

Client Update

Between Patent Protection and Abuse of Dominance: Highest EU Court Issues Landmark Decision on Standard-Essential Patents

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On July 16, 2015, the Court of Justice of the European Union (“ECJ”) issued a judgment that for the first time clarifies at which point the proprietor of a standard-essential patent (“SEP”) violates EU law by bringing an action for a prohibitory injunction.

Huawei Technologies Co. Ltd (“Huawei”) *v* *ZTE Corp.*, *ZTE Deutschland GmbH* (“ZTE”) concerned a potential violation of Article 102 of the Treaty on the Functioning of the European Union (“TFEU”) by ZTE. Article 102 TFEU prohibits an entity from abusing its dominant market position within the European Union in a way that could affect the trade between its Member States. The issue in this case was whether Huawei, whose dominant position in the market was not questioned, had abused its dominance by requesting that ZTE stop using its patent. While it is generally perfectly legitimate for a patent holder to seek an injunction against the unlicensed use of its patents, the situation is different when SEPs are at stake. The reasons for this lie in the essential nature of SEPs and the way they are granted.

THE IMPORTANCE OF STANDARD-ESSENTIAL PATENTS

Standards ensure the compatibility and interoperability of technical devices. Patents that are technically necessary for the implementation of such standards are known as SEPs. While third parties can normally design their products around pre-existing patents and still compete on the market, this is not an option when the technology is covered by one or more SEPs. Not being able to use SEPs results in incompatible products that are almost certain not to be interoperable with other products governed by the standard. SEPs are thus particularly important in industries where interoperability is key and where all or nearly all devices implement SEPs, for instance in the telecommunications sector. In such situations, a balance must be struck between maintaining free competition on

the one hand, and safeguarding the intellectual property (“IP”) rights and the right to effective judicial protection of the patent holders on the other hand.

There are three European Standards Organizations that are officially recognized by the European Commission. They act as a platform through which European Standards are developed. The European Telecommunications Standards Institute (“ETSI”) is one of them. It deals with electronic communications networks and services and creates its standards through a consensual approach and with the direct input of its members. Companies that participate in this standard-setting process are required to inform ETSI of their respective IP rights before an essential standard gets adopted in order to prevent subsequent so-called “ambush.” They must also make a binding commitment to grant licenses to their IP rights on FRAND terms (i.e., fair, reasonable and non-discriminatory). Only if these requirements are met is a patented technology included in a standard.

THE BACKGROUND OF THE CASE

The ECJ’s recent decision concerned a European patent that is essential for the Long Term Evolution Standard (“LTE”), a standard for wireless high-speed data communication for mobile phones and data terminals. ETSI had awarded Huawei SEP status for its patent in return for Huawei’s promise to grant licenses on FRAND terms.

ZTE, a manufacturer of base stations that comply with the LTE standard, used the SEP without paying royalties to Huawei. The two companies attempted to negotiate a licensing agreement on FRAND terms but were unsuccessful. In 2013, Huawei brought an injunctive action against ZTE for its continued use of the patent before the Düsseldorf Regional Court in Germany (*Landgericht Düsseldorf*). ZTE argued that because it was ready and willing to negotiate, asking for injunctive relief constituted an abuse of dominance by Huawei in violation of Article 102 TFEU.

The Düsseldorf Regional Court found that the German Federal Court of Justice (*Bundesgerichtshof*, BGH) and the European Commission appeared to have taken inconsistent approaches in determining at what point the holder of an SEP violates Article 102 TFEU by bringing an action for a prohibitory injunction. The Federal Court of Justice’s *Orange Book* decision of 2009¹ placed significant obligations on an alleged infringer, while the SEP holder could immediately file an action for a prohibitory injunction. It was up to the alleged infringer to make an unconditional offer to conclude a licensing agreement pursuant to FRAND terms. If it already used the invention, it also had to “behave like a licensee,”

¹ BGH, *Orange Book*, judgment of May 6, 2009, case-no. KZR 39/06.

i.e., pay license fees and not challenge the patent's validity. The European Commission, on the other hand, in the *Samsung* and *Motorola* cases, effectively established the principle that the holder of an SEP has no right to obtain an injunction under Article 102 TFEU if the alleged infringer has shown itself to be a "willing licensee."² What exactly this entailed was, however, not explained. While the Federal Court of Justice's standards under its *Orange Book* decision of 2009 would thus lead to Huawei's action being upheld, it would arguably have to be dismissed if the requirements set out by the European Commission applied.

On April 5, 2013, the Düsseldorf Regional Court stayed the proceedings and asked the ECJ to clarify under what circumstances the holder of an SEP who is seeking an injunction against an entity that uses this SEP abuses its dominant position in violation of Article 102 TFEU.

THE RULING OF THE ECJ

The ECJ emphasized the fact that SEP status is awarded only in exchange for the patent holder's irrevocable promise to grant licenses on FRAND terms. This, it held, creates a legitimate expectation for third parties that such licenses will in fact be granted, and it means that a refusal to do so may constitute an abuse of dominance within the meaning of Article 102 TFEU. The ECJ further found that the owner of an SEP is more likely than the alleged infringer to be aware of its SEP being used for a specific standard, and better positioned to draft the terms of a FRAND-compliant licensing agreement. The ECJ thus held that a dominant SEP holder who promised to license on FRAND terms and seeks injunctive relief or the recall of products abuses its dominant market position if it (i) fails to approach the alleged infringer in order to reach a licensing agreement or (ii) proceeds with its action even though the alleged infringer responded in good faith.

More specifically, the **obligations of the SEP holder** are as follows:

The owner of an SEP (i) who has irrevocably undertaken to license on FRAND terms and (ii) holds a dominant position does not commit an abuse within the meaning of Article 102 TFEU by seeking injunctive relief, provided:

- the owner of the SEP alerted the alleged infringer about the infringement, giving details about the patent and how it was violated;

² See European Commission press release IP/12/1448 of December 21, 2012 and Commission Memorandum 12/1021 of the same date.

- the alleged infringer was presented with a specific, written offer for a license, specifying in particular the royalty and its calculation (assuming that the alleged infringer expressed its willingness to conclude a licensing agreement on FRAND terms); and
- the alleged infringer has not diligently responded to the SEP holder's offer and the alleged infringer continues to use the patent at issue.

The **obligations of the alleged infringer** stipulated by the ECJ are as follows: In order to avoid an injunction, the alleged infringer does not need to accept the SEP holder's licensing offer. It must, however:

- respond "diligently" to that offer, which is specified as "in accordance with recognized commercial practices in the field and in good faith" (to be established on the basis of objective factors), and in particular without delaying tactics;
- if it rejects the offer, promptly make a written and specific counter-offer based on FRAND terms; and
- if the proprietor rejects the counter-offer and the alleged infringer still uses the SEP, "provide adequate security in accordance with recognized commercial practices in the field."

The parties to the dispute may also agree to ask an independent third party to determine the amount of the royalty for them. Finally, the ECJ pointed out that an alleged infringer does not violate any of its obligations towards the SEP holder if it challenges the validity and/or essential nature of these patents during the licensing negotiations.

ASSESSMENT

The judgment provides important guidelines for the assessment of the duties of SEP holders and alleged infringers of their patents. While this is relevant for patent litigation in the whole of Europe, it is worth noting that the ECJ determined the obligations of SEP holders and alleged infringers in a way that deviates significantly from the German *Orange Book* decision. Germany is one of the most popular venues for IP disputes since its bifurcated patent litigation system means that the questions of patent infringement and patent validity are dealt with separately. This lets patent holders apply for injunctive relief without having to defend the validity of their patents at the same time. The ECJ has now stated that it is up to the SEP holder, not the alleged infringer, to alert the other party and to make the first offer. Moreover, the ECJ does not hold it against an alleged infringer if it challenges the validity of an SEP parallel to negotiating a license for it. Germany's courts, which are estimated to handle sixty to seventy percent of all the patent infringement cases filed in the European Union, will

now have to adapt their jurisprudence. The consequences of this decision for future patent litigators may thus be significant.

While the ECJ succeeded in balancing conflicting interests in a hotly debated field, the legal questions arising from such conflicts are far from answered. First and foremost, the ECJ could only answer the specific questions put before it in the instant case, which means that it did not rule on several other controversial issues. Among them are:

- the requirements for finding that an SEP holder has a dominant position;
- how to define whether a license is on FRAND terms;³ and
- which framework to use to assess whether there has been an “abuse of a dominant position” if the (alleged) dominance was not the product of official SEP status but resulted from mere factual market strength.

Moreover, many of the Court’s requirements (like responding “diligently” or providing “adequate” security) are naturally very vague. Even with more caselaw on these issues, it will be hard to tell in the abstract whether those requirements are met.

Legal disputes about the unresolved issues in this field will thus continue to arise. Patent holders and users alike are advised to monitor emerging caselaw closely, pay attention to the actions of the European Commission and keep in mind that the interface of IP and antitrust law is one of the most controversial and ill-defined areas of law, an area in which most problems need to be assessed on a case-by-case basis.

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Please do not hesitate to contact us with any questions.

³ The guidelines of the European Commission on the applicability of Article 101 TFEU to horizontal cooperation agreements, 2011/C11/01, provide some guidance on FRAND commitments in paragraphs 285 and 287 – 291.