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The Commission sitting on the fence regarding SEP licensing

Jakob Dewispelaere (Sidley Austin LLP) · Thursday, February 15th, 2018

Standard essential patents (SEPs) and fair, reasonable and non-discriminatory (FRAND) licensing terms remain hotly debated topics within antitrust circles as regulators around the world stake out their positions. In November 2017, the European Commission (the Commission) published its Communication on the EU approach to Standard Essential Patents (SEPs) (the Communication).[1] It sets out a general, non-binding framework that can be used by SEP holders and implementers to reach an agreement on licensing terms. Similar efforts are being made in China, where the National Development and Reform Commission is drafting guidelines for pricing SEPs and the Guangdong Court is considering introducing trial guidance for lawsuits involving SEPs.[2]

A standard is usually defined as a document that sets out requirements for a specific item, material, component, system or service.[3] Examples of widely spread standards include LTE, WiFi or Bluetooth. Standards are generally set by standard-setting organizations such as the European Telecommunications Standards Institute (ETSI). SEPs is the acronym used to describe patents that protect technology essential to a standard. When a patent holder declares its patent essential to a particular standard, the holder typically commits to license it on FRAND terms. Unfortunately, what is FRAND or un-FRAND remains unclear, and antitrust intervention remains a source of great contention.

A particularly controversial issue is whether a SEP holder has the right to seek or enforce injunctions against implementers after it has committed to license the SEP on FRAND terms. The prime concern is that injunctions may be used to extract un-FRAND royalties from implementers.

The Court of Justice (CJEU) sought to give more guidance on the use of such injunctions in its landmark decision in *Huawei v. ZTE*[4], in which it shaped a general framework for companies to use when seeking injunctive relief based on SEPs that they committed to license on FRAND terms. It ruled, *inter alia*, that a SEP holder can indeed seek injunctions, provided that, before bringing the action, the SEP holder alerts the alleged infringer and presents to the infringer a written offer to license on FRAND terms, specifying the royalty and how it will be calculated. The CJEU did not, however, specify how exactly the royalty should be calculated in order for it to be FRAND.

Consequently, despite CJEU guidance, patent holders and implementers still find themselves frequently embroiled in lawsuits, especially in SEP-heavy industries such as telecommunications, precisely because clear guidelines are lacking. Realizing that interconnectivity is becoming more crucial than ever, particularly with the Internet of Things and the 5G telecommunications standard

in mind, the Commission has recognized that there is an urgent need for a smooth, clear and predictable framework for SEPs. The Communication aims to integrate the Commission's approach taken in earlier cases into a broader non-binding policy document, and to resolve the questions left open by the CJEU in *Huawei v. ZTE*.

Both patent holders and implementers – primarily smartphone makers – fiercely lobbied the Commission to endorse the licensing model that best serves their respective interests (i.e., licensing based on the value of the end device vs. licensing based on the value of components). The Commission eventually avoided choosing sides, saying that "*there is no one-size-fits all solution for what is FRAND.*"

When discussing licensing and IP valuation, the Communication does nothing more than articulate a few high-level principles. It states that FRAND licensing terms for SEPs "*have to bear a clear relationship to the economic value of the patented technology*", that "*parties need to take a reasonable aggregate rate for the standard into account, assessing the overall added value of the technology to avoid royalty stacking**[5]***" and that "*the FRAND value should be irrespective of the market success of the product which is unrelated to the patented technology.*" When addressing the non-discrimination element of FRAND, the Communication goes no further than saying that "*solutions can differ from sector to sector and depend on the business models in question.*"

Consequently, the Communication does not provide clear answers to the fundamental questions about which patent holders and implementers constantly litigate. What exactly is a fair royalty? Who gets a license and who doesn't? The Commission's decision not to take sides does not mean that the problems will go away. Clarity on whether the royalty set by the SEP holder is un-FRAND or whether the SEP holder can be obliged to license its patent to all implementers rather than to end-users only will still need to come from courts and/or competition authorities.

Although the Communication lacks clear guidance in that respect, it still provides some useful language in other areas. For example, the Commission's clear reference to "royalty stacking" as an IP valuation principle that should be taken into account is noteworthy. As, too, is its statement that "*PAEs*[6] *should be subject to the same rules as any other SEP holder, including after the transfer of SEPs from patent holders to PAEs.*" The implications of this sentence are potentially far-reaching. It could mean that the Commission considers that FRAND commitments travel in case of patent ownership change, irrespective of whether the buyer/PAE also pledged to license on FRAND terms.

In conclusion, parties negotiating SEP licensing agreements will no doubt want to read the Communication for general guidance on the Commission's views. However, SEP holders and implementers looking for clear answers to the questions left open by *Huawei v. ZTE* will be none the wiser and will still be forced to fight their battles in court.

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[1] See https://ec.europa.eu/docsroom/documents/26583.

[2] Mlex Report, "*Draft Chinese SEP pricing guidelines out for public comment soon, NDRC official says*", January 26, 2018; Mlex Report, "*Guangdong high court mulls trial guidance for standard-essential patent cases*", January 29, 2018.

[3] See https://www.cencenelec.eu/standards/DefEN/Pages/default.aspx.

[4] Judgment of July 16, 2015, *Huawei v. ZTE*, C-170/13, EU:C:2015:477.

[5] A standard-compliant product uses thousands of SEPs, owned by various SEP holders (e.g., think about the number of patents in a cell phone). Royalty stacking essentially means that royalties set by each SEP holder individually without having regard to the aggregate royalty burden "stack" on top of each other, making the overall royalty burden unsustainably high.

[6] Patent Assertion Entities – businesses that acquire patents (including SEPs) from third parties and generate revenue by asserting them against alleged infringers.

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