

Client Alert

FRAND Licensing of Standard Essential Patents – Judicial Guidance on How to Deal with Hold-Out Tactics

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Owners of standard essential patents (“SEP”) regularly see themselves considerably limited in their permitted scope of action vis-à-vis potential licensees (so-called implementers). The obligation to grant and agree on licenses on fair, reasonable and non-discriminatory (“FRAND”) terms often paves the way for hold-out tactics by implementers aiming at delaying the negotiations until the patent has expired (so-called patent “hold-out” or “reverse patent hold-up”). There has been limited and sometimes inconsistent guidance by courts on how to deal with hold-out tactics without running the risk of infringing applicable antitrust laws.

The German Federal Court of Justice (Bundesgerichtshof, “FCJ”) recently issued an important decision providing helpful practical guidance for SEP holders on how to deal with hold-out tactics by implementers.¹ This client alert provides an overview of the FCJ’s decision, assesses its potential impact on patent and non-patent licensing disputes and compares the German situation to the current US landscape for FRAND licensing.

¹ Federal Court of Justice, decision dated 5 May 2020, KZR 36/17.

I. Germany

The FCJ's ruling came in a licensing dispute between Sisvel, a patent licensing company based in Luxembourg, and Haier, a Chinese consumer electronics manufacturer offering, among other products, mobile phones and tablets. Sisvel had accused Haier of infringing its SEP relating to the general packet radio service ("**GPRS**") wireless communication standard. The licensing dispute concerned the questions of (i) which party bears the burden of establishing a license on FRAND terms, (ii) how the SEP holder is expected to behave to avoid accusations of abusing its obligation to grant a license on FRAND terms, and (iii) how the implementer is expected to behave to avoid accusations of using delay tactics to stall licensing negotiations.

Against this background, the FCJ

- confirmed its previous case law that an SEP holder typically enjoys a dominant position on the respective licensing market since an SEP implies that it is technically impossible to circumvent the SEP without losing important functions for the product market and the SEP cannot be substituted by a different technical design of the product;
- held that the application by an SEP holder for injunction, recall and removal or destruction of products can be abusive if
 - the implementer has made the SEP holder an unconditional offer to conclude a license agreement on FRAND terms; or
 - the SEP holder has not made sufficient efforts to enable the implementer who is in principle willing to license to conclude a license agreement on reasonable terms;
- however, also held that an SEP holder will not be found to have abused its obligation to grant a license on FRAND terms if the implementer merely declares that it is willing to consider entering into a license agreement or to enter into negotiations as to whether and under what conditions the conclusion of a license agreement is possible without
 - clearly and unequivocally declaring a willingness to conclude a license agreement on FRAND terms, and
 - participating in the license agreement negotiations in a targeted and timely manner.

In its ruling, the FCJ for the first time applied and interpreted the European Court of Justice's ("**ECJ**") decision in the case *Huawei vs. ZTE*² and held that the procedural standards of demonstration and proof in German civil proceedings also apply to the parties' out-of-court obligations when it comes to FRAND negotiations. In particular, the SEP holder bears a secondary burden of proof (*sekundäre Beweislast*) to explain and justify the licensing conditions including the basis for calculating the license fees. According to the FCJ, before accepting the license conditions the implementer must be able to verify whether the licensing conditions are indeed on FRAND terms.

As a result, the FCJ provides helpful practical guidance and sets out that SEP holders and implementers will in future have to engage in the following "ping-pong game" to preserve their respective rights:

1. In a first step, SEP holders must notify implementers of the alleged infringement unless the implementers are already aware that by implementing a technical solution required by the standard, they are unlawfully making use of the teaching of the patent in suit. While this notification may be done via so-called "claim charts", this is not necessary for a valid notification. Instead, it is sufficient for SEP holders to identify the respective patent and to explain the nature of the respective infringing act and the challenged embodiments.
2. In response to such notification, implementers must clearly and unequivocally declare that they wish to take a FRAND license on whatever terms are found to be FRAND. They do not, however, have to make an unconditional offer themselves if they are not easily in a position to

² European Court of Justice, decision dated 16 July 2015, C-170/13 – Huawei Technologies Co. Ltd. / ZTE Corp. ZTE Deutschland GmbH.

formulate FRAND terms on their own.

3. SEP holders must then make an offer for licensing terms that they consider to be FRAND. This offer must be accompanied by an explanation and justification in order to enable the implementer to evaluate whether the proposed license terms of the SEP holders are indeed on FRAND terms.
4. Finally, implementers must actively participate in the license agreement negotiations in a targeted manner. Instead of merely disagreeing with the SEP holder's offer and contesting its FRAND nature, the implementer must specify exactly which elements are not deemed FRAND and make a counteroffer within a reasonable period of time. In addition, implementers may not stall the licensing negotiations just because the SEP holder may only offer global portfolio licenses³ or different rates to competing licensees.⁴

II. US

In the US, there has been an evolution in the Federal Trade Commission's ("FTC") and the Antitrust Division of the Department of Justice's ("DOJ") approach to FRAND hold-out and hold-up issues:

- During the prior US administration, the FTC and DOJ focused their attention on scenarios in which the SEP holders declined to license their technology to implementers in order to extract a higher licensing fee (known as a patent hold-up). The agencies viewed hold-up as an antitrust concern and initiated enforcement actions to (1) require the disclosure of a company's patent rights to relevant standard setting organizations ("SSO") prior to adopting that technology as a standard,⁵ (2) require SEP successors in interest to honor licensing commitments made by their predecessors,⁶ and (3) prohibit the use of injunctive remedies against implementers willing to take a license on FRAND terms.⁷
- However, under the Trump administration, the Antitrust Division of the DOJ has shifted its enforcement focus to patent hold-outs by implementers⁸ and supports the ability of SEP holders to employ injunctive relief against infringers in appropriate cases.⁹ And in a novel

³ SEP holders may offer global portfolio licenses if such bundling does not oblige the licensee to make payments for the use of non-essential patents, and the license fee is calculated in a way that licensees who wish to develop a product for a specific, geographically limited area are not disadvantaged.

⁴ SEP holders may accept inadequate licensing terms, e.g. lower license fees, as a result of their negotiations with one licensee without being liable for discriminating other competing licensees if such acceptance is nevertheless economically reasonable for them in view of the lack of realistic possibilities for judicial enforcement of their claims vis-à-vis this licensee and the threat of personal or other economic disadvantages of public authorities.

⁵ *Dell Computer Corp.*, 121 F.T.C. 616 (1996).

⁶ *Negotiated Data Solutions LLC*, Dkt. No. C04234 (FTC Sept. 22, 2008) (decision and order), available at <http://www.ftc.gov/news-events/press-releases/2008/01/ftc-challenges-patent-holders-refusal-meet-commitment-license>.

⁷ Compl., *Robert Bosch GmbH*, No. C-4377, available at <http://www.ftc.gov/os/caselist/1210081/121126boschmpt.pdf>. The DOJ's prior position is summarized in their 2013 joint statement with the US Patent and Trademark Office. *Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments*, U.S. Dep't of Just., U.S. PAT. AND TRADEMARK OFF. (Jan. 8, 2013), available at <https://www.justice.gov/atr/page/file/1118381/download>.

⁸ "In recent years, many have expressed a one-sided focus on the so-called problem of patent 'hold up' by owners of patents incorporated into technology standards, while overlooking the arguably more problematic concern of patent 'hold out' that occurs when licensees refuse to compensate patent holders who have already incurred significant up-front costs of innovation." Makan Delrahim, *Division Update Spring 2018*, DEP'T. OF JUST. (Apr. 11, 2018) <https://www.justice.gov/atr/division-operations/division-update-spring-2018/message-assistant-attorney-general>.

⁹ "All remedies available under national law, including injunctive relief and adequate damages, should be available for infringement of standards-essential patents subject to a FRAND commitment, if the facts of a given case warrant them." *Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary FRAND*

development, the FTC and DOJ recently diverged on the question of whether US antitrust law requires SEP holders to license their technology to competitors at all. In *FTC v. Qualcomm Inc.*,¹⁰ the FTC argued, and the district court found, that SEP holders had an antitrust duty to license their technology to competitors. On appeal to the US Court of Appeals for the Ninth Circuit, the DOJ entered a statement of interest in favor of Qualcomm, the SEP holder, arguing that the district court's judgment should be stayed because the FTC and district court incorrectly applied the law. The district court's order granting injunctive relief has been stayed pending appeal, and the court of appeals has not yet issued its opinion on the merits. Because US antitrust laws generally do not impose a duty to deal upon parties¹¹ many commentators expect this aspect of the *Qualcomm* decision will be reversed by the Ninth Circuit.¹²

Despite these differences between the US federal enforcement agencies, decisions by US courts provide guidance for SEP holders in license negotiations:

1. SEP holders should engage in good-faith license negotiations with prospective licensees. The FTC also has initiated investigations into, and secured consent orders from, SEP holders who did not negotiate in good faith¹³. Although the FTC and DOJ currently disagree over whether an SEP holder's refusal to grant a license to a willing licensee may constitute an antitrust violation, a change in administration after the November 2020 US presidential election may result in the DOJ reverting to its prior view. Furthermore, an SEP holder who refuses to grant a license to a willing licensee may still be liable contractually for a violation of the SEP holder's FRAND commitments.¹⁴
2. SEP holders who negotiate in good faith may seek injunctions to protect their patent rights if the negotiation fails. Some US courts have held that the *Noerr-Pennington* doctrine immunizes SEP holders from antitrust claims challenging their legitimate pursuit of injunctive relief to protect their FRAND-committed patents.¹⁵

III. Key Takeaways

1. In Germany, the FCJ's decision provides welcome practical guidance for SEP holders on how to deal with hold-out tactics by implementers. Given the legal clarity as well as the FCJ's explicit statement regarding the role of claim charts and its acknowledgement of SEP holders' right to grant global portfolio licenses (instead of country-specific rights to individual patents)

Commitments, USPTO (Dec. 19, 2019), available at <https://www.uspto.gov/sites/default/files/documents/SEP%20policy%20statement%20signed.pdf>.

¹⁰ 411 F.Supp.3d 658 (N.D. Cal. 2019).

¹¹ See *Verizon Commc'ns., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004) (“[A]s a general matter, the Sherman Act ‘does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.’”) (citing *U.S. v. Colgate & Co.*, 250 U.S. 300 (1919)).

¹² See, e.g., Scott Graham, *Ninth Circuit Sounds Ready to Trash Qualcomm Antitrust Ruling*, LAW.COM (Feb. 13, 2020) <https://www.law.com/therecorder/2020/02/13/ninth-circuit-sounds-ready-to-trash-qualcomm-antitrust-ruling/>; Kristen Osenga, *Analyzing Judge Koh's Errors in FTC v. Qualcomm: Highlights From Three Amicus Briefs*, IP WATCHDOG (Sept. 16, 2019) <https://www.ipwatchdog.com/2019/09/16/analyzing-judge-kohs-errors-ftc-v-qualcomm-highlights-three-amicus-briefs/id=113426/>.

¹³ *Negotiated Data Solutions LLC*, Dkt. No. C04234 (FTC Sept. 22, 2008) (decision and order); *Robert Bosch GmbH*, No. C-4377 (FTC April 23, 2013) (decision and order).

¹⁴ *Microsoft Corp. v. Motorola, Inc.*, 795 F.3d 1024 (9th Cir. 2015).

¹⁵ *TCL Commc'ns Tech. Holdings, Ltd. v. Telefonaktienbolaget LM Ericsson*, 2016 US Dist. LEXIS 140566 at *7-10 (C.D. Cal. 2016); *Apple Inc. v. Motorola Inc.*, 886 F. Supp. 2d 1061, 1079 (W.D. Wis. 2012). The *Noerr-Pennington* doctrine grants antitrust immunity to private parties legitimately petitioning the government for the redress of grievances. See *E.R.R. Presidents Conf. v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 143 (1961); *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965).

and ability to apply different rates to competing licensees (instead of uniform tariffs), this decision might well render Germany the venue of choice in Europe for patent owners in licensing disputes.

2. Beyond SEP disputes, it will be interesting to see whether the FCJ's adoption of procedural standards for demonstration and proof in civil proceedings will also apply to behavioral obligations in out-of-court FRAND negotiations and whether it will be applicable more broadly outside of the patent or IP context, e.g. in refusal to supply and essential facility cases. This could result in dominant suppliers having to substantiate their claims in refusal to supply cases but could also result in access seekers having to participate more actively in negotiations of terms and conditions regarding access to essential facilities.
3. In the US, although the FTC's and DOJ's views have diverged on the relative concerns raised by hold-outs versus hold-ups, US courts have generally been supportive of an SEP holders' right to bring an infringement action against hold-outs without a significant risk of antitrust liability. Two important events will occur before year end that are likely to affect the US antitrust landscape on licensing of SEPs. First, the Ninth Circuit's forthcoming decision in the *Qualcomm* appeal will provide important guidance on whether a refusal to license SEPs to competitors can trigger antitrust liability (we believe that the district court's opinion was wrongly-decided on this point and will be reversed).¹⁶ Second, the US election in November may reunite the FTC's and DOJ's current divergent positions on these issues.

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¹⁶ Graham, *supra* note [12]; Osenga, *supra* note [12].