

Position

EU-Framework for Licensing of Standard Essential Patents (SEPs)

FRAND-licensing of SEPs for manufacturers
and suppliers



#weareready

Berlin, October 2022

Preface

The German Association of the Automotive Industry e.V. (VDA) represents the interests of the German automotive industry at national, European and international levels. The VDA unites the interests of manufacturers of passenger cars and trucks, vans and buses, suppliers of parts and accessories, and manufacturers of trailers and bodies.

With the increasing networking of products in the automotive industry, the use of telecommunications standards is becoming an important issue for this industry. The communication technologies necessary for networking products are usually the subject of international standards. They are often protected by numerous standard essential patents (SEPs). A license must therefore be obtained from the holders of these SEPs in order to use the standards. As a rule, the holders of SEPs undertake to offer licenses on FRAND (“fair, reasonable and non-discriminatory”) terms by making corresponding declarations in the course of standardization. However, there is currently no uniform understanding of what is to be understood by such FRAND conditions.

More balanced enforcement

In principle licensing of SEPs under FRAND terms is supposed to strike a balance between the interests of SEP holders and SEP users.

What FRAND means in practice is often disputed between SEP holders and SEP users during licensing negotiations. If the parties of SEP license negotiations fail to reach an agreement on FRAND terms and conditions and the patent owner wants to get a license agreement with the prospective licensee in place, the only option for the patent owner is to ask a court to decide on FRAND conditions in the context of an infringement suit.

Background

In 2015, by the judgment Huawei/ZTE (case C 170/13) the Court of Justice of the EU (CJEU) specified a FRAND-compliant process for the license negotiations between the licensor and the licensee. Within this framework, the interests and obligations of both parties must be equally taken into account.

Hence, the ECJ ruling aimed to set up a balanced approach.

Compliance with the Huawei/ZTE ruling has resolved many FRAND disputes. But today, the interpretation of the FRAND commitment is again becoming a troublesome issue. In particular the jurisprudence of German courts seems to contradict Huawei/ZTE. Whereas Huawei/ZTE balanced the interests of licensors and licensees, setting out rights and obligations on each, courts within the EU¹ interpreted it in troublesome ways. For example, German Federal Court (BGH) rulings “FRAND Einwand I” (case KZR 36/17) and “FRAND Einwand II” (case KZR 35/17) provide SEP holders with excessive rights to enforce an injunction against prospective licensees.

The BGH states that the obligation to make a FRAND offer will only arise “once the [SEP implementers] ha[ve] indicated that they were seriously prepared to acquire a license.” In other words, the SEP holder will only be obliged to make a FRAND offer if the prospective licensee establishes that it is unambiguously and unconditionally willing to take a FRAND license.

As a result of this and the fact that the willingness of a prospective licensee can be easily challenged, the BGH has reduced the SEP holder’s obligation to make a FRAND offer. The negotiation framework is unbalanced from the outset.

In that regard, the BGH has unduly weakened the most important obligation in the Huawei/ZTE framework. Post FRAND I/II decisions, the SEP holder only has to make a license offer on FRAND terms once unconditional willingness of the licensee is affirmed. Consequently, in the absence of such a confirmation of unconditional willingness to take a license by the prospective licensee, the SEP-holder can enforce an injunction, having merely provided a short infringement notice.

¹ NL Philips vs. Wiko, Dutch Court of Appeal Cases No. HR 19/04503 and HR 20/01160: The Court essentially upheld that Huawei did not create an obligation for the SEP holder to explain why its offer would be FRAND, whereby the licensor need only to stipulate the royalty rate and how it was calculated; and Huawei did not create an obligation for the SEP holder to grant access to comparable agreements with other users.

Interpretation by lower courts

Following that logic, lower court decisions in Germany have gone even further and held that the obligations of a prospective licensee may be triggered regardless of whether a SEP holder satisfied its obligation to make an offer on FRAND terms. For example, the regional court (“LG”) Munich held² that prospective licensees have to diligently respond to an offer “even if it does not meet FRAND requirements in all respects.” The higher regional court (“OLG”) Karlsruhe found³ that the obligation of the prospective licensee to make a counteroffer can already arise if the license offer of the SEP holder is not “clearly and unambiguously contrary to FRAND”. The same reasoning has been applied in subsequent cases.

This approach contradicts the Huawei/ZTE ruling. The CJEU requires the SEP holder “to present to that alleged infringer a specific, written offer for a license on FRAND terms.” This is a fundamental part of the SEP licensing framework. The SEP holder’s offer is the cornerstone of the process because it materializes the FRAND commitment given to a Standard-Setting Organization (SSO) and obligations stemming from competition law. The CJEU considers this obligation to be self-evident: “where the proprietor of an SEP has given an undertaking to the standardization body to grant licenses on FRAND terms, it can be expected that it will make such an offer.”⁴

As a result, the imbalance of imposed duties places the burden to determine FRAND terms on the licensee, although an SEP holder usually has better access to the necessary information.

The obligation to make a counteroffer without having received a FRAND offer in the first place raises many questions. First, regarding the balance, it is difficult to understand why the German courts do not assess the FRAND-ness of the SEP holder’s offer but instead decide to assess the prospective licensee’s counteroffer even when SEP holders in fact fail to make a FRAND offer. Second and at least equally important, the SEP holder is better positioned to commence with a FRAND license offer due to the information asymmetry existing between SEP holder and a prospective licensee regarding the SEPs and the standardized technology in question.

The CJEU also notes⁵ that “the proprietor of the SEP is better placed to check whether its offer complies with the condition of non-discrimination than is the alleged infringer.” By contrast, prevailing German jurisprudence does not require the SEP holder to make a FRAND offer if the licensee is considered unwilling, while in effect requiring a FRAND counteroffer from the prospective licensee.

These deviations of court rulings from the Huawei/ZTE ruling pose a threat to EU industry.

² See LG München, decision dated 19.8.2021, ref.: 7 O 15350/19 = GRUR-RR 2021, 513, para. 107.

³ See OLG Karlsruhe, decision dated 9.12.2020, ref.: 6 U 103/19 = GRUR-RR 2021, 203, para. 250.

⁴ See CJEU, decision dated 16.7.2015, ref.: C-170/13 = GRUR 2015, 764, para. 64.

⁵ See CJEU, decision dated 16.7.2015, ref.: C-170/13 = GRUR 2015, 764, para. 64.

We therefore call on the European Commission for measures, preferably legislative measures, to safeguard balanced and harmonized court rulings in SEP related disputes all across the EU. For example, the European Commission could issue its views on interpreting the CJEU ruling Huawei/ZTE for a balanced enforcement of SEPs with respect to

- the court's duty to assess FRAND compliance of the SEP holder's offer (including commercial terms of the offer)
- the sequence of assessment of an offer and a counteroffer and
- the questions if it is within EU courts' discretion to set or decide if a global royalty rate for a global SEP portfolio is FRAND compliant.

Unless the SEP holder has provided a FRAND offer, the prospective licensee should not be obliged to provide a FRAND (counter) offer under the Huawei/ZTE framework. Accordingly, unless the SEP holder has evidentially provided a FRAND offer, an injunction should not be granted. If the prospective licensee has evidentially provided a FRAND (counter) offer, an injunction should never be granted – independent of whether the offer of the SEP holder is FRAND or not. Otherwise, the process would be unbalanced.

For assessing if an offer or counteroffer is FRAND, all terms and conditions of the offer should be considered, whereby commercial terms should be strongly weighed.

For showing non-discrimination, the patent holder should be willing to disclose comparable preexisting license agreements. However, it should be noted that such agreements may fail to be reasonably used as comparables for several reasons, for example when they have been concluded after an injunction was granted by a court or if an injunction was very likely to be granted.

Terms and conditions should appropriately reflect the individual needs of both parties. To this extent, both parties should have had reasonable time and opportunities to negotiate the terms.

FRAND royalties

FRAND royalties should only reflect the value that the patented technology contributes to the licensed product but should not capture the value of downstream innovation and investment.

Accordingly, it is not the market success of the product in which the patented technology is implemented that should be decisive, but rather the technological contribution offered by the patented solution. The share of market success of a licensed product which is unrelated to the patented technology, should remain irrelevant for the assessment of a royalty value.

Some influencing factors for determining a FRAND license fee may be:

- Added value of the licensed, patented and standardized technology compared to the state of the art at the time of invention.
- Contribution of the licensed standard essential patents to the standardized technology.

Considering these influencing factors, the methodology of “top down” may be applied by which

1. a FRAND aggregate royalty based on the value for the overall patented and standardized technology is determined and
2. based on the share of the truly essential⁶ and valid patents owned by a specific licensor in relation to the overall number of truly valid and essential patents covering the standardized technology an individual royalty rate is determined.

It is to be understood that other methodologies may be applied instead or in addition to this methodology.

For valuation purposes, taking into account the value added by the standardized technology to a product at a level of a product supply chain where the standardized technology represents a principal feature of the (intermediate) product's function may facilitate determining a FRAND aggregate royalty rate.

In any event, the value of one or more FRAND licenses covering the entire supply chain including the end product does not depend on the position in the supply chain at which the license or licenses are taken.

4. Transparent license offer

In order to further reduce uncertainty, license offers and the basis for calculating the license rate must be made available to prospective licensees in a transparent form and as early as possible. Essential parameters of the initial license offer must be made accessible to the prospective licensee without any obligation of confidentiality. The main parameters of a license offer should be made available as early as possible, and preferably publicly, such that the consequences of licensing can be reasonably considered by the prospective licensee in business transactions before entering into obligations to third parties.

⁶ See VDA Position Paper “Assessing the Essentiality of Standard-relevant Patents”, dated December 6, 2021.

5. License availability and the FRAND commitment

The FRAND commitment of an SEP holder has two foundations: (1) private law (as a contract between an SEP holder and an SSO); and (2) competition law (as a safeguard of the pro-competitive character of a standardization process that inevitably leads to technology developers agreeing on the technologies which prevail, and which do not). The FRAND commitment imposes an obligation on an SEP holder to be prepared to grant a license to any third party.

Some SEP holders currently license only to manufacturers of end products (OEMs) and refuse to license other members of the supply chain. For supplier companies, uncertainty is created by the described practice of SEP licensing because suppliers cannot base their business on an existing license or, more generally speaking, on transparent access to a FRAND license.

Background

Companies operating market-oriented make an investment decision before developing and launching new products. In general, investments must be financially advantageous and lead to returns of a certain amount. This calculation also takes uncertainty into account, like e.g. the uncertainty of license fees to be considered: the greater the uncertainty, the greater the expected financial return must be to compensate this uncertainty - otherwise the investment will not be made and the project will not be implemented.

Consequently, some investment projects will not be implemented, because the royalty rate (if any) to be considered is not known. This can particularly affect projects involving an innovative product, because here the overall uncertainty is usually high. The situation is even more acute for SMEs and start-up companies, which account for a large share of overall economic value added and are dependent on innovations to compete. Typically, smaller companies do not have the resources to deal in depth with the specifics of SEP licensing and thus lack the experience and knowledge to even come close to negotiating on a level playing field – and this uncertainty affects investment decisions accordingly.⁷

For this and other reasons, upon request, a SEP holder must offer a FRAND license to its SEP or SEP portfolio to any entity in the supply chain providing units complying with the standard or portions of the standard and making use of that SEP or SEP portfolio. Upon request, the FRAND license shall cover the SEP holder's global portfolio of SEPs. In any case, the license offered must cover the use of the SEP or SEP portfolio for the unit provided by the party seeking a FRAND license; upon request of the party seeking a license, an appropriately adapted license offer should also include other acts of use in the supply chain.

By refusing to offer a respective SEP license at FRAND terms to a party upon its request, a SEP holder denies such party effective access to a standard. Such refusal should therefore be regarded as a competition law violation.

⁷ Prof. Henkel draws the same conclusion in his study "How to License SEPs to Promote Innovation and Entrepreneurship in the IoT".

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