The *Huawei v ZTE* case

The CJEU responds but questions remain

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In July 2015, the Court of Justice of the European Union (CJEU) handed down its long-awaited judgment on whether the holder of a standard essential patent (SEP) can seek injunctive relief against a manufacturer of standard-compliant products without abusing a dominant position under EU competition law. This article outlines the CJEU's key rulings; compares the CJEU's judgment with the European Commission's 2014 Samsung and Motorola decisions; and suggests that although the judgment gives some useful guidance to both SEP owners and implementers, a number of important questions remain unanswered.

Referral from the Landgericht Düsseldorf

The CJEU's ruling stems from German proceedings brought by Huawei against ZTE for infringement of a patent declared as essential to the long-term evolution standard, developed by the European Telecommunications Standards Institute (ETSI). After licensing negotiations between the two Chinese telecommunications companies broke down, Huawei – which had committed to license its patents on fair, reasonable and non-discriminatory (FRAND) terms – sought an injunction against ZTE. This was challenged by ZTE as an abuse of dominance.

Confronted with a tension between the German *Orange Book* framework (under which an implementer/would-be licensee can resist the granting of an injunction only under fairly strict conditions) and the Commission's approach (under which the mere seeking of injunctive relief by a patent holder/would-be licensor can be an abuse in certain circumstances), the German court saw a need for clarification and referred five preliminary questions to the CJEU in April 2013.

The CJEU's key rulings

The five questions referred by the German court reflected the differing requirements of *Orange Book* and the Commission, and sought guidance from the CJEU on specific points. However, the CJEU elects to treat all the questions relating to injunctive relief together as a single composite question: when is the seeking of an injunction by a SEP holder who has committed to license third parties on FRAND terms an abuse of dominance under article 102 TFEU?

In answering this question, the Court notes that there are two different interests in play – (1) the right of a SEP holder to protect and enforce its intellectual property rights, and (2) the right of a manufacturer of standard-compliant products freely to conduct its business – and expressly seeks to strike a "fair balance" between these interests.

The CJEU begins by alluding to the principle established in its previous judgments on article 102 and IP rights: that the exercise of an IP right by a dominant undertaking will amount to an abuse only in exceptional circumstances. However, the Court notes that the situation in SEP cases is different from those considered in previous cases for two reasons. First, the essentiality of the patent at issue makes it "indispensable" to all manufacturers of standard-compliant products. Second, the SEP holder has given an undertaking to grant licences on FRAND terms, which creates "legitimate expectations" on the part of implementers that such licences will be granted. As a result, the Court considers that a refusal by a SEP holder to grant licences on FRAND terms may "in principle" be an abuse under article 102. Similarly, such a refusal may "in principle" be raised by implementers as a defence to actions for injunctive relief.

On the basis of this analysis, the CJEU sets out a series of steps that should be taken by SEP holders wishing to avoid abusing a dominant position when they seek injunctive relief against implementers, and by implementers who wish to avoid having an injunction enforced against them.

- Before seeking an injunction, the licensor must identify the SEP to the would-be licensee and explain how it is infringed.
- The licensee must state that it is willing to take a licence on FRAND terms.
- The licensor must then make a written FRAND offer specifying (at least) the royalty to be paid and how it is calculated.
- The licensee must respond "diligently and in good faith", in line with "recognised commercial practices". It must not engage in delaying tactics. If it does not accept the offer made, it must "promptly" submit a written FRAND counter-offer.
- If the licensee is working the invention, it should provide appropriate security (eg bank guarantee) from the point at which its counter-offer is rejected.
- Where no agreement is reached following the counter-offer, the parties may, by agreement, request an independent third party to determine the level of royalty.

The Court's ruling places genuine obligations on both parties. In the initial stages, the burden is principally on the licensor (identifying the patent(s), explaining the infringement position, making a FRAND offer). The burden then shifts to the licensee (responding to the FRAND offer, making a counter-offer, providing security). On the face of it, the imposition of obligations on the licensee is at odds with the legal basis for the questions referred, since article 102 cannot impose obligations on non-dominant undertakings.

The intellectual property rules cited in the judgment do not in themselves provide a basis for the obligations outlined by the CJEU. We would venture to suggest that what the Court has, in effect, done is to identify the circumstances (or at least, a set of circumstances) in which the SEP holder would be objectively justified in seeking an injunction. However, the way in which the judgment is framed seems to go further towards creating a benchmark for behaviour by the non-dominant company than would usually be the case in a ruling on objective justification.

The Court also rules on the German court's question about claims for damages. It says that the seeking of damages or an

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account of profits will not be an abuse of dominance, since financial relief does not "direct[ly]" prevent standard-compliant products from "appearing or remaining on the market". The steps listed above therefore do not apply if no injunction is sought. In practice, however, implementers are likely to face a period of uncertainty as to whether the SEP holder will seek an injunction. In many cases, they are therefore likely to need to comply with their obligations under the CJEU's judgment in any event.

Comparison with the Motorola and Samsung decisions

At the time of the Düsseldorf court's reference for a preliminary ruling in April 2013, the Commission was also investigating whether Motorola and Samsung had breached EU competition law by seeking SEP-based injunctions against Apple. These investigations culminated in April 2014 with an article 7 infringement decision against Motorola and an article 9 commitments decision in respect of Samsung. Although they stemmed from separate investigations and had different procedural outcomes, the Motorola and Samsung decisions appear to have been viewed by the Commission as part of a package, intended to provide clarity to the industry on what constitutes an appropriate framework to resolve SEP disputes in accordance with EU competition law.

The Commission recognised in Motorola and Samsung that seeking injunctive relief against an alleged patent infringer is generally legitimate and cannot in itself be an abuse of dominance under article 102. However, it considered that special considerations arise in a standardisation context where the SEP holder has committed to license its SEPs on FRAND terms. In the Commission's analysis, injunctions sought against a licensee who is willing to take a FRAND licence can distort licensing negotiations and ultimately have a negative impact on consumer choice and prices. The Commission's Motorola and Samsung decisions were thus essentially underpinned by a concern about "patent hold-up". As the press release accompanying the Motorola decision put it: "[Seeking] SEP-based injunctions against a willing licensee could risk excluding products from the market. Such a threat can […] lead to anticompetitive licensing terms that the licensee […] would not have accepted absent the seeking of the injunction. Such an anticompetitive outcome would be detrimental to innovation and could harm consumers."

Keen to reduce the scope for patent hold-up, the Motorola decision established a safe harbour for implementers who are willing to enter into a licence on FRAND terms. The Commission held that if an implementer wants to be free from the threat of SEP-based injunctions, it can demonstrate willingness by agreeing to third-party adjudication of FRAND terms by a court or arbitrator. The Samsung commitments showed how the safe harbour established in the Motorola decision could work in practice. Samsung agreed not to seek injunctive relief against any implementer who submits to the commitments' licensing framework (which, broadly speaking, consists of a negotiation period of up to 12 months and the determination of FRAND terms by a court or arbitrator if no agreement is reached).

The Motorola and Samsung decisions established a relatively low threshold for licensee willingness. In the opinion of some commentators, this has opened the door for stalling tactics by implementers and made it unduly difficult for SEP holders to enforce their IP rights.

The CJEU's judgment in *Huawei v ZTE* offers rather more protection for SEP holders and commensurately less protection for implementers. The Court has sought to reduce the sometimes prolonged timescales over which SEP licensing negotiations take place. The fact that the licensee remains free to challenge the validity, essentiality or infringement of the SEP(s) in question is, however, in line with the approach of the Commission in Motorola, and shifts the balance a little in favour of implementers.

The CJEU's analysis suggests that the correct approach may be to take a licence first and litigate later. The pending preliminary ruling in *Genentech v Hoechst* may help to determine the extent to which such licences need to include some mechanism for achieving royalty reductions if licensed rights are subsequently held invalid, albeit in a very different industry context.

The CJEU's judgment can be contrasted with the Commission's Motorola and Samsung decisions in another, more abstract, sense. Whereas the Commission was relatively explicit in Motorola and Samsung that its approach was underpinned by a concern about patent hold-up, the CJEU does not explain particularly clearly the anticompetitive harm it is seeking to address and how this fits into the broader article 102 framework. The Commission's discussion about the intention behind the ETSI IPR policy is replaced by a vague reference to the "legitimate interests" of implementers who rely on this policy. In this respect, the CJEU's judgment might be seen as something of a missed opportunity.

Conclusion – unresolved questions

The CJEU's judgment seeks, pragmatically, to steer a middle path between excessive protection for SEP holders on the one hand and for implementers on the other. The CJEU has provided some practical steps that may be taken by both SEP holders and implementers, which might encourage parties to conclude licences more promptly than has sometimes been the case in the past. Yet there remains considerable scope for argument about how certain parts of the judgment should be applied in practice. Concepts such as "recognised commercial practices" and "delaying tactics" appear ripe for diverging approaches by different national courts (at least until the Unified Patent Court starts operating, and possibly thereafter).

The judgment is arguably as important for what is left unsaid as for the points that are now clearly laid out. It says nothing, for example, about portfolio licensing. While the CJEU's focus on single SEPs is understandable in the light of the questions referred by the German court, the reality of most negotiations in the mobile telecommunications sector is that they relate to portfolios of patents. Perhaps most significantly, the judgment does not contain any guidelines on the setting of FRAND royalty rates. Indeed, on one interpretation of the judgment, the SEP holder may abuse a dominant position if it seeks an injunction off the back of a non-FRAND offer, regardless of whether the implementer complies with its "obligations". Until SEP holders and implementers receive more guidance from the courts on how to determine an appropriate royalty rate for a set of SEPs, the "FRAND wars" are likely to continue apace.