Economist's Note

Unwired Planet vs Huawei: A Welcome Clarification of the Concept of FRAND and of the Role of Competition Law Towards SEP Licencing

Damien Neven and Pierre Régibeau*

I. Introduction

On 5 April 2017, the High Court of Justice (the Hon. Mr. Justice Birrs) delivered a thought-provoking judgement in the matter of *Unwired Planet vs Huawei*.[1] The dispute involved the licensing of Standard Essential Patents allegedly reading on mobile telephony standards. Some of these patents were found to be valid and infringed in a series of technical trials.

Unwired Planet claimed that Huawei was an unwilling licensee, while Huawei argued that Unwired Planet was abusing its dominant position by demanding royalty rates which were clearly higher than FRAND (fair, reasonable, and non-discriminatory) rates, by insisting on a worldwide license even though it did not enjoy worldwide IP (intellectual property), and by 'rushing to Court'.

Mr. Justice Birr's decision helps clarify two important aspects of standard essential patent (SEP) licensing: the meaning of FRAND and the interplay between European Telecommunications Standards Institute (ETSI) commitments and competition law in disciplining the behaviour of SEP holders. These clarifications rely on a number of key insights from economic analysis.

According to the judgement, there is a single FRAND rate, which corresponds to the rate that would have been negotiated *ex ante* (before the adoption of the standard) and there is no such thing as a FRAND range. In addition, Judge Birss found that the non-discrimination discipline that stems from ETSI is part and parcel of the concept of FRAND; this arises because in *ex ante* negotiation, different implementers that have the same incremental value from the inclusion of the standard and face the same alternatives should be expected to obtain similar royalty rate. Finally, the judgement concludes that FRAND obligations include constraints on the behaviour of the patent holder but also indirectly on the behaviour of the prospective licensees and injunctions should only be granted when the prospective licensee is unwilling.

The judgement also distinguishes between the obligations that arise from the contractual commitments made to ETSI and the discipline from competition law. In terms of the FRAND rate, the ETSI commitments are said to impose stricter duties than competition law. This arise because ETSI commitment relate to a unique FRAND royalty where competition law is only concerned with excessive prices which is understood as prices significantly in excess of the competitive benchmark (which, in this instance, is the unique FRAND rate). Accordingly, in Judge Birss's view, a rate can be somewhat higher than the FRAND rate and still be compliant with competition law.

Key Points:

- *Unwired Planet vs Huawei* represents an unprecedented move to rely systematically on an economic view of FRAND.
- There is a single FRAND rate, for given conditions, which corresponds to the rate that would have been negotiated before the adoption of the standard.
- The judgement fully endorses a combination of top down and 'benchmarking' approaches to the setting of the FRAND royalty.
- The non-discrimination discipline that stems from standard-setting committees (like ETSI) is part and parcel of the concept of FRAND.
- The discipline imposed by competition law is less demanding than the ETSI commitments.

* Damien Neven, Graduate Institute, Geneva and Compass Lexecon and Pierre Régibeau, Imperial College and CRA. Both authors acted as advisors to Huawei. This paper however discusses some of the conceptual issues raised by the judgement and does not comment on specific claims put forward by the parties.

1 [2017] EWHC 705 (Pat).

© The Author 2017. Published by Oxford University Press. All rights reserved. For Permissions, please email: journals.permissions@oup.com

Downloaded from https://academic.oup.com/jeclap/article-abstract/8/7/463/4055640/Unwired-Planet-vs-Huawei-A-Welcome-Clarification
by University of Geneva user
on 21 September 2017

Whether the more permissive stance under competition law is also found with respect to the constraints on the behaviour of the patent holder is however unclear, at least if the *Huawei vs ZTE* judgement of the CJEU is taken as benchmark. However, according to Justice Briss, this judgement should not be given too much significance as it failed to consider the discipline imposed by the ETSI commitment.

II. What is the FRAND royalty rate?

For years, disputes about the licensing of FRAND-encumbered patents have proceeded without a clear view as to what 'FRAND' actually means. In particular, there has been widespread disagreement as to the level of royalties which might be considered to be 'Fair and Reasonable' and about the relevance of the requirement that the offer also be 'Non-Discriminatory'. Justice Birrs sheds light on both of these issues.

A. The *ex ante* benchmark and the uniqueness of FRAND

In the context of Standard Essential patents, the economic purpose of FRAND commitments is to avoid 'hold up' situations where SEP-owners exploit the *additional* market power that they enjoy because their patents have been included in a standard and implementers no longer have the choice to use alternative technologies.

Since FRAND commitments are meant to avoid hold-up, it makes sense to define FRAND terms and conditions as those that would arise in a situation without hold-up, i.e. before the technology has been adopted as part of the standard. The recognition that FRAND actually refers to the outcome of '*ex ante*' negotiations between the parties is not new. In particular, this '*ex ante*' benchmark has been accepted by a number of Courts.[2] Like the CJEU, Justice Birss also recognises that implementers might be in a position to hold out the SEP holders, in particular if the SEP holders are deprived of any bargaining power *ex post* (as would arise for instance if injunctions could never be granted). As a consequence, the royalty rates negotiated *ex post* might be higher or lower than the rate that would have been negotiated *ex ante* depending on the balance between hold up and hold out (or reverse hold up), i.e. depending on the relative bargaining power enjoyed by licensor and licensees *ex post*. Because this relative bargaining power depends on a number of factors, such as the treatment of injunctions in a specific jurisdiction, different rates might be observed even though the (*ex ante*) FRAND rate should be the same. As put succinctly by the judgement, the FRAND rate is a rate that involves neither hold up or hold out and thus corresponds to the rate that would be agreed *ex ante* (see §92–97), while the rate that results of *ex post* negotiations can be either above or below that rate.

The judgement however goes further, arguing that the logical consequence of an *ex ante* benchmark is that, conceptually, there is a single FRAND royalty rate (taking other relevant contractual conditions as given) for any given transaction between a licensee and a SEP-holder. Contrary to what is often claimed, there is no such thing as a *range* of FRAND royalty rates (see § 147 and ff). This arises naturally because the *ex ante* negotiation would have converged to a well-defined royalty rate (for given conditions). The judgement also recognises that *ex post*, given the necessarily limited information on the basis of which any judgement would be made, courts will only have an imperfect approximation of the 'true' FRAND rate. Hence, there may different approximations of the FRAND rate *ex post* depending on the information that is available, but this is not same as saying that there is a FRAND range.[3]

B. How to evaluate the FRAND rate *ex post*?

The judgement acknowledges that two methods can be used in order to approximate the FRAND rate. On the one hand, one could use a top down approach. Starting from an estimate of what would have been considered *ex ante* a FRAND royalty *stack*, individual royalty rates could be obtained by dividing the stack by the number of patents while controlling for differences in quality among patents. Concretely, the royalty due on a given portfolio would be equal to the stack times the share of this portfolio in the total number of declared SEP. Deviations from this default would require evidence that the portfolio at issue is of a significantly different quality from the population of declared SEPs as a whole.

The second approach relies on benchmarking with existing contracts involving similar patents. This requires a careful consideration of how comparable other licences may be. In this respect however, the judgement emphasises the consequence of the conceptual approach that it has adopted; in principle, in evaluating whether other

2 See for instance the CJEU in Huawei/ZTE, the Guandgong High People's Court in Huawei vs Interdigital or US Courts in Ericsson v. D-Link.

3 The judgement also notes that Courts could not determine the FRAND rate in the context of disputes if there was a range of FRAND rates. Confronted with two rates in such hypothetical range, the Court would have not organising principle to choose one over the other (see §150).

Downloaded from https://academic.oup.com/jeclap/article-abstract/8/7/463/4055640/Unwired-Planet-vs-Huawei-A-Welcome-Clarification
by University of Geneva user
on 21 September 2017

licenses are comparable, one should consider whether they are likely to involve either hold up (because the patent holder was in a favourable position) or reverse hold up (because the implementer was in a favourable position, for instance because of the regulatory environment). Justice Birss tends to favour the second approach, while recognising the merit of the first one; but he expresses concern about the availability and reliability of *ex ante* estimates of the royalty stack. Still, if the top down approach suffers from the need to define an *ex ante* 'stack', the *ex post* benchmarking approach suffers from the need to adjust for some possible imbalances in *ex post* bargaining power, which may be difficult. It makes sense, as advised by Justice Birss, to combine these two imperfect methods.

C. The non-discrimination leg of FRAND

As a result of the settlement concluded between Unwired Planet and Samsung shortly before trial, the Court was also confronted with the question of how to give effect to the non-discrimination element in FRAND.

The judgement draws a distinction between a non-discrimination element which is part and parcel of the overall FRAND concept and what it refers to as a 'hard edged' interpretation.

With respect to the former, the judgement refers again to the *ex ante* benchmark and notes that, in principle, implementers for whom the value of the innovation is similar (§175) and who face similar alternatives should negotiate similar rates.[4] Accordingly, the very reference to the *ex ante* benchmark for the FRAND rate would seem to imply an element of non-discrimination, so that the ND leg in FRAND is indeed inseparable from the FR part of the concept.

The judgement also refers to a 'hard edged' element of non-discrimination and in order to frame that discussion it is useful to refer to the claim that the Court was faced with. Huawei argued that, since it was in a very similar situation to Samsung, it should obtain rates that should be very close to the rates that Samsung had obtained for the UP portfolio in the summer of 2016. Accordingly, the Court framed the discussion of a 'hard edged' non- discrimination element in terms of whether there was a requirement to adjust a rate, *which would otherwise be regarded as FRAND*, to reflect conditions that were granted to another implementer (see §177). What Justice Birss has in mind is thus an adjustment *ex post*, in light of what has been granted *ex post* to other implementers.

In order to deal with this question, Justice Birss notes first that the concept of FRAND as developed by ETSI does not include such a 'hard edged' element. Still, Justice Birrs goes on to consider what such a 'hard-edged' component might entail and takes inspiration from competition law. He finds that in the enforcement of Art 102, unlawful discrimination requires the existence of a distortion of competition. So, while he concludes that the ETSI FRAND undertaking does not include a 'hard edged' component he also finds that if, contrary to his view, there is such a component, then it should make reference to the possibility that granting different licence terms to two implementers that compete with one another might distort that competition.

D. FRAND as a process

The notion that FRAND obligations include some constraint on the behaviour of the patent holders is not new. This is indeed the framework that Courts have used in order to determine whether patent holders should be granted injunctions against prospective licensees (see for instance, Camesasca et al. (2013)[5]).

However, the judgement clarifies that such behavioural constraints extend to the implementer. According to the judgement (§163), 'The patentee is obliged by contract to take a FRAND approach to the negotiation and to grant a licence on FRAND terms. The implementer must take a FRAND approach to the negotiation and accept a licence on FRAND terms, if it wishes to take advantage of the constraint on the patentee's right imposed by the FRAND undertaking.'

The judgement also provides some insights with respect to the type of behaviour that can be considered FRAND and behaviour that cannot. With respect to the latter, the judgement indicates that 'making extreme offers and taking an intransigent approach which prejudice fair, reasonable and non-discriminatory negotiation is not a FRAND approach' (§163).

In this respect, the judgement found that Huawei could be considered to be unwilling because it insisted on having an offer from UP for a UK licence only. According to the judgement, a 'willing licensee and a willing licensor with more or less global sales' acting

4 One should not however carry the reasoning too far. One could for instance expect that the outcome of *ex ante* bargaining will differ depending on the relative position of the patent holder and implementer in other dimensions (for instance if the patent holder is also implementer and faces implementers which may or may not themselves hold some SEP).

5 Camesasca, P., Langus, G., Neven, D. and P Treacy, Injunctions for standard essential patents: Justice is not blind, Journal of Competiton Law and Economics, vol 9, 285–311.

Downloaded from https://academic.oup.com/jeclap/article-abstract/8/7/463/4055640/Unwired-Planet-vs-Huawei-A-Welcome-Clarification
by University of Geneva user
on 21 September 2017

reasonably and on willing basis would agree on a worldwide license (see § 543). As a consequence, a worldwide licence was found to be the FRAND licence for 'a portfolio like that of Unwired Planet and an implementer like Huawei'. The judgement concluded that 'Unwired Planet is entitled to insist on it' and that 'an insistence by Huawei on a licence with a UK scope only is not FRAND' (see §572). Huawei was thus found unwilling and, as a consequence, the Court allowed for an injunction. More generally, the Court clarifies (see §708) that in order to be qualified as willing, a licensee needs to make an unconditional commitment to take a licence found to be FRAND (either by a court, an arbitrator or in the context of a negotiation).

At the same time, the Court found that in the process of negotiation the parties could make offers that would not be FRAND. This is a natural implication of the finding that there is a single FRAND rate. Indeed, if FRAND behaviour would imply that all offers made by licensors should be FRAND, given the process of negotiation that would take place following the submission of the offer, licensors would be condemned to end up with a negotiated rate that is below FRAND (see §159). Accordingly, when it comes to the rate, the FRAND obligation is primarily applicable to the agreed rate. Licensors and licensees can make offers that are not FRAND as long as such rates are capable of being FRAND, in the sense that they will not disrupt the process of negotiation (as mentioned above).

An interesting aspect of Justice Birrs argument is that it seems to imply that a party cannot object to a clause which would appear to be common practice given the position of the two parties in order to avoid considering an offer made by the other party.

III. The discipline of competition law

In the Motorola[6] and Samsung[7] decision, the Commission found that the pursuit of an injunction for an SEP against a willing licensee would amount to an abuse of dominance. In *Huawei vs ZTE*, the CJEU further outlined the process that licensors and licensees of SEPs should follow. After notifying the potential licensee, the patent holder must make a complete 'FRAND' proposal. If the licensee disagrees with that proposal, he must make, within reasonable delays, a counteroffer that is also 'FRAND'. If the licensor and licensee still disagree, they may resort to arbitration or a Court proceeding to determine the FRAND rate.

The CJEU indicated that seeking an injunction without notifying the prospective licensee/making a complete offer or seeking an injunction after the implementer has made a complete counteroffer would be an abuse of dominance.

What underlies the approach of the Commission and the CJEU is that by seeking an injunction the patent holder would behave in such a way to obtain rates in excess of FRAND, and hence commit an exploitative abuse.

Justice Briss was confronted with the claim that UP has abused its dominant position, in particular in light of the CJEU judgement. The claim related to UP's behaviour and the prospect that its behaviour would lead to an exploitative abuse. In considering this claim, Briss clarified the difference between the discipline that arises from competition law and the discipline that arises from enforcement of the FRAND concept in contract law. In so doing, he drastically reduced the significance of the CJEU judgement in *Huawei vs ZTE*.

First, Justice Briss notes that under the ETSI contract, the patent holder commits to a FRAND rate so that any deviation from that rate is a breach of that commitment. By contrast, Art 102 only condemns excessive pricing, which is understood as a price which is necessarily in excess of the competitive benchmark (which is the FRAND rate in this instance). Accordingly, a rate can be somewhat higher than the FRAND rate and still not be contrary to competition law (see §153). This implies that the ETSI commitment exercises a more demanding discipline than competition law. This logic applies to royalty rates as well as any other licence term.[8]

Second, Justice Briss found that the Huawei/ZTE judgement failed to take into account the fact that the FRAND commitment under ETSI was justiciable and enforceable in Court, irrespective of competition law. Accordingly, the CJEU could not take into account the fact that an implementer, who is prepared to accept FRAND terms, has already a right of defence towards a claim for an injunction. According to Justice Briss, the 'legal landscape which the CJEU were presented with in Huawei vs ZTE was (thus) incomplete in a material way' (see §723).

6 Motorola – Enforcement of GPRS standard essential patents, AT 39985, 29 April 2014.

7 Samsung – Enforcement of UMTS standard essential patents, AT 39939, 29 April 2014.

8 Indeed, as noted by the judgement, if the breach of the ETSI commitment and the breach of competition law would coincide, agreed rates could be easily challenged under competition law (see §152 and ff). This would create significant legal uncertainty. Under the approach outlined by the judgement, only agreed rates that are substantially above the true FRAND rate could be potentially unwound under a competition law claim.

Downloaded from https://academic.oup.com/jeclap/article-abstract/8/7/463/4055640/Unwired-Planet-vs-Huawei-A-Welcome-Clarification
by University of Geneva user
on 21 September 2017

One can only speculate about the approach that the CJEU would have adopted if it had been confronted with a complete legal landscape in which the rights of defence of the implementer against an injunction had been fully recognised in terms of the ETSI commitment taken by the patent holder. It is possible that in such circumstances, the CJEU would not have attempted to substitute itself for the alternative enforcement mechanism[9] that it assumed away and would have imposed lighter requirements on the behaviour of the patent holder.

It is still instructive to compare the constraints on the behaviour of the parties with respect to the FRAND commitment under ETSI, as detailed by Justice Briss with those delineated by the CJEU in the *Huawei vs ZTE* judgement with respect competition law. As discussed above, under the ETSI commitments, an injunction can only be granted, following the judgement, if the prospective licensee does not negotiate in good faith, in particular if he fails to make an unconditional commitment to accept terms deemed to be FRAND and the patent holder negotiates in good faith (making offers capable of being FRAND). Under the CJEU ruling, seeking an injunction is not an abuse if the patent holder makes an initial offer capable of being FRAND, that the implementer does not respond to diligently by making its own offer capable of being FRAND.

The conditions imposed under ETSI for allowing an injunction and the conditions stipulated by the CJEU for finding that seeking an injunction is not an abuse thus look rather similar. The constraint under ETSI still seems less demanding as it allows an injunction when the prospective licensee does not make an unconditional commitment and it is unclear whether in such circumstances (and other things equal), seeking an injunction would not be seen an abuse.

It is still striking that Justice Briss interprets the CJEU judgement in non-prescriptive manner, as one would expect given that he sees the competition law constraint as more permissive than the ETSI commitment. He emphasises that the CJEU outlines mostly when seeking an injunction would not constitute an abuse (i.e. when the implementer does not respond diligently to his own complete offer). In particular, he does not read the CJEU judgement as stating unambiguously that seeking an injunction without providing an early warning is an abuse of dominance (see §740). He emphasises that what constitutes a sufficient notice ought to depend on circumstances.[10]

IV. Conclusion

Whether or not one fully agrees with his conclusions, Justice Birrs' decision in *Unwired Planet vs Huawei* is important, in five respects. First, it represents an unprecedented attempt to rely systematically on an economic view of FRAND in order to identify the legal obligations of the parties. So, far from just paying lip-service to the notion of an '*ex ante*' royalty, Justice Birrs uses this benchmark as a main building block in his reasoning. Second, the decision significantly clarifies the notion of FRAND. In terms of ETSI commitments, there is a single FRAND rate for any pair of parties (given other conditions). By contrast, the licensor's obligations under competition law are less strict as competition law would only catch royalties which are significantly in excess of the FRAND benchmark. Third, the decision fully endorses a combination of top down and 'benchmarking' approach to approximate what the single FRAND royalty should be. Each method presents its own difficulties and they are therefore best combined. Fourth, the decision argues that the relevance of the ECJ ruling in *ZTE vs Huawei* is lessened by the fact that it did not consider the nexus arising from the reliance on both contract law and competition law. Once the defences available to the licensee under contract law are considered, Judge Birss concludes that the obligations that *ZTE vs Huawei* imposes on SEP-holders should be lightened. Finally, Justice Birrs appears to indicate that a contractual clause which would appear to be common practice given the respective positions of the parties is FRAND and cannot therefore be used to justify not engaging with a specific offer.

doi:10.1093/jeclap/lpx055
Advance Access Publication 28 July 2017

9 Justice Briss recognises (at §154) that the CJEU considered that an abuse would take place if the agreed rate would be above FRAND and he disagrees with that approach. He presumably finds that the CJEU took that position because if was confronted with an incomplete legal landscape in which the ability to enforce ETSI commitments was assumed away.

10 Justice Briss also notes that the CJEU cannot have meant literally that the parties should make offers that are FRAND. As discussed above, when it is recognised that there is single FRAND rates, offers that are made in the context of a negotiation should merely be capable of being FRAND (see §738).

Downloaded from https://academic.oup.com/jeclap/article-abstract/8/7/463/4055640/Unwired-Planet-vs-Huawei-A-Welcome-Clarification
by University of Geneva user
on 21 September 2017