



Huawei vs ZTE: A Blueprint for SEP Licensing?

In December 2012 the European Commission issued a Statement of Objections against Samsung, claiming that (i) it held a dominant position, as a result of its ownership of certain standard-essential patents (“SEPs”) and (ii) it had abused its dominant position by seeking injunctions against Apple in the context of the monetisation of these patents.^{1,2} As explained in its press release, the Commission took the view that the holder of an essential patent should be presumed to abuse its dominant position if it seeks an injunction against a prospective licensee that had declared that it was willing to negotiate a licence.

This stance, which sees the pursuit of an injunction (almost) as a *per se* prohibition in the case of SEPs, did not sit comfortably with what had become the established approach of the German courts following the Orange Book judgment.³ In that approach, a SEP holder seeking an injunction could be presumed to be abusing its dominant position under more stringent conditions: only if the prospective licensee had made an unconditional offer to conclude a licensing agreement that the patent holder could not refuse without violating its FRAND commitment, and if the prospective licensee fulfilled its obligations for the use of the patents pending the award of a license. An unconditional offer was understood as one in which the prospective licensee committed not to challenge the validity of the patent. At a very general level, one could see the Commission’s approach as very favourable to a prospective licensee, with the Orange Book’s approach relatively more favourable to the patent holder.

The Landgericht Düsseldorf, faced with a dispute between Huawei and ZTE in which the former sought an injunction with respect to one of its SEPs, was thus understandably at a loss and sought guidance from the European Court of Justice. The first of five questions to the ECJ asked squarely whether the appropriate standard was either the one set out in the Orange Book, or (effectively) that formulated in the Samsung press release. The Opinion of AG Wathelet, published on 20th November, provides a good likely “preview” of the ECJ’s final judgment. According to the AG, neither the Commission’s approach, nor the Orange Book standard are appropriate and he outlines an alternative standard, in which the obligations of the patent holder and those of the prospective licensee are more finely balanced. In developing his reasoning, the AG also makes important observations on

dominance, the role of competition law in patent disputes⁴ and the scope for “hold up” by both licensor and licensee. Importantly, the Opinion clarifies that the prospective licensee should retain the right to challenge the validity of the patent – although it leaves some important issues open with respect to the operation of “non-challenge” and “termination” clauses in (SEP) licensing contracts.

A “middle way”?

The AG’s Opinion considers that an appropriate framework for the licensing of SEPs must balance the interests of the licensee – who has been promised access to the technology and has made standard-specific investments that could be “held up” – and those of the licensor whose own investments could be “reverse held up” by an unwilling licensee.

While the Opinion recognises that the “right to the Court” is fundamental, it considers that the promise to license what is part of a FRAND commitment is an “exceptional circumstance” that warrants some limitations to that right. Note however that this “commitment to license” is the only aspect of FRAND that the Opinion considers relevant to the issue of injunctions. In particular, the Opinion states clearly that the “specific conditions” of a FRAND license, which presumably include most terms and conditions, are a matter to be settled in front of civil courts or arbitration tribunals (para. 40).

This commitment to license is essential to the Opinion’s assessment of the Orange Book judgment: the opinion notes that the Orange Book ruling applied to a *de facto* standard, in which no promise to license was made. Adopting this approach when the patent at issue is “standard-essential” and FRAND commitments have been made would then provide the patent holder – according to the AG – with too much bargaining power. In other words, when applied to SEPs, the Orange Book approach puts too much weight on the “reverse hold-up” issue compared to the hold-up problem faced by the licensee. However, the AG concludes that the Commission’s definition of what is entailed by the licensee’s obligation to be “willing” was expressed in terms that are too vague to provide the SEP-holder with sufficient protection against “reverse hold-up”.

Accordingly, the Opinion proposes a “middle ground” that takes into account the promise to license implicit in FRAND commitments, but also strives to make the concept of “unwilling licensee” more precise. Concretely, a SEP-holder needs to meet two conditions before he can seek an injunction; first, he needs to warn the licensee that he is infringing some of the licensor’s SEPs and to engage in negotiations. Second, he needs to make a concrete proposal that specifies all terms and conditions that are part of a normal licensing contract. These terms and conditions include the

¹ CRA has provided economic support to a numbers of SEP holders in the context of investigations in the EU as well as other jurisdictions.

² The case against Samsung was closed with a commitment decision in April 2014 (case AT39939). A Statement of Objections was also issued in May 2013 against Motorola Mobility, and an infringement decision adopted in 2014 (case AT 39985, 29/5/2014) using a similar standard. The Opinion of AG Wathelet discussed in this note focuses on the Samsung case.

³ Judgment “Orange Book Standard”, KZR 39/06, May 6, 2009

⁴ The AG observes that IP disputes involving injunctions could possibly be better handled by other branches of law than competition law (Para 9). He also observes that standard setting bodies have an important role to play in clarifying what is meant by FRAND and that competition law can be instrumentalised by prospective licensees in order to enhance their negotiating position (Para 11).

level of royalties to be applied. The AG argues that it is natural for the SEP holder to make the first offer as he is in a privileged position to assess whether an offer is discriminatory.

In turn, the prospective licensee has the following obligations: he has a (limited) period of time to either accept the terms proposed by the SEP-holder, or come up with a proposal of its own. In case of continued disagreement, the licensee will not be considered “unwilling” if he proposes to have the terms of the licensing contract determined by a Court or an arbitrator. More generally, the licensee cannot be found to be “unwilling” on the ground that he insists on preserving the right to challenge the licenced SEPs on both infringement and validity grounds even after the signature of a licensing agreement.

The solution proposed in the Opinion seems to be concrete enough to significantly clarify what is meant for a potential licensor to be “unwilling”, and hence to clarify the conditions under which an injunction can be sought. As such, this is a welcome contribution and it seems to balance concerns about hold-up and reverse hold-up.⁵ As discussed below, the analysis of dominance is also welcome and useful, while the discussion of non-challenge and termination clauses still leaves some issues open.

Dominance

While the questions presented by the Landgericht Düsseldorf did not touch directly on the issue of dominance, the AG still decided to comment on the issue, in particular given the link between dominance, the FRAND commitment and the question of non-challenge/termination clauses. Importantly – and in contrast with the Commission’s approach – the AG does *not* subscribe to the notion that, since a SEP is by definition “essential”, the ownership of even a single SEP would necessarily suffice to create a position of dominance.⁶ Rather, the Opinion considers that, because SEPs are not necessarily essential or valid, the existence of a dominant position must be assessed on a case by case basis (Para 57). This position logically leads the AG to also consider the issue of “non-challenge” and “termination” clauses.

Non challenge and termination clauses

While “non-challenge” clauses are a commitment by the licensee not to question the validity of the licensed patents in Court, a termination clause simply stipulates that, were the licensee to mount such a challenge, the licensing agreement would be terminated.

The Opinion follows closely the European Commission’s own view that, because there is a public interest in having “bad” patents invalidated through post-grant litigation, the potential licensee cannot be forced to give up on the right to challenge the licensed SEP on infringement and/or validity grounds. Notice however that there is no requirement that the licensee must have had the opportunity to challenge infringement and validity *before* injunctions are used. The Opinion simply requires that the “concrete proposal” made by the licensee does not include either

non-challenge or termination clauses, i.e. it only requires that the licensee keeps its ability to challenge the patents *in the future*.

The Opinion could provide more clarity on a number of important aspects. First, while the licensor cannot impose restrictions on the licensee’s ability to challenge patents on both infringement and validity grounds, would it be acceptable for the two parties to actually agree to have such clauses? In particular, one would expect freely negotiated royalties to be lower if the parties agree to include non-challenge or termination clauses; are consumers better served by lower royalties with restrictive clauses or by higher royalties with a better change of invalidation?

Second, the Opinion’s reasoning on these restrictive clauses seems to apply both to SEP licensing and to the licensing of non-essential patents: there is nothing in the argument that is SEP-specific. This is a missed opportunity as there are in fact good reasons to be more lenient for non-essential patents: for instance, since SEPs come with an obligation to license, restrictive clauses cannot be defended as necessary to ensure that there is licensing in the first place. In addition, the termination of a licensing agreement for SEPs is likely to have more drastic consequences for the licensee, and hence more likely to actually prevent any challenge.

Finally, the Opinion does not sufficiently consider whether the prohibition of non-challenge or termination clauses would have the desired effect in a world where firms agree on portfolios of SEPs. Suppose that the portfolio contains ten SEPs and that one is later invalidated because of the licensee’s actions. What happens next? Is the royalty lowered? Since the other patents are still essential and valid, the bargaining positions of the parties have actually not changed appreciably. Hence, in free renegotiation, the licensee would not get much (or any) reduction of the royalty for his efforts, which means that he would have little incentive to mount a challenge to begin with. Now assume that royalties are set by some form of arbitration that relies at least partially on “patent counting”. The invalidation of a patent should lead to a lower royalty for that licensor but, as the overall contribution of the standard itself has not changed, this should also lead to an increase in the royalty *per right* charged by other SEP holders whose shares of valid SEP patents has just increased. Again, this means that the litigating licensee would not necessarily end up better off so that the benefits of banning restrictive litigation clauses should not be exaggerated.

Conclusion

The AG’s opinion appears to strike a pragmatic balance between the approach of the Commission and that of the Orange Book. The AG acknowledges the risk of hold-up as well as reverse hold-up and imposes some obligations on both the SEP holder and the prospective licensee. Importantly, the Opinion does not endorse either the “one SEP-one market-one dominance”⁷ approach favoured by the Commission. One can also wonder whether in the light of the criteria laid down by the AG, the Commission could have provisionally concluded that Samsung (for instance) had abused a dominant position. The Commission’s intervention in this area may indeed have been somewhat hasty.

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⁵ See Langus, Lipatov, Neven (2013) (Standard essential patents: Who is really holding up (and when)?, *Journal of Competition Law and Economics*, May) for a discussion of the balance between hold up and reverse hold up in a model of negotiation between SEP holder and prospective licensee.

⁶ The AG cannot therefore agree with an approach that defines each SEP as a market in itself.

⁷ See for instance, the Motorola decision (AT/39985).