



## Signs of Convergence between the US and Europe on Law and Policy relating to Standard Essential Patents?

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The Assistant Attorney General (AAG) for the Antitrust Division of the Department of Justice (DOJ) in a speech given on the 10<sup>th</sup> of November expressed an opinion which is indicative of a shift in the DOJ policy on various issues revolving around Standard Essential Patents (SEPs) that have been committed to licensing on Fair Reasonable and Non-Discriminatory (FRAND) terms. The opinion signals a move from what has been considered a perspective bias in favour of implementers towards a more balanced consideration of both patent holder and implementer interests.

The AAG's speech was delivered not long before the much-anticipated European Commission Communication on the EU approach to SEPs (Communication).<sup>2</sup> The Communication, which was published on the 29<sup>th</sup> of November, is notably devoid of previous Commission statements raising broad concerns about potential abuses by essential patent holders. The Communication has a rather neutral and less intrusive tone, one that advocates for a balanced framework that in line with the Court of Justice of the European Union (CJEU) decision in *Huawei v ZTE*.

### **The DOJ: Then and Now**

One of the main issues that was addressed in the speech and which has been a core subject of the DOJ's policy considerations is the perceived 'hold-up' problem. Put simply the hold-up theory postulates that, where there are incomplete contracts and one party has sunk costs in that contract, the other party has the incentive to opportunistically increase rents by threatening e.g. withholding delivery of goods. In the standardization context, this argument traditionally refers to where a patent holder, through the threat of exclusionary relief, force an implementer who has already heavily invested in the manufacture of allegedly infringing products to pay royalties above FRAND.<sup>3</sup> This situation is arguably worse in the standard setting context owing to the lock-in effect once a standard is adopted.

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<sup>2</sup> European Commission Communication setting out the EU approach to Standard Essential Patents (Brussels, 29.11.2017) (EC Communication)

<sup>3</sup> Mark Lemley & Carl Shapiro, 85 *Texas Law Rev.* 2007, pp. 1992 et seq.

The argument that hold-up is a widespread problem that should be addressed on a policy level has been discredited on many grounds, the main one being the lack of sufficient evidence to justify policy intervention.<sup>4</sup>

However, the biased perspective that favors a hold-up argument has as well been criticized for the failure to consider hold-out behavior on the part of implementers. Indeed, the hold-up theory equally applies to this situation as patent holders have sunk costs in R&D to develop technologies for standardization and, ex post are faced with the choice of agreeing an unfair price from implementers in the immediate or litigating against infringers over a number of years across a number of markets. The hold-out argument highlights the challenge of alleged infringers avoiding meaningful and good faith negotiations, choosing rather to apply delaying tactics that may lead a patent holder to accept royalties below FRAND.<sup>5</sup> Such hold-out behavior may be emboldened by weak Intellectual Property Right (IPR) protection, especially a low to zero chance of obtaining exclusionary relief even where the infringer has refused a FRAND offer.<sup>6</sup>

The DOJ's policy perspective had been one that considered the threat of hold-up as a problem which required policy intervention through the antitrust lens. The perceived hold-up problem has however always been couched in the conditional; in the context of a 'threat' or as something that a patent holder 'could' do once the patent is incorporated in a standard. No

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<sup>4</sup> See for instance Anne Layne-Farrar, Patent Holdup and Royalty Stacking Theory and Evidence: Where Do We Stand. After 15 Years of History?, OECD, [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD\(2014\)128&doclang=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2014)128&doclang=en); Gregory Sidak, 92 Minnesota Law Review 2008, pp. 714-748; Kirti Gupta and Mark Snyder, Smart Phone Litigation and Standard Essential Patents, Hoover Institution Working Group on Intellectual Property, Innovation, and Prosperity, 2014; Luke Froeb and Mikhael Shor, Innovators, Implementers and Two-sided Hold-up, 2015, <[http://www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/aug15\\_froeb\\_7\\_21f.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug15_froeb_7_21f.authcheckdam.pdf)>; Damien Geradin, Anne Layne-Farrar & Jorge Padilla, 14 Boston University Journal of Science & Technology Law 2008, p. 144.

<sup>5</sup> Heiden, Bowman and Petit, Nicolas, Patent 'Trespass' and the Royalty Gap: Exploring the Nature and Impact of Patent Holdout (4IP Council, 03/08/17). Available at: [http://www.4ipcouncil.com/application/files/3815/0644/6721/Patent\\_Trespass\\_and\\_the\\_Royalty\\_Gap\\_-\\_Full\\_Report.pdf](http://www.4ipcouncil.com/application/files/3815/0644/6721/Patent_Trespass_and_the_Royalty_Gap_-_Full_Report.pdf)

<sup>6</sup> Damien Geradin & Miguel Rato, 3 European Competition Journal 2007, pp. 101-161 ; Richard A. Epstein, F. Scott Kieff, & Daniel F. Spulber, 'The FTC, IP, and SSOs: Government Hold-Up Replacing Private Coordination' 8 Journal of Competition Law & Economics 1 (2012), 27; Joshua D. Wright, 'SSOs, FRAND, and Antitrust: Lessons from the Economics of Incomplete Contracts, George Mason Law Review Special Issue' 21 George Mason Law Review 791 (2014), 795; Egan, Edward J. and Teece, David J., 'Untangling the Patent Thicket Literature.' (2015) <http://www.bakerinstitute.org/research/untangling-patent-thicket-literature/>; Damien Geradin, 'Reverse Hold-Ups: The (Often Ignored) Risks Faced by Innovators in Standardized Areas in The Pros and Cons of Standard-Setting' Swedish Competition Authority, 2010; Unwired Planet International Ltd v Huawei Technologies Co. Ltd and ors [2017] EWHC 711 (pat), para 95; Anne Layne-Farrar, 'Why Patent Holdout is Not Just a Fancy Name for Plain Old Patent Infringement' (Competition Policy International, February 2016).

evidence has however been presented on how the ‘threat’ graduated to a problem that needed to be broadly addressed. The glaring lack of cogent evidence would argue for a cautious regulatory response.

In April of 2007 for instance, the DOJ and the Federal Trade Commission (FTC) issued a report addressing various issues on the intersection between antitrust and intellectual property rights. A whole chapter was devoted to addressing hold-up concerns within the standard setting context. Reading through the chapter indeed points out to hold-up merely as a threat or as a potential course of action on the part of the patent holder. The various proposals addressed in the report were also presented from the point of view of mitigating the ‘potential’ for hold-up especially in the standard setting context owing to the lock-in effect.<sup>7</sup>

Referring to this report, Deputy AAG Hesse of the Antitrust Division of the DOJ reiterated the DOJ’s position in October 2012 at a patent roundtable organized by the International Telecommunication Union’s telecommunications standardization sector (ITU-T).<sup>8</sup> Specifically, the Deputy AAG pointed out various policy choices that Standard Setting Organizations (SSOs) could implement which included placing, “...some limitations on the right of the patent holder who has made a F/RAND licensing commitment who seeks to exclude a willing and able licensee from the market through an injunction.” The Deputy AAG opined that a patent holder who has made a FRAND commitment impliedly agrees to grant a license to any licensee who is willing and able to comply with the licensing terms. The patent holder’s access to exclusionary relief should therefore be limited to cases where the implementer expresses unwillingness to submit to a neutral third-party FRAND determination or to be bound by such a determination. No consideration was given for what exactly would constitute unwillingness, especially in a situation where access to injunctive relief is constrained.

Subsequently, in January 2013, the DOJ and the United States Patent and Trademark Office (USPTO) issued a policy statement in respect of remedies for FRAND encumbered standard

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<sup>7</sup> United States Department Of Justice and United States Federal Trade Commission, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (April 2007), available at: <https://www.ftc.gov/sites/default/files/documents/reports/antitrust-enforcement-and-intellectual-property-rights-promoting-innovation-and-competition-report.s.department-justice-and-federal-trade-commission/p040101promotinginnovationandcompetitionrpt0704.pdf>.

<sup>8</sup> Department of Justice, Six “Small” Proposals for SSOs Before Lunch (October 2012) available at: <https://www.justice.gov/atr/file/518951/download>.

essential patents.<sup>9</sup> The position taken was that as a result of the market power that a holder of a standard-essential patent may obtain, there is potential for barriers to market entry for competitors as well as unreasonable royalties as a result of hold-up.<sup>10</sup> The view was taken that a patent holder's FRAND commitments may render the choice of an injunction or an exclusion order as inconsistent with public interest.<sup>11</sup> The policy statement however recognized limited instances where exclusionary relief may be appropriate where a FRAND Commitment has been made. It was highlighted for instance that where:

*'the putative licensee is unable or refuses to take a F/RAND license and is acting outside the scope of the patent holder's commitment to license on F/RAND terms. For example, if a putative licensee refuses to pay what has been determined to be a F/RAND royalty, or refuses to engage in a negotiation to determine F/RAND terms... Such a refusal could take the form of a constructive refusal to negotiate, such as by insisting on terms clearly outside the bounds of what could reasonably be considered to be F/RAND terms in an attempt to evade the putative licensee's obligation to fairly compensate the patent holder...'*<sup>12</sup>

The policy statement therefore recognized the danger of implementers adopting a hold-out position. However, in November 2013, the Deputy AAG again gave a speech that set a largely one-sided tone on the threat of hold-up and its potential to reduce the benefits of standard setting. The Deputy AAG reiterated the position taken in the policy statement that exclusion orders in the SEP-FRAND context, except in limited circumstances, are not in the public interest. The Deputy AAG further expressed the view that exclusionary relief tips the bargaining power in the patent holder's favor and that a FRAND commitment is an acknowledgement on the part of the patent holder that money damages, rather than exclusionary relief, are an appropriate remedy in most cases. Exclusionary relief for FRAND committed SEPs should therefore be rare. This view further set the tone advocating for constrained access to exclusionary relief.

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<sup>9</sup> United States Department Of Justice and United States Patent & Trademark Office: Policy Statement on Remedies for Standards-Essential Patents subject to voluntary F/RAND commitments 2013, available at: <http://www.justice.gov/sites/default/files/atr/legacy/2014/09/18/290994.pdf>.

<sup>10</sup> Ibid. The USPTO and the DOJ further state that this hold-up problem may cause a potential implementer not to effectively support a standard or that excessive royalties may be passed on to consumers as higher prices.

<sup>11</sup> Ibid. p. 6. The DOJ and USPTO however point out that there are instances where an exclusion order may be relevant. For instance, the conduct of a prospective licensee in respect of the FRAND license or commitments may influence the availability of the remedy.

<sup>12</sup> Ibid. p. 7.

Subsequently, in a March 2014 speech commemorating one year of the DOJ-USPTO policy statement, the Deputy AAG again reiterated the policy position that exclusionary relief may, except in limited circumstances, be denied in order to protect the public interest. The Deputy AAG in this speech however recognised the mutuality of the obligations of a licensor and a licensee and the need to ensure that innovators have the incentive to invest in R&D. The Deputy AAG in exploring a ‘constructive refusal to negotiate’ took the view that licensees do indeed have an obligation to engage in good faith negotiations while concluding a FRAND agreement. She acknowledged the need to ensure innovators have incentives to invest in R&D and to participate in standardization.

On September 2014, the Institute of Electrical and Electronics Engineers (IEEE)<sup>13</sup> wrote a business review request letter<sup>14</sup> to the DOJ in order to ascertain the DOJ’s enforcement intentions in respect of various contemplated policy changes to the IEEE’s approach to SEP-FRAND issues. The implementer-friendly IEEE policy proposals required component level licensing and valuation as well as severely limiting the right of SEP holders to access exclusionary relief.<sup>15</sup> The DOJ’s response in its business review letter was practically an endorsement of the IEEE policy proposals. The Deputy AAG again chose to focus on the danger of hold-up as well as citing the need to ensure access to technology and elimination of potentially anti-competitive behaviour.<sup>16</sup>

### **AAG Delrahim’s speech: Protecting Incentives to Innovate**

Given the hitherto one-sided focus of the DOJ, the AAG’s 10<sup>th</sup> November speech has been well received by proponents of a balanced consideration of innovator and implementer interests and has even been termed as a ‘long-awaited and much needed course-correction’.<sup>17</sup>

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<sup>13</sup> The IEEE is a US-based Standard Setting Organisation.

<sup>14</sup> The DOJ’s business review procedure enables industry participants to receive guidance from the DOJ especially in respect of the DOJ’s enforcement intentions in respect of prospective business conduct. See <https://www.justice.gov/atr/what-business-review>.

<sup>15</sup> IEEE Request for Business Review Letter (September 2014) available at: <https://www.justice.gov/sites/default/files/atr/legacy/2015/02/17/311483.pdf>.

<sup>16</sup> DOJ Response to IEEE Business Review Request letter (February 2015) available at: <https://www.justice.gov/atr/response-institute-electrical-and-electronics-engineers-incorporated>.

<sup>17</sup> Ginsburg, Douglas H. and Wong-Ervin, Koren W., The Department of Justice’s Long-Awaited and Much Needed Course-Correction on FRAND-Assured Standard-Essential Patents (November 18, 2017). Competition Policy International, forthcoming November 2017, available at SSRN: <https://www.competitionpolicyinternational.com/the-department-of-justices-long-awaited-and-much-needed-course-correction-on-frand-assured-standard-essential-patents/>.

On the need for balancing of both innovator and implementer interests, the AAG noted the need for antitrust enforcers to eliminate innovator uncertainties on the ability to exploit their IPRs owing to the negative impact that such uncertainties have on innovation incentives. The AAG highlighted the concern that enforcers have been very accommodating of implementers at the risk of undermining innovator incentives.

Regarding hold-up and hold-out debate, the AAG's position is that hold-out is indeed a more serious risk and a greater impediment to innovation. Noting that hold-up and hold-out are not symmetric, he drew attention to the fact that innovators engage in investment before knowing the viability of the investment. Implementers on the other hand have the advantage of investing at a point where royalties are largely determinable.

Again, touching on the imbalanced focus on the hold-up problem and the need to ensure innovators have incentives to innovate, the AAG noted that antitrust policy has been too concerned with hold-up at the risk of undermining the huge investment and risk on the part of innovators in their quest to be included in a standard. He expressed concern over the serious threat to the innovative process posed by policy proposals focusing one-sidedly on hold-up.

On the increasingly intrusive and unnecessary role that antitrust enforcers have played in the SEP-FRAND debate, the AAG opined that violations of FRAND commitments are best dealt with by the Standard Setting Organizations (SSOs) and their participants. The policing of these commitments by antitrust enforcers is a misuse of antitrust law. He highlighted the contractual nature of FRAND commitments in respect of which common law and statute provide for adequate remedies and that antitrust is not necessarily the appropriate remedy. The AAG further made a case for the *per se* legality of a patent holder's unilateral refusal to license a valid patent, arguing that,

*“A patent holder cannot violate the antitrust laws by properly exercising the rights patents confer, such as seeking an injunction or refusing to license such a patent...”*

In what can be regarded as a review of the DOJ's endorsement of the IEEE policy proposals and specifically recognising the risk of collusive behaviour between SSOs and implementers, the AAG stated that,

*“The Antitrust Division will therefore be skeptical of rules that SSOs impose that appear designed specifically to shift bargaining leverage from IP creators to implementers, or vice versa. SSO rules purporting to clarify the meaning of “reasonable and non-discriminatory”*

*that skew the bargain in the direction of implementers warrant a close look to determine whether they are the product of collusive behavior within the SSO.*

Regarding the SSPPU rule, the AAG stated that there may be a need to scrutinize the push by implementers to have it as the exclusive determinant of royalties. On the issue of access to exclusionary relief cautioned against rules that deprive a patent holder of their fundamental right to exclude as they undermine innovation incentives and exacerbate the hold-out problem.

### **Converging Trends?**

The AAG's speech reflects a recognition of the danger posed by considerations skewed in favour of one side of the innovator-implementer equation as well as an unnecessarily intrusive role played by antitrust authorities. A preservation of the incentives to innovate is regarded as central to the preservation of the patent ecosystem. The DOJ understands the need for balance and the avoidance of proposals that will destroy the proper functioning of this ecosystem.

What is telling are the similarities on approach between AAG Delrahim and the approach of the CJEU in the ruling of *Huawei v ZTE*, a case that concerned the conditions under which an injunction could be sought for infringement of a SEP. However, the CJEU's balanced approach and understanding of the rule of law is notable.

Briefly, the *Huawei v ZTE* decision arose from a reference by the Düsseldorf District Court seeking clarification from the CJEU on the rights and obligations of a SEP holder who has made a FRAND commitment and an implementer. The District Court primarily sought to reconcile two conflicting positions; the position of the Commission which seemingly favoured implementers and the perceived patentee-friendly position of the German Supreme Court in the *Orange Book Standard* decision.<sup>18</sup> The Commission's position pushed for a denial of injunctive relief where a SEP holder has made a FRAND commitment and the infringer shows willingness to enter a license. According to the Commission, threatening or seeking an injunction in such a situation could lead to abuse of dominance.<sup>19</sup> however, the concept of a willing licensee was however left largely undefined and for the SEP holder to

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<sup>18</sup> Cf. Jacob, Robin and Milner Alexander, Lessons from Huawei v. ZTE, October 2016, 4iP Council, available at [http://www.4ipcouncil.com/download\\_file/view\\_inline/182](http://www.4ipcouncil.com/download_file/view_inline/182)

<sup>19</sup> Brussels, 6 May 2013 Antitrust: Commission sends Statement of Objections to Motorola Mobility on potential misuse of mobile phone standard-essential patents- Questions and Answers, European Commission Press Release Database MEMO/13/403

establish. The German Supreme Court on the other hand was of the view that an implementer seeking to rely on a FRAND defense should: (i) make an unconditional offer which the SEP holder cannot refuse without acting discriminatively or inequitably impeding the implementer; and (ii) acting like an actual licensee by complying with the requirements of the putative license through the payment or guarantee of payment of the licensing fees. The implementer was additionally required to render accounts of his use as well as meeting the payment obligations resulting from the accounts by depositing ‘sufficient’ royalties.<sup>20</sup>

However, rather than see the case in the context of *exploitative* concerns that run at the heart of the hold-up theory, the CJEU focused on the risk of *exclusion* of a competitor. It is notable that this is consistent with US antitrust law that does not view high prices as an antitrust harm and is rather concerned with exclusionary abuses. One might assume that the CJEU therefore was not persuaded by the need to impose constrictions on a patent holder based on hold-up. More importantly, the CJEU set out a process whereby both parties have obligations to fulfil and that, if followed hold-up nor hold-out can occur, ensuring a balanced approach.

The CJEU also stated clearly that a voluntary commitment to license essential patents on fair, reasonable and non-discriminatory terms did not affect the nature of the patent and, as such, the right of access to justice and seek and appropriate remedy was a fundamental right.

The CJEU noted that the legitimate expectation created by the FRAND commitment meant that an implementer could expect a FRAND license, but it is clear that this expectation is based on the nature of the specific commitment given; as the SSO IPR policy will set out e.g. if essential patents should be royalty free or royalty-bearing. In this context one can surmise that the CJEU was well aware of the contractual nature of the commitment. And this logic is backed up by the fact that the Court left the factual and legal issues for national courts, usually patent courts, to adjudicate. Antitrust law is essentially removed from the picture and only becomes relevant as a defence to be raised before the national court in order to defeat an inappropriate request for an injunction. The AAG is therefore in good company.

The approach of the CJEU is now reflected in its Communication. Though not legally binding and therefore devoid of mandatory obligations, the Communication is expected to influence Europe’s SEP-FRAND landscape going forward.

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<sup>20</sup> Bundesgerichtshof (BGH) of 6 May 2009, KZR 39/06, 2009 GRUR 964 – Orange-Book-Standard = 41 IIC 352 (2010)

The Commission highlights the need for a *clear, balanced and reasonable* EU policy for SEPs. The Communication focuses on four main areas: transparency on SEP exposure, valuation of SEPs and the definition of FRAND, enforcement of SEPs and the role of open source in standardization.

Most of the attention and intense debate was focused on how the Communication would address principles for SEP FRAND licensing terms, more so on the effect this would have on the innovator-implementer equation. From the onset the Commission advocates for a less intrusive role, pointing out that the negotiating parties are best placed to determine FRAND terms through good faith negotiations. Parallels can be drawn to AAG Delrahim's assertion of the contractual nature of FRAND commitments and the unnecessary nature of antitrust intervention and indeed the Opinion to the CJEU of Advocate General Wathelet that AG competition law might not be the best body of law to address issues relating to the exercise of essential patents.<sup>21</sup>

The Commission carefully avoids a broad strokes approach, specifying that there is no one-size-fits-all to FRAND determination noting that it differs from sector to sector and over time. The valuation principles espoused by the Commission also reflect a very cautious approach that seeks to avoid veering to either side of the innovator-implementer equation. However, the Communication predicates this by a sophisticated recognition of the incentives to innovate, that underpins AAG Delrahim's speech. The Communication notes variously that adequate return must also reward R&D investments, must incentivise such technology developers to offer their best technologies for inclusion in standards, must incentivise them to continue to invest in R&D and standardisation activities.

Regarding the enforcement environment for SEPs, the Commission also highlighted the need to ensure a balance between the ability of patent holders to enforce their rights against infringers unwilling to conclude licenses on FRAND terms (including ensuring that remedies and damages also have a deterrent effect) and the protection of good-faith implementers from being forced to accept non-FRAND terms on the basis of injunction risk.

Developments in Europe and the US point to a growing appreciation of the delicate balance and a desire to step away from hard intervention. Both the Commission's Communication and the AAG's speech point to convergence of approaches around the need for a less

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<sup>21</sup> EC Communication para 2; Advocate Wathelet's opinion in Huawei Technologies Co. Ltd v. ZTE Corp., ZTE Deutschland GmbH, ECLI:EU:C:2014:2391, paras 9-11.

intrusive role in the regulation of FRAND licensing, encouraging balance between innovators and implementers and ensuring incentives for innovation are preserved.