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Editors Note

It is with proudness and enthusiasm that the Editorial Board presents this inaugural issue of the *Nordic Journal of European Law* (NJEL). The journal is published within Lund University and in cooperation with other Nordic universities. The NJEL is an open access, peer-reviewed journal with a Nordic perspective.

Launching a journal demands tremendous work and we are most grateful to our Student Editor Baldvin Kristjànsson and all the Members of our Advisory Board. A special thanks to our peer reviewers for their help, without which this issue would never have seen the day. We are also very proud of the contributions of the scholars and practitioners and grateful to everyone that applied for submission. Thank you.

The academic interest for European law cannot be overstated and it is a growing discipline within Nordic universities. The NJEL is PhD-managed, and serves the purpose of fostering research in European legal studies within Nordic universities and, in addition, bridging between law faculties in the Nordic countries. We strive to welcome a broad spectrum of contributions dealing with European law. Going beyond EU law, the NJEL takes a wide approach to European Legal studies and, moreover, warmly welcomes inter-disciplinary perspectives.

Looking upon this first inaugural issue, the common thread of all our contributions is that they deals with different perspectives of European business law. Lund University provides since the early 1990s, open to students from all over the world, a LL.M. programme in European business law. This first issue focuses on key developments within the Jurisprudence of the European Court of Justice and the EFTA Court, dealing with a wide range of issues: public procurement law; merger regulation; intellectual property; and company law.

Looking towards the future, nevertheless, our ambitions certainly do not stop here: we are delighted to announce that we are already planning for a call for papers for our first issue of the year of 2019. Taking a broad approach to European law, we will especially welcome articles connected to the theme of the rule of law. We will welcome a broad spectrum of contributions helping us to further broaden the horizons of European legal studies.

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YOU CAN'T BE SERIOUS: CRITICAL REFLECTIONS ON THE LIABILITY THRESHOLD FOR DAMAGES CLAIMS FOR BREACH OF EU PUBLIC PROCUREMENT LAW AFTER THE EFTA COURT'S *FOSEN-LINJEN* OPINION

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Abstract

This paper offers some reflections on the position advanced by the EFTA Court that a simple breach of EU public procurement law is in itself sufficient to trigger the contracting authority's liability in damages (Fosen-Linjen). I argue that this position is flawed because it deviates from previous case law of the Court of Justice of the European Union (Spijker), and because it is based on interpretive errors and internal contradictions in the EFTA Court's reasoning. In criticising the EFTA Court's Judgment from the perspective of the harmonisation of EU law, I rely on the better view of the UK Supreme Court. The latter held that the liability of a contracting authority for the breach of EU public procurement rules under the remedies directive is assimilated to that of the State under the general EU law doctrine of State liability and thus requires a sufficiently serious breach (Nuclear Decommissioning Authority). My reflections are based on the need to keep procurement damages litigation constrained to its main function and limited to justified cases. I use this normative position to argue against the expansion of private enforcement of EU public procurement law as a correction of the shortcomings in its public enforcement.

1 INTRODUCTION

The academic, and now also judicial, debate around the regulation of remedies for breach of EU public procurement law has focused on, amongst other issues, the contested relationship between the potential liability in damages derived from the

* Reader in Economic Law, University of Bristol Law School. Member of the European Commission Stakeholder Expert Group on Public Procurement (2015/18). All opinions are my own and they do not reflect those of the institutions with which I am affiliated. This paper builds on previous discussion of the *Fosen-Linjen* case in my blog http://www.howtocrackanut.com on 9 and 29 November 2017. I am grateful to all readers that engaged in prior discussions and offered comments and criticisms of the views offered in those posts. The paper was also presented at the BECCLE seminar on 'Public Procurement and Damages,' held at the University of Bergen on 1 March 2018. I am grateful to Dr Ignacio Herrera Anchustegui for the invitation to participate, and to all other speakers and participants for useful discussion. I am particularly grateful for the specific issues raised by Dag Sørlie Lund, Dr Kirsi-Maria Halonen and Prof Halvard Haukeland Fredriksen, as well as for the challenges presented by Theresa Haas. All of them have informed the final version of this paper. However, any remaining errors are my own. Further comments welcome: a.sanchez-graells@bristol.ac.uk.

Remedies Directive[1] and the general principle of State liability for breaches of EU law.[2] The Remedies Directive requires Member States to grant a power to their review bodies or courts to 'award damages to persons harmed by an infringement' of relevant EU public procurement rules (Art 2(1)(c)). Following the principle of procedural autonomy, the conditions for the regulation of this right to damages are deferred to Member States' legislation, subject to compliance with the general principles of effectiveness and equivalence.[3] On its part, the principle of State liability also allows for damages claims due to breaches of EU law, which at least *in principle* covers procurement law despite the existence of the Remedies Directive.[4] This doctrine (generally referred to as *Francovich* doctrine) requires Member States – or public bodies for which they are responsible,[5] including the judiciary[6] – to have incurred in a 'sufficiently serious breach' of EU law as a condition for damages claims by the affected individuals.[7]

The existing debate about the relationship between these two regulatory mechanisms boils down to disagreements over whether the Remedies Directive should

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[1] Directive 89/665/EEC on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts [1989] OJ L395/33, as amended by Directive 92/50/EEC [1992] OJ L 209/1, and by Directive 2007/66/EC [2007] L 335/31 (hereinafter, the 'Remedies Directive'). A consolidated version is available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1989L0665:20080109:en:PDF>.

[2] Following the Judgments of the Court of Justice of the European Union of 19 November 1991 in Joined Cases C-6/90 and C-9/90 *Francovich and Others* EU:C:1991:428, and of 5 March 1996 in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* EU:C:1996:79.

[3] Judgment of the Court of Justice of the European Union of 30 September 2010 in Case C-314/09 *Strabag and Others* EU:C:2010:567, paras 33-34; Judgment of the Court of Justice of the European Union of 9 December 2010 in Case C-568/08 *Combinatie Spijker Infrabouw-De Jonge Konstruktie and Others* EU:C:2010:751, para 92. See also Steen Treumer, 'Enforcement of the EU Public Procurement Rules: The State of Law and Current Issues', in ibid & Francois Lichère (eds), *Enforcement of the EU Public Procurement Rules* (DJØF 2011) 17, 37–39.

[4] A strict position could be foreseen under a unifying thesis, where it could be argued that the adoption of the Remedies Directive displaced the doctrine of State liability in this area of EU economic law. Seemingly along these lines, see Treumer (n 3) 39. Similarly, Roberto Caranta, 'Many Different Paths, But Are They All Leading To Effectiveness?' in Treumer & Lichère (eds), *Enforcement of the EU Public Procurement Rules* (n 3) 53, 71. However, this could hardly avoid the application of the general principle of State liability, as would derive from a functional equivalent interpretation of Judgment of the Court of Justice of the European Union of 19 January 2010 in Case C-555/07 *Kücükdeveci* EU:C:2010:21, see in particular para 27. See also Judgment of the Court of Justice of the European Union of 1 March 2011 in Case C-236/09 *Association Belge des Consommateurs Test-Achats and Others* EU:C:2011:100, see in particular para 32.

[5] See Judgment of the Court of Justice of the European Union of 10 October 2017 in Case C-413/15 *Farrell* EU:C:2017:745. For discussion, see Albert Sanchez-Graells, 'Interesting clarification (and broadening) of the Foster test on 'emanation of the State' for purposes of direct effect of EU Directives (C-413/15)' (howtocrackanut, 10 October 2017) <http://www.howtocrackanut.com/blog/2017/10/10/interesting-clarification-of-the-foster-test-on-emanation-of-the-state-for-purposes-of-direct-effect-of-eu-directives-c-41315?rq=farrell> accessed 16 September 2018.

[6] Judgment of the Court of Justice of the European Union of 30 September 2003 in Case C-224/01 *Köbler* EU:C:2003:513; Judgment of the Court of Justice of the European Union of 13 June 2006 in Case C-173/03 *Traghetti del Mediterraneo* EU:C:2006:391. For discussion, from a procedural autonomy perspective, see Nicolo Zingales, 'Member State Liability vs. National Procedural Autonomy: What Rules for Judicial Breach of EU Law' (2010) 11 German Law Journal 419.

[7] Michal Bobek, 'The effects of EU law in the national legal systems', in Catherine Barnard & Steve Peers (eds), *European Union Law*, 2nd edn (Oxford University Press 2017) 143, 170–171.

be constructed as a particularisation of the general principle of State liability under EU law (a 'unifying thesis') or whether a distinction should be made between 'a public law of torts in the form of Member State liability, and damages for breaches of specific EU legislation under the effectiveness postulate (the 'separation thesis')'.[8] The unifying thesis would result in the superimposition of the requirement of 'sufficiently serious breach' to the award of damages under the Remedies Directive. Conversely, the separation thesis would result in a free-standing interpretation of the liability threshold in the Remedies Directive, and possibly in a reduction of the threshold of infringement triggering potential liability in damages. This would aim to avoid what has been considered 'the paradoxical result […] that although the remedies regime is more concrete and elaborate than in other areas of the law, the Court [of Justice] would be forced into the abstract generalities of Member State liability, rather than the specificities of the procurement sector'.[9] This is the specific legal issue with which this paper is concerned.

Interestingly, this is a systemic issue that the Court of Justice of the European Union (CJEU) explicitly addressed in *Spijker*,[10] when it stated that Art 2(1)(c) of the Remedies Directive:

> […] *gives concrete expression to the principle of State liability* for loss and damage caused to individuals as a result of breaches of EU law for which the State can be held responsible […].[11]
>
> […] as regards state liability for damage caused to individuals by infringements of EU law for which the state may be held responsible, *the individuals harmed have a right to redress where* the rule of EU law which has been infringed is intended to confer rights on them, *the breach of that rule is sufficiently serious*, and there is a direct causal link between the breach and the loss or damage sustained by the individuals. In the absence of any provision of EU law in that area, *it is for the internal legal order of each member state, once those conditions have been complied with, to determine the criteria on the basis of which the damage arising from an infringement of EU law on the award of public contracts must be determined* and estimated, provided the principles of equivalence and effectiveness are complied with.[12]

It is worth stressing that, in a second layer of case law, the CJEU has created additional specific constraints on the exercise of their procedural autonomy by the Member States when establishing the specific conditions for claims for damages. For example, the CJEU has barred the possibility of subjecting the liability in damages of a contracting authority to a requirement of fault or fraud,[13] even if claimants can benefit from a

[8] Hanna Schebesta, *Damages in EU Public Procurement Law* (Springer 2016) 8. For extended discussion, see ibid 65-71, in particular 67-68.
[9] ibid 71.
[10] *Spijker*, EU:C:2010:751.
[11] ibid para 87 (emphasis added).
[12] ibid para 92 (emphasis added).
[13] Judgment of the Court of Justice of the European Union of 14 October in 2004 Case C-275/03 EU:C:2004:632.

rebuttable presumption of fault.[14] It has also declared the incompatibility with EU law of requirements that made a claim for damages conditional upon a prior finding of unlawfulness of the direct award of a public contract, where the action for a declaration of unlawfulness was subject to a six-month limitation period that started to run on the day after the date of the award of the public contract in question, irrespective of whether or not the applicant in that action was in a position to know of the unlawfulness affecting the decision of the awarding authority.[15] CJEU case law has also prevented national procurement review bodies and courts from raising of their own motion infringements other than those supporting a claim for damages, where owing to the unlawfulness raised of their own motion, the court or review body would dismiss the action on the basis that the award procedure was in any event unlawful and the harm which the tenderer may have suffered would therefore have been caused even in the absence of the unlawfulness alleged in the claims for damages.[16] The CJEU has imposed these additional constraints because the imposition of any such requirements (*eg* of fault, or exclusive causation) would erode the effectiveness of the right to damages under the Remedies Directive (Art 2(1)(c)).

In my view, there could not be a closer formulation of the unifying thesis than the one formulated in *Spijker*,[17] whereby it is clear that Art 2(1)(c) of the Remedies Directive fleshes out or particularises the doctrine of State liability for breaches of EU law in the context of public procurement.[18] Moreover, nothing in the second layer of case law constraining the exercise of procedural autonomy by the Member States should be seen as potentially challenging this systemic or fundamental position. However, maybe surprisingly, *Spijker* is not (yet) universally seen as having settled the issue of the interaction between the grounds for actions for damages under the Remedies Directive and under the State liability doctrine, and some authors consider it irreconcilable with a reading of *Strabag* that would require Member States to ensure *strict liability* for breaches of EU public procurement law. In my view, those readings of *Strabag* are incorrect in that they miss the different levels of regulatory design at which *Spijker* (top layer) and *Strabag* (second layer) operate.[19] In any case, as mentioned above, the main point of contention rests on what could be seen as a *lex specialis* understanding of the interaction between the two regulatory frameworks – ie a view

[14] *Strabag* (n 3).
[15] Judgment of 26 November 2015 in Case C-166/14 *MedEval*, C-166/14 EU:C:2015:779.
[16] Judgment of 19 June 2003 in Case C-315/01 *GAT* EU:C:2003:360.
[17] In agreement on the positive description, but criticising it normatively, see Schebesta (n 8) 65–72.
[18] Some objections could be raised to the effect that, the Remedies Directive having been adopted in 1989, it could not have logically given expression to the principle of State liability for breach of EU law, as it was only formulated in 1991 in *Francovich* (n 2). However, such objections can be dismissed on the basis of different types of arguments. A practical argument is that the Remedies Directive was revised in 2007, when the principle of State liability was already consolidated in CJEU case law, and the EU legislator did not consider it necessary to make any changes to Article 2(1)(c). A jurisprudential argument could also be used to dismiss the objection, on the basis that the CJEU does not create general principles of EU law in its case law, but rather draws from them or declares them—which logically requires their pre-existence (arguably, from the origins of the Treaties). This is an issue that, however, exceeds the possibilities of this paper and, consequently, will not be assessed in any detail.
[19] To the same effect, see the Judgment of the UK Supreme Court in *Nuclear Decommissioning Authority v EnergySolutions EU Ltd (now ATK Energy Ltd)* [2017] UKSC 34 per Lord Mance, at [24].

that the general condition for there to be a 'sufficiently serious breach' of EU law under State liability is contrary to the requirement for strict liability for breaches of EU procurement law, which would have led the Remedies Directive to impose a lower triggering threshold by solely mentioning the need for an unqualified infringement as sufficient ground for damages claims (Art 2(1)(c)).[20] The latter view has been reignited in a recent Judgment of the EFTA Court.

In its *Fosen-Linjen* Judgment,[21] the EFTA Court issued an important Opinion on the interpretation of the Remedies Directive and, in particular, on the conditions for the recognition of a right to damages compensation where the contracting authority uses an illegal award criterion and subsequently decides to cancel the tender for that reason.[22] That is, the case concerns the existence and boundaries of the right to claim damages in situations where it is clear (and acknowledged by the contracting authority itself) that the procurement procedure was not fully compliant with substantive EU/EEA public procurement rules—which comes to constrain the legal analysis to the question whether the irregularity is such as to allow disappointed tenderers to claim damages compensation. These possibly exceptional circumstances make the case particularly relevant for the assessment of the threshold of non-compliance with EU law at which the contracting authorities of the Member States risk liability in damages vis-à-vis tenderers and potentially interested economic operators.

The *Fosen-Linjen* case raised a number of issues in the six questions sent to the EFTA Court by the Norwegian Frostating Court of Appeal (*Frostating lagmannsrett*), such as the threshold for liability, evidentiary requirements, causation, exoneration causes and due diligence requirements. All of them are important but, in my view, the main relevance of the case concerns the threshold of liability, on which the EFTA Court found that:

> A *simple breach* of public procurement law is in itself sufficient to trigger the liability of the contracting authority to compensate the person harmed for the damage incurred, pursuant to Article 2(1)(c) of Directive 89/665/EEC, provided that the other conditions for the award of damages are met, including, in particular, the condition of a causal link.[23]

The EFTA Court reached this position in answer to a series of questions and sub-questions concerning whether liability under the Remedies Directive was conditional:

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[20] Whether this is compatible with a unifying thesis or with a separation thesis, or neither of them, remains unclear, but this aspect of the discussion exceeds the possibilities of this paper.

[21] Judgment of the EFTA Court of 31 October 2017 in Case E-16/16 *Fosen-Linjen AS v AtB AS*, <http://www.eftacourt.int/fileadmin/user_upload/Files/Cases/2016/16_16/16_16_Judgment_EN.pdf>. For discussion, see Totis Kotsonis, 'Case E-16/16, Fosen-Linjen AS and AtB: An EFTA Court case clarifying key aspects of EU procurement legislation' (2018) 27(2) Public Procurement Law Review NA60-NA69 <https://www.eversheds-sutherland.com/global/en/what/articles/index.page?ArticleID=en/Competition/case-e-1616-140218>.

[22] In *Fosen-Linjen* (n 21), the violation derived from the lack of verification of self-declared fuel efficiency information that carried a significant weight in the evaluation and assessment of the tenders. It was common ground that the contracting authority had violated the applicable EU procurement rules and their national transposition.

[23] *Fosen-Linjen* (n 21) para 82 (emphasis added).

(i) upon the contracting authority having deviated markedly from a justifiable course of action, (ii) upon it having incurred a material error that justified a finding of culpability under a general assessment, or (iii) upon it having incurred in an inexcusable 'material, gross and obvious error' (question 1), or whether liability can be triggered under a test of 'sufficiently qualified breach' where the contracting authority was left with no discretion as to how to interpret or apply the infringed substantive rule (question 2). These questions thus sought clarification on how to apply the general requirement for a 'substantial breach' of EU public procurement law in the context of claims for damages. Surprisingly, the EFTA Court decided not to clarify how to interpret the requirement, but rather to exclude the applicability of the requirement altogether – which in my view represents an improper deviation from the CJEU *Spijker* Judgment. It is also remarkable that the EFTA Court did this despite the possibility of having provided a useful answer to the referring Norwegian court without engaging with this issue.

Indeed, the EFTA Court decided to group the first two questions referred to it and address them together. In my view, this was determinative of the outcome of the case—ie the finding that *any breach* of the EU public procurement rules can trigger liability in damages. Had the EFTA Court addressed the questions sequentially, and inverting their order, it would have been possible to establish that a breach of a substantive provision for which interpretation and application the contracting authority has no discretion constitutes a 'sufficiently serious breach' of EU/EEA procurement law triggering liability (if all other requirements are met), which would have rendered the other issues surrounding the interpretation of the requirement of sufficient seriousness moot and unnecessary in this case.

In that respect, it is worth stressing that the scope for the exercise of discretion in the context of procurement (which is bound to modulate the strictness of the liability imposed on contracting authorities, see section 3 below) was extended in the 2014 Public Procurement Package, and that contracting authorities do enjoy a rather high level of executive discretion within the constraints created by Member States in their domestic transposition. Thus, it is hardly defensible that '[i]n the very detailed provisions contained in the public procurement directives, [a] lack of discretion is manifest. A simple breach of the Directives could then be "sufficiently serious", thus amounting to a liability closely approaching strict liability',[24] which would erase any implications of the EFTA Court *Fosen-Linjen* Judgment. On the contrary, a significant number of decisions require the exercise of executive discretion and this should be subjected to more refined tests than considering *any* infringement of the directives as sufficiently serious *per se*.[25] The analysis of the *Fosen-Linjen* case should be undertaken

[24] Schebesta (n 8) 62.

[25] A Sanchez-Graells, *Public Procurement and the EU Competition Rules*, 2nd edn (Hart, 2015) ch 5; ibid, 'Some Reflections on the 'Artificial Narrowing of Competition'' as a Check on Executive Discretion in Public Procurement, in Sanja Bogojević, Xavier Groussot & Jörgen Hettne (eds), *Discretion in EU Public Procurement Law*, IECL Series (Hart, forthcoming).

from the perspective of its intended effect: ie a reduction of the threshold of infringement of EU public procurement law triggering potential liability for damages.[26]

By choosing not to restrict its analysis to the circumstances of the case where the existence of a 'sufficiently serious' breach of EU procurement law seemed obvious (even considering space for discretion[27]), the EFTA Court grabbed an opportunity to influence the development of EU/EEA law in the area of procurement remedies in a way that I am not sure will be productive in the long run, particularly because the rather extreme position taken by the EFTA Court – ie that any *simple breach* of EU/EEA procurement law suffices to generate liability for damages – was not really necessary under the circumstances and is at odds with the previous CJEU position in *Spijker*. This is relevant in the context of the *Fosen-Linjen* litigation as it reaches the Norwegian Supreme Court after the Frostating Court of Appeal decided not to follow the EFTA Court Opinion,[28] which will prompt the Norwegian Supreme Court to formulate its own view on the issue. On this point, it is interesting to stress that, in another recent Judgment raising the same point of law,[29] the UK Supreme Court took a diametrically opposing view to the EFTA Court's and stressed the intimate interconnection created in the CJEU's case law between the Remedies Directive and the general doctrine of State liability under EU law—thus limiting the existence of claims for damages due to a breach of EU public procurement law to those cases where there is a 'sufficiently serious breach'. Comparing the approaches of the EFTA Court and the UK Supreme Court from the perspective of the harmonisation of EU law sheds some additional light on the flaws of the EFTA Court's position (see section 2 below).

Beyond the issue of conformity with prior CJEU case law and the minimum harmonisation approach followed by EU law in this area, *in its own terms*, the finding by the EFTA Court that a simple breach of EU public procurement law suffices to trigger potential liability in damages is controversial. Firstly because of the way in which the EFTA Court couches the deviation of liability standards under the Remedies Directive and under the general doctrine of State liability for breach of EU/EEA law, which largely rests on an excessively formal reading of the test applicable to establishing State liability under the evolved *Francovich* doctrine. Secondly, due to the fact that the EFTA Court engages in contradictory normative assessments – which makes the interpretation and operationalisation of its main finding rather tricky. In my view, these two points of contention make it doubtful that the CJEU – which is not bound by the

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[26] Cf speech by Carl Baudenbacher, President of the EFTA Court at the time of the *Fosen-Linjen* Judgment (n 21) (the Law Society, Competition Section, Annual Dinner, London, 22 November 2017) <http://communities.lawsociety.org.uk/Uploads/m/r/w/baudenbacher-speech-competition-section-annual-dinner.pdf> accessed 16 September 2018.

[27] Indeed, the obligation to assess the requirements included in the procurement documentation is absolute, see Judgment of the Court of Justice of the European Union of 4 December 2003 in Case C-448/01 *EVN and Wienstrom* EU:C:2003:651

[28] The decision was adopted on 2 March 2018. I am thankful to Prof Fredriksen for bringing this to my attention.

[29] *Nuclear Decommissioning Authority* (n 19).

EFTA Court's interpretation – will adopt the same approach in the future.[30] The issues also merit further discussion (see section 3 below).

The remainder of this paper offers more detailed critical reflections on the position advanced by the EFTA Court that a *simple breach* of EU public procurement law is in itself sufficient to trigger the contracting authority's liability in damages. The next section provides positive analysis of issues around the difficult fit of the EFTA Court's position with previous CJEU case law, and from the perspective of the harmonisation of EU law (2). The following section provides normative discussion of issues concerning the EFTA Court's own understanding of the purpose of the Remedies Directive and internal contradictions in the reasoning adopted in *Fosen-Linjen* (3). The conclusions bring these different lines of criticism together and reflect on the undesirability of promoting the private enforcement of EU public procurement law through maximum harmonisation by a revised Remedies Directive (4).

2 POSITIVE ANALYSIS: *FOSEN-LINJEN* DOES NOT FIT THE MINIMUM HARMONISATION OF PROCUREMENT REMEDIES

As mentioned above, the interaction between the right to damages under the Remedies Directive and under the general doctrine of State liability is contested, despite the CJEU's *Spijker* Judgment. This section adopts the perspective of the harmonisation of EU law to stress the intrinsic incompatibility between the configuration of the Remedies Directive as an instrument of minimum harmonisation and the EFTA Court's position in *Fosen-Linjen*. The discussion relies on the UK Supreme Court's analysis in *Nuclear Decommissioning Authority*, which I submit offers the proper interpretation of *Spijker* in the context of minimum harmonisation. Reflections on the possibility to engage in maximum harmonisation though a revision of the Remedies Directive are left for the conclusion (below section 4).

2.1. MINIMUM HARMONISATION TRHOUGH THE REMEDIES DIRECTIVE

The Remedies Directive is a minimum harmonization instrument that sets the basic elements of the effective and equivalent remedies that Member States must regulate for, in accordance with the peculiarities of their own domestic systems. This characterisation of the Remedies Directive is uncontroversial.[31] Following the logic of minimum harmonization, it is possible for Member States to facilitate the existence of two potential tiers of remedies: a lower or more basic EU tier (subject *inter alia* to the requirement of 'sufficiently serious breach'), and a higher or more protective domestic tier (subject eg to a trigger for 'any infringement'). This higher or more protective tier

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[30] This could happen in the decision of the pending reference for a preliminary ruling in Case C-518/17 *Rudigier* [2017] OJ C392/16, although the substance of the case and the way in which the question is put to the Court may not lead to an explicit answer on this occasion.

[31] eg Report by the European Commission on the effectiveness of the Remedies Directive concerning review procedures in the area of public procurement, COM(2017) 28 final at 4, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0028&from=EN> accessed 16 September 2018.

may or may not exist depending on the policy orientation of each EU/EEA State, but it cannot be conceptualised as a requirement of EU public procurement law on the basis of the Remedies Directive. This approach has both the advantage of being in accordance with the current state of the law as interpreted by the CJEU (as discussed above), and of not imposing – as a matter of legal compliance, rather than policy preference – an absolute harmonisation of public procurement remedies, at least as the threshold of liability for damages is concerned.

To be sure, this approach is not without some relevant practical difficulties, as there is a thick mist of uncertainty concerning what is a sufficiently serious breach of procurement rules, in particular in areas of interaction between specific rules and the general principles of procurement – not least due to the universal application of the latter.[32] There is also uncertainty as to what rules in the substantive EU public procurement directives are 'intended to confer rights' on the tenderers – ie the first *Francovich* condition for the recognition of State liability, which has been so far largely untested. Providing clarity on these issues would require a significant reconceptualisation of the existing CJEU case law on the interpretation of substantive EU procurement rules. The existence of the preliminary reference mechanism of Art 267 TFEU could alleviate this legal uncertainty (in the long term), but not without creating a significant risk of collapse of the CJEU (or, at least, an even more significant growth in procurement-related preliminary references). From that perspective, the possibility to engage in maximum harmonization of remedies deserves some consideration (see below section 4). However, that needs to take place in the context of legal reform rather than as a result of judicial activism.

2.2 MINIMUM HARMONISATION AS SPELLED OUT BY THE UK SUPREME COURT

In its *Nuclear Decommissioning Authority* Judgment,[33] the UK Supreme Court followed what I think is the correct reading of *Spijker* against the background of minimum harmonisation by the Remedies Directive, and established that *Spijker* makes clear:

> […] that *the liability of an awarding authority is to be assessed by reference to the Francovich conditions*. Subject to these conditions being met, … [it goes] on to make clear that the criteria for damages are to be determined and estimated by national law, with the further caveat that the general principles of equivalence and

[32] Art 18 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC [2014] OJ L94/65. *Eg* an open question concerns whether a breach of a general principle of EU public procurement law must always be conceptualised as a sufficiently serious breach, which would be problematic because all decisions taken in a procurement exercise are subject to the principles of equality, non-discrimination, proportionality, transparency and competition. However, its analysis exceeds the possibilities of this paper.

[33] [2017] UKSC 34 (n 19). As per Lord Mance, with Lady Hale and Lords Neuberger, Sumption and Carnwath agreeing.

> effectiveness must also be met … Finally, [it] summarises what has gone before, repeating the need to satisfy the *Francovich* conditions.[34]

More importantly, the UK Supreme Court considered that:

> […] there is […] very clear authority of the Court of Justice confirming that the *liability of a contracting authority under the Remedies Directive for the breach of the [public procurement rules]* is assimilated to that of the state or of a public body for which the state is responsible. It *is in particular only required to exist where the minimum Francovich conditions are met, although it is open to States in their domestic law to introduce wider liability free of those conditions*.[35]

Therefore, the UK Supreme Court followed a unifying thesis compatible with minimum harmonisation and took the clear view that *as a matter of EU law* the existence of grounds for an action in damages based on the Remedies Directive requires the existence of a 'sufficiently serious breach' of EU public procurement law. The UK Supreme Court explicitly ruled out any inconsistency between this approach and other case law of the CJEU, in particular *Strabag*, on the basis that the cases are not incompatible and, importantly, that the CJEU 'in *Spijker* was aware of the recent decision in [*Strabag*], cited it in […] and clearly did not consider it in any way inconsistent with what [it] said about the general applicability of the *Francovich* conditions'.[36] Importantly, the UK Supreme Court took no issue with the possibility for more generous domestic grounds for actions for damages.[37] On the whole, the UK Supreme Court considered that 'there is no uncertainty or confusion in the Court of Justice's case law, and that [it is safe to rely] on the clear language and ruling in *Spijker* as settling the position, whatever may have been previous doubts or differences of view at national level'.[38]

2.3 IRRECONCIABILITY OF THE *FOSEN-LINJEN* JUDGMENT WITH MINIMUM HARMONISATION

In stark contrast with this approach, in its *Fosen-Linjen* Judgment, and despite the fact that similar arguments on the interpretation of *Spijker* were made before it (in particular by the Norwegian Government), the EFTA Court considered that:

> Article 2(1)(c) of *the Remedies Directive […] precludes national legislation* which makes the right to damages for an infringement of public procurement law by a contracting authority conditional on that infringement being culpable. […] The same must apply *where there exists a general exclusion or a limitation of the remedy*

[34] ibid. per Lord Mance, at [23] (emphasis added).
[35] ibid at [25] (emphasis added).
[36] ibid at [24].
[37] Although it eventually decided that this was not the case in relation to the *Public Contract Regulations 2006*; see NDA, per Lord Mance at [37], with which I also agree.
[38] Ibid at [26], with reference to A Collins, 'Damages in Public Procurement - An Illusory Remedy?', in K Bradley, N Travers & A Whelan (eds), *Of Courts and Constitutions. Liber Amicorum in honour of Nial Fennelly* (Hart 2014) 339.

> *of damages to only specific cases. This would be the case, for example, if only breaches of a certain gravity would be considered sufficient* to trigger the contracting authority's liability, whereas minor breaches would allow the contracting authority to incur no liability […].
>
> *[…]A requirement that only a breach of a certain gravity may give rise to damages could also run contrary to the objective of creating equal conditions for the remedies available in the context of public procurement*. Depending on the circumstances, a breach of the same provision of EEA public procurement could lead to liability in one EEA State while not giving rise to damages in another EEA State. In such circumstances, economic operators would encounter substantial difficulties in assessing the potential liability of contracting authorities in different EEA States.[39]

This led the EFTA Court to reach the view that

> *A simple breach of public procurement law is in itself sufficient to trigger the liability of the contracting authority* to compensate the person harmed for the damage incurred, pursuant to Article 2(1)(c) of the Remedies Directive, provided that the other conditions for the award of damages are met including, in particular, the existence of a causal link.[40]

The EFTA Court does not clearly follow either a unitary thesis with a *lex specialis* twist—whereby it would come to subsume procurement damages claims under the State liability doctrine, but then immediately modify it on the basis of the literal wording of the Remedies Directive – or a separation thesis, whereby the constraints of the doctrine of State liability are simply set aside in a conceptualisation of the Remedies Directive as creating a parallel regulatory regime. Either way, the EFTA Court's position rests on an improper understanding of the level of harmonisation of EU law sought by the Remedies Directive.

In my view wrongly, the EFTA Court holds the implicit understanding that the Remedies Directive is an instrument of maximum harmonisation when it emphasises its 'objective of creating *equal conditions* for the remedies available in the context of public procurement'.[41] The EFTA Court derives this objective in an earlier passage, where it stresses that a:

> '[…] fundamental objective of the Remedies Directive is to create the framework conditions under which tenderers can seek remedies in the context of public procurement procedures, *in a way that is as uniform as possible* for all undertakings active on the internal market. Thereby, as is also apparent from the third and fourth recitals to the Remedies Directive, *equal conditions shall be secured* (sic)'.[42]

[39] Fosen-Linjen (n 21) paras 77 and 78 (emphases added).
[40] ibid para 82 (emphasis added).
[41] ibid, para 78 (emphasis added).
[42] ibid para 66 (emphasis added).

This is a clear judicial excess. The Remedies Directive cannot reasonably be considered an instrument of maximum harmonization (*ie* a tool that sets a ceiling, or even a common core of protections that must be uniformly provided in all EEA States) in the way the EFTA Court does. In my view, this is particularly clear from recital (6) of the Remedies Directive, according to which: 'it is necessary to ensure that *adequate procedures* exist in all the Member States to permit the setting aside of decisions taken unlawfully and compensation of persons harmed by an infringement'[43] – which the EFTA Court includes in its Judgment,[44] but then largely ignores.

However, the EFTA Court does have a point when it stresses that the divergence of rules on damages remedies can distort the procurement field and, in particular, discourage cross-border participation – which could be alleviated by a reform of the Remedies Directive to create such maximum harmonization. Such revision and an explicit view on the elements of a uniform system of maximum harmonisation could bring a much-needed clarification of the function and position of different types of remedies under its architecture. Notably, it would clarify whether damages are a perfect substitute for other remedies (as the EFTA Court seems to believe), or rather (solely) an ancillary remedy.[45] Maximum harmonisation could also provide an opportunity to consider the creation of safe harbours (at least of damages liability) for purely procedural errors, or in the context of certain general guidelines. However, any and all of these reforms would require legislative intervention and, in my view, they are unsuitable for judicial activism. These issues are further considered in the conclusions (below section 4).

3 NORMATIVE ANALYSIS: INTERNAL CONTRADICTIONS IN THE EFTA COURTS' VIEWS ON THE GOALS OF PRIVATE ENFORCEMENT OF EU PROCUREMENT LAW

Setting aside the positive or *de lege data* discussion had so far, it is also worth exploring some of the normative positions underpinning the EFTA Court's activism in *Fosen-Linjen*, which sought to justify the deviation from the CJEU case law on the basis that (i) the State liability doctrine is incompatible with the special requirements of EU public procurement law and/or on the strength of (ii) conflicting normative assessments of the role for the risk of incurring liability for damages as an incentive for adequate legal compliance and effective performance of their procurement function by contracting authorities. In my view, both lines of argument are flawed. The first one because it relies on an excessively formalistic view of the requirement of subjective intent initially embedded in the State liability doctrine. The second because it relies on the assumption that private enforcement of EU public procurement law is

[43] (emphasis added); note that adequate procedures are not necessarily homogeneous or identical procedures.

[44] *Fosen-Linjen* (n 21) para 3.

[45] As I posit, Albert Sanchez-Graells, '"If it Ain't Broke, Don't Fix It"? EU Requirements of Administrative Oversight and Judicial Protection for Public Contracts', in Simone Torricelli & Laurence Folliot-Lalliot (eds), *Oversight and Challenges of Public Contracts* (Brussels, 2018) 495-534.

and ought to be the main enforcement mechanism in this area of EU economic law. This section discusses both of these issues.

3.1 IS PUBLIC PROCUREMENT SPECIAL AND IS STATE LIABILITY SO SUBJECTIVE?

As discussed above (sections 1 and 2), the doctrinal issues in the background of the discussion surrounding the threshold of liability under the Remedies Directive concerns its relationship with the general doctrine of State liability for breach of EU/EEA law. As mentioned above, the position taken by the EFTA Court in *Fosen-Linjen* on this point is not very clear, but it seems to indicate that the EFTA Court considers that procurement law is somehow special, in a manner that could be compatible with either a separation thesis or a modified unitary thesis.

Whether the Remedies Directive is seen as a particularisation of the State liability doctrine (unitary thesis), or as a parallel system to ensure the effectiveness of EU public procurement law (separation thesis) can have further normative implications concerning the question of the threshold for the imposition of liability on contracting authorities. Both theories would in the abstract seem compatible with the imposition of an entry threshold at 'sufficiently serious breach' level as a trigger for damages actions.[46] However, the incompatibility of such an approach with a separation theory has been linked to the available justifications to escape liability on the basis that the breach does not reach the required level of *seriousness*. Or, in other words, on the assumption that *strict liability* needs to control this area of EU economic law. As most fully formulated, the separation theory seems to require the triggering of remedies at a lower threshold of infringement than general State liability under EU law – *ie* at simple breach – on the basis that the general theory includes an element of subjective assessment based on the intent of the Member States that can be too lenient, which would ultimately reduce the effectiveness of EU public procurement law. Indeed, it has been argued that under the general conditions for State liability:

> […] the 'mens rea' or intention of a Member State is taken into account … By contrast, the type of duty and the connected justifications under the public procurement regime are those contained in the legislative regime. Strict observance of the rules is necessary, and finding a breach may not be made contingent on the finding of fault in the field of public procurement.[47]

This approach is reflected in the EFTA Court's *Fosen-Linjen* Judgment, where it indicates that:

> [...] it has already been established that *a national rule making the award of damages conditional on proof of fault or fraud would make actions for damages more difficult and costly, thereby impairing the full effectiveness of the public procurement rules* [...]. The same must apply where there exists a general exclusion or a limitation of the remedy

[46] See above (n 4).
[47] Schebesta (n 8) 67–68.

> of damages to only specific cases (sic). *This would be the case, for example, if only breaches of a certain gravity would be considered sufficient to trigger the contracting authority's liability*, whereas minor breaches would allow the contracting authority to incur no liability.[48]

In other words, the EFTA Court is not willing to tolerate a situation where what could be termed *de minimis* breaches of EU/EEA public procurement law remain unchallenged.[49] The Court thus seems to consider that the establishment of an almost absolute right to claim damages is necessary to ensure the desirable effectiveness of EU/EEA procurement law, and seems to base this on the double rejection of (i) the inclusion of a subjective element in the assessment of the contracting authority's behaviour, as well as (ii) conditioning the existence of a right to damages to a proportionality assessment derived from a requirement of *seriousness* of the underlying breach of EU public procurement law – which the EFTA Court considers functionally equivalent.

However, it seems difficult to compare the subjection of damages to a subjective requirement of fault with the subjection of damages to an objective requirement of seriousness of the triggering infringement (or, in other words, a proportionality assessment). As mentioned above, because these requirements are operationalised at different layers of the architecture of damages in procurement. Additionally, because it pitches two different issues against each other: one, of an objective nature (sufficient seriousness) and the other of a subjective nature (fault), which can also carry very relevant differences in their discoverability and the linked burden of proof. In that regard, the rhetorical strategy employed by the EFTA Court in identifying risks of ineffectiveness linked to 'a general exclusion or a limitation of the remedy of damages to only specific cases' artificially inflates the problem of the requirement of seriousness in the breach without recognising that this is exactly the rule that applies in every setting where strict or objective liability does not apply[50] – and that, logically, strict liability is compatible with a requirement of seriousness, as strict liability is not the same as unconstrained or total liability.

The EFTA Court also considers that:

> '[a] requirement that only a breach of a certain gravity may give rise to damages could also run contrary to the objective of creating equal conditions for the remedies available in the context of public procurement. Depending on the circumstances, a breach of the same provision on EEA public procurement could lead to liability in one EEA State while not giving rise to damages in another EEA State'.

[48] *Fosen-Linjen* (n 21) para 77 (emphasis added).
[49] In that regard, the Court seems to have been influenced by the European Commission's position that 'any infringement of public procurement law should be followed up and should not be left unattended because the breach is not "sufficiently serious"'; *Fosen-Linjen* (n 21) para 59.
[50] Cf Kotsonis (n 21) text accompanying footnote 29.

However, this is by no means obvious, in particular if the preliminary reference mechanism works appropriately.[51]

This approach is objectionable on several grounds. To begin with, even if it is generally accepted that procurement remedies cannot be subjected to a requirement of fault,[52] that does not mean that actionable damages under the Remedies Directive need to be exempted from the conditions of the general State liability doctrine. In particular, because the evolution of the State liability doctrine has clearly resulted in its objectification and given rise to a consistent practice where the subjective element of a breach of EU law is not taken into account.[53] As is well known, under the doctrine of State liability for breach of EU law,[54] the CJEU defined a broad test to assess whether an infringement of EU law is 'sufficiently serious'.[55] This was first fully enounced in *Brasserie du Pêcheur/Factortame III*,[56] and has then been progressively refined in the case law of the CJEU. The test was designed in the following terms:

> […] finding that a breach of [Union] law is sufficiently serious is whether the Member State … concerned manifestly and gravely disregarded the limits on its discretion. The factors which the competent court may take into consideration include the clarity and precision of the rule breached, the measure of discretion left by that rule to the national … authorities, *whether the infringement and the damage caused was intentional or involuntary*, whether any error of law was excusable or inexcusable, the fact that the position taken by a [Union] institution may have contributed towards the omission, and the adoption or retention of national measures or practices contrary to [Union] law.[57]

In subsequent case law, the CJEU has stressed that the:

> […] condition requiring a sufficiently serious breach … implies manifest and grave disregard by the Member State for the limits set on its discretion, the factors to be taken into consideration in this connection being, inter alia, the degree of clarity and precision of the rule infringed and the measure of

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51 ibid para 78.
52 *Strabag* (n 3). See also Case C-275/03 *Commission v Portugal* EU:C:2004:632.
53 Albert Sanchez-Graells, 'Assessing the Public Administration's Intention in EU Economic Law: Chasing Ghosts or Dressing Windows?' (2016) 18 *Cambridge Yearbook of European Legal Studies* 93, 116–119.
54 For general discussion, see Paul Craig and Gráinne De Búrca, *EU Law. Texts, Cases and Materials*, 6th edn (Oxford University Press, 2015) 257–61.
55 This requirement has been found to be the most difficult condition for a claimant to establish in a State liability case; see the T Lock, 'Is Private Enforcement of EU Law through State Liability a Myth? An Assessment 20 Years after Francovich' (2012) 49 (5) Common Market Law Review 1675, 1693.
56 *Brasserie du Pêcheur* (n 2).
57 ibid paras 55 and 56 (emphasis added). See also Judgment of the Court of Justice of the European Union of 4 July 2000 in Case C-424/97 *Haim* EU:C:2000:357; and of 4 December 2003 in C-63/01 *Evans* EU:C:2003:650.

discretion left by that rule to the national authorities.[58]

> [Additionally,] where at the time when it committed the infringement, the Member State in question […] had only considerably reduced, or even no, discretion, the mere infringement of [Union] law may be sufficient to establish the existence of a sufficiently serious breach.[59] [Consequently,] the Member State's discretion, which is broadly dependent on the degree of clarity and precision of the rule infringed, constitutes an important criterion in determining whether there has been a sufficiently serious breach of [Union] law.[60]

At first reading, the inclusion of a subjective element ('whether the infringement … was intentional or involuntary') amongst the conditions that can be taken into consideration to determine whether an infringement of EU law is 'sufficiently serious' seems to create a clash with the need to exclude any element of fault in the regulation of remedies for infringements of EU public procurement law. However, a closer look at the case law of the CJEU and its evolution shows that this element has not been given significant weight in the application of the State liability doctrine.[61] Given that State liability 'cannot be made conditional upon fault (intentional or negligent) on the part of the organ of the State responsible for the breach, going beyond that of a sufficiently serious breach of [Union] law',[62] there has been no relevant assessment of subjective elements in the behaviour of the public administration at the point of engaging State liability.[63]

The assessment of the sufficient seriousness of the breach of EU law by the Member State has been objectified and redirected towards an analysis of its respect to the limits of whatever levels of discretion it enjoyed under the relevant provisions. Where there is no discretion, the assessment of intention becomes totally irrelevant. Indeed, where the CJEU had the necessary information to apply the test and determine whether the facts must be held to constitute a sufficiently serious breach of Union law

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58 Judgment of the Court of Justice of the European Union of 25 January 2007 in Case C-278/05 *Robins and Others* EU:C:2007:56, para 70; of 16 October 2008 in Case C-452/06 *Synthon* EU:C:2008:565, para 37; and of 19 June 2014 in Case C-501/12 *Specht and Others* EU:C:2014:2005, para 102.

59 Judgment of the Court of Justice of the European Union of 23 May 1996 in Case C-5/94 *The Queen v Ministry of Agriculture, Fisheries and Food, ex parte Hedley Lomas (Ireland)* EU:C:1996:205, para 28; of 8 October 1996 in Joined Cases C-178/94, C-179/94 and C-188/94 to C-190/94 *Dillenkofer and Others* EU:C:1996:375, para 25, and of 18 January 2001 in Case C-150/99 *Stockholm Lindöpark* EU:C:2001:34, para 40. See also *Robins* (n 58) para 71; *Synthon* (n 58) para 38.

60 *Synthon* (n 58) para 39. See, to that effect, *Robins* (n 58) paras 72 and 73.

61 See Takis Tridimas, 'Liability for Breach of Community Law: Growing Up and Mellowing Down?' (2001) 38 (2) Common Market Law Review 301, 310. For discussion, see Julio Baquero Cruz, '*Francovich* and Imperfect Law' in Miguel Poiares Maduro and Loic Azoulai (eds) *The Past and Future of EU Law: The Classics of EU Law Revisited on the 50th Anniversary of the Rome Treaty* (Hart 2010) 418, 423 ff.

62 *Brasserie du Pêcheur* (n 2) para 80. The situation is different when it comes to the liability of EU institutions, where the case law regarding fault requirements is much less clear. See Pekka Aalto, *Public Liability in EU Law: Brasserie, Bergaderm and Beyond*, Modern Studies in European Law (Hart, 2011) 47-51.

63 Indeed, there is a distinction between establishing liability independently of intention and then imposing a remedy that takes intention into account. This can be particularly relevant in relation to compensation claims.

in a case where the competent national institution had no substantive choice, the CJEU did not assess whether the infringement was intentional or involuntary and simply relied on the objective situation created by the public administration concerned.[64] Where there is very limited discretion, the CJEU does not engage in any subjective assessment either and applies a test of strict liability.[65] Where there is broader discretion, the analysis revolves around the clarity and precision of the rule infringed, and the CJEU tends to restrict its analysis to an objective assessment of whether the interpretation followed by the Member State was reasonable or excusable, but it does not delve into subjective assessments.[66]

Moreover, the more recent case law of the CJEU on liability derived from *judicial breaches of EU law* can provide some additional support to the claim that, generally, the test applicable under the second condition of the State liability doctrine does not give any significant weight to the subjective element requiring a determination of whether the infringement was intentional or involuntary – or, in other words, that the assessment needs to be reconfigured as an objective test. In that regard, even if it has shown some deference towards infringements of EU law by national courts, as compared to infringements by the executive or the legislator,[67] the CJEU still has rejected the limitation of State liability to cases of intentional fault and serious misconduct on the part of the court, and stressed that

> […] although it remains possible for national law to define the criteria relating to the nature or degree of the infringement which must be met before State liability can be incurred for an infringement of [Union] law attributable to a national court adjudicating at last instance, under no circumstances may such criteria impose requirements stricter than that of a manifest infringement of the applicable law.[68]

In view of all the above, it seems clear that the subjective element that can, in principle, be taken into consideration under the second condition for State liability not only has not played any significant role so far, but it cannot do so in the future because Member States cannot impose fault-based requirements stricter than a test of manifest infringement of the applicable law.[69] It is submitted that this erodes, if it does not complete eliminate, any inconsistency with the need to ensure that the same objectified approach controls the regulation of public procurement remedies – thus significantly damaging the foundations of the reasoning of the EFTA Court in *Fonsen-Linjen*.

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[64] Judgment of the Court of Justice of the European Union of 28 June 2001 in Case C-118/00 *Larsy* EU:C:2001:368, paras 39 ff.
[65] *Synthon*, (n 58) paras 41 to 43.
[66] *Robins* (n 58) paras 78 to 82. In less clear terms, Case C-501/12 *Specht*, para 103.
[67] For discussion of the standard, see Björn Beutler, 'State Liability for Breaches of Community Law by National Courts: Is the Requirement of a Manifest Infringement of the Applicable Law an Insurmountable Obstacle?' (2009) 46 (3) Common Market Law Review 773. Cf Nicolo Zingales, 'Member State Liability vs. National Procedural Autonomy: What Rules for Judicial Breach of EU Law?' (2010) 11 (4) German Law Journal 419.
[68] Case C-173/03 *Traghetti del Mediterraneo*, EU:C:2006:391, para 44.
[69] *Köbler* (n 6) paras 53 to 56.

Moreover, in my opinion, the EFTA Court's general line of reasoning against the tolerance of 'non-persecuted' breaches of EU public procurement law conflates two separate issues. First, whether any infringement of EU/EEA substantive law should trigger a ground for the review of the procurement decision concerned and, if justified, to set it aside. Second, whether any infringement of EU/EEA substantive law should provide a right to claim damages. This is once more based on a very formal reading of *Strabag*, where the CJEU indicated that:

> 'the remedy of damages […] can constitute, *where appropriate, a procedural alternative* … only where the possibility of damages being awarded in the event of infringement of the public procurement rules is no more dependent than the other legal remedies … on a finding that the contracting authority is at fault'.[70]

However, this does not mean that damages and other remedies must be absolutely interchangeable and always subjected to the same conditions. It simply implies that, the same way that other remedies cannot be conditional upon a requirement of fault, neither can damages claims. This is uncontroversial, but hardly a good reason to consider that all remedies must be subjected to a trigger of simple breach of EU public procurement law.

By conflating both issues, the EFTA Court implicitly assumes that claims for damages are the only effective remedy, or that they can only be an effective remedy where they are equally available as other remedies (such as declarations of infringement, or the setting-aside of procurement decisions). In doing that, the Court does not take into account the existence of public oversight mechanisms able to 'pick up' on those *de minimis* infringements of EU/EEA public procurement law, and seems not to think it possible for disappointed tenderers to exercise rights of review in the absence of the financial incentives resulting from damages claims. This comes both to establish a hierarchy of remedies that is absent in the Remedies Directive,[71] and to create the same risk of deformation of EU tort law that we have witnessed in other areas of EU economic law.[72] Moreover, this does not take into account important issues of balance in the public and private enforcement of EU economic law, which can hardly be properly addressed through piecemeal evaluation of different aspects of the system.[73] These are important issues of design of the overarching architecture for the enforcement of EU public procurement law, and they are further discussed in the conclusion (see below section 4).

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[70] *Strabag* (n 3), para 39 (emphasis added).
[71] Sanchez-Graells (n 45).
[72] See Okeoghene Odudu & Albert Sanchez-Graells, 'The interface of EU and national tort law: Competition law', in Paula Giliker (ed), *Research Handbook on EU Tort Law* (Edward Elgar 2017) 154–183; as well as the rest of contributions to that volume.
[73] Acknowledgedly, a problem that also affects the way in which preliminary references to the CJEU operate. However, an assessment of this issue exceeds the possibilities of this paper.

3.2 NORMATIVE CONTRADICTIONS ON THE IMPLICATIONS FOR CONTRACTING AUTHOTITIES AND TENDERERS

As mentioned above, one of the important normative aspects on which the EFTA Court built its *Fosen-Linjen* Judgment concerns the incentives that different liability thresholds and requirements create for contracting authorities and economic operators. In that regard, the Court seems to adopt two contradictory normative standpoints in dealing with the twin question of the threshold for liability and the causality requirement – which are indivisibly interlinked in its overall finding that 'A *simple breach of public procurement law is in itself sufficient* to trigger the liability ... *provided* that the other conditions for the award of damages are met, including, in particular, *the condition of a causal link'*.[74] The contradiction is as follows.

On the one hand, the EFTA Court considers that a simple infringement of EU/EEA public procurement rules must suffice to trigger liability because:

> […] damages seek to achieve a three-fold objective: to compensate for any losses suffered; to restore confidence in the effectiveness of the applicable legal framework; and *to deter contracting authorities from acting in such a manner, which will improve future compliance with the applicable rules. Liability through damages may also provide a strong incentive for diligence in the preparation of the tender procedure, which will, ultimately, prevent the waste of resources* and compel the contracting authority to evaluate the particular market's features. Were liability to be excluded, this may lead to a lack of restraint of the contracting authority.[75]

Thus, in this part of the Judgment, the EFTA Court considers a high likelihood of liability in damages a proper incentive for adequate diligence and decision-making on the part of the contracting authority. Conversely, when assessing the causality requirements for the recognition of a right to damages compensation (in the context of the fourth question referred by the Norwegian court), the EFTA Court stresses that:

> [...] there must be a balance between the different interests at stake. While liability of the contracting authority for any errors committed promotes, in principle, the overall compliance with the applicable legal framework, *exaggerated liability of the contracting authority could lead to excessive avoidance costs, reduce the flexibility of the applicable framework and may even lead to the unjust enrichment of an unsuccessful tenderer. Furthermore, excessive liability may provide an incentive for a contracting authority to complete award procedures, that were evidently unlawful, or impinge upon the freedom to contract'*.[76]

[74] *Fosen-Linjen* (n 21) para 82 (emphasis added).
[75] ibid para 76 (emphasis added).
[76] ibid para 101 (emphasis added).

This clearly indicates that the existence of liability needs to be constrained or modulated. The EFTA Court seems to want to do so by establishing a complicated approach to causality requirements that would distinguish between those applicable to claims for negative and positive damages (ie bid costs and loss of profits). This may have been justified due to the peculiarities of the Norwegian tort law system, but it is difficult to square with the general mechanism of liability in damages under EU law. Moreover, even in the context of the first question, the EFTA Court had already shown some inconsistency when establishing that: 'a claim for damages can only succeed if certain other conditions are fulfilled, such as the condition that *there must be a sufficient causal link* between the infringement committed and the damage incurred'[77] – which, however, is not equally reflected in the wording of its general finding, which only makes reference to 'the condition of a causal link'.[78] What the EFTA Court intended with the qualifier of 'sufficient' causal link, and how this results in a functional approach that materially differs from the requirement of a 'serious' rather than a 'simple' breach is left unexplained.

In my view, the approach (implicitly) followed by the EFTA Court is not better than the alternative approach of having closely stuck to a requirement for a sufficient breach of EU/EEA public procurement rules. Even if a combination of low liability threshold (simple breach) and high causality requirements ('sufficient causality') could lead to the same practical results that a requirement for 'sufficiently serious breach' (with simple causation analysis), the EFTA Court's approach creates legal uncertainty and more scope for divergence across EU/EEA jurisdictions, not the least because causation is within the remit of domestic law.[79] In addition, it comes to preclude one of the mechanisms built into EU law – in particular the doctrine of State liability—to mitigate its effects. This is done by requiring both sufficiently seriousness of the breach and direct causality in the creation of the recoverable damage. By suppressing the first, the EFTA Court *Fosen-Linjen* Judgment places all pressure on the causality mechanism, which can also have distortive effects if existing causality tests need to be adapted to compensate for the suppression of the other check of the system. More importantly, this approach can create a wave of litigation based on any (minimal, formal, irrelevant) errors in the conduct of procurement procedures in an attempt to test the boundaries of the trigger for liability in damages.

On the whole, it would have been preferable to stick to the general framework of the State liability doctrine as specified in the Remedies Directive, which is compatible with a finding of a requirement for there to be a 'sufficiently serious breach' of EU/EEA procurement law and, at the same time, with a finding that breaching a provision for which interpretation and application the contracting authority has no discretion (*eg* the obligation to be in a position to verify the content of tenders against its requirements and award criteria, as in *Fosen-Linjen*) suffices to trigger liability (the same way that the mere lack of transposition of a Directive triggers State liability under the general test).

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[77] ibid para 81 (emphasis added).
[78] ibid para 82.
[79] Cf Kotsonis (n 21) text accompanying footnote 32.

For all the reasons discussed so far, it seems clear that the EFTA Court's *Fosen-Linjen* Judgment is not reflective of the state of EU public procurement law, but rather an exercise of judicial activism aimed at pursuing a particular understanding of the need for and role of private enforcement through damages claims. The EFTA Court seemed to find the current approach based on minimum harmonisation and the subjection of damages claims to the pre-existence of sufficiently serious breaches of EU public procurement law unsatisfactory, and it took it upon itself to push for a change of this situation. In my view, it did so improperly, for the reasons already discussed.

Trying to bring the different strands of the discussion together, in the following conclusions, I reflect on whether the discontent with the EU public procurement damages system underlying the *Fosen-Linjen* case could be addressed through a reform of the Remedies Directive aimed at maximum harmonisation, as well as on whether a significant boost of private enforcement of EU public procurement law would be desirable.

4 CONCLUSIONS

As has emerged from the previous discussion, and beyond the issue of the more than difficult fit of the *Fosen-Linjen* Judgment with the previous CJEU case law, and in particular *Spijker*, most of the normative reasons provided by the EFTA Court to support the position that a *simple* breach rather than a *sufficiently serious* breach of EU public procurement law should trigger potential liability in damages involve arguments concerning the need to increase legal certainty through higher levels of harmonisation (ie maximum harmonisation) as well as the need to facilitate the private enforcement of EU public procurement rules to increase their effectiveness. In this concluding section, I partially take issue with both claims.

Firstly, the EFTA Court seems to assume that designing an EU/EEA wide maximum harmonisation set of rules for the award of damages in the context of public procurement is not only desirable, but also (relatively easily) feasible. Even if it was accepted that maximum harmonisation was desirable, and despite the potential advantages derived from a revision of the system to achieve maximum harmonization, given the vast differences in the rules on damages claims across EU jurisdictions, it would be certainly difficult, if not outright impossible, to reach an agreement on the adequate level of protection and the relevant procedural mechanisms.[80] This is not unique to public procurement, but reflects more broadly the difficulties in the approximation of private law within the EU/EEA. Given these practical difficulties, I would not think the European Commission would be willing to engage in the exercise

[80] For comparative discussion, see for example, the contributions to Treumer & Lichère (eds), *Enforcement of the EU Public Procurement Rules* (n 3), and to Duncan Fairgrieve & Francois Lichère (eds), *Public Procurement Law. Damages as an Effective Remedy* (Oxford, Hart 2011); see also Schebesta (n 8) 75–154. See also the contributions to Torricelli &Folliot-Lalliot (eds), *Oversight and Challenges of Public Contracts* (n 45), although these are mainly focused on administrative law aspects of the domestic transposition of the Remedies Directive.

of designing such maximum harmonization mechanisms, even if it decided to propose a revision of the Remedies Directive in the future. What then should not be acceptable is for such maximum harmonisation to be achieved or imposed through an excessively broad interpretation of the Remedies Directive as, in my view, the EFTA Court's *Fosen-Linjen* judgment does.

Moreover, I think it is worth stressing that, in addition to the practical difficulties derived from the dispersion of solutions implicit in the current minimum harmonization of procurement remedies, and the not smaller difficulties in attempting a maximum harmonization, there are also structural tensions in the use of damages actions for the enforcement of EU public procurement rules. As recent research has clearly shown,[81] the use of damages actions (either based on *Francovich* liability, or sector-specific rules) for the enforcement of substantive EU law creates distortions in the domestic legal systems of the Member States. From that perspective, both the minimum and maximum harmonization approaches are problematic.

From the minimum harmonization perspective, because the existence of two tiers of protection at domestic level (on enforcing the EU standard and a potential second tier enforcing more demanding rules) can also result in two tiers of regulation and/or case law concerning the interpretation and application of the rules, which is bound to create legal uncertainty. For example, if issues around the effectiveness of the remedy in the EU-tier create pressures on the interpretation of the domestic-tier remedies as a result of reverse pressures resulting from the principle of equivalence – *ie* the domestic remedy can hardly be both broader in scope and less effective in its consequences.

From the maximum harmonization perspective, because the creation of a one-size-fits-all remedy (such as that derived from the lower threshold for damages liability in the EFTA Court's Judgment) can have rather drastic impacts for some Member States (in particular, those without a 'higher-tier' domestic protection). Those impacts could be felt not only in the area of procurement law, but also in other areas of (economic) law which regulation and case law can be distorted as a result of the EU rules. For example, establishing a lower trigger of potential liability in damages for the breach of procurement rules than that applicable under the State liability doctrine in relation to general internal market law could create significant pressures on the interpretation of the 'concept' of procurement as litigants sought to fit different types of market-regarding public activity within the context of procurement.[82]

More generally, it is worth emphasising that there will be issues of (non)compliance with the EU public procurement rules that may be ill-suited for damages claims, and that there is a clear difficulty in assuming that generous procurement damages rules are in the public interest, given that all pay-outs reduce the funds available for the discharge of public sector obligations – in a notable difference with damages in other areas, such as EU competition law. This requires Member States to retain (or create) a

[81] Giliker (n 72).

[82] It is worth noting that the concept of procurement is triggering significant litigation already; see eg Judgment of the Court of Justice of the European Union of 2 June 2016 in Case C-410/14 *Falk Pharma* EU:C:2016:399. See also Opinion of AG Campos Sánchez-Bordona of 13 December 2017 in Case C-9/17 *Tirkkonen* EU:C:2017:962 (not available in English).

robust public enforcement mechanism. This was one of the missed opportunities in the revision of the EU public procurement rules in 2014,[83] but the perceived weakness of the public enforcement mechanisms cannot be compensated with a boost of private enforcement through distortive adaptations of general EU law doctrines (State liability) and/or domestic private law institutions (mainly tort law).

Thus, it seems adequate (and it may not be too late…) to reconsider a drastic change in the enforcement strategy to reduce the current over-reliance on tenderer-led administrative and/or judicial reviews, and to start to move away from damages-fuelled private enforcement of EU public procurement law and towards a more robust architecture of public enforcement with a restriction of damages compensation solely in exceptional cases – certainly where that compensation goes beyond direct participation costs. Discussing the possibilities of doing so and the challenges it implies far exceeds the possibilities of this paper, but given that reaching a 'happy median' in the regulation of (private) damages actions in the context of procurement remedies in the EU would not be a minor feat, it may be time to (re)open the discussion.

[83] Pedro Cerqueira Gomes, 'A Lost Proposal in the 2014 Public Procurement Package: Is there any Life for the Proposed Public Procurement Oversight Bodies?' in Grith Skovgaard Ølykke & Albert Sanchez-Graells (eds), *Reformation or Deformation of the EU Public Procurement Rules* (Edward Elgar, 2016) 170–190.

NON-DISCRIMINATORY ROYALTIES FOR STANDARD ESSENTIAL PATENTS: SETTING THE BOUNDARIES

JULIA ÖSTERMAN*

Abstract

Technical standards often implicate patented technologies. This poses a risk of patent hold-up, whereby a standard essential patent ('SEP') holder opportunistically exploits its market power conferred by standardization and demands excessive and possibly differential royalties from implementers of the standard. Commitments to license on fair, reasonable, and non-discriminatory ('F/RAND') terms imposed on SEP holders are intended to avoid that risk. Nevertheless, the practical implications of the non-discrimination ('ND') prong of F/RAND have become a subject of debate and litigation as a matter of contract and antitrust law. This paper seeks to answer the question: 'To what extent is a F/RAND-committed SEP holder legally allowed to charge differential royalties to different licensees for the patented technology from the U.S. and the EU perspectives?' It explores the meaning of the ND prong by examining IEEE, (= Institute of Electrical and Electronics Engineers) JEDEC, (= Joint Electron Device Engineering Council) and ETSI's (European Telecommunications Standards Institute) bylaws, inspecting U.S. and EU antitrust norms, analyzing case law of the U.S. and European courts, and reviewing legal and economic arguments in the academic literature. According to the dominant perception, SEP holders are obliged to license to similarly situated licensees on similar terms. Based on the interpretations in case law and literature, it is possible for a SEP holder to charge differential royalties legally to licensees manufacturing dissimilar devices incorporating the technology, and even to licensees manufacturing similar devices when the needed transactions differ. Discrimination in royalties may also trigger antitrust liability when it is capable of harming competition, although the threshold is significantly lower in EU law than in U.S. law.

1 INTRODUCTION

Nowadays, technological devices are an integral part of everyday life. People connect via smartphones that operate over 3G/4G networks and computers that operate over Wi-Fi. In order to function, these devices must communicate with each other, which often means compliance with technical standards. Due to the fast evolution of information and communications technology ('ICT') and the need for interoperability between devices, standards are more important than ever. Problematically, these standards may implicate hundreds of patents covering the technology and implementers of a standard may need to negotiate licenses to employ the patented

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* LL.M graduate in European Business Law from Lund University in 2018. The article builds on the author's master thesis carried out at Lund University in 2018. It scrutinizes to what extent a standard essential patent holder who has committed to license on fair, reasonable, and non-discriminatory terms is allowed to charge differential royalties for the patented technology from the U.S. and the EU perspectives by examining IEEE, JEDEC, and ETSI's bylaws, inspecting U.S. and EU antitrust norms, analyzing case law of the U.S. and European courts, and reviewing legal and economic arguments in the academic literature. The author can be contacted via email: julia.osterman@gmail.com.

technology. There is a risk of patent hold-up, whereby a standard essential patent ('SEP') holder opportunistically exploits its market power conferred by the inclusion of its patented technology into a standard and demands excessive royalties from implementers. SEP holders may be able to behave opportunistically and demand differential royalty rates across implementers as a result of different bargaining outcomes or for the reason that the implementer is a competitor.

In order to ensure follow-on innovation, SEP holders' freedom to license is limited. Limitations may flow from contractual obligations imposed by standard setting organizations ('SSOs') and/or from antitrust law.[1] The purpose of commitments to license on fair, reasonable, and non-discriminatory ('F/RAND'[2]) terms imposed by SSOs is to both grant implementers access to the patented technology and reward the SEP holder for the contribution to the standard. Fair amount of research efforts has focused on the concept of 'reasonable' terms in the context of F/RAND licensing. However, the 'non-discriminatory' ('ND') prong of F/RAND has received far less attention from the courts and commentators although it has become a subject of debate and litigation. It is a problematic component to define. For example, is an identical royalty rate charged to all licensees based on profits of end-products incorporating the technology non-discriminatory? Then the royalty rate may be the same, but the actual royalty payments differ depending on the value of the end-products. There seems to be consensus that similarly situated licensees should license on similar terms. However, the meanings of similarly situated licensees and similar license terms are not straightforward.

This paper aims to answer the question: 'To what extent is a F/RAND-committed SEP holder legally allowed to charge differential royalties to different licensees for the patented technology from the U.S. and the European Union ('EU') perspectives?' It seeks to explore the meaning of the ND prong of F/RAND in the standard setting context and to discover its practical implications for SEP licensing practices in two important jurisdictions: the U.S. and the EU. Methodologically this paper examines SSOs' bylaws, inspects U.S. and EU antitrust norms, analyzes case law of the U.S. and European courts, and reviews legal and economic arguments in the academic literature. The research kicks off in the second chapter with a brief overview of patents generally and the limited freedom to license patented technology in the standard setting context. The third chapter initiates the profound analysis of the ND prong and looks into SSOs' bylaws, concentrating on three international SSOs (standard setting organizations) that are of great economic importance and subjects of litigation today: IEEE, JEDEC and ETSI. In the fourth chapter, the attitudes of U.S. and EU competition laws towards differential pricing and patentees' licensing practices are scrutinized. The fifth chapter analyses the case law development in the U.S. and the EU, which provides some ideas on the definition and implications of the ND prong. Finally, the sixth chapter proposes a framework for answering the question whether a F/RAND-committed SEP holder may set differential royalties to different

[1] For the purposes of this paper, 'antitrust' law and 'competition' law are used synonymously.

[2] For the purposes of this paper, 'F/RAND' refers to the concepts of 'FRAND' and 'RAND.' However, the concepts of FRAND and RAND are often used synonymously. See, for instance, *Apple v Motorola* (ND Ill 2012) at 911-912; *Microsoft v Motorola*, (9th Cir 2012), at 877.

licensees lawfully and to what extent. The focus lies on the prevalent interpretation that the ND prong imposes an obligation to license to similarly situated licensees on similar terms. The chapter distinguishes between two scenarios: first, when the licensees' devices incorporating the patented technology are dissimilar; and second, when the devices are similar.

This paper concludes that based on the examined interpretations, licensees manufacturing dissimilar devices are not similarly situated, and thus a F/RAND-committed SEP holder is legally allowed to charge differential royalties at least to those licensees provided that the value contributed by the patented technology to the particular devices is apportioned convincingly. Licensees manufacturing similar devices are not inevitably similarly situated either, as factors relating the nature of the licenses may change the degree of similarity of the licensees' situations. Furthermore, it appears that F/RAND royalties may legitimately vary even across similarly situated licensees according to different licensing arrangements so long as the same menu of terms is available for all licensees. In addition, antitrust liability may be triggered in both U.S. and EU law when the practice of charging discriminatory royalties may harm competition, although the threshold is clearly lower in EU law.

2 SEP LICENSING AND THE LIMITS TO THE FEEEDOM TO LICENSE

Before looking into the ND prong of F/RAND and the question whether SEP holders have a right to set differential royalties, this chapter provides a brief overview of patents and how and why the freedom to license patented technology is limited in the standard setting context. The first section examines the patent regime, the rights it bestows, its economic rationale in the society, and some issues faced by it today. SSOs and the purpose of standard setting is discussed in the second section, as well as the risk of patent hold-up, and F/RAND commitments imposed by SSOs. The third section examines the intersection of the relevant legal regimes in relation to patent licensing practices, namely patent law, contract law, and antitrust law.

2.1 UNDERSTANDING THE CONTEXT OF PATENTS AND LICENSING

Incentives to discover and commercialize technologies are crucial in today's society where innovation drives economic growth.[3] That is exactly what the patent regime seeks to provide: an incentive to invent technical solutions.[4] In order to survive in the rapidly changing technology markets, companies must be able to protect their inventions.[5] A patent remedies free-rider problems by the grant of a right to exclude

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[3] Alan Devlin, *Antitrust and Patent Law* (Lars Kjølbye ed, OUP 2016) 63.
[4] ibid; Daniel G Swanson and William J Baumol, 'Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power' (2005) 73 Antitrust LJ 1, 2; Yann Ménière, 'Fair, Reasonable and Non-Discriminatory (FRAND) Licensing Terms, Research Analysis of a Controversial Concept' [2015] JRC science and policy report, 10; Alison Jones and Brenda Sufrin, *EU Competition Law: Text, Cases, and Materials* (6th edn, OUP 2016) 826-827.
[5] Donald Rimai, *Patent Engineering: A Guide to Building a Valuable Patent Portfolio and Controlling the Marketplace* (Wiley-Scrivener, 2016) 20.

others from practising the invention.[6] Without patents, companies might not invest capital and contribute to technological research and development ('R&D') due to the possibility of appropriation. It is a trade-off: the government grants the patentee an exclusionary right in exchange for revealing the invention to the public.[7]

Patents are traditionally creatures of national law. The U.S. has a federal patent system. A U.S. patent grants a right to exclude others from making, using, selling, offering to sell, or importing the patented invention for twenty years from the filing date.[8] It is available for inventions that are novel, non-obvious, and useful.[9] In Europe, there is no unified patent regime. However, the European Patent Convention established the European Patent Organisation ('EPO') in 1977 of which all the 28 EU member states and 10 other European states are members. It did not create a pan-European patent but a centralized prosecution process. Furthermore, all EU member states except Croatia and Spain have agreed to create and recognize unitary patent protection, which is expected to become operational during the course of 2018,[10] and a Unified Patent Court, which is awaiting ratification. Analogously to a U.S. patent, European patents are available for inventions that are novel, involve an inventive step, and are susceptible of industrial application.[11] However, unlike under U.S. law, schemes, rules and methods for doing business and programs for computers are excluded from European patentability.[12]

The potential revenue that may accrue from patents motivate companies to invest in R&D.[13] Patents can be commercialized through licensing, which refers to an act where the licensor transfers the licensee the right to make, sell and use products, processes or services embodying the technology for commercial use usually in exchange for remuneration, typically royalties.[14] Licensing benefits both the licensor and the licensee, as well as the society as a whole as it stimulates further technological development.[15] Nevertheless, there is a large variety of licensing practices, and the (typically bilaterally negotiated) license terms and royalty rates in particular may give rise to conflicts. Royalties are often based on the value of the patented technology relative to its next-best alternative.[16] Many factors may be taken into account, such as the size and value of the potential licensees' patent portfolios and the possibility of cross-licensing.[17]

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[6] Swanson and Baumol (n 4) 2; Devlin (n 3) 63; Jones and Sufrin (n 4) 830.
[7] Rimai (n 5) 22.
[8] 35 USC, §§ 154, 271(a).
[9] ibid §§ 101-103.
[10] EPO, 'When will the Unitary Patent system start?' (18 September 2017) <https://www.epo.org/law-practice/unitary/unitary-patent/start.html> accessed 15 June 2018.
[11] European Patent Convention, Art 52(1).
[12] ibid Art 52(2)(c).
[13] Swanson and Baumol (n 4) 2; Ménière (n 4) 10; Jones and Sufrin (n 4) 826-827.
[14] WIPO and ITC, *Exchanging Value, Negotiating Technology Licensing Agreements: A Training Manual* (WIPO, 2005) 18.
[15] ibid 13.
[16] Richard J Gilbert, 'Deal or No Deal? Licensing Negotiations in Standard-Setting Organizations' (2011) 77 Antitrust LJ 855, 860.
[17] Anne Layne-Farrar and Paul Stuart, 'Abusive Discrimination' in Enrique Francisco González-Díaz and Robert Snelders (eds), *EU Competition Law Volume V, Abuse of Dominance Under Art 102 TFEU* (Claeys & Casteels, 2013) 38.

The patent regime has not progressed at the same rate as the patented invention. The world of technology changed drastically in the 1970s as consumers began to embrace digital technologies.[18] The first home computer was introduced in 1977 along with video games, and companies such as Apple, Microsoft and Dell took the lead in the new consumer electronics market a few years later with simple and affordable computers.[19] Then came the Internet, and the technology markets begun developing incredibly fast.[20] Whereas a patent was initially designed to cover mechanical invention, a great number of new technologies are steered by microelectronics and computer software, and multiple technologies are often combined to create a consumer product.[21] Thousands of patents may read on one single device. Today, the patent regime is inadequate to address all the issues related to new technology and industry structure.[22] Broad exclusionary rights may both promote and impede technological progress depending on the industry.[23] The great mass of patents (the so-called 'patent thicket') deters commercialization of technology when they are overlapping and laying claim to the same technologies.[24] Furthermore, patents are not only defensive tools to protect inventions against appropriation, but also strategic weapons against rivals.[25] As industry relies on self-help measures, the antitrust regime has become more and more relevant.[26] Moreover, due to the patent regime's partial malfunction, companies avoid patent wars by joining together through, *inter alia*, patent pools and cross-licensing agreements.[27]

2.2 AVOIDING THE RISK OF PATENT HOLD-UP: F/RAND TERMS IN STANDARD SETTINGS

SSOs are private organizations that develop, promulgate or otherwise maintain standards that aim to meet the technical objectives of a particular industry.[28] They produce 'agreements containing technical specifications or other criteria' and promote economic efficiency by facilitating interoperability of devices.[29] They provide protocols for the creation of interoperable devices through collaborative process by using common architectures made of a set of technologies.[30] One of the reasons for forming SSOs is the same as for forming patent pools and cross-licensing agreements: attainment of clearing positions.[31] Standards are issued by various SSOs, including

[18] Rimai (n 5) 19.
[19] ibid.
[20] ibid 19-20.
[21] Devlin (n 3) 5-6, 66.
[22] ibid 66.
[23] ibid 9.
[24] ibid 6.
[25] ibid 60.
[26] ibid.
[27] ibid.
[28] J Gregory Sidak, 'The Meaning of FRAND, Part I: Royalties' (2013) 9(4) JCL&E 931, 946, 948.
[29] US DOJ and US Patent & Trademark Office, Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments (Jan 8, 2013), 2-3.
[30] Joanna Tsai and Joshua D Wright, 'Standard Setting, Intellectual Property Rights, and the Role of Antitrust in Regulating Incomplete Contracts' (2015) 80(1) Antitrust LJ 157, 159; Devlin (n 3) 6, 35.
[31] Devlin (n 3) 6.

IEEE, JEDEC, and ETSI. They are important in the new economy, particularly in ICT industries,[32] as they provide industries with great benefits:[33] they can reduce transaction costs, increase competition, and improve the value of consumer products especially through realization of network effects.[34]

Technical standards promulgated by SSOs often implicate patented technologies, and therefore implementers may need to negotiate licenses. The risk of abuse of standardisation is an important legal and economic concern. One of the recognized dangers with standardisation is that a patentee may 'hold-up' industry once an SSO chooses the patented technology into a standard and industry sinks capital into implementing it, although the hold-up theory lacks empirical evidence.[35] A patent hold-up situation may arise in *ex post*[36] negotiations between a patentee and an implementer when the patentee enjoys increased bargaining power than *ex ante*[37] as the standard has reduced competitive alternative technologies.[38] A Patentee may induce an SSO to adopt its technology into a standard but conceal its relevant patents from the SSO and later assert those patents against implementers (the so-called 'patent ambush'), or it may disclose them but without intention to license them on F/RAND terms and then use them to hold-up industry.[39] In the latter situation, a SEP holder opportunistically exploits the incremental market power conferred by the inclusion of its technology into a standard and charges higher royalties to implementers than it would have charged *ex ante* along with a threat of assertion.[40] A SEP holder may be able to do so when industry is locked into a standardized technology and implementers can no longer choose possible alternative technologies for their devices cheaply in order to avoid infringement.[41] A SEP holder essentially seeks to capitalize implementers' sunk investment in devices that infringe the patent. Nevertheless, SEPs may be asserted not only to acquire royalties but also to exclude competitors from the market, as happened in the smartphone wars as of year 2009.[42]

In order to avoid the risk of patent hold-up, it is common for SSOs like IEEE, JEDEC, and ETSI to require their members to disclose patents that may be essential to implementation of a standard and to agree to offer to negotiate a license on

32 Ménière (n 4) 9; Chryssoula Pentheroudakis and Justus A Baron, 'Licensing Terms of Standard Essential Patents, A Comprehensive Analysis of Cases' [2017] JRC science and policy report, 17.

33 US DOJ and US Patent & Trademark Office, Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments (Jan 8, 2013) 2; Tsai and Wright (n 30) 159; Devlin (n 3) 166.

34 Mario Mariniello, 'Fair, Reasonable, and Non-Discriminatory (FRAND) Terms: a Challenge for Competition Authorities' (2011) 7(3) JCL&E 523, 523-524; Tsai and Wright (n 30) 159-160.

35 Ménière (n 4) 15; Pentheroudakis and Baron (n 32) 27.

36 For the purposes of this paper, '*ex post*' refers to the time after the SSO has chosen the patentee's technology into the standard.

37 For the purposes of this paper, '*ex ante*' refers to the time before the SSO has chosen the patentee's technology into the standard.

38 Pentheroudakis and Baron (n 32) 24-25.

39 Devlin (n 3) 166; Pentheroudakis and Baron (n 32) 25-26.

40 Dennis W Carlton and Allan L Shampine, 'An Economic Interpretation of FRAND' (2013) 9(3) JCL&E 531, 535; Ménière (n 4) 14-15; Devlin (n 3) 166; Pentheroudakis and Baron (n 32) 24-25.

41 Carlton and Shampine (n 40) 535; Ménière (n 4) 14-15; Devlin (n 3) 166; Pentheroudakis and Baron (n 32) 24-25.

42 Devlin (n 3) 303-305.

F/RAND terms.[43] This information may affect SSOs' decisions to include a particular technology into a standard, in addition to the quality of the engineering. Although SSOs have been fairly silent about the reasons behind F/RAND terms, commentators have maintained that F/RAND terms seek to strike a balance between the interests of patentees and those of standard implementers. While F/RAND terms aim to make SEPs available to all implementers, no matter the implementer's position in the market, they should also allow SEP holders to extract rent deriving from the advantages of their technology over the next-best alternatives.[44] In order to ensure incentives to innovate and to participate in standard setting, SEP holders must be able to recover their upfront R&D investment.[45] In other words, F/RAND commitments operate as a safeguard against patent hold-up as well as patent hold-out (referring to implementers intentionally using patented technology essential to a standard without a license)[46], and to foster standardization and the resulting benefits. SSOs can thus be conceptualized as sort of joint ventures and F/RAND commitments as ancillary restraints that are essential for the joint ventures' success.[47]

2.3 INTERSECTION OF LEGAL REGIMES AS LIMITS TO THE FREEDOM TO LICENSE

SEP licensing practices may be scrutinized through the lens of different applicable legal regimes such as patent law, antitrust law, and contract law. The three legal regimes interact with each other closely. F/RAND commitments limit SEP holders' right to exclude as a means to, *inter alia*, prevent the risk of patent hold-up, and those limitations may be enforced through contract law and/or antitrust law. The tension between antitrust and patent regimes flow from the fact that whereas patents bestow monopoly power legally, antitrust law seeks to proscribe it.[48] Nevertheless, the U.S. and EU competition authorities consider antitrust and patent regimes to share the same objective: the promotion of innovation and consumer welfare, that is to say, high quality products and low prices.[49] Patents remedy appropriation concerns and competitive markets lead to economic efficiency. The two bodies of law are, at least in theory, complementary.[50] Regardless of the common objective, the rules may collide and antitrust law may override.

Antitrust law is a tool to limit the freedom of contract for the sake of competitive markets. Policy objectives such as economic freedom and fairness may be relevant too

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43 Mariniello (n 34) 524; Tsai and Wright (n 30) 171; Pentheroudakis and Baron (n 32) 28, 33.
44 US DOJ and US Patent & Trademark Office, Policy Statement on Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments (Jan 8, 2013) 5; Mariniello (n 34) 524; Ménière (n 4) 7; Pentheroudakis and Baron (n 32) 11.
45 Mariniello (n 34) 524; Ménière (n 4) 7; Pentheroudakis and Baron (n 32) 21-23.
46 Ménière (n 4) 15; Pentheroudakis and Baron (n 32) 26.
47 Sidak, 'The Meaning of FRAND, Part I: Royalties' (n 28) 951.
48 See, for instance, *United States v Westinghouse Elec Corp*, (9th Cir 1981) at 646.
49 Commission Communication, Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements [2014] OJ C 89/03, para 7; US DOJ and FTC, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (2007), 1.
50 *Atari Games v Nintendo of Am,* (Fed Cir 1990), at 1576.

in addition to economic efficiency.[51] The analysis of a company's conduct and its effects begins with examining the characteristics of the industry and the market in order to delimit the area of competition that restricts the company's ability to act independently. The market is defined by ascertaining the price elasticity of demand that the product faces at the competitive price level. However, defining the market is problematic with regards to SEPs.[52] Many issues may affect the analysis, such as the existence of competing standards or complements.[53] The prediction and prevention of anti-competitive consequences of conduct is not straightforward in a dynamic industry such as ICT. As exclusionary rights may both promote and impede R&D, patent related conduct is subject to special antitrust treatment. Special treatment applies to SSOs and SEP holders too. Standard setting is essentially collaboration between rivals and therefore SSOs may pose a threat of horizontal collusion such as price fixing, which is prohibited in both U.S. and EU law.[54] Nonetheless, standard setting is praised for producing positive economic effects.[55] SSOs must take antitrust limitations into account. SEP holders must also be aware of antitrust limitations, as for instance engaging in patent hold-up may qualify as abuse of market power derived from the essentiality of a standard. However, Makan Delrahim, Assistant Attorney General for the Antitrust Division at the U.S. Department of Justice ('DOJ'), stated in March 2018 that 'hold-up is fundamentally not an antitrust problem, and therefore antitrust law should not be used as a tool to police FRAND commitments that patent-holders make to standard setting organizations.'[56] He emphasized that antitrust enforcement requires empirical evidence, which patent hold-up theories lack.[57] The U.S. enforcement agencies and courts are clearly less inclined to interfere in patent hold-up than those of the EU. Assistant Attorney General Delrahim added further that SSOs should ensure incentives to innovate and thus concentrate not only on the risk of hold-up by patentees but also on hold-out by implementers which 'poses a more serious threat to innovation.'[58]

SEP holders' conduct may also be analysed through contract law as licensing practices may amount to a breach of a contractual obligation flowing from a F/RAND commitment. A contractual prohibition against price discrimination differs from a

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[51] Jones and Sufrin (n 4) 26-28.
[52] Devlin (n 3) 307-308.
[53] ibid 309; Anne Layne-Farrar, 'Nondiscriminatory Pricing: Is Standard Setting Different?' (2010) 6(4) JCL&E 811, 819.
[54] US DOJ and FTC, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (2007), 37; Commission Communication, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2011] OJ C 11/01, §§ 273-274.
[55]US DOJ and FTC, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (2007), 33; Commission Communication, Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2011] OJ C 11/01, § 263.
[56] US DOJ, Assistant Attorney General Makan Delrahim, 'The 'New Madison' Approach to Antitrust and Intellectual Property Law' (Philadelphia, 16 March 2018) <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-keynote-address-university> accessed 15 June 2018.
[57] ibid.
[58] ibid.

statutory antitrust prohibition at least in three ways.[59] First, the scope of the prohibition may differ, as parties to a contract are free to define the terms and the obligations imposed by them, whereas an antitrust prohibition is defined by the authorities. Second, the required evidence differs for establishing a breach of contract as opposed to a violation of antitrust law, as evidence of a valid contract and a breach of a contractual duty are required for the former. Moreover, standings to bring a claim are different. Lastly, the remedies for a breach of contract differ from those for an antitrust violation.

3 THE ND PRONG IN SSOS' BYLAWS: DEFINING THE SCOPE OF THE PROTECTION

Before answering the question whether F/RAND-committed SEP holders have a right to set differential royalties to different licensees, the definition of the ND prong of F/RAND needs to be analysed. The scrutiny to ascertain what is meant by non-discriminatory terms or royalties for F/RAND purposes logically begins with SSOs' bylaws as F/RAND commitments are essentially agreements between patentees and SSOs. This chapter examines SSOs' policies on the ND prong. Clearly, the ND prong provides an umbrella of protection for implementers against strategic licensing conduct by SEP holders – it allows implementers to benefit from license terms negotiated by previous licensees.[60] Nevertheless, the question is: to what extent can implementers rely on those terms?

The first section examines F/RAND commitments as contractual obligations and highlights the importance of identifying the intention behind SSOs' bylaws in the act of defining the ND prong of F/RAND. The second section reviews SSOs' bylaws regarding SEP licensing rules, focusing on three SSOs: international SSO IEEE, which has published standards in industries such as electrical engineering, computer science, and electronics; international SSO JEDEC in the microelectronics industry; and European SSO ETSI in the telecommunications industry. The section analyses how the prohibition of discrimination is expressed in the SSOs' policy documents, and whether they seem to allow SEP holders to set differential royalties.

3.1 F/RAND COMMITMENTS AS CONTRACTUAL OBLIGATIONS

In the context of standard setting, F/RAND commitments are essentially voluntary undertakings taken by participants to a standard in accordance with SSOs' policies by virtue of participation in the standard setting process or through a letter of assurance.[61]

[59] J Gregory Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (2017) 2 The Criterion Journal on Innovation 301, 326.
[60] Gilbert (n 16) 860.
[61] Roger G Brooks and Damien Geradin, 'Interpreting and Enforcing the Voluntary FRAND Commitment' [2011] Cravath, Swaine and Moore LLP <https://www.cravath.com/files/Uploads/Documents/Publications/3234075_1.pdf> accessed 15 June 2018, 6; Ménière (n 4) 10; Tsai and Wright (n 30) 161; Jorge L Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (2017)

F/RAND commitments are imprecise for practical reasons and detailed licenses for SEPs are often determined through bilateral negotiations between a SEP holder and an implementer.[62] Although it has been debated whether F/RAND commitments are or should be enforceable as contractual commitments by implementers acting as third party beneficiaries,[63] a popular belief is that they are.[64] For instance, in *Unwired Planet*, Justice Briss examined French law that governs ETSI's FRAND commitments and conceded that F/RAND commitments should be 'public, irrevocable and enforceable' contracts at least on grounds of public interest.[65] A F/RAND commitment can be interpreted as an encumbrance on a patent.[66]

The interpretation of the rights and obligations of SEP holders and their enforceability depends on the content of the F/RAND commitment and the applicable law.[67] In both civil law and common law traditions contracts are interpreted by looking into the intention of the parties to the contract.[68] For instance, contract laws in the U.S. provide that an agreement must first be interpreted by giving effect to the common intention of the parties as expressed in the agreement, and in any case in a way which gives a reasonable, lawful, and effective meaning to the terms.[69] Every word of a legal document is relevant. Similarly, French law requires that contract terms are interpreted in accordance with the common intention of the parties, or if the intention cannot be discerned, in a way which a reasonable person placed in the same situation would.[70] Whereas IEEE and JEDEC's bylaws are governed by New York law,[71] ETSI's bylaws are governed by French law.[72] Discerning the intention of the parties to a F/RAND commitment is, however, a challenging task due to the fact that there are a wide and diverge range of industry participants who have developed the policies of SSOs.[73] For the same reason, SSOs' policies do not necessarily correspond to economic theory or antitrust policy.[74] Lack of contractual liability does not mean lack of antitrust liability, and vice versa.

17(1) The Antitrust Source <https://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug17_full_source.authcheckdam.pdf> accessed 15 June 2018, 7; Pentheroudakis and Baron (n 32) 33.

[62] Gilbert (n 16) 858; Pentheroudakis and Baron (n 32) 33.

[63] Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 7.

[64] *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 9; *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), para 146; *Microsoft v Motorola*, (WD Wash Apr 25, 2013), at 5; Brooks and Geradin (n 61) 8; Mariniello (n 34) 525; Tsai and Wright (n 30) 158; Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 7; Pentheroudakis and Baron (n 32) 33.

[65] *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), para 146.

[66] *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 11.

[67] Pentheroudakis and Baron (n 32) 34; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 312.

[68] Brooks and Geradin (n 61) 8; Pentheroudakis and Baron (n 32) 34.

[69] Restatement (Second) of Contracts (Am Law Inst 1981), §§ 201-203; *Reda v Eastman Kodak* (NY App Div 1996), at 557.

[70] French Civil Code, Art 1188.

[71] JEDEC Manual (2017) § 8.2.10; IEEE-SA Bylaws (2017) § 3.

[72] ETSI IPR Policy (2017) § 12.

[73] Brooks and Geradin (n 61) 8; Jorge L Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (2015) 80 Antitrust LJ 39, 73.

[74] Brooks and Geradin (n 61) 8.

3.2 IEEE, JEDEC AND ETSI'S COMMITMENTS

IEEE, JEDEC, and ETSI aim to ensure that SEPs are available to all implementers on F/RAND license terms and oblige their members to establish a licensing commitment. However, their bylaws do not provide a clear definition of the ND prong of F/RAND nor do they explain in detail the rights and obligations of F/RAND-committed SEP holders. The notions of discrimination or non-discrimination have not received much attention in the SSOs' bylaws, but some implications can be drawn from the wordings of the policy documents.

The wordings of IEEE and JEDEC's policy documents are similar. They impose a qualified prohibition against discriminatory license terms. IEEE requires SEP holders to declare that they 'will make available a license for Essential Patent Claims to an unrestricted number of Applicants on a worldwide basis without compensation or under Reasonable Rates, with other reasonable terms and conditions that are demonstrably free of unfair discrimination.'[75] In a similar way, JEDEC requires SEP holders to agree that '[a] license will be offered, to applicants desiring to utilize the license for the purpose of implementing the JEDEC Standard under reasonable terms and conditions that are free of any unfair discrimination.'[76] ETSI formulates its licensing requirements slightly differently from IEEE and JEDEC. ETSI requests SEP holders to be 'prepared to grant irrevocable licences on fair, reasonable and non-discriminatory ('FRAND') terms and conditions' to implementers of ETSI's standards.[77]

Based on the wordings of the SSOs' policy documents and the incorporation of the word 'fair', it may be argued that IEEE and JEDEC set 'RAND' commitments whereas ETSI sets 'FRAND' commitments, and that they impose different obligations on SEP holders.[78] On the one hand, the bylaws of IEEE and JEDEC require SEP holders to license on terms that are free of any *unfair* discrimination as opposed to a mere requirement of non-discrimination. The wording implies that discriminatory terms can be fair.[79] In other words, differential treatment of licensees might be justified in some circumstances. On the other hand, ETSI's bylaws seem to prohibit all forms of discrimination in license terms as the non-discrimination requirement is not mitigated by fairness.[80] Be that as it may, it does not necessarily follow that ETSI's bylaws prohibit all forms of discrimination nor that they effectively oblige SEP holders to license on identical license terms. It has been argued that many SSOs with unqualified non-discrimination requirements allow some flexibility for SEP holders to

[75] IEEE-SA Bylaws (2017) § 6.2.
[76] JEDEC Manual (2017) § 8.2.5.
[77] ETSI IPR Policy (2017) § 6.1.
[78] Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 309.
[79] ibid.
[80] Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 6.

offer and negotiate differential license terms.[81] In fact, historical documentation of ETSI's policy reveals that the non-discrimination obligation of ETSI's FRAND commitment means less than a Most Favoured Licensee -clause,[82] and requires no identical license terms for all implementers.[83] The commitments required by IEEE, JEDEC, and ETSI all seem to allow SEP holders to offer and negotiate differential license terms.

IEEE is the only one of the three SSOs to specify how to determine royalty rates. IEEE has introduced an engagement for SEP holders to use the smallest saleable patent practicing unit ('SSPPU', or 'the smallest product priced in the marketplace that contains the substantive aspects of the invention,'[84] or 'the smallest salable infringing unit with close relation to the claimed invention'[85]) as the royalty base in all licenses,[86] which was approved by the DOJ.[87] Accordingly, royalties should not be based on profits of an entire end-product. However, several members have stated that they will not comply with the restriction.[88] The obligation to use the SSPPU is controversial, as the SSPPU concept seems to be mainly used in the context of patent infringement jury trials,[89] and it might reduce incentives to innovate and participate in standard setting.

4 DRAWING THE BOUNDARIES OF ANTI-COMPETITIVE PRICE DISCRIMINATION IN THE US AND THE EU

Although antitrust norms on differential pricing are distinguished from the norms in the context of standard setting, they are both relevant for the interpretation of whether SEP holders have a right to set differential royalties to different licensees, because SSOs and antitrust law share the same objective: prevention of abusive use of market power by patentees. This chapter analyses the U.S. and EU competition policies on differential pricing and patentees' licensing practices, seeking to draw the boundaries of anti-competitive discriminatory pricing.

The first section discusses the rationale behind prohibiting differential pricing in general, after which the focus shifts on the competition policies of the U.S. and the EU, scrutinizing the attitudes towards differential pricing and licensing practices of patentees. The second section provides an overview of U.S. antitrust law and the prohibition of monopolization, and the third section an overview of EU competition

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[81] Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 315.
[82] Brooks and Geradin (n 61) 32-33.
[83] ibid 33; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 314.
[84] Gregory K Leonard and Mario A Lopez, 'Determining RAND Royalty Rates for Standard-Essential Patents' (2014) 29(1) Antitrust Magazine 86, 90.
[85] *LaserDynamics v Quanta Computer*, (Fed Cir 2012), at 67.
[86] IEEE-SA Bylaws (2017) § 6.1.
[87] Letter from Renata B Hesse (Assistant Attorney General, US DOJ) to Michael A Lindsay (Dorsey & Whitney LLP), (February 2, 2015).
[88] Andrew Lloyd, 'Ericsson and Nokia the latest to confirm that they will not license under the new IEEE patent policy' (IAM blog, April 2015) <http://www.iam-media.com/Blog/Detail.aspx?g=d07d0bde-ebd6-495a-aa72-4eecb9dac67d> accessed 15 June 2018.
[89] *Ericsson v D-Link Sys*, (Fed Cir 2014), at 1226.

law and the prohibition of abuse of dominance. Lastly, the fourth section examines the existence of compulsory licensing in U.S. and EU law in order to analyse to what extent patentees may generally exclude others from practicing the patented technology and discriminate between willing licensees. Despite having the same objectives, the competition regimes of the U.S. and the EU diverge. The level of the burden of proof borne by the authorities seeking to demonstrate possible anti-competitive effects of conduct is essentially a policy decision – it depends on the employed economic theory. The standard appears to be lower in the EU than in the U.S.

4.1 RATIONALE BEHIND PROHIBITNG DIFFERENTIAL PRICING

Before looking into the reasons why differential pricing may be prohibited, it is important to define what price discrimination is in the traditional sense. The economic concept of price discrimination often refers to different ratios of price to marginal costs between customers.[90] Price discrimination thus includes pricing practices that do not take into account the seller's costs of providing the product that varies among customers.[91] Patent licensing differs from provision of tangible products in that patents involve high upfront costs related to R&D efforts and relatively low marginal costs of licensing, such as monitoring costs and patent maintenance and enforcement fees.[92] Therefore, cost differences may not be as relevant in the context of patent licensing.[93] However, the bottom line is that discrimination arises where dissimilar terms and conditions are applied to similar transactions or similar terms and conditions are applied to dissimilar transactions.

Economically speaking, differential pricing can increase efficiency and improve consumer welfare.[94] It may, however, be unlawful when it may harm competition. Price discrimination may cause either primary line or secondary line injury to competition: it may have the effect of foreclosing the company's competitors on the same market or of distorting the company's customers' competitiveness.[95] In EU law, even mere harm to innovation without obstructing competitiveness may suffice to trigger antitrust liability.[96] Some argue that the risk of vertically integrated SEP holders' anti-competitive conduct is, or should be, the primary justification for the ND prong of F/RAND.[97]

The weight of the price discrimination concern depends on the company's position in the market. Patentees are generally legally allowed to maximize their income

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[90] Layne-Farrar and Stuart (n 17) 44; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 353.
[91] Layne-Farrar (n 53) 814; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 336.
[92] Layne-Farrar (n 53) 815.
[93] ibid.
[94] Swanson and Baumol (n 4) 25-26; Layne-Farrar (n 53) 815; Carlton and Shampine (n 40) 549; Jones and Sufrin (n 4) 381; Layne-Farrar and Stuart (n 17) 44; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 337.
[95] Jones and Sufrin (n 4) 381.
[96] Case T-201/04 *Microsoft* [2007] ECLI:EU:T:2007:289.
[97] Swanson and Baumol (n 4) 27.

by charging differential royalties to licensees,[98] and they generally do so.[99] Patentees, including SEP holders, tend to engage in price discrimination by charging differential royalties according to the nature of the devices that the licensees intend to manufacture.[100] Nevertheless, the incentives for charging differential license fees vary depending on the type of the patentee. Patentees can be distinguished into two types: (1) companies operating only in the upstream market, whose only source of income is licensing revenue, and (2) vertically integrated companies, or companies operating in both the upstream and the downstream market, whose sources of income are both licensing revenue and revenue from sales in the downstream market. It has been argued that vertically integrated companies have stronger incentives to discriminate in licensing.[101] Whereas non-integrated companies' incentive is only to increase licensing revenue, the incentive for vertically integrated companies may be to favour their own subsidiaries and foreclose rivals in the downstream market.[102] The margin squeeze theory has been employed under U.S. and EU law where the vertically integrated monopolist has charged discriminatory wholesale prices to its competitors in the downstream market.[103]

4.2 U.S. ANTITRUST POLICY AND THE ISSUE OF 'MONOPOLIZATION'

Like intellectual property ('IP') law, antitrust law is unified throughout the U.S., and limitations on patent related conduct come equally from the two fields of law. U.S. antitrust law is developed by multiple institutions. There are two enforcement agencies, the Federal Trade Commission ('FTC') and the DOJ, whose enforcement policies are subject to judicial review. Furthermore, antitrust law is partly driven by private litigation, which is incentivized by the provision of treble damages.[104]

One of the main statutes of U.S. antitrust law is the Sherman Act of 1890, which was seemingly passed as a response to powerful and anti-competitive oil and railroad companies that were formed as trusts.[105] Monopoly power has been considered injurious to the public due to possible higher prices, decreased output, and deterioration in product quality.[106] The Chicago competition theory has had a great influence on the U.S. antitrust policy, although the market structure - conduct - performance -paradigm of the Harvard School has remained relevant for antitrust analysis.[107] The Chicago competition theory is part of Chicago economics, which promotes neoclassical free-market economics and holds that people are rational and markets self-correcting.[108] According to the theory, the only aim of antitrust law should

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[98] See, for instance, *USM v SPS Techs*, (7th Cir 1982), at 512.
[99] Layne-Farrar (n 53) 813.
[100] ibid 7.
[101] ibid 3; Layne-Farrar and Stuart (n 17) 17.
[102] Layne-Farrar (n 53) 824-25.
[103] C-280/08 *Deutsche Telekom AG* [2010]; *Town of Concord v Boston Edison* (1st Cir 1990).
[104] 15 USC, § 15(a).
[105] Jones and Sufrin (n 4) 29.
[106] *Standard Oil v United States*, 221 US 1 (1911), at 52.
[107] Jones and Sufrin (n 4) 14.
[108] ibid.

be the pursuit of allocative efficiency.[109] Thus, governmental interference is desirable only when harm to the overall efficiency is demonstrated. Economic reasoning has penetrated U.S. antitrust law through neoclassical economics of the Chicago School.[110] Indeed, economic theory and econometrics are an integral part of U.S. antitrust law.[111] Practices distorting competition are not necessarily considered violating antitrust law when they promote innovation in the long term.[112] Effects-based proof is required for a violation to be found.

4.2[a] Monopolization and Price Discrimination

Section 2 of the Sherman Act on monopolization applies to unilateral anti-competitive conduct. The U.S. Supreme Court has emphasized that the mere possession of monopoly power is not unlawful, but an important element of the free-market system which attracts business acumen in the first place.[113] Monopoly may be obtained lawfully by virtue of 'superior skill, foresight and industry' and thus the courts have stressed that '[t]he successful competitor, having been urged to compete, must not be turned upon when he wins.'[114] Liability for monopolization requires two elements: '(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power' not resulting from 'a superior product, business acumen, or historic accident.'[115] Demonstrating liability for attempted monopolization requires proof that (1) 'the defendant engaged in predatory or anticompetitive conduct' with (2) 'a specific intent monopolize' and that there is (3) 'a dangerous probability of achieving monopoly power.'[116]

Section 2 of the Clayton Act, as amended by the Robinson-Patman Act, expressly prohibits price discrimination. Section 2(a) of the Robinson-Patman Act prohibits discrimination in price between purchasers of commodities of like grade and quality which may substantially lessen competition or create a monopoly. The Act distinguishes between primary and secondary line injury to competition.[117] There are two affirmative defences for price discrimination: (1) cost differences in manufacture, sale or delivery of the commodity; and (2) differentiation as a good faith response to the equally low prices of a competitor.[118] Nevertheless, the economic soundness of the Robinson-Patman Act prohibition has been widely questioned,[119] and although the act has not been repealed it has been disregarded by the U.S. antitrust agencies.[120]

The analysis of conduct begins with the market definition, which includes both the product market and the geographic market. The boundaries of the product market

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[109] ibid 15.
[110] Devlin (n 3) 106-107.
[111] ibid 106.
[112] ibid 109.
[113] *Verizon Communications v Law Offices of Curtis v Trinko*, 540 US 398 (2004).
[114] *United States v Aluminum* (2d Cir 1945), at 430.
[115] *United States v Grinnell*, 384 US 563 (1996), at 570-71.
[116] *Spectrum Sports v McQuillan*, 506 US 447 (1993), at 456.
[117] See, for instance, *Volvo Trucks v Reeder-Simco GMC*, 546 US 164 (2006), at 176.
[118] *Texaco v Hasbrouck*, 496 US 543 (1990), at 555-556.
[119] Layne-Farrar and Stuart (n 17) 57.
[120] ibid 58.

are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product and its substitutes.[121] The geographic market refers to the geographic area in which consumers can find alternative sources of the product and in which there is competition.[122] The same principles are used for technology markets.[123] Monopoly power refers to 'the power to control prices or exclude competition,'[124] which often equals to a market share higher than 65 per cent.[125] However, no precise threshold has been established, and market share is not the only indicator of monopoly power. Market power depends on the industry's characteristics, such as barriers to entry.[126] Once monopoly power has been established, it is determined whether the defendant had acquired or maintained that power through anti-competitive conduct. Yet conduct with anti-competitive effects may be justified by economic efficiency.[127]

4.2.[b] Monopolization by Patentees

Patents are not presumed to confer market power upon patentees, and in case a patent is found to confer market power it does not in itself violate antitrust law.[128] It is possible for a patentee to monopolize a technology market and a patent may form a single technology market when there is definite demand for the technology that is not substitutable. The FTC has recognized the relevant market for a SEP to be a single technology market and concluded that a SEP holder is a monopolist.[129] The Third Circuit came to the same conclusion in *Broadcom v. Qualcomm* in 2007, holding that the incorporation of a patent into a standard and the subsequent industry lock-in makes the relevant market congruent with the patented technology.[130] Nonetheless, defining the market for SEPs is complex and the law is bound to evolve.

Although patents were traditionally considered an exception to the rule against monopolies, antitrust law has operated to ensure that a patent is not used to gain market power going beyond the scope of the patent grant.[131] In accordance with the patent misuse -doctrine, the monopoly of the patent may not be extended to derive benefits not attributable to the use of the patent.[132] The defence of patent misuse has been narrowed, however, as the Federal Circuit held in 2010 that misuse exists only if the anti-competitive conduct involves the patent being enforced and a substantial anti-

121 *Brown Shoe v United States*, 370 US 294 (1962), at 325.
122 *Morgenstern v Wilson*, (8th Cir 1994), at 1296.
123 US DOJ and FTC, Antitrust Guidelines for the Licensing of Intellectual Property (Jan. 12, 2017), § 3.2.2.
124 *United States v E I du Pont de Nemours*, 351 US 377 (1956), at 391.
125 *Image Technical Services v Eastman Kodak,* (9th Cir 1997), at 1206.
126 *Rebel Oil v At Richfield*, (9th Cir 1995), at 1434.
127 *United States v Microsoft*, (DC Cir 2001), at 59.
128 *III Tool Works v Independent*, 547 US 28 (2006); US DOJ and FTC, Antitrust Guidelines for the Licensing of Intellectual Property (Jan 12, 2017), § 2.2.
129 *In re Motorola Mobility LLC & Google Inc,* FTC Docket No C-4410 (2013), complaint, paras 20–21.
130 *Broadcom v Qualcomm*, (3d Cir 2007), at 315.
131 See, for instance, *ISO v Xerox*, 203 F3d 1322 (2000), at 1327.
132 *Zenith Radio v Hazeltine Research*, 395 US 100 (1969), at 136; *Morton Salt* v *GS Suppiger*, 314 US 488 (1942).

competitive effect lies outside the scope of that patent grant.[133] Patents do not confer privilege or immunity to violate antitrust law;[134] today, even conduct falling within the scope of the patent appears to be subject to antitrust scrutiny. For instance, in *Actavis*, the Supreme Court held that pay-for-delay agreements may violate the Sherman Act even though such agreements arguably fall within the scope of the patent.[135]

4.3 EU COMPETITION LAW AND THE EXERCISING OF PATENTS

Due to the lack of unified rules of contract law or IP law, competition law plays a particularly important role in the EU when it comes to exercising patents. EU competition law is developed mainly by the Commission: the Commission sets the competition policy and oversees its enforcement in cooperation with the National Competition Agencies of the member states. The investigative, prosecutorial, and adjudicatory functions are not separated. The Commission's decisions can, however, be appealed to the Court of Justice of the European Union ('CJEU').

Article 3(3) of the Treaty on the European Union provides that the EU is to establish an internal market, and that market includes a system ensuring that competition is not distorted.[136] According to the CJEU, the competition rules exist to prevent restrictions on competition to the detriment of the public interest, individual undertakings, and consumers.[137] They seek to protect the structure of the market, and thus competition as such.[138] EU competition law has been developed with a skeptical attitude towards free markets with little governmental intervention.[139] Competition law has operated as a tool of public policy.[140] The Freiburg School of Ordoliberalism provided a framework for the formation of EU competition policy.[141] Ordoliberalism promoted a fragmented market structure with and, importantly, freedom of choice.[142] Many Ordoliberal principles such as the protection of individual economic freedom are reflected in the case law and the decisional practice of the EU institutions, especially with regard to Article 102 of the Treaty on the Functioning of the European Union ('TFEU').[143] As EU competition law appears to protect not only competition but also competitors, it also reflects a structuralist view of competition similarly to the Harvard School's structure - conduct - performance -paradigm.[144] Even though Ordoliberalism was based on social values,[145] economic efficiency arguments play a role in EU

133 *Princo v ITC*, (Fed Cir 2010), at 1329.
134 *ISO v Xerox*, 203 F3d 1322 (2000), at 1325; *Intergraph v Intel*, (Fed Cir 1999), at 1362.
135 *FTC v Actavis*, 133 S Ct 2223 (2013).
136 Case C-52/09, *Konkurrensverket v TeliaSonera Sverige AB* [2011], para 20.
137 C-52/09, *Konkurrensverket v TeliaSonera Sverige* [2011], para 22; Joined Cases 46/87 and 227/88 *Hoechst* [1989], para 25.
138 Cases C-501/06 P *GlaxoSmithKline Services* [2009], para 63.
139 Devlin (n 3) 107.
140 ibid.
141 ibid; Jones and Sufrin (n 4) 36-37.
142 Devlin (n 3) 108.
143 Jones and Sufrin (n 4) 37.
144 Devlin (n 3) 114.
145 ibid 107-108.

competition policy of today. In fact, in the 1990s, the Commission began to adopt a more economic approach and reformed the enforcement of EU competition law.[146]

4.3.[a] Abuse of Dominance and Price Discrimination

Article 102 of the TFEU prohibits abuse of dominant position within the internal market in so far as it may affect trade between member states. It is not concerned with market power as such, but with the anti-competitive means of obtaining, maintaining, and enhancing it. Dominance comes with a so-called 'special responsibility' not to distort competition.[147] There is no simple definition for the concept of abuse, but it refers to behavior of a dominant undertaking which influences the structure of a market by weakening the degree of competition.[148] Abuse may be exploitative, exclusionary and/or discriminatory. Nonetheless, liability under Article 102 may be escaped by proving objective necessity or efficiency enhancing effects of the abusive conduct as a justification.[149]

Article 102(c) of the TFEU expressly prohibits 'applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage.' Price discrimination by a dominant undertaking does not automatically equal a violation of competition law,[150] but it may trigger Article 102 when there is a possibility that it causes primary and/or secondary line injury.[151] Article 102(c) deals mainly with secondary line injury,[152] but it has been applied in situations of primary line injury as well.[153] Discrimination in a downstream market might also fall under Article 102(b) of the TFEU prohibiting abuse of 'limiting production, markets or technical development to the prejudice of consumers.'[154] Nevertheless, the CJEU recognizes that presumptively abusive discriminatory treatment may escape application of Article 102 if it has an 'objective justification.'[155] The question of objective justification is actually considered at the same time as the question of comparable transactions.[156] Comparability of transactions depends on factors such as the nature of products involved and the consumer's perception of the products,[157] costs incurred by the seller,[158] and timing of transactions.[159] Engaging in price discrimination to meet

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146 See, for instance, Council Regulation (EC) No 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, 2013 OJ L 1; Jones and Sufrin (n 4) 37-38.
147 Case T-201/04 *Microsoft* [2007], para 229; Case 322/81, *NV Nederlandsche Banden-Industrie Michelin* [1983], para 57.
148 Case 85/76 *Hoffmann-La Roche* [1979], para 91.
149 Commission Communication, Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings [2009] OJ C45/02, §§ 28-30.
150 Case C-209/10, *Post Danmark A/S v Konkurrencerådet*, EU:C:2012:172, para 30.
151 See, for instance, Case C-95/04 P, *British Airways* [2007], paras 144-145.
152 Layne-Farrar and Stuart (n 17) 2-3.
153 See, for instance, Case 85/76, *Hoffmann-La Roche* [1979], para 90.
154 Layne-Farrar and Stuart (n 17) 3.
155 C-209/10, *Post Danmark A/S v Konkurrencerådet*, EU:C:2012:172, paras 40-42.
156 Layne-Farrar and Stuart (n 17) 16.
157 ibid 5, 7; Case 27/76 *United Brands* [1978], paras 224-225.
158 Case T-301/04 *Clearstream* [2009], para 186; Layne-Farrar and Stuart (n 17) 8.
159 *ABG/Oil Companies* (Case IV/28.841) Commission Decision 77/327/EEC [1977] OJ L 117/1; Layne-Farrar and Stuart (n 17) 11.

competitors' prices in the market might result in secondary line discrimination and trigger Article 102.[160]

Establishing dominance begins with examining the structure of the market.[161] According to the Commission, market definition is a tool to identify and define the competitive constraints, which includes both a product and a geographic dimension.[162] The relevant product market comprises products that are interchangeable with each other because of the characteristics, prices and intended use.[163] The geographic market refers to the area in which the undertakings are involved, and where the conditions of competition are sufficiently homogenous and distinguishable.[164] The so-called Small but Significant and Non-Transitory Increase in Price -test operates a tool for estimating substitutability, which asks whether the customer would switch to available substitutes or suppliers in response to a hypothetical small (in the range 5 to 10 per cent) but permanent relative price increase in the products and areas.[165] If substitution renders the price increase unprofitable for the company, the substitutes and areas are included in the relevant market.[166] However, in the absence of sufficient data, the Commission makes use of more impressionistic assessments.[167] The Commission uses the same principles for defining technology markets.[168] The CJEU defines a dominant position as:

> 'position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.'[169]

According to the Commission, market power depends mainly on three factors: market share, barriers to entry, and countervailing buyer power.[170] Large market shares are considered evidence of dominance.[171]

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160 Layne-Farrar and Stuart (n 17) 41.
161 Case 27/76 *United Brands* [1978], para 67.
162 Commission Notice on the definition of the relevant market for the purposes of community competition law [1997] OJ C372/03, para 2.
163 ibid para 7.
164 ibid para 8.
165 ibid paras 15, 17.
166 ibid para 17.
167 See, for instance, Case 27/76 *United Brands* [1978], paras 30-31.
168 Commission Regulation (EU) No 316/2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements, 2014 OJ L 93/17, Art 1(1)k.
169 Case 27/76 *United Brands* [1978], para 65.
170 Commission Communication, Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings [2009] OJ C45/02, § 12.
171 Case 85/76 *Hoffmann-La Roche* [1979], para 41.

4.3.[b] Abuse of Dominance by Patentees

Similarly to U.S. law, a patent is not considered to place the patentee in a dominant position in itself.[172] However, if there are no substitutes for the technology, the patent may create a single technology market, for example when a license is indispensable for competition in the downstream product market.[173] This is generally the case with SEPs.[174] Nevertheless, high market shares are not necessarily a sufficient indication of market power in high-tech markets due to short innovation cycles.[175]

Using patents to strengthen a dominant position so as to, for instance, delay or prevent a competitor's entry into the market constitutes abuse under Article 102 of the TFEU. Patents granted by the legal systems of the member states may be in conflict with the market integration objective of the EU. Article 345 of the TFEU provides protection against EU law interfering with national systems of property ownership, but the CJEU has specified that the protection is limited. EU competition rules may supersede national patent law. The Commission recognizes that although patents exclude others from exploiting the invention without consent, they are not immune from competition law intervention.[176] The CJEU has traditionally distinguished between the existence and exercise of a patent. Essentially, competition law governs matters relating to the exercise of patents, the commercial use of those rights, whereas patent ownership falls outside the scope of competition law. This distinction was initially made in the 1966 decision *Consten and Grundig*, where the CJEU struck down a license agreement which limited competitiveness of third parties.[177] The Court argued that the artificial isolation and maintenance of separate markets distorts competition in the internal market as such.[178] In the decisions following *Consten and Grundig*, the CJEU formed the concept of the 'specific subject matter' of the intellectual property right ('IPR').[179] According to the CJEU, use of an IPR in a manner which goes beyond the specific subject matter of the right constitutes an 'exercise' of that right. For the purposes of EU law, the specific subject matter of a patent is 'to ensure to the holder, so as to recompense the creative effort of the inventor, the exclusive right to utilize an invention with a view to manufacture and first putting into circulation of industrial products either directly or by the grant of licenses to third parties.'[180] It may be inferred that the specific subject matter of a patent is synonymous with the scope of the patent. For example, in *Windsurfing*, the CJEU held that restrictions imposed by a patentee on licensees' freedom over a product outside the scope of the patents violate competition

172 Cases C-241/91 P and C-242/91 *P RTE and ITP (Magill)* [1995], para 46.

173 See, for instance, Cases C-241/91 P and C-242/91 *P RTE and ITP (Magill)*, [1995], paras 24, 47.

174 See, for instance, *Google/Motorola Mobility* (Case COMP/M.6381) Commission Decision [2012] OJ C 75/1, para 54; *Motorola Mobility* (Case AT.39985) Commission Decision [2014] OJ C 344/6, para 19.

175 Case T-79/12 *Cisco* ECLI:EU:T:2013:635, para 69.

176 Commission Communication, Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements [2014] OJ C 89/03, paras 6-7.

177 Cases C-56/64 etc *Consten & Grundig* [1966], at 341-342.

178 ibid 343.

179 See, for instance, Case C-193/83 *Windsurfing International* [1986], para 45; Case 78/70, *Deutsche Grammophon Gesellschaft v Metro-SB-Großmðrkte GmbH*, [1971], para 11.

180 Case 15/74 *Centrafarm v Sterling Drug* [1974], para 9.

law.[181] Nevertheless, even conduct within the scope of the patent may breach EU competition law in certain circumstances. One example of such circumstances is the existence of a duty to license.

4.4 COMPULSORY LICENSING IN THE US AND EU: UNDERSTANDING THE DIVERGENCE ON THE FREEDOM TO CONTRACT

It has been debated whether antitrust law should require a patentee to supply its infrastructure, its essential facility, to its competitors in order to facilitate competition and innovation. Certainly, such a duty to license is contrary to the very idea of a patent. Moreover, compulsory licensing and liability rules may be inefficient and encourage free-riding as companies failing to gain access may abuse the legal process.[182] Without a duty to license, a patentee in a dominant position in the market may foreclose competition and prevent follow-on innovation.[183] Refusal to deal may be particularly problematic in two situations: first, when a dominant provider of a primary product hinders competition in secondary markets for complementary products and services by refusing to allow interoperability;[184] and second, when monopolistic components in network industries block access for entrants.[185] Consequently, compulsory licensing may be imposed as a remedy to anti-competitive conduct or to address a pressing public need.[186]

Compulsory licensing orders and the accompanying commitments are similar to commitments in the standard setting context in respect of content and implementation.[187] In fact, F/RAND commitments in standard setting originate from U.S. antitrust orders.[188] The rationale is the same, namely to allow competition and entry into the market. Significantly, those commitments entail licensing on the same standard of terms: F/RAND.[189] Therefore, analyses of antitrust orders may be helpful when interpreting and enforcing F/RAND commitments in the standard setting context.

The question of compulsory licensing is familiar to both U.S. and EU law, but the answers differ between the legal systems. EU law allows interference into a patentee's right to exclude more easily. In his speech in March 2018, Assistant Attorney General Delrahim stressed that SSOs and courts should be very cautious before adopting rules that restrict patentees' right to exclude 'or – even worse – amount to a

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181 Case C-193/83 *Windsurfing International* [1986], paras 45-51.
182 Devlin (n 3) 239.
183 ibid 231.
184 ibid 240-241.
185 ibid 241.
186 Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (n 73) 45.
187 ibid 46.
188 Jorge L Contreras and Anne Layne-Farrar, 'Non-Discrimination and FRAND Commitments' in Jorge L Contreras (ed), *The Cambridge Handbook of Technical Standardization Law, Volume 1: Antitrust and Patents* (CUP, 2017) 187.
189 Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (n 73) 46.

de facto compulsory licensing scheme.'[190] The CJEU has established a duty to license, and the existence - exercise distinction has diminished. As dominant undertakings are imposed a special responsibility not to distort effective competition, their ability to exclude rivals is very limited in EU law. Exclusionary use of property, as opposed to productive use, is placed under scrutiny. As noted by former Commissioner Neelie Kroes, dominant companies have a great responsibility to allow competition especially in high-tech industries.[191] Former Commissioner Joaquín Almunia has also emphasized that software interoperability remains central to the Commission's enforcement practice.[192]

4.4.[a] Duty to Deal in U.S. Law

U.S. law is averse to compulsory dealing. In accordance with the decades-old *Colgate* doctrine, a company has a freedom to decide with whom to contract and on what terms.[193] It applies even to monopolists. Nevertheless, a duty to deal exists in U.S. law at least in relation to tangible infrastructures.

The Supreme Court recognized a duty to deal in 1912 *Terminal Railroad*, in which a terminal association that was controlled by competing railroads breached Sections 1 and 2 of the Sherman Act for conspiring to refuse granting railroad access to competitors and attempting to monopolize commerce.[194] The Court ordered the defendants to open membership in the association to any other railroads on 'just and reasonable terms' and place applying companies upon 'a plane of equality in respect of benefits and burdens,' and to allow use of their terminal facilities 'upon such just and reasonable terms and regulations.'[195] In its later case law, the Supreme Court appears to have established an essential facilities doctrine implicitly. In 1973 decision *Otter Tail*, a naturally monopolistic company had refused to sell power at wholesale or to transmit electricity over its lines to municipalities wishing to construct their own electrical grids and was thus found to restrict competition at the rail level in violation of Section 2.[196] More recently, the Court found a Section 2 violation in *Aspen Skiing* on the basis of a dominant company terminating cooperation with its competitor by closing access to a network.[197] The dominant company failed to provide any efficiency justification and was found 'willing to sacrifice short-run benefits and consumer goodwill in exchange

[190] US DOJ, Assistant Attorney General Makan Delrahim, 'The 'New Madison' Approach to Antitrust and Intellectual Property Law' (Philadelphia, 16 March 2018) <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-keynote-address-university> accessed 15 June 2018.
[191] European Commission, 'Antitrust: Commission welcomes CFI ruling upholding Commission's decision on Microsoft's abuse of dominant market position' (MEMO/07/359, Brussels, 17 September 2007) <http://europa.eu/rapid/press-release_MEMO-07-359_en.htm> accessed 15 June 2018.
[192] European Commission, Joaquín Almunia, 'Higher Duty for Competition Enforcers' (SPEECH/12/453 International Bar Association Antitrust Conference, Madrid, 15 June 2012) <http://europa.eu/rapid/press-release_SPEECH-12-453_en.htm> accessed 15 June 2018, 5.
[193] *United States v Colgate*, 250 US 300 (1919), at 307.
[194] *United States v Terminal Railroad Association*, 224 US 383 (1912).
[195] ibid at 411.
[196] *Otter Tail Power Co v United States*, 410 US 366 (1973).
[197] *Aspen Skiing v Aspen Highlands Skiing*, 472 US 585 (1985).

for a perceived long-run impact on its smaller rival.'[198] A duty to deal arose exceptionally on the basis of termination of a prior course of dealing.

There is, however, no general duty to deal in U.S. law, and the Supreme Court has noted that such a duty is in tension with antitrust policy.[199] In *Trinko*, the Supreme Court found no duty to supply its proprietary infrastructure, as the accused company had never voluntarily shared it with its competitors.[200] The Supreme Court noted that they have been 'very cautious in recognizing [a duty to deal], because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anti-competitive conduct by a single firm.'[201] The Federal Circuit has held that patentees have a presumptive right to refuse to sell or license in the absence of illegal tying, fraud in the Patent and Trademark Office, or sham litigation.[202] The antitrust agencies have also recognized that refusal to assist competitors does not generally trigger liability partly because of the risk of undermining incentives to innovate.[203] The essential facilities doctrine is considered inconsistent with IP protection.

The courts have ordered patentees to license on F/RAND-like terms as remedies for anti-competitive conduct fairly frequently since the 1940s.[204] For instance in 1947 *United States v. National Lead*, the courts found a patent pooling arrangement to violate Section 1,[205] and the District Court ordered the defendants to 'grant to any applicant … a non-exclusive license under any or all of the patents … at a uniform, reasonable royalty.'[206] Although the number of remedial patent licensing orders has declined since the 1970s, they have remained relevant especially with regard to merger review.[207] For instance in 1997, Cadence Design Systems agreed to settle the FTC charges that its acquisition of Cooper & Chyan Technology would substantially reduce competition in the market for automated chip design routing software.[208] According to the FTC, Cadence was a dominant supplier of chip layout environments, and CCT the only company with a commercially viable constraint-driven, shape-based routing tool.[209] The FTC found that the merger would reduce the incentives of Cadence to allow competing suppliers of routing tools access to its software interface programs, which in turn would hinder routing tool developers' entry into the market.[210] As a remedy, the consent order required Cadence to allow software developers of routing tools to participate in its software interface programs on a non-discriminatory basis.[211]

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198 ibid at 610-611.
199 *Verizon Communications v Law Offices of Curtis v Trinko*, 540 US 398 (2004), at 407-408.
200 ibid at 409.
201 ibid at 408.
202 *In re Independent Service Organizations Antitrust Litig*ation, (Fed Cir 2000), at 1327; *Miller Insituform v Insituform* (6th Cir 1987), at 609.
203 US DOJ and FTC, Antitrust Guidelines for the Licensing of Intellectual Property (Jan 12, 2017), § 2.1.
204 Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (n 73) 49.
205 *United States v National Lead* (SDNY 1945), affirmed, 332 US 319 (1947).
206 ibid at 534.
207 Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (n 73) 72.
208 *In re Cadence Design Systems, Inc,* FTC Docket No C-3761 (1997), decision and order.
209 *In re Cadence Design Systems, Inc,* FTC Docket No C-3761 (1997), complaint, paras 9-10.
210 ibid paras 16-18.
211 *In re Cadence Design Systems, Inc,* FTC Docket No C-3761 (1997), decision and order, at 3.

4.4.[b] Duty to Deal in EU Law

The European Commission stresses that every company, even a dominant one, should have the right to choose its partners to contract with, and that mandatory supplying may compromise incentives to innovate and ultimately harm consumers.[212] Yet a refusal to deal has been found to be abuse of dominance on several occasions.

The CJEU has established that a dominant undertaking may violate Article 102 of the TFEU by terminating supplies to a long-standing customer.[213] What is more, a duty to license was seemingly introduced in *Magill*,[214] where broadcasters held factual and legal monopoly over their television program listings, which they had not shared with others. The Commission found abuse of a dominant position in the broadcasters refusing to license the copyrighted material to a third party who wished to create a new product.[215] The broadcasters replied with an argument that an IPR owner's refusal to license forms part of the specific subject matter of that exclusive right and thus it is justified.[216] Nevertheless, the CJEU held that a dominant undertaking's refusal to license may constitute abuse in exceptional circumstances.[217] In *Magill*, the exceptional circumstances were found to exist as the broadcasters' refusal to provide information effectively prevented the creation of a new product in a secondary market, namely a comprehensive weekly television programme guide, for which there was a potential consumer demand.[218] An obligation to license on F/RAND-like terms was imposed as a remedy.[219] The CJEU thus suggested that indispensability, the legal impossibility of replicating, is a ground for competition law interference in rights to exclude.

A few years later in *Oscar Bronner*,[220] the CJEU clarified the test of indispensability. The CJEU specified that there must be no potential realistic substitute by reason of technical, legal, or economic obstacles capable of making it impossible or unreasonably difficult for an undertaking to replicate on its own or in cooperation with other undertakings.[221] However, it is not sufficient that a substitute is merely less advantageous.[222] The CJEU expanded the duty to license in its later case law. In *IMS Health,*[223] IMS provided German regional sales data on drug products through its copyrighted grid which divided the territory of Germany into 1,860 areas or bricks (the

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212 Commission Communication, Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings [2009] OJ C45/02, para 75.
213 Cases 6 and 7/73 *Istituto Chemioterapico Italiano SpA and CommercialSolvents Corporation* [1974], para 25; Case 27/76 *United Brands* [1978], para 182.
214 Cases C-241/91 P and C-242/91 P *RTE and ITP (Magill)*, [1995].
215 *Magill TV Guide/ITP, BBC & RTE* (Case IV/31.851) Commission Decision 89/205/EEC [1989] OJ L 78/43.
216 Cases C-241/91 P and C-242/91 P *RTE and ITP (Magill)*, [1995], para 40.
217 ibid para 50.
218 ibid para 54.
219 *Magill TV Guide/ITP, BBC & RTE* (Case IV/31.851) Commission Decision 89/205/EEC [1989] OJ L 78/43.
220 Case C-7/97, *Oscar Bronner v Mediaprint*, [1998].
221 ibid paras 41-45.
222 ibid para 43.
223 Case C-418/01 *IMS Health v NDC Health* [2004].

'1860 brick structure') to pharmaceutical companies who then organized their supplies based on that structure. Consequently, the 1860 brick structure became a *de facto* industry standard. NDC, an undertaking wishing to entry into the market, adopted the structure because of the fact that customers rejected the alternative structures introduced by NDC, and IMS subsequently sued for an infringement. The CJEU found an abusive refusal to license, noting that indispensability included situations in which replication is 'not economically viable for production on a scale comparable to that of the undertaking which controls the existing product or service.'[224] The CJEU also diluted the requirement that the refusal must be likely to exclude all competition in the secondary market by holding that it is sufficient to find the effect in relation to a potential or even a hypothetical market.[225] Furthermore, the CJEU did not focus on the fact that there was no obvious new product involved in the case.

The law on the duty to deal was changed radically in *Microsoft*.[226] In *Microsoft*, the Commission deemed that Windows had become a *de facto* industry standard in the market for client PC operating systems,[227] and Microsoft had abused its dominant position by refusing to disclose (partly patented) interoperability information with its Windows operating system, which was an essential facility for companies in computer and software industries. According to the Commission, the refusal to disclose impeded market entry.[228] The Commission found that in order to compete viably in the market for work group server operating systems, such a system must be able to communicate with Microsoft's Windows client PC operating system 'on an equal footing with Windows work group server operating systems.'[229] Surprisingly enough, the Commission literally equated viability with the ability of the dominant undertaking. The General Court reformed the earlier case law and stated that a refusal to license constitutes abuse absent objective justification where, in addition to the previously established requirements, *effective* competition (and not *all*) in the secondary market is excluded.[230] Basically, a refusal to license may amount to a violation if it might eliminate a competitive constraint or prevent the development of a new one in a possible secondary market.[231] Another troublesome reform concerns the new product -test. Microsoft argued that the Commission failed to identify any new product of which emergence would be prevented by the refusal to supply and merely claims that Microsoft's competitors 'could use the disclosures to [develop] the advanced features of their own products.'[232] The Commission had replied that for a product to be new, 'it is sufficient for a product to contain substantial elements contributed by the licensee's own efforts.'[233] The General Court confirmed that it is not necessary that a refusal to license prevents the emergence of a new product – it suffices that there is a

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[224] ibid para 28.
[225] ibid para 44.
[226] Case T-201/04 *Microsoft* [2007].
[227] ibid paras 31–32.
[228] ibid para 33.
[229] ibid para 230.
[230] ibid para 332.
[231] Devlin (n 3) 153.
[232] Case T-201/04 *Microsoft* [2007], para 624.
[233] ibid para 626.

limitation of technical development.[234] Naturally, Microsoft aimed to justify its refusal by the argument that the requested technology was covered by IPRs and that a duty to disclose would eliminate future incentives to invest in innovation.[235] The General Court, however, rejected that argument by simply holding that it lacked proof.[236] That holding is a defeat for patentees trying to justify their right to exclude. Nevertheless, Microsoft had disclosed interoperability information to third parties before, which arguably affected the CJEU's decision to reject Microsoft's justification.[237]

5 CASE LAW ON THE ND PRONG

Few court decisions have provided an analysis on the meaning and implications of the ND prong of F/RAND, and no uniform definition exists. The decisions provide only evolving ideas as they are bound to the particular facts of the cases in an immature field of law. These ideas are distilled mainly from U.S. court decisions, as the courts in Europe have largely refrained from addressing disputes over the meaning of the ND prong. The disputes have concerned patent infringement damages, breaches of contract, and antitrust violations. This chapter examines the case law development on the ND prong in a chronological order, albeit no comprehensive summary of relevant cases is sought to be provided.

The first section discusses the landmark case *Georgia-Pacific* and the established framework for the determination of royalties that has been widely employed in later case law. The second section examines Judge Robart's decision in *Microsoft v. Motorola*, which was the first time a U.S. court determined RAND royalties for a SEP license. Judge Holderman's decision in *Innovatio* is examined in the third section, which offers a very different approach to determining RAND royalties than the one Judge Robart had. The fourth section discusses Justice Briss' decision in *Unwired Planet v. Huawei* in the United Kingdom, which provides a rather detailed analysis on the ND prong specifically. Lastly, the fifth section analyses Judge Selna's recently published decision in *TCL v. Ericsson*, which presents another detailed analysis on the ND prong.

5.1 GEORGIA-PACIFIC

The U.S. District Court came up with a seminal method for calculation of reasonable royalty damages for patent infringements in the landmark case *Georgia-Pacific* in 1970.[238] The method simulates a hypothetical negotiation between a willing licensor and a willing licensee, which is assumed to take place when the infringement began. Although the decision addresses patent infringement damages and not F/RAND terms, the method has been employed by the courts in F/RAND disputes.

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[234] ibid para 647.
[235] ibid para 689.
[236] ibid para 697.
[237] Case T-201/04 *Microsoft* [2007], para 702.
[238] *Georgia-Pacific Corp v United States Plywood Corp*, 318 F Supp 1116 (SDNY 1970), modified and affirmed, 446 F2d 295 (2d Cir 1971), certiorari denied, 404 US 870 (1971).

The method provides the following 15 factors to be considered when determining reasonable royalties: (1) Royalties received by the patentee for licensing the patent in suit; (2) Rates paid by the licensee for use of other patents comparable to the patent in suit; (3) Nature and scope of the license in terms of exclusivity and territory or customer restrictions; (4) The licensor's established policy and marketing program to maintain patent monopoly by not licensing to others to use the invention or by granting licenses under special conditions designed to preserve that monopoly; (5) Commercial relationship between the licensor and the licensee, such as whether they are competitors or an inventor and a promoter; (6) Effect of selling the patented specialty in promoting sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of non-patented items; and the extent of such derivative or convoyed sales; (7) Duration of the patent and the term of the license; (8) Established profitability of the products made under the patent, its commercial success and its current popularity; (9) Utility and advantages of the patent property over old modes and devices that had been used for similar results; (10) The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefit of those who have used the invention; (11) The extent to which the infringer has made use of the invention and the value of such use; (12) The portion of profit or selling price customarily allowed for the use of the invention or analogous inventions; (13) The portion of realizable profit attributable to the invention as distinguished from non-patented elements, significant features or improvements added by the infringer, the manufacturing process, business risks, or significant features or improvements added by the infringer; (14) Opinion testimony of qualified experts; and (15) Outcome of a hypothetical arm's length negotiation between a prudent licensor and a licensee.[239]

Rulings in patent infringement cases and the *Georgia-Pacific* factors may provide a useful framework for the determination of F/RAND royalties.[240] Often in patent infringement cases, reasonable royalty damages reflect the royalty that would have been negotiated before the potential licensee implemented the patented technology, which is based on the value of the patented technology over the next-best alternatives.[241] Price discrimination is legitimate to the extent that the patented technology is more valuable to one implementer than to another. In the standard setting context, the idea is that license terms should reflect terms which the SEP holder would have committed to before the standard was set, considering possible alternative technologies that existed before companies sunk investments into implementing the standard.[242] One of the approaches to determine F/RAND royalties is to measure the *ex ante* incremental value of the SEP relative to its alternative technologies (the so-called 'bottom-up approach'),[243] according to which the monetary value of the SEP technology, namely the value derived from advantages in performance and cost-savings, is calculated.[244]

[239] *Georgia-Pacific Corp v United States Plywood Corp*, 318 F Supp 1116 (SDNY 1970), at 1119-20.
[240] Brooks and Geradin (n 61) 25; Pentheroudakis and Baron (n 32) 61.
[241] Carlton and Shampine (n 40) 536.
[242] ibid 541; Mariniello (n 34) 526.
[243] Leonard and Lopez (n 84) 88.
[244] ibid 89.

However, it may be extremely burdensome to apply in practice.[245] The *Georgia-Pacific* framework allows taking into account information in addition to mathematical formulae, such as comparable licenses. The *Georgia-Pacific* framework has been referred to in F/RAND cases, although in an altered form.

5.2 MICROSOFT V. MOTOROLA

District Court Judge James L. Robart issued a decision on 25 April 2013 on a breach of contract case between Microsoft and Motorola, which was the first time a U.S. court determined RAND royalty rates, or a royalty range,[246] for a license for SEPs. Judge Robart analyzed whether Motorola had breached its RAND commitments in offering a license for its patents essential to ITU's video coding and IEEE's Wi-Fi standards.

Judge Robart specified that Motorola's RAND commitments require Motorola to make initial offers to license its SEPs in good faith, and that those offers do not need to be on RAND terms so long as the ultimate resulting license is.[247] In order to decide whether Motorola's initial royalty offers were in good faith, Judge Robart sought to determine a RAND royalty range, because 'more than one rate could conceivably be RAND.'[248] Judge Robart reasoned that RAND royalties would be best determined by resorting to a hypothetical negotiation involving RAND commitments.[249] He applied an altered *Georgia-Pacific* framework, noting that not all 15 *Georgia-Pacific* factors are applicable in a RAND situation.[250] Among other changes, he held that factors four and five of the *Georgia-Pacific* framework are inapplicable in the RAND context as a SEP holder committed to license on RAND terms is obliged to grant a license on RAND terms to all implementers of the standard and may not discriminate even against its competitors.[251] Central to the analysis was to consider 'the importance of the SEPs to the standard and the importance of the standard and the SEPs to the products at issue.'[252] Judge Robart emphasized the importance of factors six and eight that allow considering the incremental value of the SEP technology to the implementer and its products.[253] The value to the licensee created by the standard itself would not be taken into account in RAND royalties.[254] RAND-committed SEP holders may set differential royalties based on the importance of the SEP's technology to the products at issue. In determining RAND royalty rates, Judge Robart relied mainly on comparable licenses.

A SEP holder may also commit an antitrust offense by favouring some implementers over others. The Third Circuit held in *Broadcom v. Qualcomm* that a company's 'deceptive FRAND commitment to [a standard setting organization] may

[245] *Microsoft v Motorola*, (WD Wash Apr 25, 2013), para 77.
[246] ibid at 5.
[247] ibid.
[248] ibid.
[249] ibid at 7.
[250] ibid para 99.
[251] ibid paras 101-102.
[252] ibid at 7.
[253] ibid paras 103-104.
[254] ibid para 104.

constitute actionable anticompetitive conduct.'[255] Qualcomm had violated its FRAND commitment and discriminated in its SEP licensing practices by charging more and higher fees to licensees who did not use Qualcomm's UMTS chipsets and by providing discounts to those who used only Qualcomm's UMTS chipsets, and attempted to obtain a monopoly in the UMTS chipset market in violation of antitrust law.[256]

5.3 IN RE INNOVATIO

On 27 September 2013, District Court Judge James Holderman determined RAND royalties for Innovatio's portfolio of patents essential to IEEE's Wi-Fi telecommunications standard as damages in a patent infringement case between Innovatio and some wireless network users. He generally followed the *Georgia-Pacific* framework modified by Judge Robart in *Microsoft v. Motorola*.[257] However, it has been held by the courts that the framework is not always necessary.[258] Although Judge Holderman recognized the importance of considering the value of 'the patent portfolio as a whole to the alleged infringer's accused products,'[259] he set RAND royalties differently than Judge Robart in *Microsoft v. Motorola*. He held that Innovatio should charge the end-product manufacturers for the use of the portfolio of SEPs the same amount of royalties as it would charge to chip manufacturers for those patents, regardless of differences in the devices.[260]

Judge Holderman opined that 'the Top Down approach best approximates the RAND rate that the parties to a hypothetical *ex ante* negotiation most likely would have agreed upon,'[261] and relied on that approach in the absence of apparent comparable licenses.[262] According to the top-down approach, first the aggregate royalty burden that could be charged for all SEPs relevant to the standard is determined, after which the aggregate royalty burden is divided among the SEPs by considering their relative value.[263] The royalty for the infringed patents were to be calculated on the SSPPU.[264] The courts have held that in patent infringement cases, royalties may be based on the entire market value of the multi-component product only if the patented technology drives demand for the whole product (the so-called Entire Market Value -rule).[265] If that cannot be established, the patentee must somehow apportion the value contributed by the technology to the product.[266] Judge Holderman found that the SSPPU was a Wi-Fi chip that provides the device with Wi-Fi functionality, and assessed

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255 *Broadcom v Qualcomm*, (3d Cir 2007), at 315.
256 ibid at 318.
257 *In re Innovatio IP Ventures,* (ND Ill, Sep 27, 2013), at 8-11.
258 *Ericsson v D-Link Sys,* (Fed Cir 2014), at 1231.
259 *In re Innovatio IP Ventures,* (ND Ill, Sep 27, 2013), at 10.
260 ibid at 13.
261 ibid at 73.
262 ibid at 72.
263 Leonard and Lopez (n 84) 89; Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 10.
264 *In re Innovatio IP Ventures,* (ND Ill, Sep 27, 2013), at 23.
265 *Ericsson v D-Link* (Fed Cir 2014), at 1227; *LaserDynamics v Quanta Computer*, 694 F3d 51 (Fed Cir 2012), at 67.
266 *Ericsson v D-Link* (Fed Cir 2014), at 1226.

the royalty based on the profit margin on the sale of a Wi-Fi chip.[267] The approach begins with the average price of a Wi-Fi chip, based on which the average profit to a chipmaker on the sale of each chip is determined.[268] The profit on a chip is then multiplied by a fraction calculated as the number of Innovatio's relevant SEPs, and finally divided by the total number of the relevant SEPs.[269] Judge Holderman emphasized that the methodology is suitable because a RAND-committed patentee 'cannot discriminate between licensees on the basis of their position in the market.'[270]

Judge Holderman rejected Innvovatio's suggested method of using the profit margins of the manufacturers on their end-products with Wi-Fi functionality (such as laptops, tablets, printers and access points) as the royalty base,[271] adjusted to the value of the devices that is attributable to the 'Wi-Fi feature factor.'[272] Innovatio proposed that the Wi-Fi feature factor percentage varies between different types of end-products: whereas a laptop has a feature factor of 10 per cent reflecting that only 10 per cent of its value is due to Wi-Fi, an access point has a feature factor of 95 per cent reflecting that almost all of its value is due to Wi-Fi.[273] The rejection was due to the fact that Innovatio failed to apportion the value of the devices down to the patented features credibly.[274]

The decision raises the question whether the ND prong of F/RAND allows differential royalties to be charged based on different types of devices. The difference in the approaches to the non-discrimination requirement in *Innovatio* and *Microsoft v. Motorola* may be, however, due to the facts of the cases and available evidence rather than different legal interpretations. Furthermore, in *Innovatio*, the subject of litigation was the precise amount of patent infringement damages whereas *Microsoft v. Motorola* concerned license terms offered in bilateral negotiations. The SSPPU rule seems to be designed to function as an evidentiary tool primarily for patent infringement jury trials.[275] It is not the definitive rule for determining royalties in all contexts.

5.4 UNWIRED PLANET V. HUAWEI

On 5 April 2017, Mr. Justice Colin Briss of the High Court of Justice of England and Wales decided on Unwired Planet's offers to license its patents essential to ETSI's 3G and 4G standards to Huawei and their compatibility with Unwired Planet's FRAND commitment.[276] He viewed the dispute mainly through the competition law lens.[277] In the lack of previous case law on the exact definition of the ND prong of F/RAND, Justice Briss' analysis has a significant bearing.

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[267] *In re Innovatio IP Ventures,* (ND Ill, Sep 27, 2013), at 34, 74, 76.
[268] ibid at 73-74.
[269] ibid at 74.
[270] ibid.
[271] ibid at 21-22.
[272] ibid at 22.
[273] ibid.
[274] ibid at 26-27.
[275] (n 89).
[276] *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017).
[277] Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 1.

Deviating from the approach developed in *Microsoft v. Motorola*, Justice Briss reasoned that, legally speaking, there is but a single FRAND royalty rate for any given set of SEPs and devices.[278] However, parties to negotiations over SEP licenses may agree on any royalty rate within the limits of competition law.[279] SEP holders may make initial offers higher than FRAND in negotiations without violating competition law unless the offer 'is so far above FRAND as to act to disrupt or prejudice the negotiations themselves.'[280] Justice Briss thus seemingly loosened the procedural obligation set by the CJEU in *Huawei v. ZTE* that a SEP holder's initial license offer to an implementer must be FRAND in order to avoid a breach of Article 102 of the TFEU.[281] Justice Briss noted that a SEP holder would end up with negotiated royalty rated below FRAND if the initial offer was actually FRAND.[282] Nevertheless, the end result seems to be same with the two approaches, namely with the approach of fixing a single rate with a margin of error and the approach of fixing a royalty range.[283] However, no guidance is given on the margin of error by which the negotiated royalty rate that is allegedly above the single FRAND rate results in a penalty.[284]

Justice Briss offered two possible methods for calculating a benchmark FRAND royalty rate: an analysis of comparable royalty rates, and the top-down analysis.[285] Comparable transactions such as existing licenses covering the SEPs in question can be used as benchmarks for the SEP's value in order to ascertain the market's valuation of the SEPs at hand or comparable technologies.[286] Comparable licenses may indicate a likely outcome of hypothetical *ex ante* negotiations.[287] Justice Briss relied mainly on the method of benchmarking against comparable licenses, such as licenses that Unwired Planet had previously granted for those SEPs. Surprisingly enough, he departed from two yardsticks employed by the U.S. courts.[288] First, he rejected the idea that a FRAND royalty rate should reflect the *ex ante* value of the patented technology, and thus departed from *Innovatio*.[289] Second, he made no reference to the *Georgia-Pacific* factors which the U.S. courts tend to apply to determine FRAND royalties.[290]

Justice Briss examined the proposed definitions of the ND prong of FRAND and relied on the definition that SEP holders should treat 'similarly situated licensees similarly.'[291] Unwired Planet and Huawei agreed that the ND prong has the same meaning as the prohibition of discrimination under Article 102(c) of the TFEU.[292]

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278 *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), paras 156, 164.
279 ibid para 155.
280 ibid para 765.
281 Case C-170/13 *Huawei Technologies v ZTE*, EU:C:2015:477, paras 63-64.
282 *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), para 159.
283 Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 4.
284 ibid 3.
285 *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), paras 178, 179.
286 Leonard and Lopez (n 84) 91.
287 Pentheroudakis and Baron (n 32) 147.
288 Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 8.
289 *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), para 97.
290 Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 8.
291 *Unwired Planet v Huawei* [2017] EWHC 711 (Pat) (Apr 5, 2017), para 485.
292 ibid para 487.

Article 102(c) prohibits dissimilar conditions when (a) they are applied to equivalent or comparable transactions; (b) they result in actual or potential distortion of competition; and (c) there is no objective justification.[293] Transactions are comparable if '(a) they are concluded with purchasers who compete with one another, or who produce the same or similar goods, or who carry out similar functions in distribution, (b) they involve the same or similar products, (c) in addition their other relevant commercial features do not essentially differ.'[294] However, the parties' interpretations of treating similarly situated licensees similarly differed: Huawei proposed that the non-discrimination obligation requires the same or similar rates to similarly situated licensees, whereas Unwired Planet proposed that only differences that are capable of distorting competition are prohibited.[295] Justice Briss rejected Huawei's interpretation, observing that competition law prohibiting discriminatory pricing operates to achieve a fair balance, which a blanket prohibition would not do.[296] The ND prong does not introduce a 'hard-edged' non-discrimination obligation.[297] Justice Briss emphasized that the ND prong only requires the establishment of a benchmark royalty rate that is applicable to all licensees seeking the same kind of a license.[298] Furthermore, a FRAND royalty should not be based on the size, bargaining power, or other characteristics of the licensee.[299]

5.5 TCL V. ERICSSON

On 8 November 2017, the decision of Judge James V. Selna of the Central District of California on the long-standing dispute between TCL and Ericsson arising under licenses for Ericsson's portfolio of patents essential to ETSI's 2G, 3G, and 4G standards was rendered. Judge Selna evaluated whether Ericsson's license offers were compatible with its FRAND commitments. In an earlier case in August 2016, Judge Selna had ruled that TCL had not established an antitrust claim due to the lack of evidence of Ericsson making 'an intentionally false promise' to the SSO.[300] Antitrust law claim requires bad intent in violation of the policy or spirit of antitrust law in addition to a breach of the F/RAND obligation.[301] The decision of 2017 provides a detailed analysis on the ND prong of FRAND.

Judge Selna determined FRAND royalty rates by first employing the top-down method and then cross-checking them against comparable licenses, using the methods in reverse order than Justice Briss in *Uniwired Planet.* Royalties were calculated based on the end-products, and the possibility of applying the SSPPU was not addressed. Furthermore, the court 'did not find useful a full-blown *Georgia-Pacific* analysis in the

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293 ibid para 486.
294 ibid.
295 ibid para 485.
296 ibid para 501.
297 ibid.
298 ibid para 503.
299 ibid paras 175, 806(8).
300 *TCL v Ericsson*, (CD Cal Aug 9, 2016), at *5.
301 ibid at *4.

unique context of a FRAND dispute.'[302] Six companies were identified that license the same SEPs from Ericsson and appeared to be similarly situated to TCL.[303]

The parties agreed that 'like, or close to like, rates must be offered to firms which are similarly situated.'[304] Judge Selna recognized that the parties' experts tend to consider similarly situated companies as 'companies using the same technology and at a similar level in the value chain.'[305] He advocated a broad interpretation of 'similarly situated' because of the dynamic nature of the mobile phone market.[306] In addition to considering whether the companies manufacture similar devices, Judge Selna considered some relevant factors in determining which companies are similarly situated to be the geographic scope of the licensee's business, the scope of the required license, and sales volume.[307] He found the geographic scope to be the most important factor in the case at hand.[308] He rejected Ericsson's suggestion that factors such as the licensee's overall financial success or risk, brand recognition, device operating system, or retail stores would be relevant.[309] Furthermore, he specified that '[s]ales volume alone does not justify giving lower rates to otherwise similar firms,' but it is used as a filter to separate small companies from reasonably well-established global ones like TCL.[310] According to Judge Selna, the non-discrimination obligation does not require the offered royalty rate to be the same as the lowest one offered to other implementers in the market.[311] There is no single FRAND royalty rate, but the rates charged to different licensees may vary depending on the 'economics of the specific license.'[312]

Judge Selna made an important observation that royalty rates may be found discriminatory and in breach of a FRAND commitment without proof of distortion of competition in the market so long as the competitor company has been harmed.[313] In antitrust law, harm to competition is actionable whereas mere harm to a competitor is not.[314] ETSI's and other SSOs' non-discrimination obligations of FRAND commitments do not necessarily require impairment of competition as a whole.[315] The concept of discrimination in the context of FRAND commitments required by SSOs differs from the concept of price discrimination in antitrust law.

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302 *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 110.
303 ibid at 58.
304 ibid at 54.
305 ibid at 57.
306 ibid.
307 ibid at 58.
308 ibid at 59.
309 ibid at 58.
310 ibid at 61.
311 ibid at 109.
312 ibid.
313 ibid at 91.
314 ibid.
315 ibid.

6 PROPOSED FRAMEWORK ON CHARGING DIFFERENTIAL ROYALTIES

This chapter proposes a framework for answering the question: 'To what extent is a F/RAND-committed SEP holder legally allowed to charge differential royalties to different licensees for the patented technology from the U.S. and the EU perspectives?' The analytical starting point is that a SEP holder's freedom to license its patented technology is limited in order to prevent the risk of patent hold-up or, in other words, abuse of market power flowing from the essentiality of the standard. The objective of the ND prong of F/RAND commitments imposed by SSOs such as IEEE, JEDEC, and ETSI is to ensure that SEPs are available to all implementers. Thus, F/RAND-committed patentees' right to exclude others from using the patented technology is waived to some extent. The logic is similar to antitrust compulsory licensing: for the sake of follow-on innovation, SEP holders cannot refuse to license. IEEE, JEDEC, and ETSI's bylaws do not provide a detailed definition of the ND prong, but they clearly allow SEP holders to charge differential license terms to different licensees. The court decisions in *Microsoft v. Motorola*, *Innovatio*, *Unwired Planet v. Huawei*, and *TCL v. Ericsson* as well as the interpretations and normative arguments of commentators provide useful ideas on SEP holders' capability to set differential royalties. However, as already mentioned in the previous chapter, the court decisions provide no definitive all-encompassing answers as they are bound to the specific facts of the cases in a rather new, still evolving field of law. Moreover, decisions of lower courts are not binding on higher courts in the specific system, or on other jurisdictions. Be that as it may, considering the limited amount of court decisions, these decisions surely have an impact on companies' licensing strategies.

The ND prong limits SEP holders' ability to set differential license terms to different licensees. The first section analyses the legal possibility of F/RAND-committed SEP holders to set differential royalties based on the nature of licensees' devices incorporating the patented technology, and the second section examines the degree of flexibility to set license terms to licensees manufacturing similar devices.

6.1 DIFFERENTIAL ROYALTIES BASED ON THE NATURE OF DEVICES

It seems to be possible for F/RAND-committed SEP holders to charge differential royalties based on the nature of licensees' devices incorporating the patented technology lawfully. Royalty rates may be based on the value of the patented technology to the licensee and its device relative to alternative technologies *ex ante*.[316] The incremental value derived from the inclusion of the technology into a standard should not be taken into account,[317] although this assertion has been disputed.[318] There are multiple methods to establish the value of the technology, such as the bottom-up and top-down approaches and the use of comparable licenses.[319]

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[316] *Microsoft v Motorola*, (WD Wash Apr 25, 2013).
[317] ibid para 104.
[318] *Unwired Planet v Huawei* [2017] EWHC 711, para 97.
[319] Leonard and Lopez (n 84) 88-92.

The ND prong of F/RAND is commonly interpreted as a requirement to license to similarly situated licensees on similar terms,[320] and there appears to be consensus that licensees implementing the technology in dissimilar devices and competing in different product markets or industries are not similarly situated.[321] J. Gregory Sidak has found this assertion to be 'economically sound' as 'manufacturers of different products typically derive different values from implementing a given industry standard.'[322] Commentators such as Dennis Carlton, Allan Shampine, and Anne Layne-Farrar have interpreted licensees expecting to derive the same value from the patented technology (*ex ante*) to be similarly situated,[323] and licensees manufacturing similar devices and using the same production technology are likely to obtain the same value.[324] The parties in *Unwired Planet v. Huawei* considered a similar situation to mean the involvement of equivalent or comparable transactions as in the prohibition of discrimination under Article 102(c) of the TFEU, which largely correlates to Section 2(a) of the Robinson-Patman Act.[325] In relation to Article 102(c) of the TFEU, transactions may be comparable if, *inter alia*, they are concluded with purchasers competing in the same product market.[326] Similarly, Section 2(a) of the Robinson-Patman Act prohibits price discrimination injuring competition between the seller's customers, thus referring to customers active on the same product market. The parties in *TCL v. Ericsson* suggested that similarly situated licensees means those 'using the same technology and at a similar level in the value chain,'[327] which also points to licensees manufacturing similar devices.

F/RAND-committed SEP holders have the legal possibility to set differential royalties based on the nature of licensees' devices. However, when it is practically difficult to apportion the value that the implementers and their devices derive from the patented technology essential to the standard, courts have fixed a royalty rate based on a 'common component' incorporating the patented technology, which may reflect the SSPPU.[328] Thus, the definition of similarly situated licensees is flexible for practical purposes.

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[320] *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 54, 57; *Unwired Planet v Huawei* [2017] EWHC 711, para 485; Layne-Farrar (n 53) 815; Gilbert (n 16) 858; Carlton and Shampine (n 40) 546-547; Sidak, 'The Meaning of FRAND, Part I: Royalties' (n 28) 996-997.
[321] Contreras, 'A Brief History of FRAND: Analyzing Current Debates in Standard Setting and Antitrust Through a Historical Lens' (n 73) 79; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 356.
[322] Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 359-360.
[323] Layne-Farrar (n 53) 815; Carlton and Shampine (n 40) 546.
[324] Carlton and Shampine (n 40) 547.
[325] *Unwired Planet v Huawei* [2017] EWHC 711, para 486.
[326] ibid.
[327] *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 57.
[328] See, for instance, *In re Innovatio IP Ventures,* (ND Ill, Sep 27, 2013).

6.2 DIFFERENTIAL ROYALTIES TO LICENSEES MANUFACTURING SIMILAR DEVICES

F/RAND-committed SEP holders must not discriminate between licensees based on their position in the market,[329] and they are obliged to license similarly situated licensees on similar terms. Some degree of flexibility to negotiate and set license terms is implied. The court decisions and the interpretations of commentators support the view that there exists no single unique F/RAND royalty rate for specific SEPs and devices but a F/RAND range.[330] Furthermore, as mentioned in the first section of this chapter, there are many potential methods to determine royalties and thus the boundaries of a F/RAND range.

Justice Briss has held in *Unwired Planet v. Huawei* that the ND prong does not present a hard-edged non-discrimination obligation,[331] but requires SEP holders to establish a benchmark royalty rate that is applicable to all licensees seeking the same kind of a license.[332] The emphasis is on the nature of the transaction. It has been argued that the nature of the transactions between the SEP holder and the licensees may change the extent of similarity of the licensees' situations.[333] Justice Briss specified further that royalties must not be based on the size, bargaining power, or other characteristics of the licensee.[334] In *TCL v. Ericsson*, Judge Selna considered some relevant factors in determining whether licensees are similarly situated to be the geographic scope of the licensee's business, the required license, and sales volume, in addition to the nature of manufactured devices in which the standard is implemented.[335] For example, licensees whose sales occur mostly in one single country and who need a license in only one jurisdiction may not be similarly situated to licensees conducting business in various countries or geographic markets and needing a global license.[336] Moreover, Judge Selna rejected factors such as the licensee's overall financial success or risk, brand recognition, device operating system, or retail stores.[337] He held that F/RAND royalty rates may vary depending on the 'economics of the specific license.'[338]

F/RAND license terms may legitimately vary even across similarly situated licensees according to different licensing arrangements. There is a wide variety of licensing arrangements as license terms cover many different issues. Differences may appear for instance in the type of remuneration. Commentators such as Sidak, Carlton, Shampine, and Richard J. Gilbert have advocated an idea that F/RAND-committed

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329 ibid at 74.
330 *Microsoft v Motorola*, (WD Wash Apr 25, 2013), at 5; Contreras, 'Global Markets, Competition, and FRAND Royalties: The Many Implications of Unwired Planet v Huawei' (n 61) 4; Pentheroudakis and Baron (n 32) 13.
331 *Unwired Planet v Huawei* [2017] EWHC 711, para 501.
332 ibid para 503.
333 Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 361.
334 *Unwired Planet v Huawei* [2017] EWHC 711, paras 175, 806(8).
335 *TCL v Ericsson*, (CD Cal Dec 21, 2017), at 58.
336 ibid at 59.
337 ibid at 58.
338 ibid at 109.

SEP holders are obliged to offer licensees the same menu of license terms,[339] with remuneration possibilities ranging between a fixed fee, a per-unit running royalty, a royalty declining with output, etc.[340] Furthermore, arrangements like cross-licensing may function as payment in kind.[341]

An open question remains whether a F/RAND-committed SEP holder is legally allowed to set differential royalties to new licensees under exceptional circumstances such as changed market conditions and the need to meet competition from an alternative technology when the value of the SEP has changed. Such circumstances provide a justification for differential pricing under Section 2(a) of the Robinson-Patman Act.[342] Commentators have shed light on the issue.[343] For instance, Contreras and Layne-Farrar have remarked that a previously charged royalty rate may no longer be reasonable later when the market and technology have progressed.[344] They have argued that the concept of F/RAND should be adaptable to changing market conditions.[345] Nevertheless, signed F/RAND license agreements with specified durations should be considered binding and inalterable in the passage of time for the sake of contractual and business certainty.[346]

It is important to keep in mind that charging discriminatory royalties may also amount to an antitrust violation in both U.S. and EU law if the SEP holder is considered to have sufficient market power and its conduct is capable of resulting in primary line or secondary line injury to competition. EU law is generally stricter with regard to use of market power than U.S. law: whereas U.S. law is concerned about monopolization in Section 2 of the Sherman Act, EU law is cautious about abusive use of mere dominance in Article 102 of the TFEU. EU law is focused on the structure of the market and it is very suspicious of concentration of power.[347] Patent related conduct is subject to antitrust scrutiny even when it falls within the scope of the patent,[348] especially in EU law. EU law allows interference into a patentee's right to exclude more easily than U.S. law – a dominant company may even be imposed a duty to license its patented technology as dominant undertakings are under a special responsibility to allow effective competition.[349] Price discrimination is expressly prohibited under Article 102(c) of the TFEU in EU law, and in U.S. law under Section 2(a) of the Robinson-Patman Act with regard to tangible commodities, although it has been ignored by the U.S. antitrust agencies.[350] Also in the context of standard setting

339 Gilbert (n 16) 875; Carlton and Shampine (n 40) 546; Sidak, 'The Meaning of FRAND, Part I: Royalties' (n 28) 999.
340 Gilbert (n 16) 875; Sidak, 'The Meaning of FRAND, Part I: Royalties' (n 28) 998.
341 Gilbert (n 16) 875; Layne-Farrar (n 53) 833; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 356-357.
342 See, for instance, *Texas Gulf Sulphur v JR Simplot* (9th Cir 1969), at *806–07.
343 Carlton and Shampine (n 40) 551; Contreras and Layne-Farrar (n 188) 205-206; Sidak, 'Fair and Unfair Discrimination in Royalties for Standard-Essential Patents Encumbered by a FRAND or RAND Commitment' (n 59) 368.
344 Contreras and Layne-Farrar (n 188) 205-206.
345 ibid 206.
346 ibid.
347 Cases C-501/06 P *GlaxoSmithKline Services* [2009], para 63.
348 *FTC v Actavis*, 133 S Ct 2223 (2013); Case T-201/04 *Microsoft* [2007].
349 Case T-201/04 *Microsoft* [2007].
350 Layne-Farrar and Stuart (n 17) 58.

and F/RAND licensing, the threshold for antitrust liability is significantly lower in EU law. In EU law, the SEP holder's conduct must be merely proved to be abusive use of the market power conferred by the essentiality of the standard, whereas in U.S. law the SEP holder must also have made a fraudulent promise to the SSO to license its patented technology on F/RAND terms.[351] Nevertheless, charging discriminatory royalties might enhance consumer welfare and the potential efficiencies might justify the anti-competitive conduct.[352]

7 CONCLUSION

The ND prong of F/RAND commitments imposed on SEP holders has become a subject of debate and litigation. Those commitments have been enforced through contract law and antitrust law. There is no agreement on the practical implications of the ND prong, and it has been uncertain whether a F/RAND-committed SEP holder is legally allowed to charge differential royalties to licensees for the use of the patented technology and to what extent. According to the dominant perception, SEP holders are obliged to license to similarly situated licensees on similar license terms. Yet, the concepts of similarly situated and similar terms are open-ended. The purpose of this paper has been to resolve this ambiguity of the ND prong by examining SSOs' bylaws, inspecting U.S. and EU antitrust norms, analyzing case law of the U.S. and European courts, and reviewing legal and economic arguments in the academic literature.

This paper has sought to provide a practical framework for answering the question: 'To what extent is a F/RAND-committed SEP holder legally allowed to charge differential royalties to different licensees for the patented technology from the U.S. and the EU perspectives?' After discussing the patent regime generally and limitations on SEP holders' freedom to license aiming to prevent abuse of market power, the profound analysis of the ND prong begun with examining IEEE, JEDEC, and ETSI's policies as F/RAND commitments are essentially agreements between patentees and SSOs. It is clear from the SSOs' bylaws that the objective of the ND prong is to ensure that SEPs are available to all implementers, and that SEP holders are allowed to set differential license terms to different licensees. Based on the interpretations provided in the case law and academic literature, licensees manufacturing dissimilar devices are not similarly situated, and hence a F/RAND-committed SEP holder is legally allowed to charge differential royalties at least to those licensees provided that the value contributed by the patented technology to the particular devices is apportioned convincingly. Licensees manufacturing similar devices are not inevitably similarly situated either, as factors relating the nature of the transactions, such as the scope of the licenses, may change the degree of similarity of the licensees' situations. Furthermore, it appears that F/RAND royalties may legitimately vary even across similarly situated licensees according to different licensing arrangements so long as the same menu of terms is available for all licensees.

351 *Broadcom v Qualcomm*, (3d Cir 2007), at 315.
352 *United States v Microsoft*, (DC Cir 2001), at 59; C-209/10, *Post Danmark A/S v Konkurrencerådet*, EU:C:2012:172, paras 40-42.

Discrimination in royalties for the use of patented technology essential to implementation of a standard may constitute not only a breach of contract but also an antitrust violation in both U.S. and EU law when the company is considered to have sufficient market power and its conduct is considered anti-competitive. However, EU competition law is generally more suspicious with regard to use of market power than U.S. antitrust law, and EU law allows interference into a patentee's right to exclude more easily. Also in the context of standard setting and F/RAND licensing, the threshold for antitrust liability is clearly lower in EU law. In U.S. antitrust law, a SEP holder's conduct may trigger liability only if the SEP holder has made a fraudulent promise to the SSO to license its patented technology on F/RAND terms. This specific condition is not found in EU law.

The ambiguity of the ND prong has given rise to legal uncertainty and inefficiency in standard setting. The courts of the U.S. and Europe have not provided any definitive all-encompassing answers. However, based on recently emerged ideas, it is certain that F/RAND-committed SEP holders are given some leeway to negotiate and set license terms. They may charge differential royalties to different licensees lawfully to some extent, even to similarly situated licensees. Nonetheless, SEP holders might want to keep a close eye on the still evolving law and the differences between jurisdictions.

CROSS-BORDER CONVERSIONS IN THE EUROPEAN UNION AFTER THE POLBUD CASE

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Abstract

Cross-border conversions may be considered as an achievement of the Court of Justice of the European Union (CJEU, Court) since its case law paves the way towards acceptance of such cross-border operations in all Member States. In the Polbud case, the CJEU clarified the scope of the freedom of establishment in regard to cross-border conversions. That judgement should give an impulse to those Member States whose law remains silent on the issue, lacks regulation or is not in line with the provisions on the freedom of establishment, to take appropriate legislative measures. However, a creation of a legal framework at the European level is still needed to provide a commonly-accepted procedure for such operations, to secure protection for vulnerable constituencies of a company, to prevent abusive practices and to regulate cooperation between the states which are involved in cross-border conversions.

1 INTRODUCTION

A cross-border conversion is an operation of transnational nature through which a company may change the governing law of one Member State to another. Considering that EU law does not have a harmonised legal framework for cross-border conversions, they are regulated by the national laws of the Member States.[1]

Some Member States are reluctant to allow cross-border conversions in their jurisdictions because in comparison with a primary incorporation, when a company only starts functioning, a conversion is a transformation of an already existing company with debts, liability, obligations which such company may seek to circumvent. On the one hand, a cross-border conversion facilitates migration of companies within the EU, which is welcomed at the European level, but on the other, a change in the governing law poses risks of abusive practices and may adversely affect the interests of company's constituencies, including minority shareholders, employees and creditors.[2] Such possible negative outcomes may result in different treatment of

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[1] Policy Department for Citizens' Rights and Constitutional Affairs, 'Cross-Border Transfer of Company Seats' PE 583.143, 1-2. <http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/583143/IPOL_BRI(2017)583143_EN.pdf> accessed 16 July 2018.

[2] On detailed analysis of possible risks see T Biermeyer, 'Chapter 6: Empirical Data on Risks of Stakeholders in Cross-Border Seat Transfers. Stakeholder Protection in Cross-Border Seat Transfers in the EU' (WLP, 2015), 207-227 <https://ssrn.com/abstract=2747129> accessed 12 July 2018; C Cathiard, European Added Value Assessment on a Directive on the cross-border transfer of company seats (14th company law Directive)', ANNEX I Legal effects of the requested legislative instrument' (2012), 72-76. <http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN_ET(2013)494460(ANN01)_EN.pdf> accessed 12 July 2018.

cross-border conversions by the Member States. Due to the absence of a uniform legal framework for cross-border conversions at the European level, divergence in the domestic corporate laws and different theories which the Member States follow the status of such transactions is lacking clarity. However, the judgment of the CJEU in the *Polbud* case[3] contributes to the development of the concept of cross-border conversions. It clarifies the scope of the freedom of establishment in regard to cross-border conversions that affects the competence of the Member States in this area and strengthens the status of such operations in the EU.

This article is focused on an analysis of the status of cross-border conversions in the EU after the CJEU handed down its judgement in the *Polbud* case. It contains an analysis on how the freedom of establishment interacts with the reserved area and discretion of the Members States regarding companies when cross-border conversions are at stake.

The first part is focused on the concept of a cross-border conversion and its integral features. Then the article discusses how the CJEU interprets the provisions on the freedom of establishment regarding outbound and inbound stages of a cross-border conversion. In this regard it should be mentioned that a cross-border conversion presupposes consecutive application of the national laws of the home and the host state[4] and its successful consummation depends on both legal regimes.[5] An operation results in interaction with two states, the home state which a company intends to leave and the host state, which a company intends to enter. Therefore, a cross-border conversion includes two steps: an exit/move out from the home state and a move in/enter the host state where the conversion occurs. The competence of the Member States in regard to cross-border conversions differs and depends on whether a company leaves (outbound step) or enters (inbound step) their territory. Accordingly, both steps are considered separately. The final part of the article contains a brief description of how cross-border conversions are treated at national levels and possible obstacles to successful consummation of such operations.

2 THE CONCEPT OF CROSS-BORDER CONVERSIONS

One should distinguish the ability to choose a country where to incorporate a company (primary incorporation) and to obtain a legal personality from the ability to move to any other country during company's life (reincorporation), where the legal personality is preserved, but the governing law to which a company is subject, is changed. The first scenario is the 'birth' (creation) of a company in one Member State, whilst the second scenario is a transformation of an existing company within a different

[3] The case concerns a conflict between a company, incorporated in Poland, Polbud, which transferred its registered office to Luxembourg with intent to change the applicable law to Luxembourg law, and Poland which agreed to remove the company from the register if documents on liquidation are provided, see Case C-106/16 *Polbud — Wykonawstwo* [2017] EU:C:2017:804.
[4] Case C-378/10 *VALE Építési* [2012] EU:C:2012:440, para 44.
[5] Case C-106/16 *Polbud — Wykonawstwo* [2017] EU:C:2017:804, Opinion of Advocate General Kokott, para 23.

Member State. A cross-border conversion relates to the last scenario since a company can be converted only when it already exists.

A cross-border conversion is an operation through which a company, formed in one Member State is converted into a company governed by the law of another Member State.[6] In other words, a company, duly established in one Member State (the home state), moves to another Member State (the host state), where it is converted in one of the available forms of legal entity under the legal regime of the host state. An interesting point was raised by Advocate General (AG) Jääskinen in the *Vale case*: a transformation of a company into a company of the same type in the host state (for instance, a limited liability company) is not a conversion, but rather a 'cross-border reincorporation'.[7] However, the CJEU disagreed and applied the term of cross-border conversion, which seems to be more appropriate. The company laws of the Member States vary significantly and therefore limited liability companies or joint stock companies in the home state are not the same as in the host state.[8]

The features of cross-border conversions may be defined as an accumulation of the following: a transfer of a company's seat that is a connecting factor in the host state; a reincorporation in the host state through a conversion as described above; a change in the law which governs a company; a retention of legal personality; and the absence of liquidation.[9] The cornerstone of a cross-border conversion is the retention of legal personality, which means that a company does not have to undergo a liquidation procedure. Thus, assets are not distributed, liabilities and contractual relations remain unaffected.[10] In this sense, a conversion is the opposite of liquidation, the latter which presupposes termination of activities, payment and recovery of debts, carrying out other duties, sale, distribution of the assets which are left after satisfying the demands of creditors, closing accounts in banks, deposit of documents and other

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[6] Case C-378/10 *VALE* (n 4), para 23; Opinion of Advocate General Kokott (n 5), para 22; Case C-106/16 *Polbud* (n 3), para 33.
In a Proposal for a Directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions it is defined as 'an operation whereby a company, without being dissolved, wound up or going into liquidation, converts the legal form under which it is registered in a departure Member State into a legal form of a company of a destination Member State and transfers at least its registered office into the destination Member State whilst retaining its legal personality'. See European Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions' COM (2018) 241 of 25 April 2018 (Proposal for a Directive), art 86b (2).

[7] Case C-378/10 *VALE Építési* [2012] EU:C:2012:440, Opinion of AG Jääskinen, paras 33-34.

[8] By analogy with M Szydlo, 'The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment' (2010) 7 European Company and Financial Law Review 414, 437-438.

[9] European Commission, 'Study on the Law Applicable to Companies' (2016) (Study on the law applicable to companies), 215 <https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1/language-en> accessed 11 July 2018 (applied term is a reincorporation); C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems, 'Cross-border Reincorporations in the European Union: The Case for Comprehensive Harmonisation' (2018) 18 Journal of Corporate Law Studies 1, 3-4 (a term of reincorporation is used); F Stoica, 'Recent Developments regarding Corporate Mobility within EU's Internal Market' (2016), 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2783809> accessed 11 July 2018; M Szydlo (n 8) 415.

[10] European Parliament resolution with recommendations to the Commission on the cross-border transfer of the registered office of a company (2008/2196(INI)) of 10 March 2009 (European Parliament resolution (2008/2196(INI)), Recommendation 1.

actions which are required by the applicable national law. This would not make much sense in the case of cross-border conversion, where the nature of the operation is different. If, in a cross-border conversion, a company is subject to liquidation, an operation becomes pointless since there is nothing to convert anymore.[11] It is, moreover important to understand *who* the beneficiaries of the freedom of establishment are. In the case of a liquidation, ex-shareholders, which are individuals or legal entities, but not the company itself, benefit from the freedom of establishment in the host state.[12] In this sense, the operation is not a company's conversion in the host state, but rather a formation of a new company in another jurisdiction by the former shareholders.[13] To be honest, shareholders do not need to liquidate a company in order to form a new one in another jurisdiction. If prior liquidation is required, a company will be deprived of the right to convert itself in the host state. This since, after liquidation, it ceases to exist. Such a scenario contradicts the nature of cross-border conversion.

Another feature of cross-border conversions is the transfer of the seat, which is the connecting factor in the host state. For a company to be allowed to convert itself in another state, the transfer of its seat to that state is a prerequisite for the operation. A cross-border conversion is the result which a company may seek to achieve, whilst the seat transfer is the means to obtain that result. However, what one should bear in mind is that there is no uniform scenario for achieving that result. The Member States have their own rules, including the requirement on connecting factors, which are necessary for a company to obtain and subsequently maintain the status of a domestic company. Usually a conversion presupposes the transfer of the registered office, however, in some jurisdictions the transfer of the real seat is a precondition for a conversion as well.[14] Therefore, a cross-border conversion entails a 'legal mobility' which is conducted through the transfer of the registered office; which may be combined with a 'physical mobility' via the relocation of the real seat to the host state.[15] Prior to the Court's judgement in the *Polbud* case, it was unsettled whether a cross-border conversion which is conducted solely through the transfer of the registered

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[11] F Mucciarelli, 'Company 'Emigration' and EC Freedom of Establishment: Daily Mail Revisited' (2008) 9 European Business Organization Law Review 267, 297-298; M Szydlo (n 8), 438.
[12] ibid.
[13] ibid.
[14] C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 4-5;
It is interesting that the transfer of the statutory seat does not necessarily trigger a change of the applicable law in some Member States, such as Italy and Czech Republic. See Study on the law applicable to companies (n 9), 239; T Biermeyer, 'Chapter 4: Current Regulation of Cross-Border Transfers of the Registered Office at the Domestic and European Level. Stakeholder Protection in Cross-Border Seat Transfers in the EU' (WLP, 2015), 96, 108-109 <https://ssrn.com/abstract=2747105> accessed 13 July 2018; It means that a company which located its statutory seat in the host state remains to be subject to the law of the home state. Such option was considered by the Commission. However, it was recognised that a change in the law as a result of the seat transfer is a better option due to legal certainty, legal complexity, supervision and control. See Commission Staff Working Document 'Impact assessment on the Directive on the cross-border transfer of registered office' SEC (2007) 1707 (Impact assessment 2007), 45-46 <http://ec.europa.eu/internal_market/company/docs/shareholders/ia_transfer_122007_part1_en.pdf> accessed 16 July 2018.
[15] O Mörsdorf, 'The Legal Mobility of Companies within the European Union through Cross-Border Conversion' (2012) 49 Common Market Law Review 629, 630.

office (legal mobility), falls within the scope of the freedom of establishment that resulted in different positions.[16] The clarification of the Court is crucial, since if the freedom of establishment does not apply, the Member States enjoy full autonomy in when governing such operations.

The judgement of the Court in the *Polbud* case differs from the conclusions made by AG Kokott,[17] as well as several Member States. Poland and Austria submitted that the freedom of establishment cannot apply to the sole transfer of the registered office, since it does not necessarily imply the carrying out of economic activity in the host Member State.[18] AG Kokott concluded that the freedom of establishment:

> 'applies to an operation whereby a company incorporated under the law of one Member State transfers its statutory seat to another Member State with the aim of converting itself into a company governed by the law of the latter Member State, *in so far as that company actually establishes itself in the other Member State, or intends to do so, for the purpose of pursuing genuine economic activity there*'.[19]

The CJEU disagreed with this view and looked at the situation from a different angle. It pointed out that a company, formed in one of the Member States and having the registered office, the central administration or the principal place of business in the EU, in principle, may benefit from the freedom of establishment.[20] The freedom of

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16 See C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 1-2; S Rammeloo, 'Case C-378/10 *VALE Építési Kft.*, Judgment of 12 July 2012, Not Yet Reported Freedom of Establishment: Cross-Border Transfer of Company 'Seat' – The Last Piece of the Puzzle?' (2012) 19 Maastricht Journal of European and Comparative Law 563, 582-583, 588; A Baert, 'Crossing Borders: Exploring the Need for a Fourteenth EU Company Law Directive on the Transfer of the Registered Office' (2015) 26 European Business Law Review 581, 599-600; O Mörsdorf (n 15), 637-649, 670; T Biermeyer, 'Chapter 3: The Impact of European Law on Cross-Border Seat Transfers. Stakeholder Protection in Cross-Border Seat Transfers in the EU' (WLP, 2015) 67-70, 72, 90-91 <https://ssrn.com/abstract=2747103> accessed 16 July 2018; T Biermeyer, 'Shaping the Space of Cross-Border Conversions in the EU. Between Right and Autonomy: VALE' (2013) 50 Common Market Law Review 571, 586-589; W Schon, 'The Mobility of Compromise in Europe and the Organizational Freedom of Company Founders' (2006) 3 European Company and Financial Law Review 122, 139; F Mucciarelli, 'The Function of Corporate Law and the Effects of Reincorporations in the U.S. and the EU' (2012) 20 Tulane Journal of International and Comparative Law 421, 432-433; J Meeusen, 'Freedom of Establishment, Conflict of Laws and the Transfer of a Company's Registered Office: Towards Full Cross-Border Corporate Mobility in the Internal Market?' (2017) 13 Journal of Private International Law 294, 294-323; 'Cross-Border Transfer of Company Seat within the European Union' 4-7, 11-12 (4th Congress of the notaries of Europe, 5-7 October 2017) <https://www.notariesofeurope-congress2017.eu/en/media-library/> accessed 16 July 2018; M Szydlo (n 8), 423-424; Policy Department for Citizens' Rights and Constitutional Affairs 'Cross-Border Mergers and Divisions, Transfers of Seat: Is There a Need to Legislate?' (2016), 35 <http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_STU(2016)556960 > accessed 13 July 2018.

17 Opinion of AG Kokott (n 5), paras 32-43, 67.

18 Case C-106/16 *Polbud* (n 3), para 30.

19 Opinion of AG Kokott (n 5) para 43 (emphasis added). The analysis was based on the concept of establishment, elaborated by the CJEU, that presupposes actual establishment in the host state and carrying out genuine economic activity in that state. She also pointed out that the freedom of establishment grants 'economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them'. See paras 32-38, 43, 67.

20 Case C-106/16 *Polbud* (n 3), para 32.

establishment presupposes that companies have the right to set up and manage companies in the host Member State under the conditions laid down for domestic companies in the national law of that state.[21] Therefore, it encompasses the right of a company to conduct a cross-border conversion, provided that all required conditions for reincorporation are met in the host state, in particular, the test on connecting factors.[22] The CJEU then explained a cross-border conversion in the *Polbud* case by analogy with the *Centros* case.[23] A cross-border conversion through the transfer of the registered office may fall within the scope of the freedom of establishment (regardless of the fact that business is to be conducted in the home state) if that company complies with the test on connecting factors of the host state.[24] The possibility of a cross-border conversion through the transfer of the registered office depends on the test on connecting factors, which is determined by the host state. Such a test depends on the theory upon which the national system is founded, such as the incorporation theory, the theory of real seat or the mixed theory. The definition of what constitutes connecting factors (which serve as a link between a company and the national legal order) is a *reserved area* of the host state.[25] Thus, a cross-border conversion is possible through the transfer of the registered office only if it is allowed under the law of that state. However, the situation will be different if the real seat is the connecting factor as well in the host state.

3 MOVE OUT (OUTBOUND) STEP OF CROSS-BORDER CONVERSIONS

The status of a cross-border conversion depends on the rules of the Member States, who remain competent to regulate such operations. Therefore, it is necessary to understand which powers the Member States have been afforded by the CJEU under the freedom of establishment. In other words, what the home states are allowed to require; what type of measures that are prohibited; and, in particular, whether the home state has to permit a company to leave its jurisdiction for the purpose of conversion in another legal order within the EU without liquidation.[26]

In the present state of EU law companies are creatures of the national laws, which determine their incorporation and functioning.[27] It is for the Member States to decide which connecting factor should be required in order to obtain and maintain the company's legal personality within its jurisdiction.[28] Since the Member States have that

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[21] ibid para 33.
[22] ibid.
[23] Case C-106/16 *Polbud* (n 3), para 38; In the *Centros* case the CJEU confirmed the right of a company, incorporated in one Member State and having the registered office there, to establish itself in another Member State, despite the fact that the purpose of incorporation in the first Member State was not conducting business there. See Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.
[24] Case C-106/16 *Polbud* (n 3), paras 38, 41, 43, 44.
[25] Case 81/87 *The Queen v Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC* [1988] ECR-5483, para 21; Case C-106/16 *Polbud* (n 3), paras 33, 34.
[26] Study on the law applicable to companies (n 9), 217; C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 8.
[27] Case 81/87 *Daily Mail* (n 25), para 19.
[28] As examples, see Case C-210/06 *Cartesio Oktató és Szolgáltató bt* [2008] ECR I-09641, para 110; Case C-378/10 *VALE* (n 4), para 29; Case C-106/16 *Polbud* (n 3), para 43.

power, the question arises of how the home state should treat cross-border conversions which are conducted through the transfer of the company's seat, which is the connecting factor in that state. In the *Cartesio* case,[29] the CJEU considered two scenarios, depending on whether there is a change in the law applicable to the company.[30] In the first scenario, where a company, formed in one Member State, moves its seat to another Member State, but there is no change in the applicable law, the home state has the power to block a cross-border transfer.[31] However, the situation is different in the second scenario. If the transfer of the company's seat leads to a change in the applicable law, that company is converted into a form of company in the host state (the law of which is henceforth applicable to that company).[32] Here, since the conversion in another jurisdiction leads to obtaining the status of a domestic company under the law of the host state, the home state losses the possibility to require the winding-up or liquidation of a company.[33] This since such a requirement would prevent the company from a cross-border conversion in the host state, and therefore, constitute a restriction on the freedom of establishment.[34] In the *Polbud* case the CJEU confirmed that in cross-border conversions, the right of the Member States to determine connecting factors does not mean that the law of the home state on formation and winding up of companies enjoys immunity from the provisions on the freedom of establishment.[35] The home state does not have the right to impose conditions for cross-border conversions that are more restrictive than for those applying to conversions of a domestic nature.[36] In case of cross-border conversions all requirements of the home state should be in line with the provisions on the freedom of establishment. The requirement to liquidate the company before it can be removed from the register in the home state constitutes a restriction on the freedom of establishment since it is 'liable to impede, if not prevent, the cross-border conversion'.[37] All other measures of the home state are considered to be restrictions on the freedom of establishment as well if they 'prohibit, impede or render less attractive' cross-border conversions.[38]

National measures which restrict the freedom of establishment may, nonetheless, be acceptable if they are justified. Measures may be justified on the basis of public policy, public security or public health[39] on the one hand, or by overriding reasons in the public interests on the other, including the protection of the interests of

[29] The case concerns a conflict between a domestic entity, Cartesio, which transferred its seat from Hungary to Italy, and Hungary, a state, where Cartesio was incorporated. Hungary rejected to enter the amendment in new address of the company in commercial register due to prohibition of seat transfer of Hungarian company to another Member State while keeping Hungarian 'nationality'. Case C-210/06 *Cartesio* (n 28).
[30] ibid para 111.
[31] ibid paras 110-111.
[32] ibid para 111.
[33] Unless it is justified; ibid paras 111-113.
[34] ibid paras 112-113.
[35] Case C-106/16 *Polbud* (n 3), para 43.
[36] ibid.
[37] ibid paras 45-51.
[38] ibid, para 46.
[39] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C 202/47, art 52(1).

employees, creditors and minority shareholders.[40] The Member States are allowed to ensure that cross-border conversions do not affect public interests inappropriately.[41] In this regard, and in particular, the restrictive measures may be justified by the protection of the interests of employees, creditors and minority shareholders, provided that they 'are appropriate for ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective'.[42] In this respect, a general prohibition of cross-border conversions is disproportionate since not all cross-border transactions might threaten public interests protected in the Member States.[43] Equally, a requirement of mandatory liquidation applied in a general manner to all companies intending to move to another jurisdiction for the purposes of conversion, cannot be justified since it goes beyond what is necessary to achieve the objective of protecting public interests.[44] Justification is a very peculiar stage which requires an analysis of measures on a case-by-case basis. The Member State needs to consider the actual threat which an operation may cause and if it is possible to adopt less restrictive measures for ensuring the attainment of the objective pursued.[45]

In summary, a change of the applicable law defines the boundaries of the competence of the home state in relation to a company. Since a conversion presupposes a change in the governing law, the home state loses the absolute power over that company and cannot prevent it from migration to another jurisdiction.[46] Companies are creatures of the national laws which govern their functioning as well as the connecting factors required for obtaining and maintaining the company's legal status. However, this reserved area is not excluded from the provisions on the freedom of establishment when a cross-border conversion is at stake. National measures which restrict the freedom of establishment may only be accepted if they are justified.

4 MOVE IN (INBOUND) STEP OF CROSS-BORDER CONVERSIONS

The inbound step of a cross-border conversion concerns an interaction between the host state and a foreign company which intends to convert itself there. In its judgment in *Cartesio*, the CJEU held that the home state cannot prevent a company

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40 However, the Member States may rely on other public (general) interests as well. Measures should fulfil the following conditions: be justified by overriding reasons in the public interest (imperative requirements in the general interest), be applied in a non-discriminatory manner, be suitable for achievement of objective they pursue, and not go beyond what is necessary in order to attain it. As examples, see Case C-55/94 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, para 37; Case C-212/97 *Centros* (n 23), para 34; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* [2003] ECR I-10155, paras 132, 133; Case C-411/03 *SEVIC Systems AG.* [2005] ECR I-10805, paras 28-29; Case C-378/10 *VALE* (n 4), para 39; Case C-106/16 *Polbud* (n 3), paras 52-56.

41 Case C-106/16 *Polbud* (n 3), para 55.

42 ibid paras 52, 56.

43 Case C-378/10 *VALE* (n 4), para 40; by analogy, see Case C-411/03 *SEVIC Systems AG* (n 42), para 30.

44 Case C-106/16 *Polbud* (n 3), paras 58-59.

45 ibid para 58.

46 V Korom, P Metzinger, 'Freedom of Establishment for Companies: the European Court of Justice Confirms and Refines its Daily Mail Decision in the Cartesio Case C-210/06' (2009) 6 European Company and Financial Law Review 125, 154-155.

from a conversion in the host state 'to the extent that it is permitted under that law to do so'.[47] One might wonder whether the host state enjoys full autonomy and can regulate cross-border conversions at its discretion. That question was clarified by the CJEU in the *Vale* case, where it ruled that its judgement in *Cartesio* does not mean that the national law on conversions is excluded from the scope of the provisions on the freedom of establishment, but rather demonstrates that:

> 'the mere consideration that a company established in accordance with national law exists only on the basis of the national legislation which 'permits' the incorporation of the company, provided the conditions laid down to that effect are satisfied'.[48]

Linking back to the previous discussion, the Member State has thus the right to, of course, determine the rules applicable to companies, including the connecting factors required for incorporation of the company and subsequently maintaining its status in its national jurisdiction.[49] The autonomy of the Member States in this regard is not impinged on by the obligation to permit cross-border conversions.[50] If the company intends to be converted in another jurisdiction it is for the host state alone to define what conditions should be met. It follows from the judgment in *Polbud* that a company has the right to convert itself in the host state provided that the company met all necessary conditions of the national law of that state, including national requirements on connecting factors.[51] Accordingly, the question is not whether the national law permits a cross-border conversion, but what the conditions of domestic law are for a conversion of a foreign company, and whether the company is satisfying all necessary conditions, including the requirement on connecting factors.

Along with that, the host state does not have the right to refuse a conversion on the ground that national rules provide an opportunity to convert only for domestic companies. Such a difference in treatment for cross-border conversions of foreign companies amounts to a restriction on the freedom of establishment.[52] If conversion is possible for domestic companies, the same possibility should be provided for a foreign company which intends to convert itself in the host state.[53] Accordingly, the provisions on the freedom of establishment guarantee equal treatment of foreign and domestic companies in the host state.[54]

The host state has the right to determine the national law applicable to cross-border transactions and apply the national law for incorporation and operation of companies.[55] Therefore, substantive rules which regulate domestic conversions can be applied to cross-border operations as well. Such rules should not be less favourable

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[47] Case C-210/06 *Cartesio* (n 28), para 112.
[48] Case C-378/10 *VALE* (n 4), para 32.
[49] ibid paras 29-31.
[50] ibid para 30.
[51] Case C-106/16 *Polbud* (n 3), paras 33, 35, 43.
[52] Case C-378/10 *VALE* (n 4), para 36.
[53] ibid para 46.
[54] ibid; Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C 202/47, arts 49, 54.
[55] Case C-378/10 *VALE* (n 4), para 62.

than those applicable to domestic transactions (principle of equivalence) and they should not make such transactions impossible in practice or it should not be excessively difficult to implement them (principle of effectiveness).[56] The principle of equivalence will be breached if the host state provides specific opportunities for domestic transaction (such as record data in the register that a company is a predecessor in law to a converted company), but not in the case of cross-border transactions.[57] The refusal of the host state to take into account documents, obtained from the home state, in order to be sure that a company complied with all its requirements and is disconnected with the law of the home state, is contrary to the principle of effectiveness.[58] The rejection of such documents deprives a company of the opportunity to demonstrate that it fulfilled all conditions in the home state and puts the transaction at risk.[59]

Based on the case law it can be summarised that the host state has the power to define connecting factors, location of which within its territory is required for cross-border conversions. All connecting factors (the registered office, the central administration and the principal place of business) are placed on an equal footing in this regard.[60] It is up to the host state to define which factor that serves as a link between a company and its national legal order, as well as what should be transferred to its territory for obtaining the status of a domestic company under its jurisdiction. This area enjoys immunity from the provisions on the freedom of establishment and companies have to comply with it. Along with that, the host state is empowered to define what national rules should be applied to cross-border conversions. It may apply rules, governing conversions of domestic companies, provided that such an application is in line with the principles of effectiveness and equivalence.

When comparing the respective powers of the home and the host state to determine the connecting factor, required for obtaining and maintaining the legal personality of the company, the following picture emerges: only rules of the host state enjoy immunity from the provisions on the freedom of establishment in case of cross-border conversions.

5 NATIONAL LEGAL FRAMEWORKS AND POSSIBLE OBSTACLES TO CROSS-BORDER CONVERSIONS

Despite the case law of the CJEU, some Member States prohibit the exit step in cross-border conversions, whilst in others it is unclear exactly how such operations are regulated in law, or dealt with in practice.[61] Some Member States do not have any

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[56] ibid paras 48, 54.
[57] ibid paras 56, 57.
[58] ibid paras 58-61.
[59] ibid para 60.
[60] Case 81/87 *Daily Mail* (n 25), paras 19-21; Case C-106/16 *Polbud* (n 3), para 34.
[61] C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 20-25. On a detailed description of how the home states treat the outbound step of a cross-border conversion, see Study on the law applicable to companies (n 9), 223-235; T. Papadopoulos 'Reincorporations: A Comparison between Greek and Cyprus law' (2018) 61 International Journal of Law and Management 901, 903-914. On the transfer of the registered office see T Biermeyer, M Meyer, 'Cross-border Corporate Mobility in the

provisions that allow or regulate the inbound step of cross-border conversions.[62] In the latter case, due to the absence of such operations in law, it is not clear whether they are possible in practice or how they are regulated in fact. Although, even in the absence of domestic law in the matter, scholars tend to consider cross-border conversions as possible based on the case law of the CJEU.[63] However, such a prediction is insufficient to understand the real state of affairs regarding the status of cross-border operations. Moreover, even if cross-border conversions are explicitly permitted by law, or implicitly allowed in fact, the lack of procedural rules complicates or hinders the implementation of such operations. In the absence of procedural rules, the competent officials/authorities[64] may lack sufficient understanding of how cross-border conversions should be carried out. Equally, the concerned companies may lack information on what actions are required. This complexity might prevent companies from conducting cross-border conversions.

Since a conversion is of cross-border nature (ie, involving two states), the implementation of such an operation will be successful only if the home and the host state cooperate. Such cooperation is vital for maintaining continuity of a company's legal personality, which is one of the integral features of cross-border conversions. It is important to define the exact stage when a company has to be removed from the register in the home state and when the respective data has to be recorded in the register in the host state respectively.[65] The outcome in the home state should be based on what was achieved in the host state.[66] Therefore, a conversion should take effect on the date when it was registered in the host state and included in its register.[67] After the registration in the host state the company has to be removed from the register of the home state. Ideally, this interaction between the two states should not entail any delays in entering the required data in the registers.

However, the absence of coordination between the home and host state may prevent successful consummation of a conversion and cause negative consequences. If a company is removed from the register of the home state before its registration in the host state it results in a situation where a company is registered nowhere.[68] For instance, in the *Vale* case, VALE Costruzioni Srl, a company duly incorporated in Italy,

EU. Empirical findings 2017' (2018) (Empirical findings 2017) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3116042> accessed 13 July 2018, 25-29.

62 C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 27-29. On a detailed description of how the host states treat the inbound step of a cross-border conversion see Study on the law applicable to companies (n 9), 240-247; T. Papadopoulos (n 61), 903-914. On the transfer of the registered office see Empirical findings 2017 (n 61), 25-29.

63 C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 28-30; Study report on the law applicable to companies (n 9), 248.

64 ie the officials/authorities which are competent to certify cross-border conversions and to register the respective data (notaries, registrars, courts, etc.).

65 Study report on the law applicable to companies (n 9), 222; 238.

66 By analogy, J Rickford, 'Current Development in European Law on Restructuring of Companies: An introduction' (2004) 15 European Business Law Review 1225, 1232.

67 European Parliament resolution (2008/2196(INI)) (n 10), Recommendation 1; European Parliament resolution with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats (2011/2046(INI)) of 2 February 2012 (European Parliament resolution (2011/2046(INI)), Recommendation 2, para 3.

68 Study on the law applicable to companies (n 9), 222; C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 16-17.

was removed from the Italian register due to its conversion into VALE Építési kft, a company governed by Hungarian law. The refusal of Hungary to register the company gave rise to a situation where VALE was not a company under Italian law anymore and not yet a company under Hungarian law. During this period the status of the company was uncertain and AG Jääskinen raised a series of questions in this regard, such as who owns the company's assets, or who is responsible for the company's obligations before third parties?[69] Other important questions arise in such situations, such as, what law regulates the relations between the company's constituencies?

When a company is not registered in any register, the existence of that company during that period may be questionable.[70] In fact, the company may not be subject to any legal regime, resulting in possible opportunistic behaviour at the expense of vulnerable constituencies such as minority shareholders, employees and creditors.[71] Moreover, a situation may occur where a company does not have the status of a domestic company in any jurisdiction. For instance, in the *Interedil* case, where an Italian company, which transferred its registered office to London, was removed from the Italian register of companies and included in the United Kingdom (UK) register of companies as a foreign company.[72] Such non-coordinated actions of the Member States resulted in a situation where in Italy the company was considered as an English company and as an Italian in the UK.[73] This means that for both countries the company had the status of a foreign company, but nowhere it was recorded as a domestic company.[74] A question which arises here is which country's corporate law should govern the company? Let us consider another scenario: what would be the consequence if a company after consummation of a cross-border conversion is not removed from the register of the home state and is included in the register of the host state? Here, the same company is still a domestic company under the law of the home state, but in addition a domestic company under the law of the host state. What law should apply and how should the relations between constituencies of that company be regulated?

Such problematic situations illustrates why a common legal framework, coordinating actions of the home and host state, is necessary. It is important to pay attention not only to the specific moment when required data is entered in the register in the host state and removed from the register in the home state, but also what status a company obtains as a result of cross-border conversion.

Another aspect which may affect a cross-border conversion is the concept of seat. Diversity in the national laws of the Member States result in differences regarding connecting factors. That leads to the question of *what* a company is required to transfer under the national law for the purpose of conversion in the host state. Article 54 of the Treaty on the Functioning of the European Union (TFEU) defines the connecting

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[69] Opinion of AG Jääskinen (n 7), paras 43-45.
[70] Study on the law applicable to companies (n 9), 222.
[71] ibid.
[72] Case C-396/09 *Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Crediti SpA* [2011] ECR I-09915, para 10.
[73] Study on the law applicable to companies (n 9), 238-239.
[74]ibid.

factors as the registered office, the central administration and the principal place of business, however that list is not exhaustive and the national legal orders have more options. For instance, some Member States use the term of statutory seat which means a company's seat as stated in its charter.[75] The stautory seat can be the registered office as well, however, both seats do not necessarily coincide.[76] If the statutory seat is different from the registered office, a change of the statutory seat may not lead to a change of the registered office and consequently to a change of the applicable law.[77] However, there are legal entities which are not subject to registration in the Member States, and these entities are not excluded from the scope of the freedom of establishment.[78] Here, a question arises as to what such a legal entity should transfer in order to be allowed to convert itself in another jurisdiction?

The concept of the real seat is more divergent[79] and identification of its location is an uneasy task in modern technological life.[80] The possibilty to govern the company, to interact, meet and take decisions remotely through electronic means of communication may make it difficult to define where the real seat of the company is located.[81]

The understanding of what type of seat was transfered by the company to the host state is vital for defining the consequences of such transfer. For instance, there was a misunderstanding regarding *what* was relocated in the *Cartesio* case: the registered office or the real seat?[82] The reference for a preliminary ruling in its English version concerned the transfer of the registered office.[83] AG Poiares Maduro considered the transfer of the operational headquarters.[84] Based on this Ireland asked the CJEU to reopen the oral procedure.[85] The CJEU indicated that the case concerned the transfer of the real seat.[86] Interstingly, the company's seat under Hungarian law was the place where the company's central administration was located, but it should coincide with

[75] ibid 221.
[76] ibid.
[77] ibid; C Gerner-Beuerle, F Mucciarelli, E Schuster, M Siems (n 9), 4-5.
[78] For instance, German Gesellschaft bürgerlichen Rechts. See Policy Department for Citizens' Rights and Constitutional Affairs (n 16), 34-35.
[79] Impact assessment 2007 (n 14), 42; Study report on the law applicable to companies (n 9), 119-127.
[80] S Lombardo, 'Conflict of Law Rules in Company Law after Überseering: An Economic and Comparative Analysis of the Allocation of Policy Competence in the European Union' (2003) 4 European Business Organization Law Review 301, 309-310; J Borg-Barthet, 'A New Approach to the Governing Law of Companies in the EU: A Legislative Proposal' (2010) 6 Journal of Private International Law 589, 617-618; K Sorensen, M Neville, 'Corporate Migration in the European Union' (2000) 6 Columbia Journal of European Law 181, 184-185; J Armour, H Fleischer, V Knapp, M Winner, 'Brexit and Corporate Citizenship' (2017) 18 European Business Organization Law Review 225, 236.
[81] ibid.
[82] V Korom, P Metzinger (n 46), 134-136.
[83] Official Journal of the European Union C 165 of 15 July 2006, 18 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:165:0017:0018:EN:PDF> accessed 17 July 2018.
[84] Case C-210/06 *Cartesio Oktató és Szolgáltató bt* [2008] ECR I-09641, Opinion of AG Poiares Maduro, paras 1, 3, 23, 36.
[85] Case C-210/06 *Cartesio* (n 28), paras 43-45.
[86] ibid paras 47-50, 101.

the registered office.[87] Thus, when the national law contains the term 'seat' it might not be obvious whether it refers to the registered office or the real seat.[88]

Such inconsistency may cause difficulties for the successful implementation of a cross-border conversion, since it depends on what type of seat is transferred. Lack of understanding, or misunderstanding, of *what* was transferred or *what should be transferred* may give rise to false analyses, and consequently affect cross-border conversion where a company has to comply with the test on connecting factors in the host state.

6 CONCLUSION

The analysed case law confirms that cross-border conversions are covered by the freedom of establishment, provided that the requirements of the host state, including the test on connecting factors, are satisfied. The test on connecting factors may be considered as a reserved area of the host state where the home state loses its absolute power. In the current situation of EU law where no uniform legal framework is established, it is for the Member States to provide the opportunity for companies to carry out cross-border conversions.

Cross-border conversions may be considered as an achievement of the CJEU since its case law paves the way towards acceptance of such operations in all Member States. The CJEU clarified the scope of the freedom of establishment regarding cross-border conversion in the *Polbud* case. That judgment should give an impulse to those Member States whose law remains silent on the issue, lacks regulation or is not in line with the provisions on the freedom of establishment, to take appropriate legislative measures. However, that may not be sufficient in the current situation, where the laws of the Member States vary significantly. It should be acknowledged that a uniform legal framework at the European level is better than 28 divergent legal regimes, which are likely to result in various barriers to cross-border conversions. The lack of common rules on coordination between the home and the host state may result in a situation where a company is registered as a domestic company in the home and the host state simultaneously or is registered nowhere. The absence of an acceptable level of constituencies protection at the European level may lead to the imposition of burdensome requirements by the Member States. Therefore, a creation of a legal framework at the European level is needed to provide a commonly-accepted procedure for such operations, to secure protection for vulnerable constituencies, prevent abusive practices and to regulate cooperation between the states which are involved in cross-border conversions. Furthermore, a reconciliation of the concept of

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[87] Case C-210/06 *Cartesio* (n 28), para 101; V Korom, P Metzinger (n 46), 135, 142.

[88] This is also the case in Poland which followed the real seat theory before joining the EU and the term 'seat' was perceived as the real seat, but now due to the case law of the CJEU, Poland is considered as a country which follows the theory of incorporation; it is also considered that no change occurred. See A Mucha, 'New Chapter in the Corporate Mobility in Europe – Some Remarks on the Polish Supreme Court Request for a Preliminary Ruling on the Outbound Limited Company Seat Transfer in the case C-106/16 Polbud-Wykonastwo' (2017) Allerhand Working Paper 20/2017, 8 <https://ssrn.com/abstract=2954639> accessed 17 July 2018; Study on the law applicable to companies (n 9), 124-125.

seat could bring more clarity regarding connecting factors and facilitate cross-border conversions.

The Commission submitted a Proposal for a Directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions on 25 April 2018, but whether it will be adopted in the same version and when remains to be seen. If a proposed directive is adopted in the version it is submitted by the Commission, a legal framework will be created only for limited liability companies.[89] According to the case law all companies and firms, which are formed in one of the Member States and have the registered office, the central administration or the principal place of business within the EU, may benefit from the freedom of establishment and have the right to conduct cross-border conversions. If that directive is adopted, the Member States may prohibit cross-border conversions, initiated by legal entities which have the right to convert, but are excluded from the scope of the directive, unless the issue is considered by the CJEU. However, the absence of secondary law in the EU should not result in an unenforceability of the provisions on the freedom of establishment, meaning that the limited scope of the proposed directive may not be a ground for prohibition of cross-border conversions.

[89] Proposal for a Directive (n 6), art 86 (a). The scope of the proposed directive in regard to cross-border conversions was defined by analogy with cross-border mergers. It was explained that only limited liability companies are within the scope of a Proposal for a Directive due to little use of cross-border mergers by other types of legal entities (such as partnerships, cooperatives, foundations) and due to possible difficulties concerning EU company law and accounting rules since they cover only limited liability companies. See Commission Staff Working Document 'Impact Assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law and Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions' SWD (2018) 141 final, 54; Proposal for a Directive (n 6), 18.

THE EU COURT OF JUSTICE CLARIFIES THE ROLE OF THE FULL-FUNCTION CRITERION IN THE INTERACTION BETWEEN ARTICLE 3(1)(B) AND 3(4) OF THE EU MERGER REGULATION

VASILIKI FASOULA*

Abstract

Case note: C-248/16 Austria Asphalt GmbH & Co OG v Bundeskartellanwalt, Judgment of the Court of Justice of the European Union of the 7th of September 2017. Joint venture is a common business strategy that provides companies with benefits in scale economies, R&D, operational efficiencies and synergies. Joint ventures can be potentially harmful for the state of free competition in a market if they coordinate with their parent companies or if their operation can restrict access to the market for other competitors. Within the Internal Market, joint ventures fall under the scrutiny of two pieces of competition legislation in a non-cumulative way: the EU antitrust provisions and the EU Merger Regulation (EUMR) under Article 3(1)(b) and 3(4). Before the Austria Asphalt preliminary ruling, the Commission, despite its ambiguous decisional practice, considered those two paragraphs to constitute two different jurisdictional criteria applying to two different types of notifiable transactions. In Austria Asphalt the CJEU examined the correlation of those two paragraphs. It interpreted Article 3(4) as a restriction of Article 3(1)(b) by considering that the full-function criterion set by Article 3(4) should apply to all concentrative joint ventures: those newly created by a transaction as well as to those resulting from a change in the control of an existing company. In practice, the CJEU's view limits the one-stop shop principle of the EUMR in favour of national competition authorities.

1 INTRODUCTION

By this preliminary ruling, the Court of Justice of the European Union (CJEU) provides some clarity on the extent of the scope of implementation of the EUMR[1] to joint ventures. The incoherence in the European Commission's (the Commission) decisional practice regarding joint ventures falling under the scope of the EUMR had led to a division of the legal scholarship and to a certain degree of legal uncertainty on the interaction between the jurisdictional criteria set out in Article 3(1)(b) and 3(4) of the EUMR.[2] The question asked by the referring court was whether a change from sole control to joint control over an

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[1] Council Regulation (EC) 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] OJ L24/1.

[2] According to Article 3(1)(b), a notifiable concentration under the EUMR is any transaction where a lasting change of control arises from the acquisition of direct or indirect control of the whole or parts of one or more other undertakings. According to Article 3(4), the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity constitutes a concentration within the meaning of Article 3(1)(b).

existing undertaking constitutes a notifiable concentration only where the resulting joint venture performs on a lasting basis all the functions of an autonomous economic entity, ie a full function joint venture, post-transaction. The CJEU must therefore determine the role of Article 3(4) in the structure of the EUMR. Is it meant to be interpreted as a limit to the scope of application of Article 3(1)(b) of the EUMR to joint ventures or to establish an additional notifiable transaction next to those under article 3(1)(b) if a full-function joint venture is created post-transaction?

The Court's answer to the referred question was that a change from sole to joint control over an existing undertaking was a notifiable concentration under the EUMR only if the joint venture created by such a transaction performs all the functions of an autonomous economic entity. This means in practice that a high number of transactions may no longer fall under the scope of the ex ante control established by the EUMR.

2 FACTS OF THE CASE

The events leading up to a request for this preliminary ruling concern the evolution of a production joint venture in the Austrian city of Mürzzuschlag. Austria Asphalt GmbH & Co OG (AA) is an indirect subsidiary of Strabag SE while Teerag Asdag (TA) belongs to the Porr Group. Both companies are international construction groups operating mainly in the field of road construction. The Mürzzuschlag asphalt mixing plant produces asphalt used in road construction and supplies it almost exclusively to TA which is its sole owner. On 3 August 2016, the two above mentioned companies notified a transaction to the Austrian Federal Competition Authority (*Bundeswettbewerbsbehörde*) by which AA would acquire 50% of the shares of the asphalt mixing plant, *i.e.* the target undertaking, previously owned solely by TA. According to the referring court, the transaction should not be viewed as a full-function joint venture because the joint venture created would supply the asphalt produced in the plant almost exclusively to both its parents companies. Under the Austrian merger control provisions, the creation of a non-full-function joint venture may fall under the scope of national law, ie *Kartellgesetz*, if certain criteria are met, therefore, the transaction would constitute a notifiable concentration before the competent authority of Austria.

According to the procedure of national law, the Austrian Federal Cartel Prosecutor (*Bundeskartellanwalt*), lodged with the Higher Regional Court in Vienna (*Oberlandesgerichtshof Wien*) acting as cartel court, an application for review under Paragraph 11(1) of the *Kartellgesetz*. According to the cartel court, the notified transaction constituted a concentration with an EU dimension and therefore it should fall under the scope of the EUMR. AA lodged an appeal before the Austrian Supreme Court (*Oberster Gerichtshof*) arguing that the transaction should be treated as a concentration requiring notification under the scope of Paragraphs 7 and 9 of national competition law, ie *Kartellgesetz*. The referring court noted that there was no clarification in the case law on the interpretation of Article 3(4) of the EUMR and its correlation with Article 3(1) of the EUMR, nor in the Jurisdictional Notice[3] or the Commission's decisional practice. Therefore, under Article 267 of the Treaty on the Functioning of the European Union (TFEU) the Austrian Supreme Court submitted a

[3] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2008] OJ C95/1.

request for a preliminary ruling asking the following: must Article 3(1)(b) and 3(4) of the EUMR be interpreted as meaning that a move from sole control to joint control of an existing undertaking, in circumstances where the undertaking previously having sole control becomes an undertaking exercising joint control, constitutes a concentration only where the undertaking, the control of which has changed, has on a lasting basis all the functions of an autonomous economic entity?

3 THE OPINION OF ADVOCATE GENERAL KOKOTT

In her opinion,[4] Advocate General (AG) Kokott states that the actual wording of Article 3(1)(b) and 3(4) of the EUMR does not provide for a clear picture on the joint ventures that fall under the scope of EUMR. Therefore, many interpretations are plausible, like the ones argued by the parties during the proceedings. On the one hand, AA argued that only full-function joint ventures were subject to the EUMR based on Article 3(4). On the other hand, the Commission argued that a change in control, from sole to joint, of an existing undertaking should at all times be subject to the EUMR, even if the target undertaking was not a full-function one based on Article 3(1)(b). The Commission also emphasized that the application of the full-function criterion, in cases of change in the control, could create an 'enforcement gap' in the EU merger control regime. Interesting enough, the Commission had argued for the opposite interpretation on the same case, when AA consulted the Commission and received a non-binding comfort letter from the Commission's Directorate General for Competition (DG Competition) that the transaction did not appear to constitute a concentration falling under the scope of Article 3 of the EUMR.[5] While the comfort letter came with the disclaimer that the view expressed in it is an opinion of the DG Competition and does not bind the Commission as an EU institution, the AG criticised the incoherence within the Commission's services in the matter of the scrutiny of joint ventures under the EUMR.

Since the textual interpretation could not clarify Article 3 of the EUMR, the AG proceeded to a teleological approach of the general scheme as well as the drafting history of the EUMR. According to the AG, the provision of Article 3(4) read alongside with recital 20 of the EUMR does not distinguish between newly created joint ventures and those that result from a conversion of an existing company into a joint venture. Instead, it lays down the full-function criterion as being applicable to all joint ventures, irrespective of whether the joint venture concerned is a newly created one or an existing company converted to a joint venture.[6] The AG continues by stating that recitals 8 and 20 aim at bringing under EU merger control those transactions that may cause significant structural changes in the internal market. In the AG's opinion, an undertaking with no autonomous presence in the market cannot effect its structure such as to justify an EU merger control scrutiny. According to the AG, if a transaction gives rise to a joint venture which is not full-function:

[4] Case C-248/16 *Austria Asphalt GmbH & Co OG v Bundeskartellanwalt* [2017] ECLI:EU:C:2017:322, Opinion of AG Kokott.
[5] ibid pt 14.
[6] ibid pt 28.

> [T]here will at most be a need to deal with any coordination by the two parent companies of the behaviour in which they engage on the market as part of their collaboration within the joint venture. Such coordination of market behaviour, even though it may be entirely relevant from the point of view of Articles 101 and 102 TFEU, is an issue to be considered not under the EU merger control regime but under Regulation 1/2003[7]'.[8]

Further, the AG strongly disagreed with the Commission's view during the hearing of the case that the application of the full-function criterion to all the joint ventures under the EUMR – which was according to her, the intention of the legislator of Regulation 1310/97[9] from which originated Article 3(4) of the EUMR- would create a gap in the effective enforcement of the EUMR. The AG did not comment on the effect to the market structure by a possible disappearance of a joint venture as being a matter subject to the EUMR.[10]

4 JUDGMENT OF THE COURT

The Court held that the wording alone of Article 3 of the EUMR was not clear enough to determine whether a transaction, as the one of the case, involving a change of sole to joint control by two shareholders, over an existing undertaking, is notifiable to the Commission only if the joint venture resulting is a full-function one. According to the Court, such a transaction would on the one hand, satisfy the criterion of a change of control on a lasting basis under Article 3(1)(b), but on the other hand, it is not clear whether it could be regarded as a creation of a joint venture under Article 3(4) because of the pre-existence of the joint venture as an undertaking prior to the transaction.

Since the textual interpretation cannot offer clarity on the legal matter at hand, the Court proceeds to the teleological interpretation of legal provisions by analysing the purpose and the general scheme of the EUMR. In order to specify the objective of the EUMR, the Court is referring to the combined reading of Recitals 5,[11] 6,[12] 8,[13] and 20[14] as well as to Article

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[7] Council Regulation (EC) 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty [2003] OJ L1/1.

[8] Opinion of AG Kokott (n 4), pt 38.

[9] Council Regulation (EC) 1310/97 of 30 June 1997 amending Regulation (EEC) 4064/89 on the control of concentrations between undertakings [1997] OJ L180/1.

[10] Opinion of AG Kokott (n 4), pts 46-47.

[11] Recital 5 of the EUMR stipulates that 'it should be ensured that the process of reorganisation does not result in lasting damage to competition; Community law must therefore include provisions governing those concentrations which may significantly impede effective competition in the common market or in a substantial part of it'.

[12] Recital 6 of the EUMR stipulates that the aim of the Regulation is 'to permit effective control of all concentrations in terms of their effect on the structure of competition in the Community and to be the only instrument applicable to such concentrations (…)'.

[13] Recital 8 of the EUMR stipulates that 'the provisions to be adopted in this Regulation should apply to significant structural changes, the impact of which on the market goes beyond the national borders of any one Member State. Such concentrations should, as a general rule, be reviewed exclusively at Community level, in application of a "one-stop shop" system and in compliance with the principle of subsidiarity. Concentrations not covered by this Regulation come, in principle, within the jurisdiction of the Member States'.

[14] Recital 20 of the EUMR stipulates that 'it is expedient to define the concept of concentration in such a manner as to cover operations bringing about a lasting change in the control of the undertakings concerned and therefore in the structure of the market. It is therefore appropriate to include, within the scope of this

2(1) and 2(4) of the EUMR on the appraisal of concentrations. The purpose of the EUMR is to ensure that the reorganisation of undertakings does not result in lasting damages to competition in the European Union therefore this regulation should apply to significant structural changes on the market the impact of which goes beyond the national borders of any one Member State.[15] The transactions that fall under the scope of the EUMR are, according to the Court, the ones that bring about a lasting change in the control of the undertakings and therefore in the structure of the market. Thus, as regards joint ventures, 'these must be included within the ambit of the regulation if they perform on a lasting basis all the functions of an autonomous economic entity'.[16]

Following point 28 of the Opinion of the AG, the CJEU states that a distinction between the creation of a new undertaking after the transaction and the change of control over an existing undertaking prior to the transaction is not necessary. The reason being that in both cases the potential effects of the transaction on the structure of the market depend 'on the actual emergence of a joint venture into the market, that is to say, of an undertaking performing on a lasting basis all the functions of an autonomous economic entity'.[17] A converse interpretation of Article 3 of the EUMR would lead, according to the Court's ruling, to an unjustified difference in treatment between the creation of a new undertaking which would be treated as a concentration only if the full-function criterion was fulfilled, and a change of control of an existing undertaking, which would be covered by the concept of concentration irrespective of whether that undertaking would be active as an autonomous economic entity post-transaction.[18]

The Court states that its interpretation of Article 3 is consistent with the general scheme of the EUMR. The latter alongside Regulation 1/2003 on the implementation of Articles 101 and 102 TFEU, form a 'legislative whole' establishing a system of control ensuring that competition is not distorted in the internal market of the European Union.[19] Pursuant to Article 21(1) of the EUMR, the latter applies to concentrations within the meaning of Article 3, whereas transactions that are covered by the concept of concentration but are nevertheless capable of leading to coordination between undertakings in breach of Article 101 TFEU are subject to Regulation 1/2003.[20] In that view, treating a change from sole to joint control over an existing undertaking as a notifiable concentration even if the full-function criterion was not fulfilled, as this was argued by the Commission, would be inconsistent with Article 21 of the EUMR, because that would extend the scope of the Merger Regulation's preventative control, and, at the same time, limit the scope of Regulation 1/2003.[21]

The CJEU's conclusion is that Article 3 of the EUMR must be interpreted as meaning that a concentration is deemed to arise upon a change in the form of an existing undertaking

Regulation, all joint ventures performing on a lasting basis all the functions of an autonomous economic entity […]'.

[15] Case C-248/16 *Austria Asphalt GmbH & Co OG v Bundeskartellanwalt* [2017] ECLI:EU:C:2017:643, pt 21.

[16] ibid pt 22.

[17] ibid pt 24.

[18] ibid pt 27.

[19] ibid pt 31.

[20] ibid pt 33.

[21] ibid pt 34.

which, previously exclusive, becomes joint, only if the joint venture created by such a transaction performs on a lasting basis all the functions of an autonomous economic entity.

5 COMMENTS

The concept of joint venture is essentially an economic one without a clear legal definition in the European legal order. Joint ventures are subject to contract law provisions, corporate law as well as competition law provisions. In the present ruling, the CJEU makes a clarification on the criteria that must be fulfilled in order for a joint venture to fall under the scrutiny of the EUMR. The term of joint venture describes, in general, a contractual agreement between two or more autonomous undertakings willing to cooperate in order to achieve a determined economic objective during the course of a reasonable period of time or for a time frame that may not be specifically determined in the contract.[22] All parties are able to exercise considerable control or influence over the legal form chosen for the joint venture.[23] Largely used in the practice of US firms, the American antitrust legal doctrine and practice supported the compatibility of these contractual agreements with antitrust rules due to the efficiency effects they were producing but also recognised that they could have some potentially anticompetitive effects similar to mergers and board of directors' interlocks.[24] Joint ventures are viewed as 'an important and distinct category for antitrust analysis because of their potential to bring about an efficiency-enhancing integration of economic activity. Many different forms of economic integration may be effected by joint ventures and each may enhance efficiency in more than one way'.[25]

In EU law, the assessment of joint ventures falls under two different bodies of EU competition law in a non-cumulative way: a joint venture may fall either under the scope of the antitrust provisions as laid down in Articles 101 and 102 TFEU and enforced by Regulation 1/2003 or under the scope of merger control provisions as laid down in the EUMR. This normative distortion in the assessment of joint ventures under EU competition law prohibited the development of a unitary competition analysis of joint ventures in the European market. The enforcement of EU antitrust rules was established almost at the beginning of the economic integration of the European market by Regulation 17.[26] Hence, the cooperation agreements between undertakings in connection with the establishment and functioning of joint ventures were falling under the exclusive scrutiny of Article 85 EEC Treaty, now Article 101 TFEU. In its early decisional practice under Regulation 17, the Commission forwarded the thesis that EU antitrust scrutiny was necessary when the joint ventures would act as actual or potential competitors to their parent undertakings with the

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[22] Antony Woolich, 'Joint Ventures in the European Union' in Martin Mankabady (ed), *Joint ventures in Europe* (3rd edn, Tottel Publishing, 2008); Laurent Deis, 'Les contrats de coopération inter-entreprises' (PhD thesis in Law, University of Paris II 2002).

[23] Wolf Ronald, *The complete guide to international joint ventures with sample clauses and contracts* (3rd edn, Kluwer Law International 2011).

[24] Jeffrey Pfeffer, Phillip Nowak, 'Patterns of Joint Venture activity: Implications for Antitrust Policy' (1976) 21 Antitrust Bulletin 315.

[25] Werden Gregory, 'Antitrust Analysis of Joint Ventures: An Overview' (1998) ALJ 702; Ian Hewitt, *Joint Ventures*, (2nd edn, Sweet & Maxwell 2001).

[26] Council Regulation (EEC) No 17 First Regulation implementing Articles 85 and 86 of the Treaty (at present Articles 101 and 102 TFEU) [1962] OJ 13/1.

exception of two types of situations that were falling outside the scope of Article 85 EEC Treaty: 1) the cases where the parent undertakings had transferred all their assets to one or multiple joint ventures while maintaining their independence only for the purpose of monitoring the joint ventures activities; 2) the cases where the parent undertakings would transfer a significant part of their assets to a joint venture and then they would withdraw entirely from the market where the joint venture was active. These latter cases where qualified by the Commission as partial concentrations.[27] Until the adoption of the first EUMR in 1989,[28] the above mentioned two types of joint ventures were not subject to any particular form of competition scrutiny due to the absence of a legal framework on direct control of concentrations.[29]

The first EUMR tried to cover this legal lacuna in joint venture competition scrutiny by stipulating in its Article 3(2) that only joint ventures that performed on a lasting basis all the functions of an autonomous economic entity and that did not give rise to coordination of the competitive behaviour of the parties amongst themselves or between them and the joint venture at stake would fall under the scope of the EUMR. This caused a qualification division between joint ventures viewed as a concentrative entity, subject to the EUMR, and those viewed as a cooperative entity, subject to the EU antitrust provisions. The distinction between concentrative and cooperative joint ventures that is still in force today, served as a jurisdictional factor assigning joint ventures to different substantive and procedural systems to the detriment of predictability of the outcomes of jurisdictional rules. That distinction was criticised as being 'deeply flowed'[30] from an economic perspective because it assigned operations with similar effects on market structure to different substantive and procedural systems. The legal criteria for the qualification of joint ventures, under both bodies of EU competition law, which were delineated by the Commission for the first time in its 1990 Interpretative Notice on the distinction between concentrative and cooperative operations[31] were subject to an evolutionary interpretation. The 1994 Interpretative Notice between concentrative and cooperative joint ventures[32] broadened the scope of qualification of joint ventures as concentrative entities subject to the EUMR, as did the amendment of EUMR by Regulation 1310/97.[33]

The objective of the Commission's White Paper on Modernisation of EC Antitrust Law[34] was to decentralise the application of EU competition law by national authorities and courts leading up to a convergence of national law and EU law and to a consistent and uniform application of antitrust law within the European Market. Concerning the decentralisation of the exemption mechanism of now Article 101 (3) TFEU, the Commission

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[27] Karen Banks, 'Mergers and Partial Mergers' in Barry Hawk (ed), *Annual Proceedings of the Fordham Corporate Law Institute: North American and Common Market Antitrust and Trade Laws 1987* (M. Bender 1988).
[28] Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings [1989] OJ L395/1.
[29] Luis Silva Morais, *Joint Ventures and EU Competition Law* (Hart, 2013).
[30] Barry Hawk, 'Joint Ventures under EEC Law' [1991] Fordham Int'l LJ 303.
[31] Interpretative Notice on the distinction between concentrative and cooperative operations [1989] OJ L395/1.
[32] Interpretative Notice on the distinction between concentrative and cooperative joint ventures [1994] OJ C385/1.
[33] Council Regulation (EC) No 1310/97 amending Regulation (EEC) No 4064/89 on the control of concentrations between undertakings [1994] OJ L180/1.
[34] White Paper on Modernization of the rules implementing Articles 81 and 82 of the EC Treaty [1999] OJ C132/1.

argued that the requirement of prior central authorisation should be maintained for partial-function production joint ventures to which a certain minimum level of assets was to be contributed. The reason being that these transactions required substantial investment and profound operational integration which would be difficult to unravel once the transaction was concluded.[35] The Commission argued for a system of compulsory prior notification for these transactions. In the Commission's view.

> [T]he procedures established by the Merger Regulation allow rapid and effective prior control. The Commission accordingly envisages extending the scope of that Regulation to include partial-function joint production ventures, which would be subjected both to the dominance test, under Article 2(3) of the Regulation (i.e. Regulation 4064/89 at the time), and to the Article 85 test, under Article 2(4)'.[36]

Two years after the White Paper on the modernisation of EU antitrust provisions, the Commission did not include any specification on partial-function production joint ventures constituting a concentration under the scope of the EUMR in its Green Paper on the Reform of the Merger Control Regulation.[37] Finally, the EUMR that resulted after that process, adopted the ambiguous wording of Article 3(1)(b) and 3(4) that the *Austria Asphalt* ruling comes to clarify.

In *Austria Asphalt*, the Court equates the 'creation of a joint venture' laid down in Article 3(4) with a 'transaction as a result of which an undertaking controlled jointly by at least two other undertakings emerges in the market'.[38] Hence, the creation of a joint venture includes the acquisition of joint control of an existing undertaking and the formation of a new undertaking by two or more parties. This means that the CJEU interprets Article 3(4) as a restriction of Article 3(1)(b) since it applies the full-function criterion not only to transactions falling under the scope of Article 3(4) but also to changes over existing undertakings that fall under the scope of Article 3(1)(b). This expansion of the full-function criterion to also Article 3(1)(b) essentially adds a criterion that the legal text applies only to Article 3(4). One may, in that case, wonder of the choice of the legislator to separate a single concept –according to the Court's ruling- in two different paragraphs of the same piece of legislation, ie the EUMR.

The Commission's position during the proceedings, that the joint control of Article 3(1)(b) and the full-function criterion of Article 3(4) apply to different types of notifiable transactions was consistent with the views laid down by the Commission in its soft law instruments providing guidance as to jurisdictional issues under the EUMR, ie the Notice on the concept of full-function joint ventures[39] and its corresponding section of the Consolidated Jurisdictional Notice[40] which replaced it. The Jurisdictional Notice stipulates that '[…] a transaction involving several undertakings acquiring joint control of another

[35] ibid paras 79-80; Lennart Ritter, David Braun, *European Competition Law: A Practitioner's Guide* (3rd edn, Kluwer Law International 2005).
[36] ibid para 81.
[37] Green Paper on the Review of the Council Regulation (EEC) n° 4064/89, COM (2001) 745.
[38] Case C-248/16 *Austria Asphalt GmbH & Co OG v Bundeskartellanwalt* [2017] ECLI:EU:C:2017:643, pt 28.
[39] Commission Notice on the concept of full-function joint ventures [1998] OJ C66/5.
[40] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) 139/2004 on the control of concentrations between undertakings [2008] OJ C95/1.

undertaking or parts of another undertaking, fulfilling the criteria set out in paragraph 24, from third parties will constitute a concentration according to Article 3(1) without it being necessary to consider the full-functionality criterion'.[41] Also, as far as article 3(4) of the EUMR is concerned it 'provides in addition that the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity (so called full-function joint ventures) shall constitute a concentration within the meaning of the Merger Regulation […]'.[42] The joint venture is 'not full-function if it only takes over one specific function within the parent companies' business activities without its own access or presence on the market'.[43] For a joint venture to be viewed as an independent economic actor in the market place for a significant amount of time, the legal scholarship recognises that, in general terms, the joint venture must be self-sufficient in the matter of financial, material and human resources and be able to design its own commercial strategy.[44]

In the Commission's decisional practice, the elements of the full-functionality criterion have been assessed in a variety of ways.[45] For example, in *RSB/Tenex*[46] the Commission found the EUMR inapplicable in the transaction because of lack of the full-function character for the reason that in its shareholders' agreement it was written that the main purpose of the joint venture was to provide services to one of its parent undertakings. In *Mærsk Data/Den Danske Bank*[47] the transaction was assessed as a concentration under the EUMR and the joint venture had full functionality because 15% of its sales were destined to third parties in the first year of its creation with a gradual rise until 65% by its third year. *In La Poste/Swiss Post*[48] the Commission approved the concentration with commitments and it assessed the joint venture to have full-functionality because of its sales that were destined to, mostly, third parties despite the fact it would have to purchase supplies almost exclusively from its parents. In the matter of resources of a joint venture, the Commission in *KLM/Alitalia*[49] did not require that the joint venture be the owner of such resources but to have access to them by its parents in order to carry out its business plan and to operate in the market.

Although the Commission's position in the proceedings before the CJEU was that Article 3(1)(b) and Article 3(4) should constitute two different jurisdictional criteria for a transaction to be assessed under the EUMR, its decisional practice has not been, in the past, very clear about that distinction.[50] In Eni/Acegasaps/JV[51] the Commission stated in paragraph 9 that:

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[41] ibid para 91.
[42] ibid para 92.
[43] ibid para 95.
[44] Kadir Baş, *The Substantive Appraisal of Joint Ventures under the EU Merger Control Regime* (Wolters Kluwer 2015); Michel Glais, *Économie de l'entreprise et des marchés,* (Economica 2017).
[45] Maher Dabbah, *EC and UK Competition Law: Commentary, Cases and Materials,* (Cambridge University Press 2004).
[46] *RSB/TENEX/Fuel Logistic* (Case No IV/M.904) [1997] OJ C168/5.
[47] *Mærsk Data/Den Danske Bank-DM Data* (Case No IV/M.1005) [1998] OJ C46/4.
[48] *La Poste/Swiss Post/JV* (Case No COMP/M.6503) [2012] OJ C94/1.
[49] *KLM/Alitalia* (Case M/JV-19) [1999] OJ C184/1.
[50] Francesco Russo *et al.*, *European Commission Decisions on Competition: Economic Perspectives on Landmark Antitrust and Merger Cases* (Cambridge University Press 2010).
[51] *ENI/Acegasaps/JV* (COMP/M.6068) [2011] OJ C144/6, paras 10-11.

[F]or the purpose of the present case there is no need to assess the full-functionality nature of the Target as the envisaged transaction consists of the acquisition of joint control over a pre-existing business with a market presence consistent with Paragraph 91 of the Commission Jurisdictional Notice'.

While at the following paragraph it cited that 'it follows from the foregoing, that the operation consists in a concentration within the meaning of Article 3(4) of the Merger Regulation'.[52] In *Volvo/Henleys*[53] the notified transaction concerned a joint control of a holding company. The Commission cited in its paragraph 12 that the undertaking resulting from the transaction 'will constitute a concentrative, full-function, autonomous joint venture in the terms of the Merger regulation'. In *Soulès*[54] the transaction concerned an acquisition of joint control by two undertakings of an existing third one 'within the meaning of Article 3(1)(b)' that according to the Commission in paragraphs 8-9 would now 'constitute a full function joint venture within the meaning of Article 3(4) (…) Therefore, the operation is a concentration within the meaning of Article 3 of the EC Merger Regulation'. In *Laucool*[55] the Commission also applied the full-function criterion to Article 3(1)(b) concerning the acquisition of a joint control of an existing undertaking already in operation in the market. It stated in paragraph 11 that:

> '[H]aving regard to the above, the joint venture will perform on a lasting basis all the activities of an autonomous economic entity. NYK's acquisition of joint control of LauCool therefore constitutes a concentration within the meaning of Article 3(1)(b) of Council Regulation (EC) No 139/2004'.

In the aftermath of *Austria Asphalt* ruling, there is no need for the Commission to make a distinction between Article 3(1)(b) and (4) of the EUMR in its decisions since the CJEU imposes the fulfilment of the full-function criterion to transactions falling under both cases. In fact, since 2018, in decisions concerning joint ventures, the Commission has adopted the wording that the notifying parties have acquired 'within the meaning of Article 3(1)(b) and 3(4) of the EUMR' the joint control of the undertaking or of the newly founded joint venture or just of the joint venture.[56] Also, following the Court's interpretation of Article 3 of the EUMR, the 'one-stop shop' principle of EU merger control may in fact be limited. Joint ventures that may potentially effect the structure of competition on the market place – either by their emergence on the market or by their disappearance from it, which the CJEU considered the latter to be irrelevant - may not fulfil the thresholds set by the EUMR, thus ending up being caught by national merger control provisions and falling under the scrutiny of national competition authorities. If the transactions may not be qualified as concentrations under national merger control, they may fall under the scope of EU and national antitrust law if the criteria of these provisions are fulfilled.

[52] Ibid para 10.
[53] *Volvo/Henlys* (Case No IV/M.593) [1995] OJ C132/2.
[54] *Toepfer/InVivo/Soulès* (Case No COMP/M.4042) [2005] OJ C68/20.
[55] *NYK/Lauritzen Cool/LauCool JV* (Case No COMP/M.3798) [2005] OJ C178/6.
[56] For instance, *Elg Haniel/Iberinox/JV* (Case No M.8606) [2018] OJ C100/2, *Oney/4Finance/JV* (Case No M.8726) [2018] OJ C82/1, *Diamond Transmission Corporation/Infrared Capital Partners/JV* (Case No M.8728) [2018] OJ C107/2, *Amtrust/Madison Dearborn Partners/Mayfield Holdings JV* (Case No M.8737) [2018] OJ C29/1, *Repsol/KIA/JV* (Case No M.8783) [2018] OJ C73/1, *GE/Rosneft/JV* (Case No M.8820) [2018] OJ C165/1.

In the matter of scrutiny of concentrative joint ventures, there is no harmonisation amongst the EU Member States.[57] For instance, some national legislations have a broader definition of what constitutes a concentration by including the acquisition of minority shareholdings in the concept of joint control like Austria, Germany and the UK while in France, the Netherlands and Spain the full-function of a joint venture, newly created by the transaction or by a change in the control of a pre-existing undertaking, is a prerequisite for notification.[58] Most of the national competition authorities follow the Jurisdictional Notice as a mean to provide guidance to a consistent application of competition law within the European Market. Since the qualification of a joint venture as a full-function undertaking requires a more 'forward-looking assessment'[59] on the basis of specific criteria set out in the Jurisdictional Notice, it remains to be seen if after *Austria Asphalt*, the Commission will reassess the concept of full-functionality as laid down in paragraphs 91-109 of the Jurisdictional Notice in order to reinforce legal security of market operators and provide guidance to the national competition authorities for a more convergent application of national merger control provisions on joint ventures.

[57] Richard Whish, David Bailey, *Competition Law* (8th edn, Oxford University Press 2015).
[58] Maher Dabbah, K.P.E. Lasok, *Merger Control Worldwide: Volume I and Volume II* (2nd edn, Cambridge University Press 2012).
[59] Johannes Lübking, 'Commission adopts Jurisdictional Notice under the Merger Regulation' (2007) Competition Policy Newsletter 3, 4.