

# Kluwer Competition Law Blog

## ECJ rips up Orange Book! New standards in Europe for SEP injunctions

James Killick (White & Case) · Friday, September 4th, 2015

Standards lie at the heart of the digital economy – without standards, we would not have smartphones, tablets and other key parts of modern life. Europe’s highest court recently delivered a judgment in *Huawei v. ZTE*<sup>[1]</sup> explaining when EU competition law will prevent holders of patents that are essential to comply with a standard (SEPs) from seeking an injunction against a willing licensee.

According to the judgment, an SEP holder cannot seek an injunction to bar a competitor from making or selling a product infringing an SEP, unless the SEP holder: 1) alerts a potential infringer of the infringement; and 2) presents a specific, written offer for a licence on FRAND terms, including precise details on the royalty. An injunction can be issued only if the infringer does not respond in a serious and diligent manner within a reasonable timeframe. **No injunction can be issued if the alleged infringer responds with a written counter-offer corresponding to FRAND terms and provides a guarantee or deposits a provisional sum for past and future use of the SEPs.**

“An injunction can only be issued if the infringer does not respond in a serious and diligent manner within a reasonable timeframe.”

The judgment is carefully worded and its scope of application is narrow. The affirmative obligations set out above apply *only* to SEP holders who – having given a FRAND commitment over an SEP to a standard setting body – apply for an *injunction* that would prevent products manufactured *by competitors* from being put or remaining on the market. SEP holders are free to enforce their patents in other actions, such as those seeking the rendering of accounts in relation to past acts of use of the relevant SEP or an award of damages in respect of those acts of use.

The Court of Justice (ECJ) goes further than the European Commission’s (EC) previous decisions in this field in **imposing affirmative duties on SEP holders**, notably the duty to first present a licence offer. The practical impact of the judgment is that phones or tablets are now unlikely to be blocked from EU markets due to a dispute about royalties.

**The key question: to follow Orange Book or Samsung/Motorola?**

The *Huawei* case was referred to the ECJ by the Düsseldorf District Court, which was hearing a patent dispute between two Chinese companies: Huawei Technologies (Huawei) and ZTE Corp (ZTE). Huawei was the holder of a patent, which it had declared to be essential to practise the LTE standard published by the European standards organization, ETSI. Huawei agreed to license that patent on FRAND terms to parties seeking to implement the standard. ZTE claimed it was one such party. Huawei and ZTE had negotiations on the licensing terms and royalty rate, but did not reach agreement. Huawei then sought an injunction against ZTE, which countered that this was an abuse of Huawei's dominant position and contrary to Article 102 TFEU.

The Düsseldorf court, in essence, asked the ECJ whether it should follow the well-established German practice (*Orange Book*) or the approach advanced by the EC in *Samsung* and *Motorola*.

- The German Federal Court of Justice's 2009 *Orange Book* judgment (KZR 39/06) provides that a competition law defence may be relied on to prevent the grant of an injunction only in exceptional cases. The alleged infringer can successfully rely on a competition law defence only if it: (1) unconditionally offers to enter into a licence agreement with the SEP holder; and 2) behaves as if it were an actual licensee, i.e. renders account of its acts for use of the patent and pays royalties (albeit in an escrow account as long as the patent holder does not accept the licence agreement offer). It is up to the defendant to prove that the two conditions above are fulfilled. The "unconditional nature of the offer" means, in particular, that the offer should not be conditional on a court holding that the licensee's behaviour did in fact infringe the patent. In practice, this makes the competition law defence very unattractive, in particular because a number of lower German courts basically required the defendant to waive all defences with regard to non-infringement and invalidity of the patent.
- The other alternative was the approach taken by the EC in its cases against *Motorola* and *Samsung*, where the EC stated that a patent holder abuses its dominant position when, having given a FRAND commitment over an SEP to a standard setting body, it seeks an injunction against a willing licensee. The key element in these cases is that, if the party agreed to take a licence and to be bound by a determination of the FRAND royalties by the relevant court or arbitration tribunal, then no injunction should be granted. The EC took the view that a declaration to be bound by a litigated award was sufficient to make an infringer a "willing licensee", while the latter remained free to challenge the validity of the patent or its infringement.

### **The ECJ chose *Samsung/Motorola*, but went further**

#### *The legal and economic context applicable to SEP cases*

The questions posed by the Düsseldorf court to the ECJ related only to the existence of an abuse (para. 43). Thus, the ECJ did not analyse whether all SEP holders should automatically be deemed dominant (which is a pre-condition for invoking Article 102 TFEU). (The Advocate General had previously expressed caution about assuming that all SEP holders are dominant.<sup>[2]</sup>)

The ECJ referred to the classic case law about the need to maintain the right balance between competition rules and protection of intellectual property (IP) rights and the right to effective judicial protection (para. 42). Under that case law, the exercise of an IP right, e.g., by bringing an infringement action, cannot in itself constitute an abuse of a dominant position (para. 46). Enforcement of IP rights violates competition rules only in exceptional circumstances (para. 47). The ECJ focused on two main factors (the second of which distinguishes this case from the previous case law on compulsory licensing):

- **the indispensability of the patent at issue**, in the sense that it is essential to a standard established by a standardization body, rendering its use indispensable to all competitors that envisage manufacturing products complying with the standard to which the patent is linked (paras 49-50); and
- **the fact that the SEP status was given in return for the proprietor's irrevocable undertaking to the standardization body that it is prepared to grant licences on FRAND terms**, in conjunction with the fact that SEP status means that its proprietor can prevent products manufactured by competitors from appearing or remaining on the market and thereby reserve to itself the manufacture of the products in question (paras 51 – 52).

These two circumstances “*create legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licences on such terms*”, and therefore “*a refusal [...] to grant a licence on those terms*” may, in principle, constitute an abuse within the meaning of Article 102 TFEU and could be raised as a defence in actions for a prohibitory injunction or for the recall of products (paras 53 – 54).

The reference in the judgment to “competitors” may simply reflect the underlying facts of the case, i.e. it was between two companies that are competing manufacturers. While the operative part of the judgment applies on its face to all SEP holders, the reference to “competitors” in the reasoning of the judgment does leave open a question of whether the same legal standard would apply to the seeking of an injunction by a pure licensing entity which is not a competing manufacturer.

The ECJ stressed that the SEP holder is not prevented from enforcing its patent, but only obliged to grant a licence on FRAND terms. If the parties disagree as to what constitutes FRAND, an injunction can only succeed if the SEP holder sought to ensure “*a fair balance of the interests concerned*” (para. 55). SEP holders cannot be denied judicial protection and therefore should have recourse to legal proceedings to ensure effective enforcement of its exclusive rights (paras 57 – 58). However, the irrevocable offer to grant licences on FRAND terms justifies “*the imposition on that [SEP holder] of an obligation to comply with specific requirements when bringing actions against alleged infringers*” (para. 59).

*The steps required by the ECJ before an injunction can be granted*

The ECJ set out “*specific requirements*” with which the SEP holder needs to comply in order to be able to seek an injunction without abusing its dominant position. The requirements on the SEP holder described below are cumulative and need to be fulfilled in the order presented by the judgment.

- **The SEP holder must alert the alleged infringer, by giving notice or engaging in prior consultation, of the alleged infringement by designating the SEP at issue and specifying the way in which it has been infringed** (paras 60 – 61). The ECJ reasoned that this criterion is justified because, due to the large number of SEPs, the alleged infringer may not be aware that it is infringing a patent (para. 62).
- After the alleged infringer has expressed its willingness to take a FRAND licence, **the SEP holder must present to the alleged infringer a specific, written offer for a licence on FRAND terms**, specifying the amount of the royalty and the way that royalty is to be calculated. The ECJ noted that this requirement stems from the SEP holder's commitment to limit its exclusive IP right by licensing it on FRAND terms, and from the fact that it has the necessary information to comply with the principle of non-discrimination, in particular, if it has already granted other

licences (paras 63 – 64). This requirement of a written offer as a prelude to discussion goes beyond the approach of the EC, i.e. it is an additional requirement to be complied with.

It would then be up to the alleged infringer to take action as follows:

- **The alleged infringer must diligently respond to the SEP holder's written offer**, “in accordance with recognized commercial practices in the field and in good faith, a point which must be established on the basis of objective factors and which implies, in particular, that there are no delaying tactics.” Should the alleged infringer not accept the SEP holder's offer, it has to submit, promptly and in writing, a specific counter-offer that corresponds to FRAND terms (paras 65 – 66).
- If the alleged infringer is using the teaching of the SEP prior to the conclusion of a licensing agreement, **it must provide appropriate security from the point at which its counter-offer is rejected**, which must include the number of past acts of use of the SEP for which the alleged infringer must be able to render account (we note that this conclusion differs from the Advocate General's Opinion, which did not consider that security should be proactively provided for the Article 102 TFEU defence to succeed). Security can be provided by, for example, providing a bank guarantee or placing the necessary amounts on deposit (para. 67).

The ECJ then states that if no agreement is reached after this round of offer and counter-offer, the parties “*may, by common agreement, request that the amount of the royalty be determined by an independent third party, by decision without delay*” (para. 66). It is not entirely clear whether this is a “requirement” to be fulfilled before an injunction could be issued. It appears that this is of less relevance than the four requirements listed above, given that this point is not included in the operative part of the judgment, which is the part that binds the national court. This is another difference in emphasis from the EC's approach in *Samsung* and *Motorola*.

The ECJ clarified that an alleged infringer “*cannot be criticized*” for challenging, in parallel to the negotiations relating to the grant of licences, the validity of the relevant SEPs, their essential nature to the standard, or their actual use (para. 69). This is in line with the EC's views expressed in the *Motorola* and *Samsung* cases.

Finally, the ECJ made clear that all the above requirements do not apply to actions seeking the rendering of accounts in relation to past acts of use of the SEP at issue or an award of damages in respect to those acts of use, because such actions do not directly affect competitors marketing products complying with the standard in question (paras 72 – 76).

## Implications

The detailed guidelines set by the ECJ establish a clear procedural framework for SEP holders seeking injunctive relief. They also limit the possibility to use the threat of an injunction against users of a standardized technology, at least if the latter are prepared to take a licence under valid patents which they actually use.

The judgment, coming as it does on top of the EC's *Samsung* and *Motorola* decisions, will significantly change the balance of German SEP litigation. So far, Germany has been a forum of choice for European patent litigation. German courts have been generous in granting injunctions for patent infringements and have taken the view that competition law defences generally do not bar an injunction, even if the litigation concerns an SEP. Accordingly, it was the defendant's burden to prove all elements of a competition law defence. Under the ECJ's approach, the SEP

holder seeking injunctive relief will be obliged to prove that he approached the infringer and offered him an agreement on FRAND terms. If the defendant contests the FRAND assertion, for example on the basis of its own FRAND royalty calculation, the court will have to appoint an expert to resolve this issue. This will likely be time-consuming and costly.

Though **the ECJ required the SEP holder to present to the alleged infringer a FRAND offer, specifying the amount of royalty and the way the royalty is calculated, it did not attempt to define FRAND** (indeed it was not asked to do so by the national court). The ruling suggests that there is no one single right view of FRAND in any particular licensing discussion, given that the alleged infringer is able to submit its FRAND counter-offer to a FRAND offer of the SEP holder. So FRAND is something that is for negotiation. Accordingly, though the ruling is clear as to the procedures that have to be followed to obtain an injunction, it will not end, but only shift the focus of the controversies in SEP cases pending before national courts.

Finally, one striking feature of the case is that no European companies are involved. It is a battle between two big Chinese tech companies, Huawei and ZTE. The choice of Europe for a tech dispute between global players is not new – Sun and Real Networks took their battle with Microsoft to Brussels over 15 years ago. However, it is perhaps a sign of changing times that a key EU decision is for the first time set by Chinese tech giants rather than US ones.

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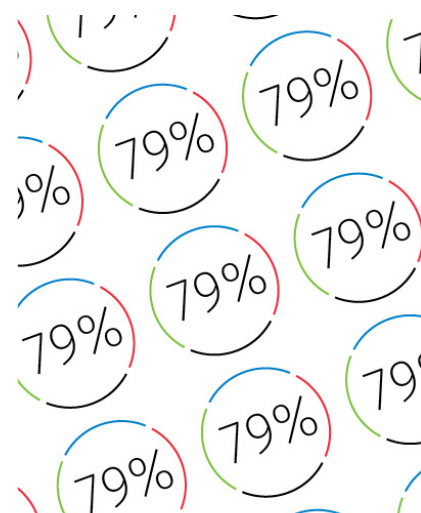
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