

EU's approach to SEPs

The state of play in competition law and FRAND following the Commission's Standard Essential Patents Communication. By **Sophie Lawrance** and **Matthew Hunt**, Bristows LLP

On 29 November 2017 the European Commission released a highly anticipated Communication: 'Setting out the EU approach to Standard Essential Patents' (the "Communication")¹. Taking into account the views not only of the Commission's Directorate General ("DG") for Competition, but also of other DGs such as the DG for the Internal Market, Industry, Entrepreneurship and SMEs ("DG GROW"), it was hoped that this document would answer some of the many uncertainties in the field of standard essential patent ("SEP") licensing. Although the Communication is not binding on the Commission (or any court) when applying articles 101 and 102 TFEU, it is a useful indication of the current position of the Commission as a whole on SEP licensing.

Background

SEP licensing is a complex field. Holders of SEPs covering standards such as UMTS, LTE or Wi-Fi are required to license them on fair, reasonable and non-discriminatory ("FRAND") terms. There is considerable dissent over whether this obligation is:

- i. intended primarily to protect implementers from the risk of exploitation by SEP holders, who are in a position to 'hold up' innovation by refusing to licence or by seeking unduly high royalties; or
- ii. designed simply to prevent absolute refusals to license while ensuring that implementers are not able to 'hold out' from taking a licence.

However, many (including the English High Court in the recent judgment in *Unwired Planet v Huawei*²) believe that the obligation is designed to strike a balance between rewarding SEP holders for their innovation and allowing implementers to access standards by implementing the relevant technology.

The Commission has sought to shape interactions in this sector before. It has previously investigated Motorola³ and Samsung⁴, making an infringement finding against the former and agreeing commitments from the latter. These decisions confirmed that it may be an abuse of dominance for a company to seek injunctions based on SEPs against a company that is willing to take a FRAND licence.

The Court of Justice of the European Union ("CJEU") offered further guidance in *Huawei v ZTE*⁵. It set out a framework for SEP licensing negotiations, which included practical steps to be followed by SEP holders and implementers wishing to ensure that their conduct was compliant with their FRAND obligations. SEP holders that followed these steps would not be at risk of abusing a dominant position under article 102 TFEU.

However, while the CJEU went into some of the practicalities of licensing interactions, the judgment was not a comprehensive guide to SEP negotiations. Considerable lack of clarity remained over matters such as how the steps mentioned in the judgment should be applied in a portfolio cross-licensing context, or on factual matters such as when a delay would be too great. In addition, while the CJEU requires SEP owners to specify how they have calculated a FRAND royalty, it does not explain what kind of methodologies are acceptable, beyond noting that patent holders are best placed to assess non-discrimination. It does not comment on the appropriate royalty base, i.e. whether a royalty rate should be based on the selling price of the handset, or on the cost of a component. (Some licensees have called for a method that measures royalties based on the 'smallest saleable patent practising unit' (or 'SSPPU'), which might be a chipset in a mobile phone, for example.) Nor does it offer any guidance on whether royalty rates should be expressed as a percentage of the royalty base or whether a flat rate is preferable (or indeed whether both approaches are acceptable). Other practical issues were not covered, such as what the geographic scope of a licence should be, whether different rates could or should apply in different territories, or what the consequences are if neither party makes an offer that is later determined to be FRAND (or alternatively if both parties have made a FRAND offer).

A number of courts around Europe have subsequently grappled with some of these issues. However, they have reached quite different outcomes on sometimes similar facts, creating a divergence in decisions across Europe. For example, in *Archos v Philips*⁶, the Hague District Court interpreted *Huawei v ZTE* as indicating that a FRAND licence would have a 'specific bandwidth', i.e. a range of rates could be FRAND. In *Unwired Planet v Huawei*, the English High Court held that there could only be one true FRAND rate in any given set of circumstances⁷. In *Pioneer v Acer*⁸, the Karlsruhe Higher District Court indicated that an SEP holder could fulfil its

obligations under the *Huawei v ZTE* criteria even after initiating litigation without having made a FRAND offer (a view shared by the English High Court in *Unwired Planet v Huawei*), despite the CJEU indicating that an SEP holder must at least alert an alleged infringer of a potential infringement before bringing proceedings⁹. By contrast, in *NTT DoCoMo v HTC*, the Mannheim Court held that a counter-offer made several months after the start of proceedings was too late¹⁰.

This level of debate over what a FRAND rate really is, and how *Huawei v ZTE* should be interpreted, can create considerable uncertainty for businesses involved in implementing SEPs. With 5G due to be rolled out in the next few years, and with the advent of the Internet of Things ("IoT"), SEP licensing is likely to become increasingly complex, and even more high value. Many new companies producing IoT enabled products will have to begin in engaging in SEP licensing for the first time, making it even more important that there is clear, consistent guidance as to the rules under which SEP licences must be negotiated. In that environment, the Commission's Communication has the potential to be a welcome resource.



What does the new Communication cover?

Additional guidance on how the CJEU decision in *Huawei v ZTE* should be applied.

Huawei v ZTE of course concerned the particular situation when an injunction is sought. However, the Commission's proposal for how SEP licensing negotiations should be conducted are put forward as having a more general application.

In that context, the Commission confirms that in order for an implementer to assess a FRAND offer and make an appropriate counter-offer, it must be provided with a clear explanation of: the essentiality of the SEPs, the implementer's allegedly infringing products, the proposed royalty calculation, and the non-discrimination element of FRAND (for which some measure of transparency about the SEP holder's other licences is likely to be important).

On the counter-offer side, the Commission notes that an implementer's counter-offer should contain information on the exact use of the standard in the relevant products. The Commission is not prescriptive on timing, stating that 'no general benchmark can be established', although it is suggested that if better information is provided by the SEP holder, the implementer should be in a position to respond more quickly. There is a recognition that the lack of transparency over which patents are truly essential leads to delays in the licensing process.

The Commission also states that security being provided by an implementer in accordance with the *Huawei v ZTE* criteria to protect itself from being subject to an injunction should be fixed at a level that discourages patent hold-out strategies. It is unclear if this is intended to suggest merely that security payments should be more than nominal, or whether they should be pegged to the licensor's offer and the potential geographic scope of any licence. In the authors' view, excessive security requirements could risk having damaging effects on implementers, in particular when they face multiple claims by non-practising licensors.

The Commission outlines a series of general FRAND licensing principles:

- A FRAND declaration by an SEP holder gives rise to a legitimate expectation that it will grant licences on FRAND terms.
- There is 'no one-size-fits-all solution' to FRAND: what can be considered fair and reasonable differs from sector to sector and over time.
- The FRAND value of an SEP should reflect its present value, and should not include any element resulting from the decision to include the technology in the standard. The endorsement of *ex ante* assessment of rates is in line with the previous position of the Commission as set out in guidance dating from 2011¹¹, as well as the approach recently taken by the US District Court in *TCL v. Ericsson*¹²
- In defining a FRAND value, parties must take into account a reasonable aggregate rate for a standard: this suggests that

a 'top-down' calculation should be used at least as a cross-check (as in the *UK Unwired Planet* judgment), although it does not address the difficult question of the level of the total aggregate royalty.

- e. SEP holders cannot discriminate between implementers that are 'similarly situated'.
- f. For products with a global circulation, a worldwide licence can be FRAND. By contrast, a country-by-country licensing approach may not be efficient, and may not be in line with recognised commercial practice (although the paper recognises that there may be exceptions for regional-specific products).

The Commission confirms that patent assertion entities (PAEs) should be subject to the same rules as any other SEP holder. This includes where SEPs have been transferred from SEP holders to PAEs. The Commission notes that it intends to monitor the impact of PAEs on SEP licensing in Europe closely.

The Commission confirms that there is no obligation for parties to use ADR

However, the Commission notes that the willingness of a party to submit to binding third-party FRAND determination, should its offer be found not to be FRAND, was an indication of FRAND behaviour. It also seeks to encourage arbitration or mediation and suggests that the outcomes of disputes should be recorded in SEP databases, even where these follow arbitration. (This contrasts with *Unwired Planet*, where the Court rejected the relevance of licences concluded after arbitration, at least where the arbitral award is not available¹¹.)

The Commission believes better processes for declaring and identifying SEPs are required

It is calling for standard developing organisations ("SDOs") to turn their declaration databases into tools providing more up-to-date and precise information on SEPs that are more easily accessible to all. This should include information about patent transfers. It may also set up a new European body to carry out SEP assessment (likely only for future standards, if at all). The Commission also intends to set up an expert group to bring together industry practice and expertise on FRAND licensing.

The Commission states that the creation of patent pools or other licensing platforms should be encouraged

The Commission suggests that this can address many of the SEP licensing challenges by offering better scrutiny on essentiality, clarity on licensing fees and a one-stop-shop solution. It notes that this will be particularly valuable for IoT industries and SMEs, but warns that such patent pools need to be compatible with EU competition law.

The FRAND licensing principles espoused by the Commission are generally sensible. They seem intended to strike a fair balance between the differing interests of SEP holders and implementers,

and go some way towards filling in the gaps left by *Huawei v ZTE*. However, though the Communication explains that the parties must take the aggregate royalty rate for a standard into account when defining a FRAND value, there is little other detail on how FRAND royalty rate calculations should be done. The Commission has also avoided dealing with some of the more controversial current and future issues in SEP licensing.

What does the Communication miss out?

Two of the most controversial current debates about SEP licensing relate to 'chipset' and 'use-based' licensing. Early drafts of the Communication indicated that the Commission intended to weigh in on these issues.

The drafts seemed to favour SEP holders by providing for the adoption of use-based licensing. This refers to the idea that SEP holders should be able to charge different royalty rates depending on the nature of the final product implementing the relevant standardised technology. This is a controversial concept, particularly in the light of the IoT. For example, IoT connected products that use 4G may not necessarily make much use of that connectivity, and may have a significantly higher sale price than that of a smart phone. Implementers were concerned that under this model, SEP holders would be charging for the value created by the implementers' innovative new IoT products, even where that value does not relate to the product's use of a standard like 4G¹⁴.

As a concession to implementers, the earlier drafts showed that the Commission also intended to adopt a 'license-to-all' approach. Whereas, typically SEP holders only grant licences to the manufacturers of end-user devices (e.g. a mobile phone), under this approach companies manufacturing components of those end user products (e.g. the chipsets within a mobile phone) which would have been able to seek and be granted licences from the SEP holders. These manufacturers could then have sold pre-licensed chips on to the end-device manufacturers.

This was an equally controversial idea. It would be difficult for an SEP holder to secure a royalty rate that it felt reflected the value of its invention when granting a licence to a manufacturer of chipsets costing a fraction of the price of a smart phone¹⁵. In addition, although patents relating to connectivity standards like UMTS or LTE predominantly read on chipsets, some contain much broader claims (whilst still being essential to the connectivity standards). This means it could be impossible for an SEP holder to achieve complete patent licensing exhaustion (where all of their patents essential to a particular standard are licensed) at the chipset stage: even if they licensed chipset manufacturers, they would still have to agree separate licences with handset manufacturers for the other broader SEPs within their portfolios. This would be complicated (in terms of attributing value between the different parts of the 'ecosystem'), and expensive. In contrast, solely licensing the end handset manufacturer means only one licence is required – this covers all of the relevant patents that are essential and used by the handset.

And arguably, if truly FRAND licence rates are being agreed, the total remuneration obtained by the SEP holder should be the same regardless of which level of the production chain the licences are agreed at.

Press reports suggest that there was fierce debate between the Commission DGs in the weeks leading up to publication of the Communication, and significant lobbying efforts from bodies representing SEP holders and implementers¹⁶. Ultimately, the Commission dropped the contentious wording, and the Communication has no mention of chipset or use-based licensing. Instead, it simply notes that what is fair and reasonable differs from sector to sector, and that it encourages businesses to try and establish common licensing practices in different sectors based on the principles set out in the Communication. Detailed guidance on this issue may therefore have to wait for litigation to work its way through the courts. Cases in the pipeline such as *Apple v Qualcomm*, in which Apple alleges before the English High Court (as well as in other fora) that Qualcomm is abusing a dominant position by refusing to licence its LTE, CDMA and UMTS SEPs to competing chipmakers, may provide some answers¹⁷.

The future of competition law in FRAND

Following the findings in *Unwired Planet v Huawei* that: (i) *Unwired Planet* did not breach EU competition law despite failing to comply with the *Huawei v ZTE* criteria by initiating litigation and seeking an injunction before having made a FRAND offer (or any offer), and (ii) a FRAND undertaking could be enforced on a contractual basis without recourse to competition law, it was arguable that competition law had only a limited role to play in future FRAND disputes (at least in England and Wales).

However, the *Unwired Planet* decision was reached based on the specific facts and circumstances before the Court in that case. It is not an indication that competition law concerns will never be relevant in FRAND disputes before the English courts. It is also worth noting that other competition law defences had originally been raised in the *Unwired Planet* proceedings by Samsung¹⁸. Though these were not heard at trial as neither Samsung nor Ericsson were still involved in the proceedings at that point, these kinds of competition law defences remain a potential option for defendants.

The Communication now specifically recognises the continuing relevance of competition law in FRAND: when encouraging the creation of patent pools or other licensing platforms, it notes that this must be done in accordance with EU competition law. It also recognises the importance of safeguards (such as the CJEU's *Huawei v ZTE* decision) against the risk that implementers acting in good faith are forced to accept non-FRAND licensing terms when threatened with an injunction, or otherwise risk being unable to market their product¹⁹.

Competition law may be particularly relevant to the non-discrimination aspect of FRAND in the future. The Higher

“It may be an abuse of dominance for a company to seek injunctions based on SEPs against a company that is willing to take a FRAND licence.”

Regional Court of Düsseldorf has noted that an offer may be fair and reasonable but still be discriminatory²⁰. In that case, the offers made to the defendant by the claimant were found to be discriminatory when compared to the claimant's agreements with other licensees. FRAND would not mean that each offer has to be similar, but the difference has to be justified in an objective way²¹.

In *Unwired Planet*, the English court also examined the importance of non-discrimination. The judge noted that it was common ground between the parties that competition law (article 102(c) TFEU) only prohibits discriminatory behaviour to the extent that behaviour is capable of distorting competition, and considered whether such a condition should also be applicable to FRAND.

The judge's conclusion was that FRAND implied a general obligation of non-discrimination: a benchmark FRAND rate should be derived which is applicable to all licensees seeking the same kind of licence. However, he went on to find that even if the FRAND undertaking also includes a specific non-discrimination obligation, where a licensee has the right to demand the same (lower than benchmark) rate granted to another 'similarly situated' licensee, then this obligation only applies if the difference between the benchmark and lower rate would distort competition between the two licensees.

The Communication appears to endorse a specific non-discrimination obligation. It states that “the non-discrimination element of FRAND indicates that rightholders cannot discriminate between implementers that are ‘similarly situated’”²², referencing *Unwired Planet*. However, it does not explicitly say that there is a requirement for distortion of competition between those similarly situated licensees. This issue has arisen again since the date of the Communication in the decision of the US

District Court for the Central District of California in *TCL v Ericsson*²⁵. The Court in that case held that discrimination in violation of a FRAND commitment can be found so long as an individual firm is harmed – harm to competition itself is not required²⁶. This appears to be an easier condition to satisfy than the distortion of competition requirement suggested by the English court. Interestingly, the US court also analysed which firms were similarly situated to TCL. Whereas *Unwired Planet* only considered the position as between Samsung and Huawei, TCL found that Apple, Samsung, Huawei, LG, HTC and ZTE were all similarly situated to TCL. This is important – it is often the case that the largest implementers, particularly those that focus on high-end devices such as Apple and Samsung, are able to negotiate more favourable licence rates, partly based on the higher selling price of their products. Following the TCL decision, companies like TCL that typically sell lower-price devices may be able to benefit when negotiating with particular SEP holders from licence rates already secured with that SEP holder by implementers like Apple.

Final considerations

Neither the Communication nor these recent cases provide answers to all of the questions left unanswered following *Huawei v ZTE*. In some cases, new issues arise. For example, if *Unwired*

Planet, the Communication and TCL do result in greater focus on the non-discrimination elements of FRAND, how will potential licensees establish what rates have previously been granted to other licensees? How would licensors reveal those rates without breaching the confidentiality provisions of their existing licences? Although the licences could be disclosed in litigation under suitable confidentiality protections, that would be a costly way of negotiating. Implementers in future licensing negotiations might instead seek to take advantage of the sort of pre-action disclosure given in *Big Bus Co Ltd v Ticketogo Ltd*²⁷ (not a FRAND case), although this would be likely to be resisted both by licensors and their other licensees.

Although the Communication says that a worldwide licence can be FRAND, what will the English court of Appeal say about the jurisdiction of the English Courts to set a global FRAND rate when the *Unwired Planet* appeal is heard later this year?

The Communication offers useful guidance in an uncertain area of law that is still developing. However, it is by no means a panacea. If anything, the volume of litigation over FRAND rates is likely to increase in the future as 5G and the IoT come to the fore. □

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Notes and references

- Available at <https://ec.europa.eu/docsroom/documents/26583> (accessed 10 January 2018).
- [2017] EWHC 2988 (Pat).
- Case AT.39985, decision of 29 April 2014.
- Case AT.39939, decision of 29 April 2014.
- Case C-170/13.
- ECLI:NL:RBDHA:2017:1025.
- [2017] EWHC 2988 (Pat).
- Case No. 6 U 55/16.
- Huawei v ZTE*, paragraph 60.
- Case No. 7 O 66/15.
- Guidelines on the applicability of article 101 TFEU to horizontal Cooperation Agreements, para. 289: "it may be possible to compare the licensing fees charged by the company in question for the relevant patents in a competitive environment before the industry has been locked into the standard (*ex ante*) with those charged after the industry has been locked in (*ex post*)."
- TCL Communications v. Ericsson* (SACV 14-341 JVS(DFMx) and CV 15-2370 JVS (DFMx)).
- Unwired Planet v Huawei*, paragraph 171.
- Note that in the Communication, the Commission indicates that in valuing patented technology, the focus should be on the value of the technology itself, and not value arising from the decision to include the technology in the standard.
- Although a flat royalty rate could be adopted rather than a percentage of product price royalty to address the low price of a chipset, it would be conceptually difficult for an SEP holder to charge a royalty rate that could exceed the cost of the chipset. But without doing that, SEP holders would not be able to maintain their current revenue levels under this model.
- See for example the following reports by MLex and PaRR (subscriptions required): www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=940221&siteid=190&rdir=1; <http://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=926469&siteid=190&rdir=1> and goo.gl/cFgwBn.
- Apple v Qualcomm*, Case HP-2017-000015.
- See *Samsung Electronics Co Ltd & Anor v Telefonaktiebolaget LM Ericsson & Ors* [2016] EWCA Civ 489.
- An interesting comparison can be drawn between the Commission's recognition of the need to protect implementers against these kinds of 'hold-up' strategies, and the comments of Assistant Attorney General Makan Delrahim in a November 2017 speech in which he claimed that 'hold-out' (implementers refusing to take a licence until their royalty demands are met) is a more serious problem than hold-up. See here: <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-us-school-laws-center> (accessed 10 January 2018).
- Sisvel v Haier* (docket no. I-15 U 66/15).
- See <http://pkitten.blogspot.co.uk/2017/11/dusseldorf-court-of-appeal-in-sisvel-v.html> (accessed 10 January 2018).
- Communication, page 7.
- See note 12 above.
- See <https://patentlyo.com/patent/2017/12/contreras-ericsson-decision.html> (accessed 10 January 2018).