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INTELLECTUAL PROPERTY AND STANDARD SETTING

-- Note by the European Union --

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EUROPEAN UNION¹

1. Introduction

1. Standards are not only ubiquitous in a modern economy, they also create significant economic and other benefits for consumers. This is true for standards in general and for interoperability standards in particular, without which, it would be impossible to make calls or browse the Internet on a smartphone. Standards can facilitate the creation and integration of markets, foster positive feedback loops, reduce uncertainty in the market place and lower costs and prices for downstream products.

2. Standards also change the nature of competition in many important ways. In particular, they tend to shift the mode of competition from "for the market" to "in the market". By the same token, the focus of innovative activity often shifts from the standardised technology to the implementation of the technology, and the overall benefits and incentives of market participants can change dramatically.

3. Standards and standard-setting do, however, not come without any risk for competition. For instance, standard-setting entails that competitors come together and discuss, which facilitates anti-competitive collusion. Similarly, standards that set detailed specifications can limit technical development and innovation to the detriment of consumers. Anti-competitive results can result from standard-setting if companies are prevented from having access to the standardised specifications and/or the underlying essential intellectual property ("IPR"). This latter concern is the focus of this contribution.

1.1 *SEPs, hold-up concerns and FRAND*

4. Standards do not necessarily need to be based on technologies that are IPR-protected, but in reality many are. If a technology that is essential to a standard – in the sense that it is impossible to manufacture standard-compliant products without using that technology – is covered by a patent, the patent becomes a standard-essential patent ("SEP").

5. SEPs are particularly prevalent in the ITC sector, not at least because of the sectors inherent need for interoperability. According to estimates, a modern laptop computer implements at least 250 interoperability standards. Many standards, in turn, rely on hundreds or even thousands of patents that have been declared as standard-essential by members of standard-setting organisations ("SSOs"). For instance, more than 23 500 patents have been declared essential to the "2G" (GSM) and the "3G" (UMTS) mobile telecommunications standards developed by the European Telecommunications Standards Institute ("ETSI"), which need to be implemented in virtually all smartphones and tablets sold in Europe.

6. As a result of the patent's essentiality for the standard, it is possible that a SEP holder acquires control over the use of a standard. When the standard constitutes a barrier to entry and implementers are "locked-in", the company could thereby also control the product or service market to which the standard relates. In such a scenario, the SEP holder could be in a position to engage in anti-competitive behaviour, for example by "holding-up" standard implementers after the adoption of the standard either by refusing to

1. Note by the European Commission on recent enforcement of EU competition rules with respect to standard essential patents

license the necessary SEP or by extracting excess rents by way of excessive royalty fees. Lock-in occurs in particular once the standard is widely implemented and implementers have made standard-specific investments.

7. Hold-up can be compounded where a product implements a large number of SEPs that cover multiple standards. In such a scenario, the number of potential licensors may result in the payment of supra-competitive aggregate royalty payments to various SEP holders. This phenomenon is often referred to as "royalty-stacking".

8. It has been argued that patent hold-up is at best a coherent theory which lacks sufficient empirical evidence. If anything, the problem would be rather the other way around: limiting SEP holders' right to seek injunctions would increase the risk that SEP holders receive sub-FRAND royalties, something that has been called "reverse hold-up" or "hold out".

9. Whilst both phenomena "hold-up" and "reverse hold-up" may occur in the market, the basis for competition law intervention must remain a stringent, facts-based case-by-case analysis of the effects of certain conduct on the market. The Commission determined, for instance, in its Motorola decision that Apple was held up by having to sign a licence agreement which, in effect, barred it from being able to challenge the validity, essentiality and infringement of the patents in Motorola's entire German SEP portfolio or face the continued prohibition to sell products in Germany.

10. It also seems that standard-setting organisations ("SSOs") take hold-up concerns seriously because many have implemented safeguards in their IPR policies, in particular by requiring their members to disclose their standard-essential IPRs and to commit to license these IPRs on (fair,) reasonable and non-discriminatory ("RAND" or "FRAND") terms. FRAND commitments grant a large degree of flexibility and allow companies to negotiate agreements that fit their individual needs. However, when giving a FRAND commitment, SEP holders need to anticipate the implications of this commitment, in particular on their ability to freely set the royalty level. Moreover, the uncertainty surrounding the actual boundaries of FRAND – the flip-side to its flexibility – have recently prompted criticism, arguing for stronger commitments to a clearer FRAND licensing process in order to mitigate hold-up problems, reducing litigation costs and speeding innovation.

2. Recent competition law enforcement and court cases in the ITC sector in Europe

11. In the past, the Commission repeatedly investigated issues related to SEPs and FRAND commitments in the ITC sector. For instance, the Commission investigated allegations that Rambus infringed its obligations under the JEDEC patent policy to disclose patents that the company later claimed to be essential (so-called "patent ambush"). The investigation ended with a commitment decision after Rambus undertook to put a worldwide cap on its royalty rates for products compliant with the relevant standards. The Commission furthermore investigated ICom for allegedly not honouring a FRAND commitment related to patents that it had acquired from a member of a SSO. Following the Commission's investigation, ICom declared that it was willing to be bound by the originally given FRAND commitment.

12. More recently, the Commission's focus in this area has shifted to the use of injunctions on the basis of FRAND-encumbered SEPs (see in particular the Motorola and Samsung cases summarised below).

13. This has to be seen against the backdrop of a clearly noticeable surge in high profile patent litigation in the mobile telecommunications industry sometimes referred to as the "smartphone patent wars".

14. A big part of the litigation involved requests for preliminary and permanent injunctions against the products of competitors, often also on the basis of FRAND-encumbered SEPs. Some of the national courts in the EU granted injunctions with respect to FRAND-encumbered patents, others rejected them. Importantly, however, they did so on very different legal grounds.

15. At the same time, several companies subject to injunctions proceedings filed complaints with the Commission.

16. In its enforcement and advocacy efforts, the Commission was guided by the following general principles:

- First, injunctions are generally a legitimate remedy for patent holders in case of patent infringements.
- Second, however, seeking an injunction on the basis of a SEP may constitute the abuse of a dominant position under Article 102 of the Treaty on the Functioning of the European Union ("TFEU") if the SEP holder has given a commitment to license on FRAND terms. The standard-setting creates a specific competition law context (not at least because the standard-setting in most cases eliminates pre-existing technology competition). The commitment to license on FRAND terms is a quid pro quo for being included in the standard. By doing so, the SEP holder voluntarily chooses to forgo its right to exclude others from the use of its patented technology and decided to provide access to its technology to everybody in the industry in exchange for FRAND royalties.
- Third, a finding of an infringement of Article 102 TFEU requires that the patent infringer is unwilling to take a licence on FRAND terms. This is ultimately the flip-side of the FRAND commitment under which the SEP holder has committed to licence to everybody willing to take a licence on FRAND terms.

2.1 *Motorola Mobility Decision*

17. On 29 April 2014, the Commission adopted a prohibition decision addressed to Motorola Mobility LLC ("Motorola"). The Decision held that, in the exceptional circumstances of the case and in the absence of any objective justification, Motorola infringed Article 102 TFEU and Article 54 of the EEA Agreement by seeking and enforcing an injunction against Apple Inc., Apple Sales International and Apple Retail Germany GmbH ("Apple") on the basis of a FRAND-encumbered SEP before the courts of the Federal Republic of Germany.

2.1.1 *Facts*

18. In 2003, Motorola declared one of its patents essential to the GPRS standard, which forms part of the GSM (or "2G") standard. In line with the ETSI IPR policy, Motorola had committed to license on FRAND terms.

19. In April 2011, Motorola sought injunctions against Apple in Germany on the basis of, inter alia, one of its GPRS SEPs. In the course of the injunction proceedings, Apple made six successive licensing offers to Motorola, which it also submitted to the German courts. These offers were made by Apple with a view to availing itself of the competition law defence established by the Bundesgerichtshof in its Orange Book judgment.

20. In its second licensing offer, Apple proposed to enter into a licence agreement which would have given Motorola the right to set the royalties according to its equitable discretion and according to FRAND principles, without any limitations (other than FRAND and Article 102 TFEU) as regards the royalty rates and the method of calculation of the final amount of royalties. The offer also allowed for a full judicial review of the amount of FRAND royalties, whereby Motorola and Apple could submit their own evaluations, calculations and reasoning for consideration to the court.

21. Motorola, however, rejected that offer and continued the injunction proceedings and in December 2011, the lower German courts granted Motorola an injunction against Apple.

22. In January 2012, when Motorola decided to enforce the injunction, Apple made its sixth licensing offer. In this offer, Apple (i) accepted a clause whereby Motorola would be entitled to terminate the agreement in case Apple challenged the validity of any of the licensed SEPs (the so-called "termination clause"); and (ii) explicitly acknowledged the infringement of the licensed SEPs by all of its devices, including an Apple device that it claimed was not infringing those SEPs.

23. Based on Apple's sixth licensing offer, the German courts stayed temporarily the enforcement of the injunction, and Motorola and Apple signed a settlement agreement.

2.1.2 *Legal assessment*

24. In line with the principals outlined above in paragraph (17), the Commission took the position in its Decision that the seeking and enforcement of an injunction by a patent-holder is generally a legitimate course of action. However, the context is different with regard to the seeking and enforcement of injunctions on the basis of SEPs for which a voluntary commitment to license on FRAND terms has been made during the standard-setting process. The essence of the commitment to license on FRAND terms is a recognition by a SEP holder that, given the purpose of the standardisation process, its essential patents will be licensed in return for FRAND remuneration, in contrast to those patents which do not read on a standard and for which no FRAND commitment has been given by the patent holder.

25. The Decision found Motorola to be dominant on the market for the licensing of the technologies, as specified in the GPRS standard technical specifications, on which Motorola's GPRS SEP reads. The Decision established that it was indispensable for manufacturers of mobile devices to comply with the GPRS standard and that the industry was locked-in to the standard. The Decision rejected Motorola's argument that it could not be dominant because of Apple's alleged countervailing bargaining power.

26. The Commission further considered the GPRS standard-setting process and Motorola's commitment to license the GPRS SEP on FRAND terms as exceptional circumstances that would warrant the finding of an abuse of a dominant position in a situation that concerns the exercise of an IPR. The Decision established in detail that, as of Apple's second licensing offer, Motorola's conduct was capable of having the following anti-competitive effects:

- i) a temporary ban on the online sale of Apple's GPRS-compatible products in Germany;
- ii) the inclusion in the settlement agreement of licensing terms, disadvantageous to Apple; and
- iii) a negative impact on standard-setting.

27. Among the disadvantageous licensing terms that Apple accepted as a result of Motorola's seeking and enforcing of an injunction was Motorola's right to terminate the licence should Apple challenge the validity of the SEPs in Motorola's portfolio. In light of the high invalidity rates of patents challenged in court, this clause is capable of significant anti-competitive effects, in particular because, as the Court of

Justice held in *Windsurfing International*, it is in the public interest to eliminate any obstacles to economic activity arising from patents granted in error.

28. The Decision also rejected Motorola's allegations that its behaviour was objectively justified. A SEP holder that has given a commitment to license on FRAND terms is entitled to take reasonable steps to protect its interests by seeking and enforcing an injunction against a potential licensee, inter alia, in, the following scenarios:

- the potential licensee is in financial distress and unable to pay its debts;
- the potential licensee's assets are located in jurisdictions that do not provide for adequate means of enforcement of damages; or
- the potential licensee is unwilling to enter into a licence agreement on FRAND terms, with the result that the SEP holder will not be appropriately remunerated for the use of its SEPs. The corollary of a patent holder committing, in the standardisation context, to license its SEPs on FRAND terms is that a potential licensee should not be unwilling to enter into a licensing agreement on such terms for the SEPs in question.

29. Apple's second licensing offer, allowing for judicial rate-setting, constituted a clear indication that Apple was willing to enter into a licence agreement on FRAND terms with Motorola, and pay FRAND remuneration for the licensed SEPs. Therefore, as of that licensing offer, there was no need for Motorola to have recourse to an injunction in order to be appropriately remunerated for the use of its SEPs.

30. Finally, the Decision also established that the finding of an abuse of a dominant position by seeking and enforcing an injunction on the basis of a FRAND-encumbered SEP was consistent with the European Union's international obligation under the TRIPS agreement and struck a fair balance between the fundamental rights and freedoms at stake. In particular, the right of access to court enshrined in Article 47 of the Charter of Fundamental Rights of the European Union does not exclude that the seeking of an injunction can, in exceptional circumstances, such as in the present case, constitute an abuse of a dominant position.

31. However, the Commission decided not to impose a fine on Motorola in view of the fact that there was no case-law by the European Union Courts dealing with the legality under Article 102 TFEU of SEP-based injunctions and that national courts have so far reached diverging conclusions on this question.

2.2 Samsung Decision

32. Also on 29 April 2014, the Commission adopted a commitments decision addressed to Samsung Electronics Co., Ltd., Samsung Electronics France, Samsung Electronics GmbH, Samsung Electronics Holding GmbH and Samsung Electronics Italia s.p.a. (collectively "Samsung"). Samsung offered commitments in order to address the competition concerns related to Samsung's seeking of preliminary and permanent injunctions against Apple Inc. ("Apple") before the courts of various Member States.

2.2.1 Facts

33. In 1998, Samsung committed to ETSI to license its UMTS (or "3G") SEPs on FRAND terms. As Motorola before, when giving the commitment Samsung expected to obtain remuneration for its SEPs by means of licensing revenue rather than using these patents for exclusionary purposes. However, between April 2011 and December 2011, Samsung sought injunctions, based on its UMTS SEPs, seeking to enjoin Apple from selling the iPhone and iPad in Germany, UK, Italy, France, and the Netherlands.

2.2.2 *Commitments*

34. In order to address the competition concerns expressed in a Statement of Objections, Samsung offered commitments pursuant to Article 9 of Regulation (EC) No 1/2003.

35. Under its commitments, Samsung undertakes not to seek injunctions before any court or tribunal in the European Economic Area ("EEA") for infringement of its SEPs (including all existing and future patents) implemented in smartphones and tablets ("Mobile SEPs") against a potential licensee that agrees to, and complies with, a particular licensing framework ("Licensing Framework") for the determination of FRAND terms. The Licensing Framework encompasses either a unilateral licensing agreement covering Samsung's Mobile SEPs or, if either Samsung or the potential licensee so requests, a cross-licensing agreement covering both Samsung's Mobile SEPs and certain of the potential licensee's Mobile SEPs.

36. The Licensing Framework consists of:

- i) a negotiation period of up to 12 months; and
- ii) a third party determination of FRAND terms in the event that no licensing agreement or alternative process for determining FRAND terms has been agreed upon at the end of the negotiation period.

37. The third party determination of FRAND terms will consist in the submission of the dispute to arbitration or to court adjudication in order to determine the FRAND terms of either a unilateral licensing or cross-licensing agreement. In case of disagreement between Samsung and a potential licensee about the venue for the determination of FRAND terms, the dispute would be submitted to court adjudication.

38. The duration of the commitments is five years. Samsung also appointed a trustee that will monitor its compliance with the commitments during this time.

39. The Commission took the view that the commitments were adequate to meet the concerns expressed in the Statement of Objections because they will ensure that, in the future, Samsung will not seek injunctions on the basis of its SEPs (which read on mobile devices and tablet computers) against any potential licensee willing to enter into an agreement on FRAND terms. In essence, the commitments provide for a "safe-harbour" available to all potential licensees of Samsung's Mobile SEPs – as long as they submit to the Licensing Framework, they are protected by the commitments.

2.3 *Case C-170/12 Huawei v ZTE*

40. Further clarity on the application of EU competition law with respect to the use of injunctions on the basis of FRAND-encumbered SEPs can be expected from the ruling of the European Court of Justice in *Huawei v ZTE*. The case came before the Court as a preliminary reference from the Regional Court of Düsseldorf. The case has been argued before the Court of Justice and the Advocate General has published his opinion on 20 November 2014.

2.3.1 *Facts*

41. The background of the case is dispute between Huawei Technologies Co. Ltd ("Huawei") and ZTE Corp. and ZTE Deutschland GmbH (together, "ZTE").

42. End 2010, Huawei had informed ZTE that the latter's products would infringe Huawei's LTE (or "4G") patent portfolio and asked it to take a licence. ZTE responded that Huawei's product would infringe ZTE's patents and suggested a royalty free cross-licence. Huawei disagreed with this evaluation of the

respective portfolios and after five months of negotiations sued ZTE, inter alia, before the Regional Court of Düsseldorf for the infringement of four LTE SEPs for which it had given a commitment to license on FRAND terms requesting rendering of accounts, damages, product recall and an injunction against ZTE.

43. The Düsseldorf court decided to ask the Court of Justice five questions with respect to the application of EU competition law to the dispute before it.

44. In its first question, the court asked whether a SEP owner who has given a commitment to licence on FRAND terms abuses its dominant position pursuant to Article 102 TFEU when seeking an injunction against a potential licensee who is willing to negotiate a licence on FRAND terms. Questions 2 to 4 concern the requirements for establishing the potential licensee's willingness. Question 5 asks to which extent the same considerations apply to other means of redress of a patent infringement, notably rendering of accounts, recall of products, and damages.

2.3.2 *Opinion by Advocate General Wathelet*

45. Advocate General ("AG") Wathelet proposed the following answer to the first question (which in his mind also answered questions 2 and 3):

46. The fact that a holder of a SEP which has given a commitment to a standardisation body to grant third parties a licence on FRAND terms requests an injunction against an infringer, which may lead to the exclusion from the markets covered by the standard of the products and services supplied by the infringer of an SEP, constitutes an abuse of its dominant position under Article 102 TFEU where it is shown that the SEP-holder has not honoured its commitment even though the infringer has shown itself to be objectively ready, willing and able to conclude such a licensing agreement.

47. In the view of AG Wathelet, compliance with that commitment with respect to Article 102 TFEU means that, prior to the seeking of an injunctions, the SEP holder must inform the potential licensee about the infringement (in writing, giving reasons, and specifying SEP concerned and manner of infringement). The SEP-holder must also present to the potential licensee a written offer of a licence on FRAND terms (contains all the terms normally included in a licence, including the precise amount of the royalty and the underlying calculation).

48. With respect to the obligations of the potential licensee, AG Wathelet held that it must respond to that offer in a diligent and serious manner and in case of disagreement present make a reasonable counter-offer relating to the clauses with which it disagrees. If the potential licensee engages in purely tactical, dilatory and/or not serious behaviour, the SEP holder does not run afoul of Article 102 TFEU when seeking an injunction.

49. Conduct of the potential licensee cannot be regarded as dilatory or as not serious if it requests that FRAND terms be fixed either by a court or by an arbitration tribunal (in which event the SEP holder can ask the for a bank guarantee/escrow payment determined by the court/tribunal).

50. Similarly, the potential licensee's conduct cannot be regarded as dilatory or not serious if it reserves the right in the licence agreement to challenge validity, infringement or essentiality before a court or arbitration tribunal.

51. Finally, AG Wathelet concluded that the considerations with respect to injunctions would also apply for the requesting of corrective measures, such as product recalls. However, SEP holders do not infringe Article 102 TFEU by merely requesting to secure the rendering of accounts or by bringing a claim for damages for past acts of use in order to obtain compensation for previous infringements of their FRAND-encumbered SEPs.

3. Conclusions

52. With respect to the limits for seeking injunctions on the basis of FRAND-encumbered SEPs under Article 102 TFEU, the main broad lines that underlie the Commission's enforcement action (which are supported by AG Wathelet's opinion) are:

- While injunctions are generally a legitimate remedy, there should be no injunctions against potential licensees willing to take a licence on FRAND terms.
- Potential licensees must be regarded as willing if they agree to be bound by the determination of FRAND terms by a court or arbitration tribunal.
- Potential licensees cannot be regarded as unwilling merely because they challenge the validity, infringement or essentiality of a SEP.

53. Evidently, it will be ultimately for the Court of Justice to decide these questions. Even if the Court were to decide along the lines of the opinion by AG Wathelet, this would not mean, however, that all issues surrounding FRAND and SEPs will be solved – there are still several issues that continue to be hotly debated, such as what FRAND actually means concretely (beyond not to seek injunctions against willing licensees), whether the rules must be applied patent-by-patent or to entire patent portfolios, or whether the activities of patent assertion entities possibly raise competition concerns.

54. In any future action, the Commission's goal will be to protect the benefits of standard-setting while minimising any anti-competitive risks.