

Client Alert

Will the European Court force Germany to bid farewell to *Orange Book*?

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Summary

The Advocate General's advisory Opinion in the *Huawei v. ZTE* FRAND Case (C-170/13) would, if followed by the full European Court of Justice (ECJ), usher in a significant shift in the playing field in German litigation on Standard essential patents (SEPs). Germany has been known as a plaintiff's venue in patent cases for a long time. Not only do German courts practice the bifurcation of infringement and invalidity proceedings, they have usually also been rather reluctant to accept non-infringement related defenses against threatened injunctions. For cases involving SEPs, this structural preference of plaintiff's interests may have come to a sudden end if the ECJ follows its Advocate General.

The Advocate General states that before seeking an injunction, the SEP holder must inform the infringer that the latter needs a licence, specifying the SEPs concerned, and present the infringer with a written offer for a licence on FRAND terms, including precise details of the royalty. An injunction can only be issued if the infringer does not respond in a serious and diligent manner within a reasonable timeframe. In any case, no injunction can be granted if the infringer agrees to be bound by a Court or arbitral ruling on the terms of the licence and provides a guarantee or deposits a provisional sum for past and future use of the SEPs.

This test differs significantly from the *Orange Book* Approach currently espoused by the German courts, as explained in detail below. If the Advocate General's proposed approach is followed it would make it much more difficult to enforce SEPs in Germany by way of seeking injunctions given the defendant could rely on the EU competition law defense.

The Advocate General's Opinion is only advisory; it is the ECJ's ruling which establishes binding law. We now have to await the ruling of the ECJ, which historically has followed the Advocate General in around 80% of cases, to see if this approach is confirmed and will become binding law. That ruling is expected in the first half of 2015.

The starting point

On 20 November 2014 Advocate General Wathelet issued his Opinion in the *Huawei v. ZTE* Case. The terms of reference for the Opinion were set by the referral decision of the Düsseldorf District Court. The facts can be summarized relatively quickly: Huawei was the holder of a patent, which it had declared to be essential to practice ETSI's LTE standard. Huawei had agreed to license that patent on FRAND terms to parties seeking to implement the standard. ZTE was one such party. Huawei and ZTE had negotiations on the licensing terms and FRAND rate, but did not reach agreement. Huawei then

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sought an injunction against ZTE, which invoked Article 102 TFEU (which prohibits abuses of a dominant position) as a defence. It was assumed in the reference that the holder of the SEP in question was dominant, although the Advocate General noted that such a finding should be made on a case by case basis and there could at most be a rebuttable presumption that an SEP holder was in a dominant position.

The key question posed by the Düsseldorf court to the European Court was what approach should be taken when judging this competition law based defence to an injunction. Should the Düsseldorf court follow the approach of the European Commission in the *Motorola* and *Samsung* cases or should it follow the German Federal Court of Justice's (FCJ) *Orange-Book-Standard* criteria?

The Court did not have the benefit of the published decisions in the *Motorola* and *Samsung* cases, so the Opinion was based on the approach set out in the Commission's press releases. Those decisions found that a patent holder abuses its dominant position when, having given a FRAND commitment over a SEP to a standard setting body, it seeks an injunction against a willing licensee. The key point of the decisions in terms of judging the willingness of the licensee (and something that was not public at the time the Düsseldorf court made the reference to the ECJ) was that the party threatened by the injunctions had agreed to take a licence and to be bound by a determination of the FRAND royalties by the relevant German court. In other words, a declaration to be bound was sufficient. Moreover, in the Commission's view, the party agreeing to be bound to a licence should remain able to challenge the validity of the patent or its infringement.

By contrast, the more onerous conditions that must be fulfilled for a successful defense under the *Orange Book* Approach can be summarized as follows:

- The defendant has to make an unconditional offer to conclude a licensing agreement which the applicant is obliged to accept, since the refusal of the offer would unfairly hamper the defendant or breach the principle of non-discrimination.
- The unconditional nature of the offer in particular relates to the question of infringement. According to the case-law of some of the lower courts, the defendant is also obliged to accept the validity of the patent.
- The defendant must meet the obligations which, for use of the patent, will be incumbent on them under the future licensing agreement. That means, in particular, that the defendant must render an account for their acts of use in accordance with the terms of a non-discriminatory agreement and that they must meet the resulting payment obligations, even though they might choose to deposit a security instead of paying directly as long as the patent owner has not accepted the license agreement offer.

The *Orange Book* Approach is based on the theory that the compulsory license defense creates an exception from the general enforceability of the patent right and must therefore be granted very conservatively. Also, under *Orange Book* it has been seen as the defendants' burden to prove that the patent owner's conduct amounts to an abuse of their dominant position in the market. In practice, this made the compulsory license defense very difficult to succeed on or at least unattractive, in particular because a number of German courts basically required the defendant to waive all defenses with regards to non-infringement and invalidity of the patent-in-suit.

The Advocate General's opinion

The Advocate General starts the substantive part of his opinion (par. 52) by stating that he is seeking a middle path between *Samsung/Motorola* and the *Orange Book* test. This is one point on which there may be some debate. It is true that the Advocate General tries to set a middle path between *Orange Book* and the language used in press releases in *Samsung* and *Motorola*. However, the solution that he legislates in the Opinion seems to these authors to be more prescriptive for the patentholder in practice than the *Samsung* and *Motorola* Decisions. It is a pity that the Advocate General was not able to consider the best "middle path" based on comparing *Orange Book* with the tests actually set forth in those decisions (which were not published at the time of the

reference).

The Opinion starts by noting that the German FCJ's Orange-Book-Standard case regarded a different fact set since the standard at issue there was a de facto standard, not an SEP. According to the Advocate General it was only natural that, in those circumstances, the patent owner will have greater negotiating power than in the case of an SEP, and that an action for an injunction in case of such a de facto standard will ultimately be regarded as abusive only if the royalty they demand is clearly excessive (par. 48). This, however, is not so persuasive since the difference between the German FCJ's *Orange Book* Approach and the Advocate General's opinion does not lie in the degree of excessiveness of the royalties demanded but in the framework of both parties' obligations.

The Advocate General starts by recalling that in the light of competition law 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 which economic operators enjoy, on the other hand (par. 52, 59).

On the one hand, he considers the interests of the patent owner and takes the view that, in accordance with settled case-law, the exercise of an exclusive right linked to an intellectual property right could not in itself constitute an abuse of a dominant position (par. 61). Accordingly, he states that any restriction of the right to bring those actions necessarily constitutes a significant limitation of intellectual property rights and could therefore be permitted only in exceptional and clearly defined circumstances (albeit that the *IMS Health* case law on compulsory licences under Article 102 was in the Advocate General's view "only partially applicable" to the current dispute – par. 69-70).

On the other hand, the Advocate General points out that the patent owner's notification of that patent to the standard setting body and their commitment to license it had an impact on the standardization procedure and the content of the standard itself (par. 71), which created a relationship of dependence between the SEP-holder and the undertakings which produce products and services in accordance with that standard. The Advocate General drew inspiration from *Volvo v Veng* (a very old case about refusal to licence car part designs, which held this could be an abuse if the right holder arbitrarily refused to supply such spare parts), which he said (par. 73) attached importance to the relationship of dependence on one side and the abusive exploitation of the right through methods different from normal competition on the other. This conclusion and the reliance on this old case may generate some academic reaction from competition law theorists – though these remarks do not seem to be strictly necessary to rule on the present case.

The weighing of interests resulted in the Advocate General's following conclusions on the applicable guidelines:

1. The holder of a FRAND-encumbered SEP abuses their dominant position by seeking an injunction where it is shown that the SEP-holder has not honoured their commitment even though the infringer has shown itself to be objectively ready, willing and able to conclude such a licensing agreement.
2. Prior to seeking an injunction, the SEP-holder must — unless it has been established that the alleged infringer is fully aware of the infringement — alert the alleged infringer to that fact in writing, giving reasons, and specifying the SEP concerned and the manner in which it has been infringed by the infringer. The SEP-holder must, in any event, present to the alleged infringer a written offer of a license on FRAND terms which contains in particular the precise amount of the royalty and the way in which that amount is calculated.
3. The infringer must respond to that offer in a diligent and serious manner. If they do not accept the SEP-holder's offer, they must promptly present in a reasonable written counter-offer relating to the clauses with which they disagree. Seeking an injunction does not constitute an abuse of a dominant position if the infringer's conduct is purely tactical and/or dilatory and/or not serious.
4. If negotiations are not commenced or are unsuccessful, the conduct of the alleged infringer cannot be regarded as dilatory or as not serious if they request

that FRAND terms be fixed either by a court or by an arbitration tribunal. In that event, it is legitimate for the SEP-holder to ask the infringer either to provide a bank guarantee for the payment of royalties or to deposit a provisional sum at the court or arbitration tribunal in respect of its past and future use of the patent.

5. An infringer's conduct can neither be regarded as dilatory nor as not serious during the negotiations for a FRAND license if they reserve the right, after concluding an agreement for such a license, to challenge the validity of that patent, their supposed use of the teaching of the patent and the essential nature of the patent in question.
6. The fact that the SEP-holder takes legal action to secure the rendering of accounts does not constitute an abuse of a dominant position. The same applies to bringing a claim for damages for past acts of use for the sole purpose of obtaining compensation for previous infringements.

How does this affect the German patent litigation landscape?

If the ECJ follows the Advocate General's opinion, the impact on German SEP litigation will be tremendous. With his detailed guidelines (almost legislative in nature), the Advocate General establishes a framework of obligations which will limit the possibility to use the threat of an injunction against users of a standardized technology, at least if the latter are generally prepared to take a license under valid patents which they actually use. The negotiation of royalties may not necessarily get simpler since both sides will have to follow the Advocate General's guidelines and the infringer/licensee would have to ensure its attitude remained diligent/serious rather than tactical/dilatory. So there may be an increased incentive for positioning/gaming during licence negotiations. But the threat of an injunction will play a much lesser role. This may help smaller companies and could in theory lead to lower royalty assessments given the patentholder potentially has lesser bargaining power in an SEP scenario compared to an *Orange Book* scenario (at least this is what the Advocate General thought). However, it also entails the risk that innovative companies with market power (i.e. innovative must-have technology) refuse to contribute further to standardization work and withdraw from standard setting organizations, which could hamper innovation.

Until now, in German SEP litigation, it was the defendant's burden to prove the SEP-holder's abuse of a dominant position to establish an antitrust defence. This will no longer be the case. The Advocate General considers it the SEP-holder's obligation to approach the infringer and offer him an agreement on FRAND terms. In German litigation, this will result in the SEP-holder's burden to prove that not only he made an offer but also that this offer actually contains FRAND terms. If the defendant contests this assertion, for example on the basis of its own, detailed FRAND royalty calculation, German courts will have to take evidence with court appointed experts. This will take up a lot of time and cost a lot of money. It is doubtful that many SEP-holders will want to go into this. In this way, the Advocate General's opinion could lead to a significant shift in the burdens in German SEP litigation, thus changing the balance between the parties.

The Advocate General does not consider it essential for a successful defense that the user of the patent proactively pays reasonable royalties to the SEP-holder or at least puts these royalties into an escrow. It is up to the SEP-holder to ask the infringer either to provide a bank guarantee for the payment of royalties or to deposit a provisional sum at the court or arbitration tribunal in respect of its past and future use of the patent. This ends the guessing game which infringers recently had to play when they tried to find out how much they had to do and pay in order to be covered by the *Orange Book* Approach.

Finally, and most fundamentally, the Opinion and the judgment that will follow it (likely in the first half of 2015) once again show the global reach of EU competition law in the technology sector and, indeed, in all sectors where IP plays an important role. The case involved two Chinese multinationals, litigating about a standard which has global reach. Yet it was decided based on EU competition law. EU competition law continues to play a dominant role in driving developments in the tech sector, such that companies in this field ignore developments in Brussels at their peril.