Court of Justice provides further direction on the path between patent hold-up and hold-out

On 16 July 2015, the Court of Justice of the European Union (the CJEU) issued its ruling on the preliminary reference from the Landgericht Dusseldorf in *Huawei Technologies Co v ZTE*.[1] The ruling concerns the question of whether the holder of standard essential patents (SEP) can pursue injunctive relief against a party which implements the technology without a licence. The ruling provides some helpful practical guidance regarding licensing negotiations but still leaves a number of areas of uncertainty.

STRIKING A BALANCE

SEPs are patents that are essential to implement an industry standard, such as 2G, 3G or 4G in mobile telecommunications. Standardised technology is beneficial to consumers; it ensures compatibility and interoperability between different handsets or other products produced by multiple suppliers and lowers switching costs.

Holders of SEPs are usually required to provide a commitment to license their SEPs on fair, reasonable and non-discriminatory (FRAND) terms. Otherwise, there is a risk that SEP holders may prevent implementers from using the technology and accessing the market, unless they pay above-market royalty rates (known as "patent hold-up").

However, if SEP holders are prevented from exercising their IP rights, implementers will be able to refuse to pay unless the SEP holder accepts a licence on below-market rates (known as "reverse hold-up" or "hold out"). This may lead innovators to withdraw, or reduce, their contributions to standardised technology in the future in favour of proprietary technology.

The issue confronting the courts is how to strike a balance to ensure that SEP holders are compensated for their investments in standardised technology, whilst not unfairly restricting access to the standard. One of the most controversial questions is in what circumstances the FRAND commitment is compatible with the right to seek an injunction against implementers who use the technology without a licence.

PRELIMINARY REFERENCE: ORANGE BOOK OR EUROPEAN COMMISSION APPROACH

The preliminary reference arose from an action before the Landgericht Dusseldorf where Huawei sought injunctive relief against ZTE for infringement of one of Huawei's SEPs. The existing case law in Germany, known as the *Orange Book* approach[2], is considered by some commentators to be favourable to SEP holders. The Dusseldorf court requested guidance from the CJEU on the circumstances in which a SEP holder can bring an action for an injunction.

[1] Case C-170/13 *Huawei Technologies Co. Ltd v ZTE Corp., ZTE Deutschland GmbH*.

[2] Judgment of the Bundesgerichtshof in *Orange Book Standard* (KZR 39/06, 6 May 2009).

At the time, there was limited precedent in this field and the same question has also arisen before competition authorities in the US, Brazil, India and China. However, in April 2014, while the preliminary reference was pending, the European Commission issued its decisions on this issue in *Motorola*[3] and *Samsung*[4], concluding that seeking an injunction may be an abuse of dominance in some circumstances.

JUDGMENT OF THE CJEU

The CJEU recognises that the protection of IP is a fundamental right, protected under Article 17(2) of the Charter of Fundamental Rights, and that the provision of a FRAND commitment cannot negate such rights. However, it considers that the standardisation context justifies the imposition of additional requirements before a SEP holder can legitimately seek an injunction.

Overall, the CJEU's judgment emphasises the need for balance between the interests of SEP holders and implementers, following the approach of the Advocate General who had sought a "middle path" to avoid over-protection or under-protection of either party[5].

Article 102 TFEU and the threshold for abuse

Unlike the Advocate General, the CJEU declined to comment on the question of whether a SEP holder automatically holds a dominant position by virtue of the SEP. Although it was outside the scope of the questions referred by the Dusseldorf court, in practice this remains an important question.

Where dominance is established, previous EU case law stated that the exercise of the right to seek an injunction can only be abusive in 'exceptional circumstances'. However, the CJEU sought to distinguish this earlier case law in its ruling. According to the CJEU, cases involving SEPs differ for two reasons: the indispensability of the patent (a SEP, by definition, means that there are no workarounds available) and the provision of a FRAND commitment. SEP holders can therefore exclude competitors' products from the market and can reserve the market for themselves.

Approach to licensing negotiations

The CJEU sets out the circumstances in which a SEP holder will not abuse its position when seeking injunctive relief:

- The SEP holder must alert the implementer to the infringement and then, if the implementer expresses its willingness to conclude a licence agreement, it must make a written offer on FRAND terms to the implementer (including the proposed royalty rate and how it is to be calculated). This contrasts with the *Orange Book* approach where it is the implementer who must present an initial offer to the SEP holder – the CJEU considers that the SEP holder is better placed, particularly as it is more able to verify the non-discriminatory aspect of the FRAND requirement.

- The implementer is then required to respond "*diligently*" and "*in good faith*" to the offer proposed by the SEP holder, without delaying tactics (although the CJEU does not elaborate on what may be considered to be a delaying tactic). If it does not accept the offer, the implementer must also make a written counter-offer on FRAND terms and, if the counter-offer is rejected, provide appropriate security for the unpaid royalties.

[3] Case AT.39.985 – *Motorola – Enforcement of GPRS standard essential patents*

[4] Case AT.39.939 – *Samsung – Enforcement of UMTS standard essential patents*

[5] Opinion of Advocate General Wathelet in Case C-170/13 *Huawei Technologies Co. Ltd v ZTE Corp., ZTE Deutschland GmBH*, issued on 20 November 2014 (the AG Opinion). The Advocate General's view was that the German *Orange Book* approach may over-protect SEP holders.

This provides some guidance on when a licensee will be considered 'unwilling', something that the *Motorola* and *Samsung* decisions did not provide. However, in practice, it may be of limited assistance to SEP holders and implementers deciding when to seek an injunction – it will be difficult to assess whether the licensee has acted in 'good faith' and without 'delaying tactics', at least until courts provide more specific guidance.

It is also unclear what action is permitted if the parties still cannot agree on the FRAND terms after both parties have taken these initial steps. This is likely to be a key point in practice as the parties will often be at an impasse over what exactly constitutes FRAND terms, having already exchanged the initial offer and counter-offer. From the CJEU's perspective however, it would have been difficult to provide more concrete guidance on the content of a FRAND offer as each case will turn on its facts. Like the Commission, the CJEU clearly does not want to become a rate setter for FRAND disputes.

Third party determination

The CJEU adds that if no agreement is reached, the parties "*may, by common agreement*" request a third party determination of the licence terms.

Third party determination was a key element of the *Motorola* and *Samsung* decisions: the Commission established a 'safe harbour' for implementers who agree to third party determination. The AG Opinion also adopted the same approach. It is not clear where this more permissive formulation by the CJEU leaves the Commission's safe harbour. It seems that a SEP holder does not have to agree to third party determination (and indeed it may not want to incur the expense if it has already made a FRAND offer) but, if the implementer requests it, will the SEP holder be prevented from bringing an injunction?

On the other hand, if the SEP holder wants third party determination but the implementer refuses, will this be considered a 'delaying tactic' or might there be legitimate reasons for an implementer to refuse an offer of third party determination?

Challenges to validity and essentiality

Like the Commission and the Advocate General, the CJEU recognises the public interest in implementers being able to challenge the validity and essentiality of the patents in question. This is considered particularly important as standards setting organisations do not verify the validity or essentiality of the patents declared essential to their standards.

Implementers will be allowed to challenge validity or essentiality in parallel to negotiations, or to reserve the right to challenge in the future. It is notable that the CJEU goes further than the AG Opinion, allowing challenges "*in parallel to*" negotiations as well as following the conclusion of the licence. Importantly however, the CJEU does not endorse the argument that an implementer should be able to delay entering into a licence until essentiality and validity have been exhaustively determined. This is an important issue as determining the validity and essentiality of a patent portfolio can take many years and can significantly delay the conclusion of a licence agreement.[6] Furthermore, the CJEU requires implementers to provide appropriate security (e.g. a bank guarantee) if they continue to use the SEP during negotiations; challenging validity or essentiality does not negate this obligation.

[6] Implementers still have the incentive to challenge the validity of a weak patent portfolio following the conclusion of an agreement as licences are typically renegotiated every five years in the telecommunications industry.

COMMENT

The CJEU's ruling provides some helpful practical guidance for SEP holders and implementers regarding their conduct in licensing negotiations. It does however leave a number of areas of uncertainty and SEP holders are likely to remain unsure of when they can legitimately seek an injunction, other than in a small number of clear-cut cases where the implementer simply fails to respond. In particular, one of the most difficult issues is determining whether an offer is FRAND. It is notoriously difficult for courts and competition authorities to provide any general guidance on this issue. Patent courts, however, are well versed in establishing what patents are worth and show an increasing willingness to determine a FRAND rate for a portfolio of patents.[7]

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[7] See, for example, *Microsoft Corporation v. Motorola, Inc. et al*, Case 2:10-cv-01823 (W.D. Wash. Apr. 25, 2013); In *re Innovatio IP Ventures, LLC Patent Litigation*, Case 1:11-cv-09308 (N.D. Ill. Oct. 3, 2013); *Realtek Semiconductor Corporation v LSI Corporation and Agere Systems LLC*, Case 5:12-cv-03451 (N.D. Cal. Feb. 26, 2014).