their willingness to sign a license contract under FRAND terms, and both parties should resolve the license issues through good faith negotiations. If a failure to conclude a license contract due to faults on both parties results in patent infringement by the implementer without the SEP owner’s license, this differs from patent infringement by the implementer without a non-SEP owner’s license. Specifically, SEP infringement often arises from negotiation failures by the implementer or by both parties, unlike non-SEP infringement which typically results from the implementer's unilateral reasons. In SEP infringement litigation, if the rights holder and the implementer fail to conclude a contract due to both parties' contracting faults, the responsibility for patent infringement, especially compensation liability, should primarily be based on the degree of fault of both parties, differing from the unilateral responsibility of the implementer in non-SEP infringement.

Specific to this case, the SPC determined that the ACT’s losses were mainly due to a failure to reach a licensing agreement with OPPO over an extended period. The loss is the difference between the benefits ACT should have obtained under the assumption of a timely FRAND contract and its current benefits. Assuming both parties promptly conclude the license contract under FRAND terms, and considering the industry’s general practice of lump-sum payment for licensing and the comparable agreements provided by both parties in this case, the licensee usually pays all licensing fees for the entire period of patent protection at the beginning of the contract. Therefore, the licensing fees determined through judicial proceedings should also follow the same logic. Whether ACT promptly receives the licensing fees under ideal conditions via negotiation or later according to the effective judgment, the principal amount of the licensing fees should be constant, and the additional loss suffered due to failure to conclude a contract is essentially the foreseeable interest loss.

It is noteworthy that in this case, the SPC explicitly states that the implementer's liability for infringement includes: 1) All licensing fees for the infringing products covered by the patent's effective protection period; 2) Interest loss on all licensing fees from the time the license agreement should have been concluded until the actual payment of the licensing fees; 3) Court fees; 4) Reasonable patent enforcement expenses (including attorney fees if applicable); 5) Provided there is a delay in fulfilling the above monetary obligations, double payment of debt interest. Additionally, the case didn't address injunctions due to the patents expiring during the trial. According to China’s current legal framework, if the behavior of the SEP holder meets the requirements of FRAND obligations, and the implementer is obviously at fault, the people’s court should consider granting permanent injunctive relief provided the infringement of SEP is established.

It should be noted that the SPC considers that there is a way to determine the actual loss in this case, so there is no need to alternatively determine the amount of compensation by referring to a multiple of the royalty. It also does not further clarify whether the parties' behavior affects the determination of the "multiple." The author believes this ruling is innovative, and whether it applies to the determination of damages in all SEP dispute cases remains to be further clarified by more judicial judgments in the future.

III. Prospect on SEP Licensing in China

The judgment in the case between ACT vs. OPPO over SEP infringement marks a significant advancement in enhancing the predictability of FRAND licensing negotiations and dispute resolution in China. Because of various factors, such as the patents and market scope covered in the licensing negotiations being different from the patents and scope of the infringing products involved in the litigation, the rate determined based on comparable license agreements was notably lower than that in prior agreements, and the amount awarded in damages reflects only part of the commercial value of the portfolio with Chinese patents at issue. Nevertheless, this judgment sets an important and pioneering precedent for SEP licensing in China.

As an increasing number of Chinese companies transition from technology followers to leaders in the telecommunications industry and play more significant roles in global competition, China's role as a key site for both technological innovation and implementation is growing in importance on the global stage. Therefore, when conducting SEP licensing in China, both licensors and licensees should adhere not only to the universal principles of fairness, reasonableness, and non-discrimination, but also develop more targeted licensing and litigation strategies within the context of Chinese licensing practices and legal frameworks.

Furthermore, there is an expectation for the Chinese judicial system to work towards making China a preferred venue for resolving international intellectual property disputes. This entails strengthening the protection of intellectual property rights, encouraging compliance with FRAND obligations, penalizing violations of FRAND obligations, and playing a critical role in correcting fault actions that disrupt commercial order, thereby restoring normal business practices. Such efforts are crucial for the efficiency and predictability of SEP licensing in the Chinese market, thus providing judicial support for China's strategy of innovation-driven development.