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The European Court of Justice on Enforcement of FRAND Patents: Huawei v. ZTE

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The European Court of Justice (ECJ) rendered its highly anticipated ruling in *Huawei v. ZTE*[1] on the enforcement of standard essential patents (SEPs) which are subject to a fair, reasonable, and non-discriminatory (FRAND) commitment. SEPs play a significant role in the mobile communications sector and patent owners have widely asserted them to try to enjoin their competitors' standard compliant products (in what often is referred to as the "smartphone wars"). With its latest decision, the ECJ requires that a specific process be followed when seeking injunctive relief in the European Union based on the alleged infringement of FRAND-committed SEPs in order to balance the interests of the patent owner and the implementers of standards.

The German Proceedings

After unsuccessful licensing discussions, Huawei sued ZTE for patent infringement in the Higher Regional Court of Düsseldorf, Germany, seeking injunctive relief and damages. The patent in suit has been declared to the European Telecommunications Standard Institute (ETSI) as essential to the LTE standard, and Huawei committed to ETSI to license the patent on FRAND terms to any third party in accordance with ETSI's policies.

The Düsseldorf Court was confronted with conflicting German precedent, on the one hand, and evolving EU legal standards, on the other hand, on when it is proper for an owner of a FRAND-committed SEP to seek injunctive relief against a potential infringer.

In its leading *Orange Book* decision,[2] the German Federal Court of Justice (BGH) held that seeking injunctive relief under SEPs against a potential infringer amounts to an anticompetitive abuse of the SEP holder's dominant position only under very narrow circumstances. It placed the burden on the alleged infringer to take specific steps in order to avoid an injunction. Specifically, under the *Orange Book* standard:

- The alleged infringer must make an unconditional and binding offer to license the patent.
- The offer, specifically, may not be subject to the condition that the patent is, in fact, found to be infringed by the alleged infringer's actions.
- The alleged infringer must account for all past and ongoing acts practicing the patent at issue and pay to the patent owner or into escrow all sums that would be owed under the license agreement on account of such use.
- If the amount of a reasonable license fee is disputed, the alleged infringer must offer to pay a license fee to be determined by the patent owner in its reasonable discretion (which is subject to court review).

The European Commission took a markedly different approach in its antitrust decisions in *Samsung v. Apple* and *Motorola v. Microsoft*.[3] Both decisions suggest a much lower threshold for finding an abuse of a dominant position under EU law[4] when holders of FRAND-committed SEPs are seeking injunctive relief against potential infringers. In *Samsung*, the Commission indicated that the "willingness" of the potential infringer to negotiate a license will render it unlawful for the patentee to pursue an injunction. Samsung's commitments to the Commission to avoid a fine indicate that the Commission considers a prospective licensee to be "willing" when it commits to a negotiation period of up to 12 months and, if no agreement is reached, to a binding third-party determination of FRAND terms.

Similarly, in *Motorola*, the Commission found that Motorola abused its dominant position by insisting, among other things, on certain anticompetitive licensing terms, including a requirement to make payments for SEPs that actually may not be infringed; prohibiting the licensee from challenging the licensor's patents or providing for a termination right upon challenge; and insisting on a reciprocal cross-license.

The Düsseldorf Court found that, when applied to the instant case, the BGH's *Orange Book* standard and the Commission's approach in *Samsung* and *Motorola* would lead to opposite results. The Court stayed the proceedings and referred several questions to the ECJ, all focusing on when seeking an injunction under SEPs that are subject to a FRAND commitment is improper and constitutes an abuse of a dominant position.

The ECJ's Decision

The ECJ held that seeking an injunction against an alleged infringer of a FRAND-committed SEP is an abuse of the patent owner's dominant position where the SEP holder fails to comply with certain requirements before initiating the action. The specific requirements and sequence are as follows:

- Before bringing an action, the SEP holder must alert the alleged infringer of the infringement by designating the SEP in question and specifying the way in which it has been infringed.
- If the alleged infringer expresses a willingness to take a license, the SEP holder must provide a written licensing offer on FRAND terms, specifying, in particular, the royalty and how it is to be calculated.
- Only if the alleged infringer continues to use the SEPs in question and fails to respond diligently to the SEP holder's offer in accordance with recognized commercial practices in the field and in good faith (and in particular without delaying tactics) may the SEP holder seek an injunction.

The Court emphasized that the exercise of an intellectual property right does not in and of itself constitute an abuse of a dominant position, but can be abusive under "exceptional circumstances." The Court found these exceptional circumstances in the standard-essentiality of the patent at issue, including the fact that competitors do not have the option of avoiding the patent with respect to standard-compliant products, and in the patentee's FRAND commitment, which "creates legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licenses on such terms."

With respect to the notice requirement, the Court agreed with the Advocate General's observation that, given the large number of SEPs (here 4,700), it cannot always be assumed that the alleged infringer is aware of its use of the SEP.[5] Moreover, given the SEP holder's FRAND commitment, the burden should be on the SEP to provide a specific licensing offer to the alleged infringer. In this regard, the Court emphasized that the SEP holder, in the absence of a standard license agreement or a publicly accessible prior agreement with another competitor, is in a better position to propose non-discriminatory licensing terms.

If the alleged infringer does not accept the SEP holder's licensing offer, an abuse of dominant position defense is available only, if the alleged infringer has promptly submitted a written counter-offer on FRAND terms. If the counter-offer is rejected, the alleged infringer also must provide appropriate security with respect to its past and continued use until an agreement is concluded, *e.g.*, by providing a bank guaranty or paying amounts into escrow.

If the parties continue to fail to agree on what terms constitute FRAND terms, the Court indicated that the parties may, by common agreement, request that the amount of the royalty be determined by an independent third party.

The Court provided little substantive guidance on what terms would or would not meet the FRAND requirement, except for the important clarification that the alleged infringer must remain free to challenge, during the negotiations and in the future, the validity and the essential nature of the SEPs at issue as well as the alleged infringer's actual use of the SEPs.

Implications and Open Questions

The ECJ chose a middle ground between the *Orange Book* standard established by the BGH and the Commission's position in *Samsung*. While seeking to establish a process that limits room for stalling and delay tactics by the alleged infringer, overall the approach favors the alleged infringer, when compared to the *Orange Book* approach, by shifting the burden of making the first FRAND offer to the SEP holder and leaving the option open for the alleged infringer to challenge the validity, essentiality, and infringement of the SEP during and after the licensing discussions. It presumably will be more difficult now, especially in Germany, to obtain injunctions under FRAND-committed SEPs.

No Guidance on FRAND Royalty

Many important issues remain open, however. Most importantly, the Court provided little substantive guidance on when licensing terms are FRAND, and no guidance at all with respect to the setting or reasonableness of FRAND rates.

Several US courts have discussed FRAND rate-setting issues over the last couple of years, including the district court decisions in *Microsoft v. Motorola* (appeal currently being heard in the Ninth Circuit),[6] *In re Innovatio IP Ventures*,[7] *Realtek Semiconductor v. LSI*,[8] *CSIRO v. Cisco*,[9] and the Federal Circuit's decision in *Ericsson v. D-Link*.[10]

The US approach is still evolving. Courts have considered various (and sometimes different) factors, including that a "reasonable" royalty should: (1) be consistent with the relevant "SSO's goal of promoting widespread adoption of their standards;"[11] (2) "mitigate the risk of patent hold-up;"[12] (3) "address the risk of royalty stacking;"[13] (4) ensure that "holders of valuable intellectual property will receive reasonable royalties on that property,"[14] such that innovators "have an appropriate incentive to invest in future development and to contribute their inventions to the standard-setting process;"[15] and (5) "be based on the incremental value of the invention, not the value of the standard as a whole or any increased value the patented feature gains from its inclusion in the standard."[16]

The Federal Circuit, however, has declined to endorse any one set of factors that should be used for all FRAND-encumbered patents.[17] Although the Federal Circuit recognized that "SEPs pose two potential problems that could inhibit widespread adoption of the standard: (1) patent hold-up and (2) royalty stacking,"[18] it held that, in order for these potential problems to be considered as part of a FRAND damages analysis, the accused infringer must present "actual evidence of hold-up or stacking," stating that "[c]ertainly something more than a general argument that these phenomena are possibilities is necessary.[19] The Federal Circuit did reiterate, however, that apportionment often is required with respect to the royalty base, holding that unless the "entire value of a machine as a marketable article is 'properly and legally attributable to the patented feature,' courts must insist on a more realistic starting point for the royalty calculations by juries—often, the smallest salable unit and, at times, even less."[20]

No such guidance exists in Germany or elsewhere in the European Union. The Mannheim District Court was asked to set the FRAND rate in a dispute between Motorola and Apple.[21] In the course of those proceedings, the Mannheim court asked the Commission for its opinion on a number of questions concerning the application of EU competition rules relevant to the setting of FRAND rates, and requested the Commission's opinion with respect to the exact method it should employ to set the FRAND royalty rate in compliance with EU competition law.[22] The specific questions that the court posed are not public, but in *Motorola* the Commission quotes one of the questions: "Is it sufficient to comply with the FRAND industry standard in view of Article 102 TFEU that the fact that usually a number of patents of a portfolio are not valid or upon review turn out to be non-essential is taken into account by other means than a judicial review of each and every patent, for instance through sampling and/or general reduction as regards the royalties or something similar?"[23] As it stands, no response by the Commission to any of the questions has been published, and the Mannheim proceeding was settled and dismissed following the Commission's *Motorola* decision.

Whether a licensing offer or counter-offer was consistent with FRAND terms, including with respect to the royalty base and royalty rate, is going to be a crucial question when applying the ECJ's *Huawei* rules. This issue will remain one for national courts to resolve on a case-by-case basis.

Other Open Questions

Other open questions that national courts will need to address over time include the following:

- What are the guidelines for determining whether the alleged infringer has "diligently responded to [the initial FRAND offer], in accordance with recognized commercial practices in the field and in good faith"? The ECJ's guidance on this point is vague, stating only that "this [is] a matter which must be established on the basis of objective factors and which implies, in particular, that there are no delaying tactics."
- Whether it is mandatory for the alleged infringer to provide "appropriate security" if the counter-offer has been rejected, and whether appropriateness should be determined based on the SEP holder's initial offer, the alleged infringer's counter-offer, or on some other standard, in order to avoid an injunction?
- Whether a party can unilaterally satisfy the requirements for a FRAND offer by deferring

the determination of the FRAND rate (and possibly other terms) to an independent third party. The ECJ suggests that this is a possible path to resolution if the parties so request "by common agreement?"

- Whether injunction proceedings are to be stayed pending any resolution (by an independent third party or by the court) of the parties' disagreement as to what is FRAND?

1. Huawei v. ZTE, case no. C-170/13, European Court of Justice, (July 16, 2015).
2. Orange Book, case no. KZR 39/06, German Federal Court of Justice, (May 6, 2009).
3. Samsung v. Apple, case no. AT. 39939, European Commission; Motorola v. Microsoft, case no. AT. 39985, European Commission.
4. Article 102 of the Treaty on the Functioning of the European Union (TFEU).
5. *Huawei*, case no. C-170/13, Advocate General, (November 20, 2014).
6. Microsoft v. Motorola, 2013 WL 2111217 (D. Wash. 2013).
7. In re Innovatio IP Ventures, 2013 WL 5593609 (N.D. Ill. 2013).
8. Realtek Semiconductor v. LSI, 2014 U.S. Dist. LEXIS 81673 (N.D. Cal. 2014).
9. CSIRO v. Cisco, 2014 U.S. Dist. LEXIS 107612 (E.D. Tex. July 23, 2014).
10. Ericsson v. D-Link, 773 F.3d 1201 (Fed. Cir. 2014).
11. *Microsoft*, 2013 WL 2111217 at *12 (involving ITU, ISO/IEC, and IEEE policies).
12. *Id*.; *see also Innovatio*, 2013 WL 5593609 at *9 (involving IEEE policy and stating "one of the primary purposes of the RAND commitment is to avoid patent hold-up"); *Ericsson*, 773 F.3d at 1234.
13. *Microsoft*, 2013 WL 2111217 at *12; *Innovatio*, 2013 WL 5593609 at *9; *Ericsson*, 773 F.3d at 1234.
14. *Microsoft*, 2013 WL 2111217 at *12.
15. *Innovatio*, 2013 WL 5593609 at *9.
16. *Ericsson*, 773 F.3d at 1235; *Microsoft*, 2013 WL 2111217 at *12 ("a reasonable royalty on the economic value of its patented technology itself, apart from the value associated with incorporation of the patented technology into the standard").
17. *Ericsson*, 773 F.3d 1201.
18. *Id*. at 1209.
19. *Id*. at 1234.
20. *Id*. at 1227. *See also* VirnetX, Inc. v. Cisco Sys., 767 F.3d 1308, 1327 (Fed. Cir. 2014) ("Where the smallest salable unit is, in fact, a multi-component product containing several non-infringing features with no relation to the patented feature …, the patentee must do more to estimate what portion of the value of that product is attributable to the patented technology.").
21. Motorola v. Apple, case no. 7 O 122/11, LG Mannheim. *Motorola*, case no. AT. 39985 at 167 *et. seq*., provides a detailed summary of the initial stages of the rate-setting proceeding.
22. *Motorola*, case no. AT. 39985 at 174.
23. *Id*. at 302.