

EUROPEAN COMMISSION CONSULTATION ON FRAND

Enforcement of Standard Essential Patents - current bottlenecks and possible solutions

19 May 2021

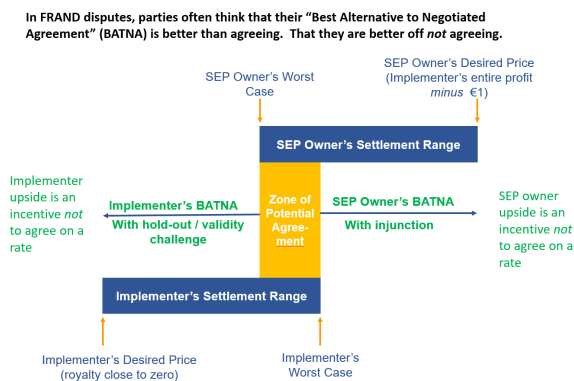
The EC should, and can, incentivise FRAND arbitration

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In FRAND negotiations, like in any negotiations, a key concept is your BATNA – Best Alternative to a Negotiated Agreement.¹

In current FRAND disputes, parties are often tempted to think that their BATNA is better than an agreement. That they are better off *not* agreeing.

This discourages efficient negotiated settlements without protracted litigation.



- Let's first check the BATNA of a SEP holder.
 - In principle, a SEP owner is entitled to the fair and reasonable value of their patents. This is the "incremental value *over the next best alternative*", before the standard was set." This is also called the "ex ante" value.²
 - Step 1 (determine value of the standard): Check, before the standard is set, (i) what alternative technical solution was available providing a similar feature or standard, and (ii) whether the SEPs improve the feature or standard so as to improve the implementers' overall profit.

¹ Roger Fisher and William Ury, "Getting to Yes: Negotiating Without Giving In", 1981. Summary [here](#)

² See, e.g., FTC Report "The Evolving IP Marketplace", March 2011, 23 ("Courts should cap the royalty at the incremental value of the patented technology over alternatives available at the time the standard was chosen.")

- If so, those whose IP contributes to that feature are entitled to a fair share of that additional profit (“incremental value”)
 - IP owners are not entitled to appropriate all of the incremental, because other IP owners and implementers add value too (and run risks as well).³ Consumers are entitled to a “fair share” also.⁴
- Step 2 (determine individual SEP owner’s contribution to the value of the standard): The various contributors then have to divide that fair share of the incremental profit amongst them, in accordance with the marginal value of their relative contributions.⁵
- **SEP owners know that if they get an injunction, or threaten with an injunction, they may be able to extract more than the FRAND royalty.** Let’s take a car example.
 - An injunction holds a penalty over the car maker’s head. One patent amongst many, reading on one component amongst many, can deprive the car maker of the entire revenue from a car model.
 - As is sometimes said “*it takes only one bullet [patent] to kill.*”⁶
 - And injunctions are quasi-automatically available in certain EU jurisdictions, even while invalidity proceedings are pending.”⁷
 - This is called an “ultimatum game” by behavioural economists.⁸ The car maker has an incentive to pay up a large share of the revenues from making

³ See, for instance, *In re Innovatio* and *Ericsson v D-Link*, p. 108 (“the patentee’s royalty must be premised on the value of the patented feature, not any value added by the standard’s adoption of the patented technology ... [so that] the royalty award is based on the incremental value that the patented invention adds to the product, not any value added by the standardisation of that technology.”) Cf. also *Microsoft 2004*, para. 1008: “terms imposed [must] be reasonable and non-discriminatory... in particular: ... (ii) ... remuneration should not reflect the “strategic value” stemming from ... market power...; (iii) ...restrictions should not create disincentives to compete ..., or unnecessarily restrain the ability of the beneficiaries to innovate; (iv) ... implementing the specifications will ...constitute a significant investment, which ... vendors will not incur if they have no assurance that the terms under which they can make use of the disclosed specifications will remain reasonably stable.” Confirmed on appeal by General Court (Case T-167/08 *Microsoft v EC*)

⁴ Article 101(3) TFEU.

⁵ The Shapley value is a way of fairly distributing both gains and costs to several actors working in coalition (like SEP owners working together to set a standard). See Shapley LS (1953b) A value for n-person games. In: Kuhn HW, Tucker AW (eds) *Contributions to the Theory of Games (AM-28)*, Volume II. Princeton University Press, pp. 31–40. For a simpler explanation, see [here](#)

⁶ Testimony by Samsung’s expert Prof. D. Teece in the *Motorola v Microsoft* (H.264 patents), cited [here](#).

⁷ See, for example, *Stierle*, *Der quasi-automatische Unterlassungsanspruch im deutschen Patentrecht*, GRUR 2019, 873; AIPPI, Klaus Haft et al., *Injunctions in cases of infringement of IPRs*, 10 May 2011, p. 8 (GRUR-Int. 2011, 927, available [here](#)).

⁸ See Dolmans, “A Tale of Two Tragedies – A plea for open standards”, (2010) 2 IFOSS L Rev 115, p. 6 and fn 48; Sidak, “What Makes FRAND Fair? The Just Price, Contract Formation, and the Division of Surplus from Voluntary Exchange”, in *The Criterion Journal on Innovation*, Vol. 4, 2019, p. 701.

the car.⁹ This *ex post* royalty is much more than the “ex ante incremental value” that is FRAND.

- Indeed, the cost of the injunction to the implementer is the same whether one SEP or 1,000 SEPS are valid and infringed. This demonstrates that the value of the injunction is unrelated to the value of the SEP portfolio.
- **The BATNA of a SEP owner is therefore often to litigate, seek an injunction, offer a high royalty**, thus threatening a high penalty while limiting risk by appearing to follow the sequence of the *Huawei/ZTE* case.
 - This is even easier now that German courts have started to deviate from the *Huawei/ZTE* case, and look at the implementer’s offer only.
- Now let’s check the BATNA of a SEP implementer.
 - **The implementer may have an incentive to challenge the validity or infringement of the patents at issue.**
 - They know that the SEP owner often has a large portfolio, and that the chances it does not infringe *any* of the patents is small.
 - But they also know that they *only* have to knock out the patents at issue, and that more than 50% of SEPs end up being invalid or not infringed.¹⁰
 - **So the BATNA of an implementer may therefore be to seek judgment for invalidity or non-infringement**, thus threatening long delays, while limiting risk by appearing to follow the sequence of the *Huawei/ZTE* case.

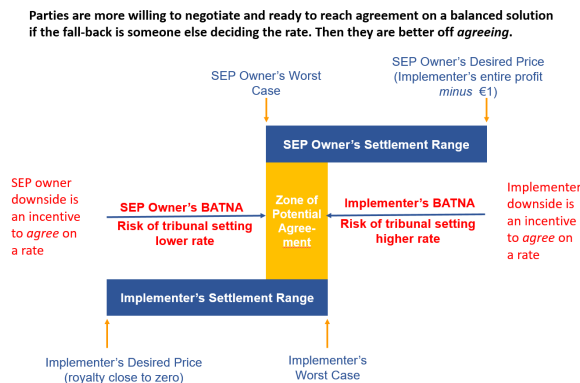
We have to cut through this conundrum.

The best way to do that is to ensure that the BATNA is no longer a *positive* outcome, but a *possible negative* one for each party.

⁹ Fügemann, H./ Danielsson, C./ Gallagher, N. (2019): Economic Implications Of Automatic Injunctions In German Patent Litigation. Bargaining, settlement outcomes, and patent valuation, Copenhagen Economics

¹⁰ Lemley, Mark A., and Simcoe, Timothy, ‘How essential are standard-essential patents’, Cornell Law Review 104, 2018, p. 627; Henkel, J., Zischka, H., ‘How many patents are truly valid? Extent, causes, and remedies for latent patent invalidity’, European Journal of Law and Economics, 48 (2), 2019, pp. 195-239. See also <https://www.patentprogress.org/2018/05/01/a-little-more-than-forty-percent/> and SEP Expert Group p. 71.

This can be done by ensuring that, absent agreement within a reasonable time period, someone else is going to set the rate for the parties.¹¹ With the *risk* that the outcome is *not* what they want.



This can be done by ensuring that, absent agreement within a reasonable time period, someone else is going to set the rate for the parties.

Parties tend to be much more willing to negotiate and ready to reach agreement on a balanced solution if the fall-back is someone else deciding the rate.

- **An offer to arbitrate or have a court set the rate and key terms should therefore be seen as a rebuttable presumption of being a “willing” licensor/ee.**¹²
 - The offer could take different forms:
 - An offer to arbitrate;
 - In Germany, an offer to enter into a “rate setting” agreement (Sect 315 BGB);
 - in the UK, a SEP owner request for a court to issue a “FRAND injunction”;¹³
 - in The Netherlands an offer to agree on “binding advice” (Art 7:900 BW);
 - a request for a declaratory judgment on the meaning of FRAND, or
 - a claim for specific performance of the “*stipulation pour l’autrui*” inherent in the FRAND Undertaking.
 - The effect of a rate setting offer is that the other party’s BATNA becomes negative – a risk:
 - If the SEP owner makes the offer, it reduces the implementer’s upside of holding out (by increasing the risk of being hit with an injunction);
 - If the implementer makes the offer, it reduces the SEP owner’s upside of holding up (by eliminating injunctive relief, and leaving only damages).

¹¹ There is a “Rawlsian” philosophical basis for this approach. J. Rawls, *A Theory of Justice*, 1971, paraphrased: parties who do not know whether they would be a winner or loser (i.e., parties behind a “veil of ignorance”), would likely agree on a reasonable compromise.

¹² For a range of criteria to determine willingness, see Contreras, “A Framework For Evaluating Willingness Of FRAND Licensees”, *Law360*, March 22, 2021, <https://ssrn.com/abstract=3810703>

¹³ *Huawei/Unwired Planet*.

- This presumption is consistent with the CJEU comment in *Huawei/ZTE*
 - *“In addition, where no agreement is reached on the details of the FRAND terms following the counter-offer by the alleged infringer, the parties may, by common agreement, request that the amount of the royalty be determined by an independent third party, by decision without delay.”*¹⁴
 - See also *Huawei / Unwired Planet*.¹⁵
- The other party can rebut the presumption by proving that the arbitration / rate setting litigation offer is not genuine, for instance, if the party offering the arbitration / rate setting
 - refuses (or does not promise) to disclose past agreements, thus inhibiting comparison, and potentially cloaking discrimination;
 - refuses (or does not promise) to allow disclosure of the award/ judgment / settlement to the database the EC proposes;
 - imposes other conditions indicating that the offer is not genuine.
- In all cases, the offer should be accompanied by a promise to accept the rate the court set (subject to right to appeal).
 - *“[w]hat mattered [...] was that Unwired had shown itself willing to license Huawei on whatever terms the court determined were FRAND, whereas Huawei, in contrast, had only been prepared to take a licence with a scope determined by it.”*¹⁶
 - This also means that to give rise to the presumption, an offer should be irrevocable.
- The offer can be made at any time to give rise to the presumption.
 - We need not worry about timing, because if one party thinks the other delays negotiations too much, it can take the initiative to offer arbitration or rate setting litigation, and so take away the other party’s BATNA.
 - If a SEP owner has started injunction litigation, an implementer has an incentive to offer arbitration or rate setting litigation early on in the process.
- **A refusal to offer (or to agree to) arbitration or rate setting should be seen as rebuttable presumption of being a “unwilling” licensor/ee, for the purpose of the question whether an injunction is available on a SEP.**
 - See AG Opinion in *Huawei/ZTE*: *“Furthermore, if negotiations are not commenced or are unsuccessful, the conduct of the alleged infringer cannot be*

¹⁴ *Huawei/ZTE*, para 68

¹⁵ *Huawei/Unwired Planet*, para 158.

¹⁶ *Huawei/Unwired Planet*, para 158; See also German case law.

*regarded as dilatory or as not serious if it asks for those terms to be fixed either by a court or an arbitration tribunal.”*¹⁷

- The party who refuses arbitration / litigation can rebut the presumption of unwillingness by proposing a rate that is FRAND. It bears the burden to prove that it is FRAND. This has the benefit of an in-built incentive to disclose all evidence
- **The advantage of the system is that it encourages a reasonable outcome:**
 - **Both parties have an incentive to agree on a rate:**
 - If the SEP owner offers, and the implementer refuses, a FRAND injunction is available, unless the implementer offered a FRAND rate;
 - If the implementer offers, and the SEP owner refuses, no injunction is issued, although damage claim is still available;
 - If neither offers, no injunction is issued, unless the SEP owner offers a FRAND rate and the implementer refuses, although damage claim is still available.
 - **Even if they cannot agree on a rate, the rate will be set.**¹⁸
- **Arbitration is better than court litigation.**
 - Arbitration allows the parties to address IP rights implicating multiple national jurisdictions in a single proceeding;
 - Arbitration avoids forum shopping and ASI tactics, and have inbuilt principles that reduce bias;
 - Awards are rendered by neutral arbitrators selected for their relevant expertise (and who must not be of a party's nationality, unless the other party agrees, or the parties are of the same nationality);

¹⁷ See AG Opinion in *Huawei / ZTE*, para 93. See also Alexander Italianer, Director-General of DG COMP of the European Commission, “Level-playing field and innovation in technology markets”, Conference on Antitrust in Technology 28 January 2013, Palo Alto (“*There is however a convergent opinion among competition regulators across the Atlantic. A FRAND commitment given in the standardisation context entails that a SEP holder can no longer have recourse to injunctive relief so long as the potential licensee is willing to negotiate a FRAND licence or to submit any dispute to a court or binding arbitration. This general position seems to be shared by the FTC and the DoJ.*”) See also C Shapiro, “Injunctions, Hold-Up, and Patent Royalties” (August 2006), [here](#). See also Farrell Hayes, Shapiro, Sullivan, “Standard Setting, Patents and Hold-Up,” (2007) *Antitrust Law Journal* 74(3) 638; M Lemley, C Shapiro, “Patent Holdup and Royalty Stacking,” (2007) *Texas Law Review* Vol 85 (1991) 2049, [here](#).

¹⁸ Cf. Roth J, in *Nokia v ICom* [2012] EWHC 1446 (Ch) May 18, 2012. (“*You [patent owner] are willing to give a license. [Potential licensee] wants to get a license. You cannot agree on the terms. They will be determined. There will then be a license. In those circumstances [...] to get an injunction seems to me quite extraordinary.*”)

- Procedural flexibility and discovery can be tailored to the individual dispute under, for instance, WIPO Rules,¹⁹
 - These allow parties to challenge validity and infringement as well (even if validity findings have no automatic *erga omnes* effect);
 - These also allows arbitrators to permit *amicus* briefs, directly or as attachments to party submissions;
- Arbitration allows worldwide enforcement under the New York Convention on Recognition and Enforcement of Arbitral Awards.
- Arbitration has some disadvantages, but these can be addressed:
 - Arbitration tends to be private and confidential;
 - An offer or acceptance of arbitration should not count if the party does not agree to register the award with the (confidential) registry of judgments and decisions;
 - Arbitration generally does not allow for appellate review, unless the parties agree, or the award violates due process or public policy (Art. 5 NY Convention);
 - Violation of competition law is a matter of public policy, so at least in the EU, an award can be set aside if it is inconsistent with competition law;
 - And because arbitration is a creature of contract, the European Commission can act under Art 101 TFEU if enforcement infringes competition law, and such decisions can be appealed to the CJEU to ensure integrity of EU rules;²⁰
 - Support services that would facilitate the work of arbitrators include:
 - A (confidential) database of arbitral awards and court decisions from different jurisdictions accessible by counsel, experts and arbitrators on condition of confidentiality;
 - Repository of SEP licensing agreements, to ensure available comparators and non-discrimination.
 - We need not worry about arbitration taking away the basic right of access to the courts.²¹

¹⁹ See Herrington et al, “Why Arbitrate International IP Disputes” 2021, [here](#) and the Guide [here](#).

²⁰ See Dolmans and Grierson, 'Arbitration and. Modernization of EC Antitrust Law: New Opportunities and New Responsibilities', (Fall 2003), 14(2) ICC,

²¹ Article 47 of the Charter of Fundamental Rights. In *Huawei v ZTE*, however, the Commission argued that *ITT Promedia* and *Protégé International* did not apply in a FRAND context, and that even if Article 47 applied, the *Alassini* case permits certain limitations to fundamental rights (Cases C-317/08 to C-320/08, para. 63:

- If one of the parties does not want to arbitrate, and still be seen as “willing”, it can use the litigation option;
 - But to reduce the risk of forum shopping, litigation should be brought in a neutral jurisdiction, or the country of origin of the opponent, so long as due process is guaranteed. If not, the offer to litigate should not create a presumption of willingness.
- Mediation is not really a solution in itself.
 - Experience suggests it may not succeed if one of the parties thinks it can do better afterwards (for instance, by scuttling the mediation and demanding an injunction, or holding out).
 - So an offer of mediation should not create a presumption of willingness unless the party also offers arbitration, rate setting litigation, or binding advice in case the mediation fails.
- **The Commission can and should encourage SSOs to require arbitration/rate setting as a fallback, as part of the FRAND Undertaking.**
 - The DVB, for instance, provides for arbitration in its IPR Rules.²²
- **The Commission can provide in the forthcoming Horizontal Guidelines that an offer to agree on rate setting creates a presumption of willingness.**
 - **There is an excellent opportunity: The Horizontal Guidelines are coming up for renewal).**
 - Proposed text, added to current para 291: *“However, it should be emphasised that nothing in these Guidelines prejudices the possibility for parties to resolve their disputes about the level of FRAND royalty rates by having recourse to the competent civil or commercial courts, or to arbitration, “binding advice” or similar dispute resolution procedures. An irrevocable offer to have the rate and key terms set by an independent tribunal, court or expert in accordance with a reasonable procedure creates a rebuttable presumption that the party is a “willing licensee or licensor” for purposes of whether an injunction can be granted on the basis of a standard essential patent [footnote reference to Huawei/ZTE], provided that the party*

“fundamental rights do not constitute unfettered prerogatives and may be restricted, provided that the restrictions in fact correspond to objectives of general interest pursued by the measure in question and that they do not involve, with regard to the objectives pursued, a disproportionate and intolerable interference which infringes upon the very substance of the rights guaranteed.”) The Advocate-General opined that it is necessary to strike a balance between the right to intellectual property and the SEP-holder’s right of access to the courts, on the one hand, and the freedom to conduct business that SEP users enjoy under Article 16 of the Charter, on the other hand.

²² See Eltzroth “IPR Policy of the DVB Project: Negative Disclosure, FR&ND Arbitration Unless Pool Rules OK” (IJTSR) 6(2), [here](#).

does not refuse to disclose relevant past agreements, or to register the award with an EU database of FRAND judgments and awards (subject to reasonable confidentiality provisions). If negotiations are not commenced or are unsuccessful, the conduct of the alleged infringer cannot be regarded as dilatory or as not serious if it asks for those terms to be fixed either by a court or an arbitration tribunal.”

- **And the Commission could issue further guidance under the IP Action Plan that an offer to agree on rate setting creates a presumption of willingness –** provided that the presumption of (un)willingness is has a legal basis:
 - As the Commission wrote: *“it is essential to have stable, efficient and fair rules governing the licensing of SEPs. Despite the guidance provided in the SEPs Communication in 2017, some businesses continue to find it difficult to agree on SEP licensing. This can frequently lead to disputes, in which patent holders claim that their SEP has been infringed and the other party complains that the patent holder has imposed unfair conditions on a licensing agreement. Although currently the biggest disputes seem to occur in the automotive sector, they may extend further as SEPs licensing is relevant also in the health, energy, smart manufacturing, digital and electronics ecosystems. ... building on the 2017 approach, the Commission will consider reforms to further clarify and improve the framework governing the declaration, licensing and enforcement of SEPs.”*

I hope the Commission will grab this opportunity. It could solve the endless FRAND disputes, and end hold-up and hold-out.

EUROPEAN COMMISSION CONSULTATION ON FRAND

AGENDA

Enforcement of Standard Essential Patents - current bottlenecks and possible solutions

19 May 2021 14:15

The problems reported most by SEP holders and implementers are hold up and hold out. On the one hand, SEP holders claim that it is necessary to go to court in order to conclude a license agreement with an implementer and thus obtain a return on investment. This takes time, involves significant costs and may not always be efficient to achieve a fair and reasonable compensation. On the other hand, implementers claim that willing licensees have difficulties to obtain licences at FRAND terms and conditions and fear abuse of a dominant position by SEP holders. How are we able to reduce litigation for both SEP holders and implementers?

14h30 Key note presentation: Edgar Brinkmann, Senior Judge, Court of The Hague

14h50 Some thoughts from the US: Marie Critharis, Chief Policy Officer and Director for International Affairs

15h00 Roundtable 1: Enforcement of SEPs and SEP licensing negotiations

- Why do implementers hold out? What is the impact of hold out on SEP holders business? What are the options for SEP holders when they face hold out? What is the impact of enforcement by SEP holders on implementers' business?
- Why do SEP holders hold up? What are the options for implementers when they face hold up?
- What would could be done to incentivise and facilitate SEP holders and implementers to engaging in good faith negotiations?

Moderator: **Elena Kostadinova**

Discussion with: Dan Lang (Head of IP and Deputy General Counsel, Cisco), Roman Bonn (Senior Vice President Intellectual Property at Continental Automotive GmbH), Miriam Kiefer (Managing Partner, Kather Augenstein), Patrick Hofkens (Director IPR Policy, Ericsson), Aleksandra Kuźnicka – Cholewa (Senior Associate in the IP/TMT Group)

16h15 Round table 2: Anti-(anti) suit injunctions: what is the problem and what could be the possible solutions?

- What are the newest developments and their impact on business?
- What are the possible solutions?
- To which extent can state courts deal with SEP portfolios? Are state courts the right venue to determine FRAND terms and conditions and calculate royalties?
- What is the role of the policy regulators?

Moderator: **Jan Schmitz**

Discussion with: Florian Muller (app developer and IP activist, FOSSPatents blog), Xu Jing (Partner, King, Wood and Mallesons, China), Dr. Matthias Zigann (Presiding Judge, Regional Court Munich I)

17h00 Roundtable 3: Would international arbitration and/or mediation be a solution and under what conditions?

- What are the advantages and disadvantages of arbitration and/or mediation?
- What would be the conditions for a successful arbitration or mediation process?
- What would be the most appropriate arbitration and/or mediation centre(s)? Would any of the existing structures be appropriate, would we need to build a new international arbitration and/or mediation centre? Could we go in stages?
- What would be the right support services that would facilitate the work of such arbitration and/or mediation centres?
 - Repository of SEP licensing agreements
 - A specialised service assisting FRAND determinations
 - A database of court decisions from different jurisdictions
 - A database with some information from the arbitration and mediation procedures that could inform future cases
 - Other?

Moderator: **Adriana Van Rooden**

Discussion with Hon Lord Justice Richard Arnold (Judge, Court of Appeal of England and Wales, UK), Maurits Dolmans (Partner, Cleary Gottlieb Steen & Hamilton LLP), Sam Granata (Judge, Court of Appeal Antwerp, Belgium), Ignacio de Castro (Deputy Director of the WIPO Arbitration and Mediation Centre), David Perkins (Independent Arbitrator and Mediator)

17h45 Closing remarks: **Kamil Kiljanski** (Acting Director GROW C)