

# IP licensing strategies in complex markets

In a rapidly changing business and legal environment, licensing strategies must adapt if they are to keep up with developments

By **Guillaume Ménage** and **Yann Dietrich**

John Bessant, professor of innovation and technology management at Imperial College, London, has said that innovation “is a multi-player game and the issue is less about creating knowledge, than it is about knowledge flows” (www.SupplyManagement.com, 25th May 2006). IP licensing – whether offensive or defensive – is a strategic tool that can be used in order to facilitate such knowledge flows. The goal of any company in implementing its IP strategy is to ensure freedom to innovate and to support and promote its business goals. While such strategies might differ in their operational and practical aspects, they generally involve the granting of licences to players either at the same level in the value chain (eg, cross-licences between competitors) or at different levels (eg, patent licences granted to clients or suppliers). The latter is becoming increasingly common in complex markets.

Complex markets involve at least three levels in the value chain. For example, in the telecommunications world, IP core providers develop some of the basic technologies; component manufacturers make integrated circuits (chips) using those technologies; original equipment manufacturers (OEMs) make products (eg, smartphones) incorporating those chips; and network operators create services around those products. Another example is the electricity market, where utilities play a similar role to network operators. This

model is distinct from that in more traditional markets, where a manufacturer sources materials, builds a product and then sells it to end users. Thanks to the emergence of new services and software, such complexity is increasing everywhere.

Contractual licensing arrangements within the value chain must take into account the specificities that have emerged over the last few years. In this article, we analyse several of these, and the ways in which companies are dealing with them to protect and promote innovation and their business goals.

## From neutrality to strategy

For many years most players in the value chain remained IP neutral, with intellectual property effectively the exclusive preserve of OEMs. However, this is now changing as markets become more complex.

In the telecommunications sector in particular, lawsuits are increasingly being launched against network operators. A quick online search reveals that in the United States, players such as AT&T, T-Mobile, Sprint and Verizon each year face a multitude of IP lawsuits (eg, *DNT LLC v Sprint Nextel Corp*, Case 3:09-cv-00021, in the US District Court for the Eastern District of Virginia; *Red River Fiber Optic Corp v Verizon Services Corp*, Case 08-cv-00215, in the US District Court for the Eastern District of Texas; *Tendler Cellular of Texas LLC v AT&T Mobility LLC*, Case 09-cv-00115, in the US District Court for the Eastern District of Texas). The same trend – albeit somewhat less pronounced – can be observed in Europe (eg, *High Point Sarl v KPN BV*, Docket 352544, *The Hague District Court*; *Gemstar-TV Guide Intl Inc v Virgin Media Inc*, Case HC08CO0200, Patents Court).

Competition and pricing pressure have also intensified, forcing players to consider

issues such as the potential uncertainty around IP rights and the costs associated with such rights. In the telecommunications sector again, most handsets are not paid for by end users, but rather subsidised by the operators themselves, and the IP costs associated with such products are thus indirectly paid by these players.

The end result is that players which previously were not so much in evidence in the IP world have now become more prominent. For instance, in late 2009 British Telecom (BT) filed a lawsuit in the US District Court for the District of Massachusetts accusing Taiwanese integrated circuit designer MediaTek of infringing its patents relating to cell phone microchips. BT filed a similar patent infringement action against Broadcom in mid-2009. Both cases settled on confidential terms, so the motivation behind the litigation is still unknown. In hazarding an educated guess, however, it is worth noting that in 2009 Vodafone Group Plc, which competes with BT in certain markets, announced an alliance with MediaTek which would see MediaTek chipsets incorporated into some Vodafone models.

Another recent example of an initiative launched by players that were previously IP neutral is the NGMN alliance between network operators. This introduced a mechanism under which every member must declare its expected royalty rates for various competing technologies for the next generation of wireless technologies, with the aim of making IP costs more predictable.

Finally, technologies are becoming increasingly complex and integrated in today's world of convergence. This again is especially true in the telecommunications sphere. For example, Oracle is currently suing Google in relation to its Android mobile operating system; neither company was active in the mobile world five years ago. Nokia and Apple are also doing battle over Nokia's latest smartphone. Meanwhile, Kodak is suing various handset makers, which have become some of the most significant camera retailers since cameras were integrated into handsets as standard. The boundaries between different technologies are also shifting, with certain technologies previously implemented at equipment level now fully integrated at component level (eg, system-on-chips). This trend will have an interesting influence on licensing agreements.

The same trend may well play out, from a business and legal perspective, in the electricity sector, with the emergence of smart grids and more generally as business becomes increasingly complex.

### Preserving and managing rights

In terms of strategy, no licensing operation can be considered without anticipating the upstream and downstream effects – especially when many principles are still not well established and remain to be tested in court (eg, exhaustion of patent rights and related concepts).

In Figure 1, Company C may believe that its exposure to patents owned by A is minimal, given that C buys most of its equipment from B and B has cross-licensed with A. However, this presupposes that the cross-licensing between B and A has exhausted all of their respective patents and claims, and that A has not anticipated this situation. If A has in fact contemplated that C may assert some of its patents against it, it may have structured the cross-licence in a manner that preserves some of its defensive value.

One question is thus how to preserve the value of patent portfolios against upstream players in a situation where, for instance, two component manufacturers are negotiating a cross-licence. How can one manufacturer preserve some of the value of its patents against any equipment provider to which the other manufacturer sells certain products? The same situation may arise at other levels of the value chain. Preserving the value of a patent portfolio (eg, not exhausting the patent rights) is important for various reasons – at the very least for defensive reasons, if upstream players assert patents against downstream players.

In today's increasingly complex world, the cross-licensing game is not limited to agreements with competitors; you need to be able to handle cross-licensing between players at different levels in the value chain and manage the effects of such agreements on competitors. In Figure 2, companies A and C are willing to negotiate a cross-licence; but A will need to understand how

### An example of a value chain

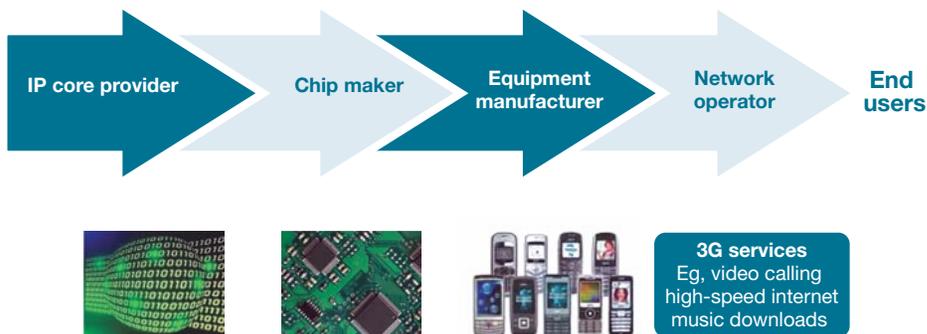


Figure 1. Example of patent exposure

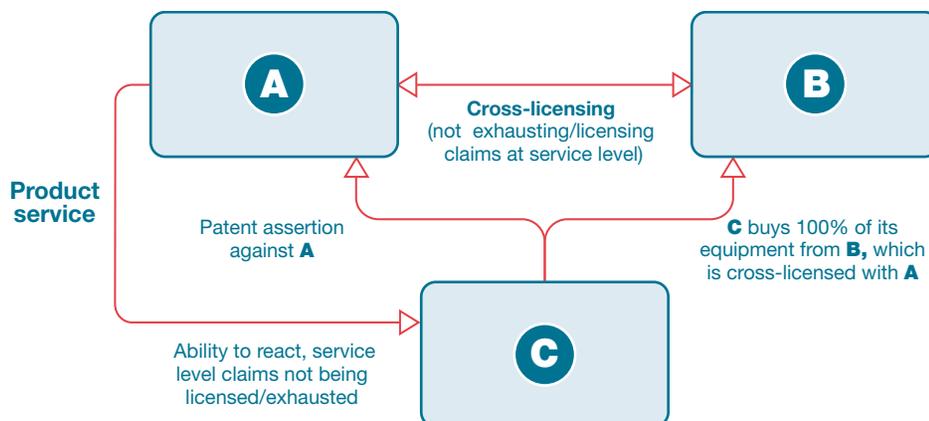
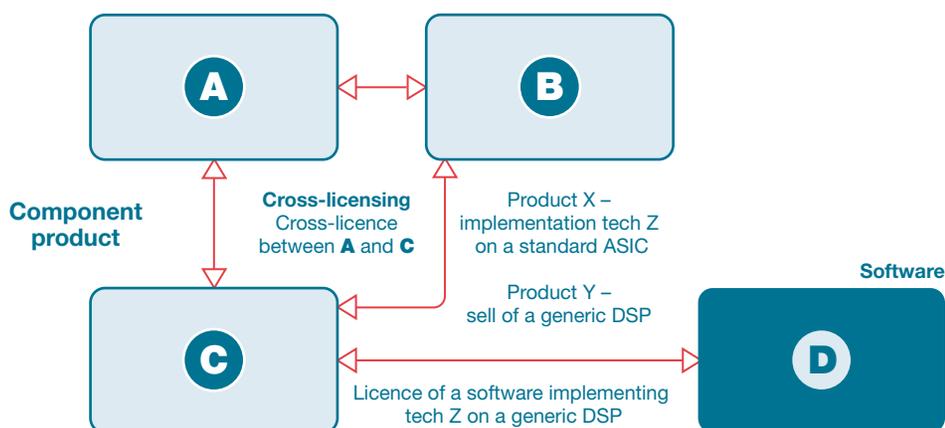


Figure 2. Cross-licensing at different levels



this will affect its offensive/defensive capabilities against competitor B and/or even D, which supplies software incorporating its technology.

However, licensing between market players at different levels in the value chain can be challenging. The US Supreme Court’s 2008 decision in *Quanta Computer, Inc v LG Electronics, Inc* (128 S Ct 2109) provides some helpful guidance when drafting licence agreements, to the extent that they concern US patents. The ruling clarifies how the doctrine of exhaustion will apply to the sale of components of a patented system, where such components must be combined with additional components in order to practise patented methods. In the context of this decision, two essential elements should be borne in mind. First, the court considered that Intel was fully entitled to “make, use [and] sell” patented microprocessors and chipsets to customers that wished to combine them with non-Intel products, and that Intel’s

obligation to notify such customers that they were not licensed by LG did not restrict its capacity to enter into such sales. Second, the court found that the Intel products substantially embodied patents of LG – the only additional step to practise the patents being the application of common processes or the addition of standard parts.

In a post-*Quanta* world, it is possible to manage multi-level licensing flows – in particular, through field of use restrictions, conditional sales and the granting of restricted rights (eg, not granting the right to use); but more attention is now required in order to manage exhaustion. The exact technology and related patents licensed should also be examined in light of the ruling, in order to determine what steps need to be taken by which players in the relevant value chain.

Another option – although one that is more difficult from a business perspective – is to exclude certain patents from certain licensing arrangements. However, this can generate a degree of risk which cannot be ignored, particularly in view of the US Court of Appeals for the Federal Circuit decision in *LP v Electronic Transaction Consultants Corp* (563 F 3d 1271 – Fed Cir 2009). In this case Transcore had sued Mark IV for patent infringement back in 2000 and the parties had settled the dispute, with Mark IV making a lump-sum payment to Transcore in return for an unconditional covenant not to sue Mark IV on the asserted patents.

A few years later, Transcore sued ETC, a customer of Mark IV, for infringement of both the patents originally in dispute and related patents that had not yet issued at the time of the settlement. ETC defended the case by arguing that the covenant not to sue authorised Mark IV to manufacture and sell the relevant products, and that accordingly, on the basis of the settlement between Transcore and Mark IV, all of the asserted patents were exhausted – including those that had not yet issued at the time of the settlement.

The Federal Circuit concluded that where a later issued patent was “necessary to practise” at least one of the original patents subject to the covenant not to sue, exhaustion would also extend to that later issued patent. This decision was grounded on the principle of legal estoppel: the court concluded that it would be unfair for a patent owner to receive financial compensation in return for a covenant that a potential infringer could practise a certain patent, and then acquire another patent which would

limit the potential infringer's right to exercise the covenant for which it had paid.

Finally, it is also crucial to control the scope of the rights granted, in order to minimise the likelihood of exhaustion – based, among other things, on the “authorised sale” principle – resulting from the sale of an article that embodies a patented invention. In particular, one option could be to license only for a limited field of use and require the licensee to inform its customers that the purchased article is licensed for use in that field only (eg, specific technical domain, specific equipment). Under the rules established in *General Talking Pictures v Western Electric Co* (305 US 124 (1938)), decided many years before *Quanta*, purchase of the patented product in order to use it outside the licensed field of use would make the sale unauthorised and thus avoid patent exhaustion.

### Cultivating and benefiting from the ecosystem

Meanwhile, understanding the environment in which knowledge flows take place can add further value to a licensing programme.

For example, within the value chain, it is likely that a group of upstream players which supply the most basic element of a technology will be interested in some form of IP protection. These players – generally small companies – will not generally factor prominently in licensing activities; they are not attractive targets in terms of either revenues/profits or defensive value, as they are generally small companies with minimal patent portfolios. One alternative option might thus be to trade their willingness to ensure some form of protection against being dragged into patent litigation were you, as patent holder, to enforce your patents against a prospective licensee. But trade against what? Information about their clients, to fuel your pipe of prospective licensees, for example. In a post-*Quanta* world, this will obviously require considerable attention to the licensing details.

Another form of multi-level approach has been developed in the context of royalty sharing. “Apportion reasonable royalties throughout MPEG-4 value chain” are the exact words used by MPEGLA to describe its licensing model ([www.mpegla.com/main/programs/M4V/Documents/m4vweb.ppt](http://www.mpegla.com/main/programs/M4V/Documents/m4vweb.ppt)). The idea here is to share such costs between equipment makers and service providers, using sophisticated disclaimers and notices in particular to manage any implications under the doctrine of implied licence (see the sample disclaimer below). Royalties will be collected at decoder/encoder level from

## Action plan



There is no doubt that a single-level licensing strategy is no longer sufficient in today's complex markets:

- In terms of IP strategy, no licensing operation can be considered without anticipating the upstream and downstream effects.
- In today's increasingly complex world, the cross-licensing game is not limited to agreements with competitors; you need to be able to handle cross-licensing between players at different levels in the value chain and manage the effects of such agreements on competitors.
- In a post-*Quanta* world, it is possible to

manage multi-level licensing flows – in particular, through field of use restrictions, conditional sales and the granting of restricted rights (eg, not granting the right to use); but more attention is now required in order to manage exhaustion.

- Above all, when building a licensing strategy, it is fundamentally important to understand the ecosystem within which you are operating, determine the type of value (offensive, defensive or monetary) that is critical to your company, and identify the level of the value chain at which this value should be extracted.

traditional players delivering hardware and software for recording and/or viewing content, and also at service level from companies delivering content that has been encoded using these standards through video on demand and/or broadcasting. However, securing market acceptance of this model may prove a challenge.

Finally, Qualcomm's licensing programme is another example of a multi-level licensing scheme. Its application-specific integrated circuit (ASIC) patent licence agreement authorises chip makers to make ASICs, and to sell them only to handset makers that have also been licensed by Qualcomm under a separate subscriber unit licence agreement. The ASIC patent licence agreement does not include the right to use. While this licensing scheme been subject to various claims against it, it is still holding and is providing Qualcomm with important licensing revenues, as well as protecting its own chip business from competitors – thus delivering both monetary and defensive value.

Imagine that your company has invented a strong technology, but your business is primarily to sell components, not products. You will be obviously interested in two things: extracting value from your patent portfolio and protecting your freedom to operate. Licensing value will be primarily at product/equipment level, while protecting your freedom to operate will require some licensing arrangement at the component level. Achieving your objectives on both fronts will require a complex licensing arrangement.

### Complex world

There is no doubt that a single-level licensing strategy is no longer sufficient in today's complex markets. However, the *Quanta*

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decision, which revitalised the doctrine of patent exhaustion in 2008, means that multi-level licensing schemes are more complex to organise. Fortunately, however, such schemes are still available in order to optimise the value of a patent portfolio – whether defensive, offensive or monetary.

In developing an IP strategy, and in particular a licensing strategy, it may be appropriate to mix the principles in force over many years with those presented in *Quanta* and post-*Quanta*. Since 2008, the US courts have been consulted on a number of disputes presenting similar but divergent fact patterns. In some cases the courts have extended the *Quanta* rule, while in others they have decided that exhaustion should not apply.

Above all, when building a licensing strategy, it is fundamental to understand the ecosystem within which you are operating, determine the type of value (offensive, defensive or monetary) that is critical to your company, and identify the level of the value chain at which this value should be extracted. Additionally, you need to understand the driving forces at play in your ecosystem at

each level of the value chain; the options available at each level will be different, depending on the nature of the competition (monopoly, duopoly or oligopoly).

Ultimately, it is imperative that IP strategies recognise and provide for management of this growing complexity – a complexity which makes the IP world so rich and interesting. **iam**

**Guillaume Ménage** is IP and technology senior counsel with France Telecom/Orange. **Yann Dietrich** recently joined Schneider Electric as vice president, IP Strategy.

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