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## *HUAWEI v ZTE:* Judicial Conservatism at the Patent-Antitrust Intersection

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### I. INTRODUCTION

At its core, the preliminary ruling of the Court of Justice of the European Union (“CJEU”) in *Huawei v ZTE* explains whether, and if so how, holders of FRAND-pledged Standard-Essential Patents (“SEPs”) abuse a dominant position under Article 102 TFEU when they apply for an injunction and/or product recall against unlicensed implementers of their technology.<sup>2</sup>

*Huawei v ZTE* has several specific features. First, it is a judgment of the upper court of the European Union. Only this Court can provide a definitive interpretation of Article 102 TFEU. Once affirmed, CJEU-made law applies to all stakeholders in Europe.<sup>3</sup> With this, *Huawei v ZTE* can be expected to set an EU-wide antitrust standard on the question of injunctive relief for FRAND-pledged SEPs.

Second, judgments issued under the preliminary rulings procedure relate to questions of law, not facts.<sup>4</sup> Neither their reasoning, nor their operative parts, lend themselves to much distinguishing on grounds of case-specificity, beyond the factual framework delineated in the question addressed to the Court. In *Huawei v ZTE*, the questions referred to the Court were phrased in large terms and concerned the conduct of holders of FRAND-pledged SEPs generally. *Huawei v ZTE* can thus be deemed to talk of principles.

This short paper contends that *Huawei v ZTE* is a conservative judgment. It only extends by a razor-thin margin the zone of antitrust liability for patent owners. The *Huawei v ZTE* Court is reluctant to relax its traditional case-law that affirms antitrust liability on patent owners only in

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<sup>2</sup> See CJEU, *Huawei v ZTE*, 16 July 2015, not yet reported. To put things in context, Article 102 TFEU allegations have been raised before national patent courts as a shield to infringement proceedings by unlicensed implementers. Article 102 TFEU allegations have also been made as a sword against SEP holders before and by competition agencies across the world.

<sup>3</sup> It must therefore be observed by all subordinate courts, antitrust agencies, and natural and legal persons subject to their jurisdiction, including foreign firms. See CJEU, Joined cases 28 to 30-62, *Da Costa en Schaake NV, Jacob Meijer NV, Hoechst-Holland NV v Netherlands Inland Revenue Administration*, ECR, 0031 p.69.

<sup>4</sup> See CJEU, Recommendation to national courts and tribunals in relation to the initiation of preliminary ruling proceedings, (2012/C 338/01), ¶ 7: “As stated above, under the preliminary ruling procedure the Court’s role is to give an interpretation of European Union law or to rule on its validity, not to apply that law to the factual situation underlying the main proceedings. That is the task of the national court or tribunal and it is not, therefore, for the Court either to decide issues of fact raised in the main proceedings or to resolve any differences of opinion on the interpretation or application of rules of national law.”

“exceptional circumstances.” To be sure, the Court admits that SEPs covered by a FRAND pledge generate “particular circumstances,” which justify an extension of antitrust liability.<sup>5</sup> But on close read, the Court only expands antitrust liability in relation to a slice of cases of injunctions on FRAND-pledged SEPs that lead to exclusionary leveraging.

In contrast, *Huawei v ZTE* does not seem to contemplate any antitrust liability against firms that use injunctions on FRAND-pledged SEPs to extract “unfair” licensing terms, a problem mundanely described as “patent hold-up.”<sup>6</sup> This is significant, because the Court was perfectly free to frame Article 102 TFEU liability in terms both of abusive exclusion and exploitation, as the Commission did in its *Motorola* and *Samsung* enforcement initiatives which actually prompted the *Huawei v ZTE* reference of the German Court in the first place.

After *Huawei v ZTE*, the basis for antitrust liability against FRAND-pledged SEPs holders is thus very thin. With this, the judgment may also have ramifications on ongoing antitrust cases, in particular those started against a subset of upstream licensing entities—also often referred as Non Practicing Entities (“NPEs”) or Patent Assertion Entities (“PAEs”)<sup>7</sup>—for those firms do not generally purport to, and cannot, engage in anticompetitive leveraging.

## II. FROM EXISTENCE OF ABUSE, TO ABSENCE OF ABUSE

The referring German court questioned the CJEU on the “existence of an abuse,” and the conditions thereof.<sup>8</sup> Instead, the CJEU reverses the perspective. It proceeds to explain, throughout the judgment, the circumstances in which an application for an injunction and/or product recall does not constitute an abuse. The reasoning of the CJEU could not be less clear. At paragraph 55, the Court talks about how “the proprietor of an SEP” can “prevent an action for a prohibitory injunction or for the recall of products from being regarded as abusive.”<sup>9</sup> After setting out a long list of “conditions” relating to the SEP holder’s conduct, the Court repeats, at paragraph 71, that a SEP holder that complies with those prescriptions “does not abuse its

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<sup>5</sup> See CJEU, *Huawei v ZTE*, ¶ 48.

<sup>6</sup> For an early formulation, see Mark A. Lemley & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEXAS L. REV. (1992).

<sup>7</sup> As noted in the European Commission JRC Science and Policy Report, Innovation in the Digital Single Market: The Role of Patents, 17 March 2015: “The preliminary ruling is also expected to have ramifications for the future of Patent Assertion Entities (PAE) practices. In particular, concerns are voiced over possible abuse of the enforcement system and the UPC procedure by PAE.” See also, *Management Plan 2015, DG Competition*, at 34-35 [2015], available at [http://ec.europa.eu/atwork/synthesis/amp/doc/comp\\_mp\\_en.pdf](http://ec.europa.eu/atwork/synthesis/amp/doc/comp_mp_en.pdf): “The Commission further observes that a phenomenon coming with the proliferation of IT patents and patent litigations is the emergence of so-called non-practising entities (NPEs). There are companies which are not involved in R&D activities or in the manufacturing or sale of goods or services, but whose business is limited to the acquisition and enforcement of patent and patent portfolios. In Europe, it is expected that NPEs will become more active with the installation of the new unitary European patent and the new Unified Patent Court which will allow for European-wide enforcement of patents. Competition law obligations with regard to patents, and in particular SEPs, apply in the same way to NPEs as to any other company”; A. Italianer, Director-General for Competition, European Commission, “Shaken, not stirred. Competition Law Enforcement and Standard Essential Patents” (Apr. 21, 2015): “We will remain on guard in our antitrust enforcement. Because holders of SEPs find new ways of challenging alleged patent infringement. In a recent case before the [German] Mannheim district court, the SEP-holder sued not the *producer* of the phone, but the *distributor* of the phone: Deutsche Telekom. This is a new development and we are watching it closely”.

<sup>8</sup> *Id.*, ¶ 43.

<sup>9</sup> *Id.*, ¶ 55.

dominant position ... by bringing an action for infringement.”<sup>10</sup> Finally, the operative part of the judgment, which is the response to the German court, is again worded in terms of the conditions under which Article 102 TFEU can be deemed inapplicable.

In plain words, the German court asked the Court: Can you tell me when there is abuse? And the Court responded: No, I will tell you when there is no abuse. This is subtle, and as a result *Huawei v ZTE* is not primarily about antitrust liability. It is predominantly about antitrust immunity.

### III. LIABILITY FOR PRACTICING ENTITIES, IMMUNITY FOR UPSTREAM LICENSING ENTITIES

*Huawei v ZTE* only finds antitrust liability against SEPs holders that manufacture or sell products on the basis of the licensed technology. Paragraph 52 of the judgment explains the sort of antitrust concerns which the Court finds are raised by injunctions on FRAND-pledged SEPs: a SEP owner “can prevent products manufactured by competitors from appearing or remaining on the market and **thereby reserve to itself the manufacture of the product in question** (emphasis added).”<sup>11</sup> Actions for injunctions and/or product recall are problematic because SEP owners with a certain degree of vertical integration can monopolize the manufacturing market.

Readers well versed in antitrust law will recognize here the classic anticompetitive leveraging scenario for Article 102 TFEU liability.<sup>12</sup> An actual or potential degree of vertical integration in manufacturing by the SEP holder is necessary to trigger a finding of abuse. The practical implication of this is that upstream licensing entities remain immune from Article 102 TFEU liability for this type of conduct.

In the antitrust field, some stakeholders contend that the Court’s holding in *Huawei v ZTE* is much broader.<sup>13</sup> They argue that the FRAND commitment generates antitrust liability in itself, *vis-a-vis* an indefinite number of third parties, and regardless of whether the SEP owner who gave the commitment is or not vertically integrated. Their argument is based on paragraph 53 of the judgment, which says that “an undertaking to grant licences on FRAND terms creates legitimate expectations on the part of third parties” such that a “refusal by the proprietor of the SEP to grant a licence on those terms may, in principle, constitute an abuse within the meaning of Article 102 TFEU.”<sup>14</sup>

This reading is specious. Paragraph 53 opens with “In those circumstances.” It is thus safe to assume, given our numeral system, that paragraph 53 chimes with paragraph 52, and that the “circumstances in which FRAND terms create legitimate expectations” are those in which a vertically integrated SEP owner initiates infringement proceedings.

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<sup>10</sup> *Id.*, ¶ 71.

<sup>11</sup> *Id.*, ¶ 52.

<sup>12</sup> For an early formulation, see Aaron Director & Edward Hirsch Levi, *Law and the Future: Trade Regulation*, 51 NORTHWESTERN UNIV. L. REV. 281 (1956): “The doctrine of abuses sees them as exclusionary devices useful for getting a monopoly, or expanding it, or for moving from one monopoly to the creation of another. Thus when vertical integration is concerned, the inquiry is often as to the “leverage” of the device.”

<sup>13</sup> See speech of Commissioner Vestager, 11 September 2015, 19<sup>th</sup> IBA Conference, Florence, *available at* [https://ec.europa.eu/commission/2014-2019/vestager/announcements/intellectual-property-and-competition\\_en](https://ec.europa.eu/commission/2014-2019/vestager/announcements/intellectual-property-and-competition_en)

<sup>14</sup> *Id.*, ¶ 53.

#### IV. ANTITRUST LIABILITY VIS A VIS COMPETITORS

Like it or not, the other implication of the anticompetitive leveraging theory of liability endorsed in *Huawei v ZTE* is that it is only abusive for a SEP holder to seek an injunction and/or product recall against an implementer with whom it does (or will) compete in a market. This, in turn, implies that a SEP owner with upstream manufacturing activities (e.g., a networking equipment provider) remains free to start injunction and/or product recall proceedings against an unlicensed downstream manufacturer (e.g., a handset manufacturer) with whom it does not compete. And this makes perfect sense, because as is well-known, only a relevant market is worth monopolizing.

#### V. ANTITRUST LIABILITY FOR EXCLUSION OF COMPETITORS, NOT EXPLOITATION

Though this is a subtle nuance, the *Huawei v ZTE* Court's antitrust concern is one of anticompetitive exclusion, not exploitation. The Court is silent on the alleged risk that SEPs owners resort to patent litigation to charge unFRAND licensing terms from rival implementers. Instead, it is vocal on risks of anticompetitive foreclosure.

At first glance, this omission looks mysterious. The patent hold-up/royalty stacking theory has fueled many antitrust initiatives, including the Commission's *Motorola* decision which devoted 15 of the 17 pages on "anticompetitive effects" to its discussion.<sup>15</sup>

Did the patent hold-up theory fall through the cracks of judicial proceedings? This is unlikely. The question of patent hold-up (and hold-out) had been placed front and center before the CJEU, which mentions it in its ruling.<sup>16</sup> And even before this, patent hold-up was mentioned in the December 21, 2012 Press Release which prompted the reference from the German court,<sup>17</sup> at the oral hearing, and in the Opinion of Advocate General Wathelet.<sup>18</sup>

All this confirms that the question of hold-up had entered the scope of the proceedings brought before the CJEU. And it kills for good the argument that *Huawei v ZTE* was not a case about hold-up, so that the Court could not allegedly reason the case in terms of abusive exploitation.

Against this background, the Court's silence conveys a message, but which one? Does it repudiate the hold-up/royalty stacking theory? Maybe. Is it reluctant to let antitrust enforcers interfere with the price system, and believe that the national courts system adequately deals with such issues in the context of FRAND setting proceedings? This is more likely.

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<sup>15</sup> See Commission Decision, Case AT.39985 – Motorola – Enforcement of GPRS Standard Essential Patents, 29 April 2014.

<sup>16</sup> See CJEU, *Huawei v ZTE*, *supra* note 2, ¶ 38.

<sup>17</sup> See EU Commission, Press Release, Brussels, 21 December 2012, Antitrust: Commission sends Statement of Objections to Samsung on potential misuse of mobile phone standard-essential patents: "Standards bodies generally require members to commit to license patents that they have declared essential for a standard on FRAND terms. This commitment is designed to ensure effective access to a standard for all market players and to prevent "hold-up" by a single SEP holder, since access to those patents which are standard-essential is a precondition for any company to sell interoperable products in the market."

<sup>18</sup> See AG Wathelet Opinion under *Huawei v ZTE*, FN 50.

## VI. PATENTEE (ANTITRUST) OR IMPLEMENTER (IP) LIABILITY FOR NEGOTIATION BREAKDOWN

The *Huawei v ZTE* Court ascribes procedural courtesy obligations to a FRAND pledge. Interestingly, those rules of conduct apply both to the SEP holder and to the infringer.

The Court seems to use the threat of antitrust (abuse) and IP (injunction) liability as backstops, to discipline both SEP holder and infringer in order that they converge towards a mutually agreeable FRAND royalty level (a process denoted by the inverted trapezoid figure below).<sup>19</sup> This leads the CJEU to map out the negotiation process that should be followed by SEPs holders who have given a FRAND commitment if they wish to stay clear of the strictures of antitrust enforcement, and by unlicensed infringers who wish to resist actions for injunctions and product recall.

From an antitrust standpoint, this is interesting, because the SEP holder retains at several junctures the freedom to start injunction/product recalls actions, “as long as” he observes a certain procedural courtesy.<sup>20</sup> Instead of reciting the process, let us identify the circumstances in which injunctions relating to FRAND-pledged SEPs remain available: if in response to a notice of infringement, the implementer does nothing; in response to the initial FRAND offer of the SEP holder, the implementer does not submit a FRAND counter offer, or submits an UNFRAND counter offer, or submits a FRAND counter offer but practices the SEP without putting royalties into escrow; in case the offer is on the higher bound of the FRAND range and the counter-offer is in the lower bound, though this conclusion remains unclear from the judgment (see question marks in the figure below). Conversely, a finding of antitrust liability can arise when the SEP holder starts infringement proceedings: without prior alert; before making a FRAND offer

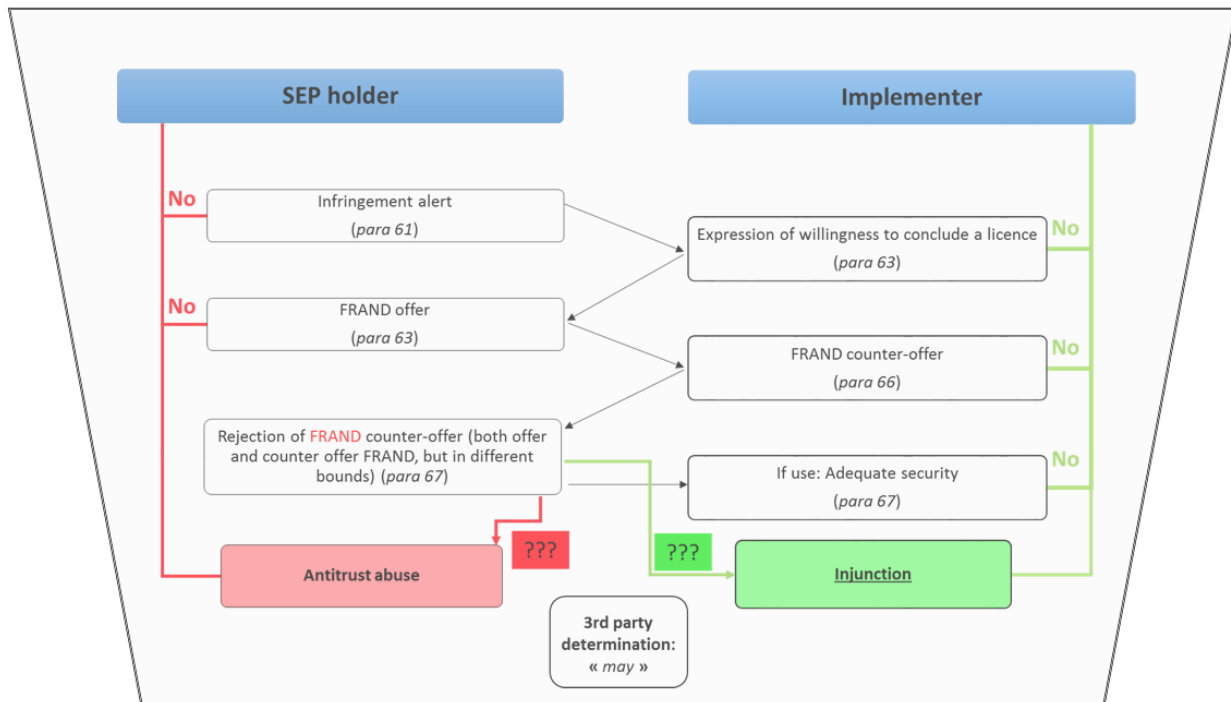
Moreover, the Court steers clear from laying down detailed FRAND pricing principles. In fairness, this was not unexpected. The referring Court had not queried the Court on the meaning of FRAND. That said, the Court suggests that it is not an UNFRAND counter-offer, or UNFRAND behavior, for the licensee to challenge the validity or essentiality of the SEP.<sup>21</sup>

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<sup>19</sup> Figure reproduced and adapted from N. Banasevic, *The Implications of the ECJ's Huawei/ZTE Judgment*, BRUSSELS MATTERS, (17 September 2015).

<sup>20</sup> See CJEU, *Huawei v ZTE*, *supra* note 2, ¶ 71.

<sup>21</sup> *Id.*, ¶ 69.



**VII. FRAND IS A RANGE, NOT A PIXEL PRICE**

Even though the *Huawei v ZTE* Court does not address FRAND pricing, it acknowledges that both parties can make FRAND offers and counter-offers and, in spite of this, remain in disagreement.

This gives currency to the view that there is not a pixelized FRAND point, and that several distributional prices exist that are FRAND. In particular, if the SEP holder makes a FRAND offer in the upper bound, and the implementer makes a FRAND counter-offer in the lower bound, the parties “may” submit their dispute to third-party determination. But if they disagree over this, the ultimate question is what happens. And on this, the Court gives no guidance.

**VIII. CONCLUSION**

*Huawei v ZTE* does not address comprehensively all issues related to standards, patents, and antitrust policy: e.g. dominance, standards competition, countervailing buyer power among SEP holders, portfolio licensing, Non-SEPS, *De facto* standards, FRAND pricing, valuation techniques, etc.

It suggests, however, that beyond competitor exclusion, there is little space for antitrust policy in disputes relating to FRAND-pledged SEPs. Advocate General Wathelet had recognized the existence of distributional, bargaining, and revenue-sharing problems among Standard

Setting Organizations (“SSOs”) participants.<sup>22</sup> His Opinion urged SSOs to address those problems internally, and to use only antitrust law as a “last resort.”<sup>23</sup>

The *Huawei v ZTE* Court goes further. In the context of FRAND-pledged SEPs, the law on abuse of dominance applies only to the exclusion of rivals.<sup>24</sup> Its reach is limited, and does not encompass the conditions at which SEP licenses are granted, unless they amount to a refusal to license. Disputes over such conditions seem left to the wisdom of national courts.

The Court could have sought to address the alleged hold-up problem. An obvious route, for instance, would have been to tell the German judge that an injunction or product recall action is abusive when it leads to “unfair selling prices,” within the meaning of Article 102 (a) TFEU. It did not. And this contrasts with the judicial activism of the Court in other areas, where it has resorted to Article 102 (a) TFEU of its own motion, to establish antitrust liability.<sup>25</sup>

After *Huawei v ZTE*, it is predictable that some stakeholders with an iron in the fire—in particular those who have railed and taken steps against so-called “patent trolls”—will contend that Article 102 TFEU remains applicable to the conduct of NPEs on the ground that the case referred to the CJEU concerned competing firms, and that the Court could not possibly talk of NPEs conduct. This does not only ignore the nature of preliminary rulings. It also obfuscates that the question referred by the German court drew no distinction between the conduct of upstream licensing entities and practicing entities, and talked of owners of FRAND-pledged SEPs generally. Moreover, the implicit repudiation of the hold-up theory, which is the main type of harm allegedly caused by NPEs, corroborates that Article 102 TFEU does not—in the Court’s view—apply to NPEs.

One could attempt to dwell on the reasons underpinning the Court’s lack of consideration of upstream licensing entities conduct as a possible source of abuse. A tentative one is that the Court believes that hold-up is an issue of less concern than anticompetitive exclusion. Another plausible explanation is the Court’s trust in the national courts to deal with revenue-sharing disputes among industry players.

Unfortunate as it may be for some policy makers, the solution given by the Court of Justice is crystal clear. *Dura lex, sed lex...*

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<sup>22</sup> See AG Wathelet Opinion under *Huawei v ZTE*, ¶ 11.

<sup>23</sup> *Id.*

<sup>24</sup> It also remains arcane on the test of anticompetitive foreclosure that ought to apply to admissible antitrust defenses. Indeed, if the grant of an injunction leads to the removal of products from a given geographic market, it does not flow that large firms with multi-market operations will necessarily be excluded by a simple request for an injunction or product recall. Moreover, EU law connoisseurs know all too well that the notion of “legitimate expectations” is subject to a case-by-case, strict assessment, and that if this is the test to be used, then the first question to address is whether, in the proceedings at hand, the FRAND commitment was likely to generate such expectations.

<sup>25</sup> See for instance, in Case C-52/09, *Konkurrensverket v TeliaSonera Sverige AB*, [2011] ECR I-00527, ¶ 25.