Institutional Aspects of the Holdup Debate

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Necessary Ingredients for a Holdup for non-SEPs

1. A patent holder and an implementer of the patented technology.
2. It is not practical to negotiate a license prior to investment in product design. Therefore, licensing negotiations take place after the product design costs are sunk (ex-post negotiations).
3. The patent owner can obtain an injunction for a patent infringement if licensing negotiations fail.

Holdup Mechanism for non-SEPs

- In ex-post negotiations, the outside option for the prospective licensee is relatively worse than in negotiations prior the product design investment (because of sunk product design cost).
- The value to the parties of reaching an agreement in ex-post licensing negotiations is thus higher when compared to the value of reaching an agreement in ex-ante negotiations.
- The patent owner can extract some of the increment in the value of the agreement in the form of higher royalties in ex-post negotiations. Product design investment creates a negative bargaining externality. This may result in sub-optimal investments.
- The solution is deceptively simple. Either (1) force ex-ante negotiations, prior to implementer's investment or; (2) limit availability of injunctions – that is, apply liability rather than property rule to patent infringements (with reference to some “fair” royalty rate).

Holdup Mechanism for SEPs

- After the patented technology is included into the standard, there is no alternative technology available to an implementer of the standard.
- This increases the value of reaching an agreement in licensing negotiations relative to the value of an agreement prior to the inclusion into the standard (when alternatives were available).
- The patent holder with bargaining power can appropriate some of this value increase.
- The inclusion of patented technology into the standard therefore introduces a bargaining externality which may lead to suboptimal investments by the implementer.

A Necessary Ingredient for an SEP Holdup

For implementer holdup, it is necessary to assume that FRAND commitment is not enforceable.

- To see this, consider two options:
  - Option 1: Unbiased 3rd party review of FRAND terms
    - The outside option for the implementer is 3rd party determination of royalties – this removes (or reduces) the bargaining externality from inclusion of the patent into the standard (or from investing in product design). No holdup.
    - Same effect as if negotiations took place prior to implementer's investment (or prior to inclusion into the standard with some definition of FRAND).

A Necessary Ingredient for an SEP Holdup - cont'd

- Option 2: The court does not itself set a FRAND rate, but rather assesses the willingness of the licensor to take a license before granting an injunction (while, at the same time assessing validity and infringement)?
  - Langus, Lipatov and Neven. JCLE 2014: The court assesses the prospective licensee's offer and only grants injunctions if the offer is below FRAND and the patent is found to be valid.
  - We find that there is no systematic hold up in such a setting. In fact, the patent holder may end accepting royalties below FRAND in equilibrium.
  - In this model, weak patents are litigated in equilibrium – consistent with what we see in reality.

- If the courts indeed balance the concerns about hold-up and reverse hold up, there is no need for additional antitrust liability.

Institutional Setting for SEPs before ZTE/Huawei

- So, are the necessary conditions for holdup in the SEP context satisfied in reality? Most likely not.
- Camesasca et al. (2014, JCLE) - review of court procedures in France, Germany, Italy, the Netherlands and the UK.
- Injunctions for SEPs have not been readily available:
  - Preliminary injunctions in the EU have been extremely difficult to obtain for all patents.
  - National courts in the EU would only grant final injunctions if the prospective licensee has not made any offer, or has actually made offers that the court considers to be inadequate, or has refused to agree to accept a license on FRAND terms adjudicated by the court to be FRAND.

Additional Risks of Reverse Holdup for SEPs

- FRAND commitment is a one-sided one:
  - It confers obligations on the patent holder but none on the implementer.
  - Froeb et al, JIE, 2012: the implementer can accept a FRAND fee proposal and later sue the patent holder for FRAND commitment infringement. This can lead to a hold up of the patent holder, thus depressing innovation by the patent holder below socially optimal.
- Antitrust liability risk is also one-sided.
  - When courts balance the risk of holdup against the risk of reverse holdup, the added antitrust liability risk imposed on patent holders risks that they might systematically obtain royalties below FRAND.

Huawei/ZTE Preliminary Judgment

- Not good: does not eliminate a separate antitrust risk associated with actions for injunctions.
- Good: In contrast to the EC's Samsung and Motorola, it offers no easy escape for any of the parties:
  - Before an infringing implementer can raise the abusive nature of the action for an injunction, it must give a FRAND counter-offer [Recital 66]. Confims the need for an explicit FRAND assessment in the procedure (Langus et al, 2014).
  - The seeking of injunction does not constitute an abuse where the patent holder has made a FRAND offer and the alleged infringer has not dilligently responded to that offer (FRAND counteroffer?) [Recital 71] – still no easy escape for the implementer.
  - A unilateral proposal for a third party FRAND determination establishes no safe harbor [Recital 68].

Conclusion

- Systematic hold up is unlikely when courts consider FRAND defense before granting an injunction.
- Reverse hold up may arise in equilibrium, depending on the exact way in which FRAND defense is considered.
- Adding antitrust liability to the current institutional setting likely contributes to the risk of reverse holdup.
- While the ZTE/Huawei judgment does not remove (the unnecessary) additional antitrust liability risk, I see it as reducing it somewhat from the level where it was after the EC's Samsung and Motorola.

Who is holding up (and when)?