

FRAND Defence in German Courts: Remedy Against Standard-Essential Patents?

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Standard setting is considered an inevitable process nowadays. It enables the interoperability of products and services from different vendors. The telecommunication sector, for example, is heavily penetrated by standards, including USB, 3G, 4G, USTM and many others. Standards make it possible for telecommunication devices, such as smart phones, to work almost anywhere in the world and run applications from a plurality of software developers. If a standard cannot be applied without using a patent, the industry terms such a patent a “standard-essential patent”. Such patents may conflict with the need for market participants or entrants to have access to standards. This situation is particularly critical in areas where standards have obtained market- or industry-wide recognition and where products that do not provide “standard compliance” may therefore be unsalable. This is an important issue, particularly given the ongoing patent wars relating to smart phones and tablets taking place in the German courts and elsewhere.

Potential Solution to the Conflict

In 2004, the German Supreme Court was faced with such a conflict for the first time (*Standard Tight-Head Drum: Spundfass*). An Italian manufacturer of barrels for chemical liquids argued that the patentee’s refusal to grant the manufacturer a licence constituted an abuse of a market-dominating position by discriminating against the manufacturer in the face of other manufacturers to whom licences had been granted by the patentee. Indeed, a refusal of that licence would have kept the manufacturer away from a particular market. The German Supreme Court recognised that in such a situation, it is the patentee’s duty to grant a licence and that, furthermore, the accused infringer may rely on a defence against an injunction requested by the patentee in patent litigation.

In a second decision from May 2009, the *Orange Book Standard* decision, the court maintained its general position that the defendant can raise a defence in patent litigation when a market-dominating position could result from the assertion of a patent (Art. 102 TFEU). The considered case refers to joint innovation efforts mainly made by Philips and Sony, which have been internationally accepted under the intellectual property rights declaration and licensing policies of the European Computer Manufacturers Association, and internationally recognised by the International Organisation for Standardisation and the International Electrotechnical Commission. The parties in that case were not competitors within the product market. Rather, the patentee was essentially in the business of selling licences offered publicly on the internet under standard terms. The defendants, who found these terms to be commercially unacceptable, mainly sought to obtain more favourable conditions. When the defendants continued to use the patented invention by adhering to the technical standard, the plaintiff brought an infringement action seeking injunctive relief. The defendants claimed that they were entitled to a licence under Fair, Reasonable and Non-Discriminatory (FRAND) terms. The Federal Supreme Court concluded that such defence was admissible, provided, however, that the defendant had behaved like a “hypothetical licensee.”

Several recent decisions of the District Courts Düsseldorf and Mannheim rendered in the aforementioned smart phone and tablet wars have further exemplified and elucidated the requirements of the FRAND defence as developed by the Supreme Court in the so-called *Orange Book* decision.

The Requirements of the FRAND Defence

A successful defence requires the following:

- (1) That the patentee hold a market-dominating position thanks to a patent or plurality of patents. This requirement is typically fulfilled if the use of the standard necessarily requires the use of the patent and if the standard compliance is a precondition to participate in a particular market.
- (2) That the hypothetical licensee (*i.e.*, accused infringer)
 - (a) Has made an unconditional offer to license under fair, reasonable and non-discriminatory terms that cannot be rejected by the patentee without violating the prohibition of discrimination and obstructive practices. The patentee is not obliged to make that offer, but it will violate antitrust law (Art. 102 TFEU) if it refuses an adequate and unconditional offer made by the accused infringer.
 - (b) Behaves like a licensee and renders account (*i.e.*, produces adequate reports about past sales).
 - (c) Has compensated the patent owner for any previous use of the patent, under FRAND terms.

The accused infringer must have fulfilled the above conditions by the day of the hearing so that the court can take the defence into account.

(a) Offer

Defining a FRAND complaint offer presents challenges. In particular, the accused infringer may have difficulty determining the proper royalty rate. To facilitate the process, the case law allows that the accused infringer leave the determination of the amount to the patentee's discretion. The determination made by the patentee will not be binding on the accused infringer if the amount is evidently inequitable, in which case the determination can be referred to a court and thus be made by judicial decision. Accordingly, the accused infringer may stipulate in the offer: "the royalties shall be set by the licensor according to its equitable discretion and according to the FRAND standard in the industry within . . . days from the execution of this agreement. Whether the royalties fulfill the FRAND standard in the industry shall be subject to examination and be changed with retroactive effect by a court."

Of importance is that the offer must be unconditional. This means the accused infringer must waive its objections against the patent. In other words, the accused infringer must give up. It would not be possible to make the defence dependent upon the court first deciding whether the patent is actually infringed. Also, the accused infringer would have to withdraw a pending nullity action filed against the patent.

(b) Reports

The accused infringer must render account like a licensee, *i.e.*, it must produce adequate reports about past sales. This report will form the basis of the determination of the amount to be paid for the past.

(c) Payments for Previous Use

A FRAND complaint royalty must have been paid for past use. Determining the right amount for previous use of the patent presents a particular challenge because the alleged infringer must pay it in advance of the hearing. Accordingly, the alleged infringer must also determine the amount to be paid and cannot leave this assessment to the patentee or court. For this, the alleged infringer would have to rely on the available evidence that is usually used for determining reasonable royalties. Existing licence agreements may be used as a reference frame. The alleged infringer is not obliged to pay the determined amount to the patent owner directly, but can instead pay it into a trust account at the German court. If the deposited amount is later found to be too high, it is then possible to reclaim the excess. To ensure that everything is in place by the day of the hearing, and because the accused infringer's assessment of the royalty for past use is not binding, it is always advisable to side with caution and pay more. The amount determined by the patent owner for previous use must not necessarily represent the FRAND complaint future use of the patent, which can be determined at a later date.

Conclusions

The FRAND defence is being considered in many current patent litigation cases. It plays a particularly important role in the ongoing patent wars between companies of the telecommunication sector, including hardware/software companies, in particular the smart phone and tablet computer producers of Silicon Valley in the United States.

German courts strictly apply the requirements of the defence, in a manner seemingly friendly to the patentee. Accused infringers often are unsuccessful because not all of the indicated requirements have been sufficiently fulfilled.

FRAND defence cannot be considered as a typical defence. It implies that the accused infringer fully waives all objections which can be brought up against the injunction and the foundation of the damage claim. Hence, it generally cannot be raised in parallel to other defences usually raised in patent litigation. Accordingly, at one point during the infringement proceedings the accused infringer must make that decision, which requires a well-balanced analysis of the involved risks and chances. On the one hand, there is the risk that an injunction be granted and the patentee be excluded from further selling the accused products on the market; on the other hand, the application of the FRAND defence discards the chance to win the case as the court would not decide on infringement or validity of the patent.

Because of the narrow time frames given by German courts before the hearing, the assessment of the chances to invalidate the patent and the quality of the non-infringement arguments and other defences must be carried out as soon as possible after service of the complaint, and preferably even earlier—namely, as soon as there seems to be a risk of patent infringement action in Germany. This ground-work will help the patentee make a good decision at the right time. Even if the accused infringer decides later not to opt for the FRAND defence, the assessment still will be useful for its defence.

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