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FRAND Licensing Levels Under EU Law

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Summary

The Internet of Things will see 5G and other interoperability standards deliver a new wave of digitisation to many industries. Automotive, health, home appliances, industrial robots, defence industries and many more will be connected to the internet and have products communicating with each other. In this changed environment the proper licensing framework of standard essential patents (SEPs) and the meaning of commitments taken by SEP owners at the request of Standard Setting Organisations (SSOs) to license their SEPs on fair, reasonable and non-discriminatory (FRAND) terms will grow even more important.

The question at which point to license in the production chain is becoming topical in the IoT debate. On the one hand, current industry practice is for SEP owners to choose at which level of the production chain to license, which is usually the end-product device (“**access to all**” or **ATA**). ATA has been justified by arguments that functionality of the standard is realised in end-product devices, as well as on efficiency grounds: i) transaction costs savings in negotiating with one group of licensees; ii) the ease of monitoring and compliance with royalty payments and use of products; iii) the possibility to obtain mutual cross-licenses and iv) to ensure non-discrimination between similarly situated licensees. Under ATA approach, SEP holders exercise their patent rights by choosing the level of the supply chain at which they want to conclude licenses, and firms located elsewhere in the value chain indirectly benefit having access to standard without the need to directly obtain a license. On the other hand, there are arguments that SEP owners must license at all levels of the value chain to any company that requests a license (“**license to all**” or **LTA**). LTA approach considers that components (such as baseband chip) best reflect the value of a standardised technology and, therefore, that licences should be concluded with component manufacturers, or some other intermediate supplier. Basing royalties on end-products has been likened by some to a “tax on innovation” that inappropriately overcompensates SEP holders for the value of multiple inventions and components unrelated to the standardised technology.

The paper provides doctrinal analysis about what value chain licensing requirement the FRAND commitment actually does impose under EU law. Most of the existing literature on LTA v ATA is focused on *normative* arguments, while there is no comprehensive legal survey of the actual requirements imposed by a FRAND commitment under European and national law.

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We look at various sources of law that may impact the obligation SEP owners to license at different points in the value chain:

- **General principles of EU law**

Legitimate expectations

In *Huawei v ZTE* the CJEU held that FRAND terms “create legitimate expectation on the part of third parties” that such licenses will be given. We examine the argument that this reference to general principles of legitimate expectations be interpreted as imposing an LTA obligation.

Upon closer reading of the case we find that the court does not interpret FRAND as a specific price level, but conveys a procedural understanding of FRAND that arises out of good faith negotiations. Importantly, under pre-existing case-law on legitimate expectations only “precise, unconditional and consistent information” can lead third parties to entertain legitimate expectations. However, third parties’ expectations will very much depend, in each case, on the content of the specific FRAND commitment given to the specific SSO in question, which in turn depends on the latter’s specific IPR policy (no one size fits all). Finally, to date the EU principle of legitimate expectations has applied exclusively to vertical relations between the State and economic agents. Its introduction in the context of horizontal licensing practices between SEP owners and implementers would be unprecedented and *Huawei v ZTE* does not cite any other case law in support of such reading.

Non-discrimination

We further examine whether general principle of non-discrimination under EU can be applied. An argument could be made that by refusing to license, certain SEP owners make a discrimination based on the position in the value chain. However, we find that the EU principle of non-discrimination would be difficult to apply in this horizontal setting. Moreover, in *Huawei v ZTE*, the CJEU implicitly admitted that the SEP holder enjoyed the possibility to differentiate FRAND terms across levels of production. It held that the patent holder’s obligation to equal treatment only applies to the licensee and its “competitors”, that is players located at the same level in the value chain and in the same product and geographic market.

- **Patent Law**

Under basic principles of patent law only those who infringe patent claims need to take a licence and then only if the patent holder so requires. Therefore, from a patent law perspective, the first step is to analyse the claims of SEPs. We looked at publicly available analysis and information on litigated cases where SEPs have been found to be valid and infringed.

We found that SEPs typically claim combination of components and whole networks, which means that SEPs cannot be subsumed to only to one component – i.e.

a chip. Therefore, under patent law, implementers could potentially request a license only for a subset of SEPs that read on components. However, under patent law, they would not have an active right to force licensing, as patent law permits patent owners to choose whether they want to enforce their patents (or not).

A doctrine of patent exhaustion prevents licensing across multiple production levels – since the same patent can be licensed only once. Accepting LTA approach would lead to portfolio splitting – some SEPs that claim components would be licensed by component makers, while other SEPs that have wider claims would continue to be licensed by end-device manufacturers. ATA effectively resolves this by licensing only at a single point in the supply chain.

- **Contract Law**

FRAND commitments given to various SSOs are widely recognised as being of contractual nature. Therefore, whether a FRAND commitment imposes a LTA duty depends on the particulars of that specific commitment given to a specific SSO. We analyse in depth ETIS's FRAND commitment, which is governed by French law, as well as commitments given to other prominent SSOs.

ETSI's FRAND commitment

ETIS's FRAND commitment applies to "equipment" defined as "any system, or device fully conforming to a standard". Thus, the core question is whether the word "equipment" covers all types of devices, or only end-user devices. Under French law, a contract should be interpreted in accordance with the parties' intention when entering the contract, but when the intention cannot be discerned, then interpretation should be carried out in accordance with what a reasonable person placed in the same situation would have given to the disputed terms.

In the literature, there are different accounts on the intention of the parties at the time of the adoption of the initial ETSI's IPR Policy. However, elements that are posterior to the conclusion of the contract, such as behaviour of the parties, can be used to shed light on parties' intention. The fact that ETSI has apparently resisted proposals to modify its IPR Policy in order to explicitly endorse the LTA approach would suggest that the initial intention of ETSI members was indeed to grant licenses only at the end-device level.

Moreover, a reasonable person would probably pay attention to the fact that ETSI IPR Policy uses the word "device", and avoids words such as "element", "component", "part", or "unit". Also at the time when the ETSI IPR Policy was adopted, the common practice in the telecom industry was to grant licenses at the end-user device level, and not at the component level. It can therefore be assumed that, absent a clear indication that the ETSI IPR Policy intended to depart from this practice, a reasonable person familiar with the industry would have interpreted the Policy as simply confirming this practice, and thus seeking only to guarantee licensing at the end-device level.

Other SSOs

We analyse FRAND commitments given at other SSOs and find that they typically come in two variants.

The first category is to directly and clearly impose an LTA obligation, as is the case with IEEE's IPR Policy that defines "Compliant Implementation" as "any product (e.g., component, sub-assembly, or end-product) or service that conforms to any ... IEEE standard". Such wording leaves no doubt that SEP owners are under a contractual duty to license to any company in the supply chain that so requests.

The second, and most common, category of SSOs require licences to be available to "unrestricted number of applicants" or to "all applicants." (such as ITU-T, ISO and IEC). However, who can be considered as an "applicant" is often not clearly defined and it is unclear whether LTA duty can be imposed by such contractual wording. In our view, it would be wrong to impose a wide LTA obligation in case of unclear contractual interpretation because: i) SSOs could change their policies to clearly provide for LTA obligation as IEEE did; ii) the wide industry practice in case of SEPs appears to be licensing at downstream level, and iii) SEPs have wide claims that are not necessarily implemented in one single chip.

- **Competition Law**

Abuse of dominant position

Finally, we look at whether EU competition might impose a LTA duty to SEP owners. We first analyse whether refusal to license to component makers might represent an abuse of dominant position under Article 102 TFEU and doctrines established by CJEU in *Magill*, *IMS Health* and *Microsoft*. We find the abusive refusal to license doctrine inapplicable in cases where the SEP holder adopts a policy of licensing at the end-device level, and thus indirectly licensing component makers.

This is because licensing directly to component makers is not indispensable for carrying on their activities. It is important to stress that refusal to grant a license does not mean denying access to the standard. Component makers and other producers situated upstream will normally be protected by "have made" rights resulting from the licenses granted to the end-device producers to which they sell their products. And if this is not the case, SEP owners cannot seek an injunction against them without first offering them a licence, according to the rule set by the CJEU in *Huawei v ZTE*. It should also be added that, in practice, SEP licensing agreement are often concluded *after* companies have started bringing a product to the market, and not all SEP holders are able to license and/or willing to sue, owing to transaction costs of both licensing and litigation.

An abusive refusal to license would require an extreme set of facts: a SEP holder refuses to license all and any third party, and reserves for itself the manufacture of standard-compliant products. This has never happened in practice. And for good

reasons. Given the repeated nature of standard setting, a SEP holder of this kind would likely be punished by exclusion from most standardisation organisations.

Horizontal Cooperation Guidelines (Article 101 TFEU)

Finally, a possible policy argument for LTA could be para 285 of the European Commission's Guidelines on Horizontal Cooperation Agreements (HCG) which provides that "in order to ensure effective access to the standard, the IPR policy would need to require participants wishing to have their IPR included in the standard to provide an irrevocable commitment in writing to offer to license their essential IPR to *all third parties* on fair, reasonable and non-discriminatory terms."

However, a careful examination of the scope, letter and spirit of the HCG calls into question that idea. First, the HCG do not prescribe an antitrust obligation. They provide a safe harbour whereby specific competitor's agreements can be deemed presumptively lawful, but there is no antitrust presumption of liability outside of that safe harbour.

Additionally, the term "all third parties" is not further defined. As seen, however, SEPs have wide claims covering end-devices, networks and combination of components. Therefore, this question will often be industry and depend from industry to industry.

Finally, the goal of the HCG is to ensure effective *access* to the standard, which is mentioned throughout the text, and not to set an LTA duty. For instance, paragraph 283 of the HCG provides that "the standard-setting organisation's rules would need to ensure effective access to the standard on fair, reasonable and non-discriminatory terms". Then in paragraph 287 the HCG continue to explain that FRAND commitments "are designed to ensure that essential IPR protected technology incorporated in a standard is *accessible* to the users of that standard..." Finally, the assessment of whether the SSO IPR policies restrict competition will focus on "access to the standard".

In conclusion, we demonstrate that EU law (general principles, patent, contract and competition law) does not require LTA from SEP owners. An LTA duty may exceptionally exist only if a specific SSO IPR Policy expressly requires so.

What the EU law requires is access to the standard. Access to the standard can be achieved in various ways: i) by having a direct license; ii) by indirectly benefiting from a license by selling components to licensed end-device manufacturers; iii) by concluding non-assertion agreements; iv) or not having a license at all if the patent owner does not monetize patents and does not have licensing program

SEP owners, if they decide to monetise their patents, should adopt a licensing strategy and choose the level of the production chain at which to license. Patent exhaustion doctrine prevents licensing the same patents further downstream, while upstream manufacturers are be protected by "have made" rights.