The EC Communication on SEPs: Convergence, Divergence, or Silence?

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On November 29, 2017, the European Commission (EC) released a communication entitled, "Setting out the EU approach to Standard Essential Patents." The EC Communication outlines a strategy to "create[] a fair and balanced system for Standard Essential Patents." This article analyzes what the EC Communication says—and, more importantly, does not say—discusses how the EC Communication fits in with recent developments in competition law related to SEPs in the United States, and offers practical guidance to those involved in standard setting.

Standard-Setting Background

Standards are "consistent protocols that can be universally understood and adopted" that "fuel compatibility and interoperability and simplify[] product development." Some ubiquitous standards include mobile network standards, such as 3G or 4G (and soon 5G), which allow any cell phone to connect to the same network, WiFi standards that allow any computer to connect to wireless Internet, or Bluetooth standards that allow wireless products to connect to various devices. But not all standards are high-tech: 19th century railroads strived to create standards for track gauges so a train could move between tracks made by different manufacturers in different regions of the country with ease.

Once standards are adopted, numerous competitors can build products that use the standards and allow consumers to take advantage of "interoperability" even though consumers use products created by different firms (e.g., Google phones can communicate with Samsung phones and computer accessories manufactured by a range of suppliers can all plug into the same USB port). The benefits of standardization and interoperability are expected to increase exponentially with the advent of "the Internet of things" (IOT). This is because more and more consumer products—from cars to refrigerators—will connect to WiFi, mobile, or other networks to share information. The EC estimates that upwards of 40 percent of the benefits from the IOT comes from "interoperability enabled by standards."

But standards and standard setting can implicate competition concerns. Indeed, Standard Development Organizations (SDOs) consist of groups of competitors that agree on a single technological protocol for an industry. These types of agreements raise fundamental competition questions. The selection of a standard may confer market power on a firm that owns patents that cover technology needed to practice a standard. A patent that is essential to practicing a standard is called a "Standard Essential Patent" or SEP.

Typically, prior to adopting a standard, SDOs require firms to disclose the existence of potential SEPs and promise to license them on fair, reasonable, and non-discriminatory (FRAND) terms. The FRAND commitment is designed to protect industry members against the risk of an SEP owner abusing the market power conferred via the standard while still allowing SEP owners to collect a reasonable royalty for the invention. If a potential SEP owner refuses to make the FRAND commitment, the SDO may elect to choose a different standard that does not incorporate the relevant technology or abandon efforts to create a single standard entirely.

The potential for a firm to use SEPs to exercise market power over the standardized industry has piqued the interest of competition authorities. Most enforcers have focused on patent hold-up, which is "[t]he tactic of withholding a license unless and until a manufacturer agrees to pay an unduly high royalty rate for an SEP." More recently, especially in the United States, competition authorities have also voiced concern about "hold-out," which is when the licensee (or a group of licensees) refuses to pay a reasonable royalty, using FRAND as a shield against a patent infringement suit to drive royalties down. Antitrust authorities have not yet settled on a consistent competition analysis for standard setting and the licensing of SEPs, and a heated debate has emerged about the role competition laws have to play in standard-setting processes, the licensing of SEPs, and setting royalty rates compliant with the FRAND promise.

The EC Communication

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Recognizing the need to “reward patent holders so they continue to invest in R&D,” the EC Communication avoided declarations on the thorniest intersections of competition laws and SEPs. Thus, the EC Communication is not likely to change the current landscape of FRAND litigation and licensing in Europe or the United States. Nevertheless, it has been welcomed by licensors and licensees of SEPs (companies often embody both roles simultaneously), which have indicated that the Communication “is a victory for all European consumers and innovative businesses—especially Europe’s car industry and the hundreds of SMEs active in the growing IoT sector.”

The Creation of the EC Communication. The adoption of the Communication is part of the EC’s wider Digital Single Market initiative, and it comes after considerable internal work and consultations, as well as intense lobbying.

Within the EC, a task force composed of members spanning different Directorates-General, or DGs, met regularly over several months to discuss issues related to licensing and the EC’s Digital Single Market initiative. This group was set up in 2014, after DG Grow launched its public consultation on patents and standards. The purpose of the consultation was to allow interested stakeholders to share their views on how the current framework governing standardization and SEPs was performing and how to ensure that standard setting remains effective in a fast-changing economic and technological environment. These consultations confirmed that the FRAND concept is important, but DG Grow indicated that it had doubts as to whether FRAND could be further refined because it was generally defined through bilateral negotiations.

Following these consultations, FRAND licensing issues were hotly debated, in particular among DG Competition, DG Grow, and DG Connect. For DG Competition, these discussions took place shortly after its FRAND-related decisions in the Samsung and Motorola cases, which clarified that an SEP owner seeking an injunction for infringement of the SEPs could violate competition laws when that SEP holder has otherwise committed to license the SEP on FRAND terms and the (allegedly infringing) licensee has said it would be willing to enter a license on FRAND terms. While Commissioner Margrethe Vestager of DG Competition offered additional guidance going beyond its case law on the practical implications of FRAND—specifically that FRAND required the SEP holder to license SEPs to all willing licensees—other DGs refused to take a clear position.

Both SEP holders and licensees lobbied intensely for the positions most favorable to their businesses (perhaps most notably whether the royalty of an SEP may be based on the value of the end device or whether the smallest saleable patent practicing unit (SSPPU) was the proper royalty base). These lobbying efforts extended beyond the Commission to members of the European Parliament and of the European Council.

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EC Communication Summary. In its Communication, the EC focuses on four areas “where the SEP licensing environment could be improved.” Each is discussed below, followed by a discussion of the significant areas left untouched by the EC Communication.

Increasing Transparency and SEP Exposure. The EC Communication laments the “lack of transparency” in SEP licensing and argues that this makes licensing for start-ups and small- and medium-sized entities more difficult. Transparency issues cause problems when licensees have difficulty identifying the SEPs they need to license to practice a standard and then verifying that these SEPs’ “fair value” to facilitate licensing negotiations. These issues are especially pronounced when it is not clear whether the declared-SEP is truly essential to the standard. To this end, the EC Communication encourages SDOs to (1) “provide detailed [patent] information in their databases”; (2) develop “an information tool to assist in licensing negotiations”; (3) require more precise SEP-declarations with sufficient information “to assess patent exposure”; and (4) impose greater scrutiny on SEPs to ensure they are truly essential. Notably, each of these suggestions imposes upfront costs on SEP owners and thus departs from the policies and procedures currently followed by most (if not all) SDOs worldwide. But increased transparency should reduce hold-up and hold-out during negotiations because each side will have a more symmetric view of the value of the SEPs.

General Principles for FRAND Licensing. SEP owners promise to license SEPs on FRAND terms. But FRAND is famously (or infamously) undefined and is in the eye of the beholder. The EC Communication does little to change this. Instead, it establishes a “set of key signposts on the FRAND concept.” These “key signposts” are: (1) FRAND “creates legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licences on such terms”; (2) FRAND forbids SEP owners from “discriminating between implementers that are ‘similarly situated’”; (3) FRAND requires parties to engage in “good faith negotiations” for SEP licensing but recognizes that there is “no one-size-fits-all” solution and what “can be considered fair and reasonable differs from sector to sector and over time”; (4) a FRAND-compliant royalty must be related to the “economic value of the patented technology” and may not
include value resulting from the “success of the product which is unrelated to the patented technology”; (5) FRAND allows SEP owners to charge royalties sufficient to “ensure continued incentives for SEP holders” to continue to invent; (6) FRAND takes a “reasonable aggregate rate for the standard” into account; and (7) FRAND allows SEP owners to use portfolio-wide and global licenses. Taken together, these “signposts” offer little clarity on what an SEP owner is promising when it commits to FRAND terms. The EC Communication implicitly recognizes this by calling for “an expert group” to study FRAND licensing and continue to “deepen” expertise in the area.

**A Predictable Enforcement Environment for SEPs.** The EC Communication lays out a number of principles for the enforcement of SEPs, noting that “SEPs show a higher degree of litigation than other patents.” Again, attempting to strike a balance between the interests of SEP owners and licensees, the EC Communication affirms that the ability “to enforce is one of the key aspects of intellectual property rights,” but recognizes that the FRAND commitment can limit this right. Most notably, the EC Communication affirms that “SEP holders may not seek injunctions against users willing to enter into a license on FRAND terms,” but suggests that licensees should pay a “security” that is “at a level that discourages patent hold-out strategies.” Further, the EC Communication appears to embrace alternative dispute resolution, noting that a “willingness of the parties to submit to binding third-party FRAND determination” is itself an “indication of FRAND behaviour.” Finally, the EC Communication cautions Patent Assertion Entities that they are “subject to the same rules as any other SEP holder.”

**Guidance for Open Source Standards.** Finally, the Communication focuses on the importance of integrating open source projects and standard development processes within the Information and Communication Technology (ICT) sector. The EC believes this integration will speed up the standardization process and increase the use of standards in the field of ICT (especially for small and medium firms), leading to the wider dissemination and use of open source software implementations if standards can provide interoperability. The press release accompanying the Communication acknowledges that FRAND terms and royalty free licenses are not necessarily incompatible in open source contexts.

**Unresolved Issues.** The EC chose not to wade into a number of complex issues that have plagued competition enforcers, SEP owners, SEP licensees, and SDOs, likely leaving these issues to the interpretation of the courts, and ceding an opportunity to lead global SEP and competition policy. Some of the most prominent questions left unanswered are:

**At What Level in the Distribution Chain are SEP-Owners Required to License?** The EC Communication is unequivocal that SEP licenses “should be made available to any potential user of the standard.” But what does this mean in practice? Does this require an SEP owner to license to any willing licensee, no matter whether it manufactures components or end-products? Or, can an SEP owner license to end-product manufacturers only (leaving component manufacturers unlicensed)? Moreover, the EC Communication asserts that SEP owners can discriminate among potential licensees that are not “similarly situated,” without defining “similarly situated.” Thus, while the EC Communication hints that SEP owners must license to all willing licensees regardless of their position in the supply chain, the fact that the EC Communication did not explicitly affirm this means this debate is likely to continue.

And this is not a hypothetical debate. This is one of the key questions the U.S. FTC is litigating in its case against Qualcomm, having alleged that “Qualcomm refuses to license FRAND-encumbered cellular SEPs to competing suppliers of baseband processors” even though Qualcomm does license its SEPs to end-product manufacturers. Qualcomm, on the other hand, argues that this structure respects FRAND licensing, stating that it “grants exhaustive licenses to any willing licensee, no matter whether it manufactures components or end-products.” But what does this mean in practice? Does this require an SEP owner to license to any willing licensee, no matter whether it manufactures components or end-products? Or, can an SEP owner license to end-product manufacturers only (leaving component manufacturers unlicensed)?

**How to Calculate a FRAND Royalty?** While the EC Communication gave “signposts” for determining FRAND-compliant royalties, the EC Communication stopped short of mapping how to calculate FRAND-compliant royalties. The most precise guidance offered in the EC Communication is the observation that a FRAND-compliant royalty must be related to the patent itself and may not include value resulting from the “success of the product which is unrelated to the patented technology” and that parties should take a “reasonable aggregate rate for the standard” into account.

That a FRAND-compliant royalty cannot incorporate value from the “success of the product which is unrelated to the patented technology” alludes to the idea that a FRAND-compliant royalty should capture only the *ex ante* value of the patents (i.e., the value of the patents before they were incorporated into a standard). But it is unclear whether the EC is really advocating for an *ex ante* valuation of SEPs. More specifically, the idea of a “reasonable aggregate rate” may conflict with the *ex ante* value idea because the *ex ante* approach would likely require a “bottom-up” approach to value the individual patent on a standalone basis, whereas the “aggregate rate” approach implies a need first to establish a reasonable FRAND-rate for all SEPs based on the products incorporating the standard and then determining the proper proportion of the aggregate rate to assign to each relevant SEP (a “top-down” approach). This tension has also reared its head in U.S. courts, which have not taken a consistent approach to calculating FRAND rates.

In a related but separate question, the EC Communication did not discuss whether FRAND imposes limits on what can be used as the royalty base to which the rate is applied. Under U.S. patent law, courts setting a “reasonable” royalty
typically use the SSPPU, but some SEP owners may calculate the royalty based on the sale price of the (often far more expensive) consumer product, not the component that practices the patent. This question is becoming increasingly more relevant as cars, appliances, and other high-priced consumer products begin to use standards to connect to the IoT. The closest the EC Communication comes to resolving this issue is asserting that a FRAND royalty should not include value resulting from the “success of the product which is unrelated to the patented technology,” which can be very difficult to parse.

The Extent to Which Competition Laws Should Govern SEP Licensing Practices. Finally, the biggest open question from the EC Communication is whether, and to what extent, competition laws should be used to enforce FRAND or SEP licensing more generally. Indeed, the EC Communication barely mentions competition law. The EC Communication mentions “hold-up” and “hold-out” exactly one time each, but does not discuss how each implicates competition laws. The EC Communication also does not refer to the market power that can flow from an SEP portfolio. The EC Communication does not take any position on how competition law weighs on SEPs, leaving significant questions unanswered, including: (1) Can a refusal to license a SEP constitute an antitrust violation? (2) Does unilateral patent hold-up or hold-out create antitrust liability? (3) Is the EC concerned with potential cartel-like behavior within SDOs? (4) Can SEP owners tie licenses for SEPs with other commitments, such as product purchase agreements or licenses with non-SEPs? The EC chose not to address any of these issues, perhaps waiting for further guidance from courts adjudicating specific practices. The EC Communication’s only stance on the application of competition laws to SEPs is its apparent endorsement of Huawei v. ZTE, which applied EU competition law (Article 102 TFEU) to forbid an SEP owner from seeking an injunction against a willing licensee of an SEP.

Interestingly, the EC Communication also does not mention a role for contract law to enforce FRAND commitments, even though reliance on private contract law is the preferred route for enforcing FRAND by those skeptical of applying competition laws to SEP licensing. The EC Communication’s silence on these issues was likely intended to preserve maximum flexibility for itself (and the courts of EU member states) for future issues regarding SEP licensing.

Contrasting the EC Communication with the DOJ Speech. Only a few weeks prior to the release of the EC Communication, Makan Delrahim, Assistant Attorney General for the Antitrust Division of the Department of Justice, gave a speech setting out a new policy for the DOJ with regard to SEPs. In contrast to the balance sought by the EC Communication between the rights of SEP owners and licensees, Delrahim argued that the rights of SEP owners should be emphasized over SEP licensees. The DOJ speech asserted that “competition policy has focused too heavily” on the danger of patent “hold-up” by SEP-owners, and that hold-up is based on a “shady empirical foundation.” On the other side of the ledger, the DOJ speech argued that “[t]he [h]old-[a]ut [p]roblem [p]oses a [m]ore [s]erious [t]hreat to [i]nnovation than the [h]old-[u]p [p]roblem.” The DOJ speech posited that “enforcers have strayed too far in the direction of accommodating the concerns of technology implementers” and risk undermining incentives for SEP owners, who the DOJ fears are not being sufficiently rewarded in proportion to their investment in the underlying technologies they own.

The DOJ speech also focused on risks from “cartel-like behavior” by SEP licensees, who may band together in violation of Section 1 of the Sherman Act to extract an agreement for an unreasonably low royalty. The DOJ speech’s concern with collective action within SDOs is in stark contrast to the EC Communication, which does not address the dangers of “cartel-like” behavior within SDOs, and encourages some forms of collective action within SDOs to make SEP licensing more transparent and efficient. Specifically, the EC Communication encourages stakeholders to pursue sectoral discussions with a view of establishing common licensing practices.” The EC Communication also encourages the “creation of industry licensing platforms and patent pools.” While the EC would clearly not condone a cartel maintained within an SDO, its encouragement of coordination among stakeholders contrasts with Delrahim’s concern that coordination could lead to “cartel-like behavior” and that coordination among horizontal competitors in the standard-setting context merits “careful[] scrutiny[].”

The EC Communication and DOJ speech also part company with regard to injunctive relief for SEPs. As discussed above, the EC Communication finds that SEP owners cannot seek to enjoin a willing licensee from practicing an SEP. In 2015 the DOJ recognized that a ban on injunctions for SEPs by an SDO was “consistent with the direction of U.S. law.” In contrast, the DOJ speech argues that “[a] patent holder cannot violate the antitrust laws by properly exercising the rights patents confer, such as seeking an injunction or refusing to license such a patent.” While U.S. courts have not established a “per se rule that injunctions are unavailable for SEPs,” prior to the DOJ speech U.S. courts typically found that “money damages are adequate to fully compensate” an SEP owner. Thus, the DOJ speech’s position that injunctions for SEPs do not violate competition laws can fairly be read as a break from prior U.S. policy; and the position laid out in the EC Communication.

Finally, whereas the EC Communication seeks to create “[a] predictable enforcement environment for SEPs,” the DOJ speech has likely accomplished the opposite. For example, in 2015 the DOJ released a Business Review Letter endorsing a number of policy changes by the Institute of Electrical and Electronics Engineers (IEEE), including prohibiting injunctions for SEPs and encouraging royalty rates based on the SSPPU. Recent reports indicate that the DOJ may now be investigating conduct within the IEEE, stating...
that “some interpretations of that letter that we have learned 
seem to be totally inconsistent with modern antitrust law.”
Whether the DOJ’s Business Review Letter to the IEEE still 
reflects DOJ policy is unclear, thus creating additional uncer-
tainty in the United States.

In many ways, the EC Communication and the DOJ 
speech advocate competing views of SEP competition poli-
cy, with the EC Communication balancing SEP policy 
between licensors and licensees, while the DOJ speech argues 
that policies regarding SEPs need to be corrected in favor of 
SEP owners. Nonetheless, both the EC Communication and 
the DOJ speech should be viewed as starting places for SEP 
competition guidance and not a culmination of these debates. 
The EC Communication sets out only general principles 
and offers broad guidance, leaving significant space for 
SDOs, SDO members, and European courts to fill in the 
spaces. Similarly, the ultimate effect of the DOJ speech—
especially to the extent that it breaks with DOJ policy dur-
ing the Obama administration—may be that U.S. courts 
must devise a consistent SEP policy since the DOJ has not 
embraced a consistent policy across political administrations.

**Practical Guidance for Stakeholders**

Because the primary goal of the EC Communication was to 
strike a balance among stakeholders in standard setting, it 
cannot be viewed as a safe harbor for any single stakeholder. 
Nonetheless, some guidance can be teased out of the EC 
Communication for SDOs, SEP owners, and SEP licensees.

**SDOs.** SDOs should take a more active role in encouraging 
efficiency and transparency in the standard-setting 
process. This includes increasing disclosure requirements for 
putative SEP owners, easing the burdens of potential licensees 
to research SEPs, and exploring ways to encourage patent 
pools or other mechanisms to make it easier for licensees to 
practice a standard. That said, in light of the DOJ speech, 
before making any reforms discussed in the EC Communica-
tion, SDOs should act cautiously and seek antitrust counsel 
to ensure they insulate themselves from accusations of 
facilitating cartel-like behavior within their walls. SDOs 
should make sure that both licensees and SEP owners are sup-
portive of policy initiatives to avoid scrutiny from the DOJ, 
even if the change is in line with the EC Communication’s 
suggestions.

**SEP Owners.** SEP owners should work with SDOs to 
increase transparency of SEPs without imposing significant 
costs on participation in the standard-setting process. SEP 
owners should also enact licensing policies consistent with 
the FRAND commitment, such that the SEP owner cannot 
be accused of abusing market power flowing from SEPs. 
While nothing prevents an SEP owner from seeking signifi-
cant royalty payments from licensees, the SEP owner should 
be ready to justify its position based on the share of its SEPs’ 
contribution to a reasonable aggregate royalty or based on a 
valuation of the patent prior to the enactment of the stan-
dard. SEP owners may even consider publicly announcing 
FRAND rates for SEP portfolios like Ericsson did with 
regard to its 5G SEP portfolio. Finally, SEP owners should 
consider asking licensees to submit to binding arbitration 
should the licensing negotiation break down, or at least be 
prepared to accept binding arbitration as a last resort at the 
request of the licensee.

**SEP Licensees.** SEP licensees should work with SDOs to 
ensure that they have sufficient information with regard to 
SEPs to facilitate fair negotiations with SEP owners. But in 
light of the DOJ speech, SEP licensees should be cautious in 
their communications with fellow SDO members to ensure 
no communications raise the specter of cartel-like behavior. 
SEP licensees should be especially wary of discussing specifics 
regarding what constitutes a “reasonable” royalty with other 
licensees.

An SEP licensee should also establish a policy regarding its 
licensing practices that ensure it is in a position to offer a 
“concrete” counter-offer that protects it from being labeled 
an “unwilling” licensee and/or in engaging in patent hold-
out. An SEP licensee also needs to consider the terms on 
which it would accept binding arbitration in the event of a 
failed negotiation. Further, should SEP policies in Europe 
and the United States diverge, SEP licensees may consider 
seeking separate SEP licenses for each jurisdiction such that 
they can take advantage of EC policies that are more friend-
ly to licensees without attracting scrutiny from the DOJ, 
which is shifting its focus to patent hold-out.

**Conclusion**

Ultimately, the EC Communication is not likely to change 
how competition laws govern SEPs as the EC’s attempt to a 
strike a balance among standard-setting stakeholders result-
ed in a plain-vanilla recitation of uncontroversial principles. 
The national courts of the Member States in the EU and fed-
eral courts in the United States will likely remain the main 
actors in bringing more clarity to the FRAND concept, as 
illustrated by the recent judgments of Justice Birss in the 
Unwired Planet v. Huawei case, which handed down the first 
UK court decision determining the value of a FRAND roy-
alty rate and whether the licensee (Huawei) should be subject 
to an injunction in the UK. The EC Communication’s 
biggest legacy may be whether its attempt to find common 
ground can become a starting place for a consistent policy of 
how competition law governs SEPs globally or whether it is 
overshadowed by competition authorities willing to take 
more concrete steps like the positions outlined in the DOJ 
speech.
The communication emphasizes a need for “balance” between SEP owners and SEPs licensees no fewer than six times. See, e.g., EC Communication, supra note 1, at 2 (“There is therefore a need for a clear, balanced and reasonable policy for Standard Essential Patents in the EU.”); id. at 9 (“A balanced and predictable enforcement environment has particularly positive effects . . . .”); id. at 13 (“A balanced IPR framework is needed that supports a sustainable and efficient standardization ecosystem and SEP licensing environment.”).

12 Under EU law, a Communication is an administrative document with no legally binding effect and merely summarizes current Commission views on a topical issue, here SEPs.


19 Press Release, supra note 2.

20 The doctrine of patent exhaustion states that “when a patentee sells one of its products . . . the patentee can no longer control that item through the patent laws.” Impression Prods., Inc. v. Lexmark Int’l, Inc., 137 S. Ct. 1523, 1529 (2017). Thus, “The purchaser and all subsequent owners are free to use or resell the product just like any other time of personal property, without fear of an infringement suit.” Id.

21 See EC Communication, supra note 1, at 7.

22 Complaint at 59, FTC v. Qualcomm, Inc., No. 5:17-cv-00220 (Jan. 17, 2017), ECF No. 1. Authors Ian Simmons and Benjamin Hendrickx submitted an amicus brief on behalf of Qualcomm Electronics Co. in FTC v. Qualcomm, Inc.

23 Motion to Dismiss at 5, FTC v. Qualcomm, Inc., No. 5:17-cv-00220 (Apr. 3, 2017), ECF No. 69.

24 Order Denying Motion to Dismiss, FTC v. Qualcomm, Inc., No. 5:17-cv-00220 (June 26, 2017), ECF No. 133.


27 EC Communication, supra note 1, at 6–7.

28 The only reference to competition laws in the EC Communication is a note that the communication “does not bind the Commission” with regard to competition laws and a caveat that transparency initiatives and patent pools containing SEPs must be made in accordance with EC competition laws. See supra note 1, at 3, 7.


31 DOJ Speech, supra note 10, at 1.

32 Id. at 3 (emphasis added).

33 Mr. Delrahim stated that “enforcers should carefully examine and recognize the risk that SSO participants might engage in a form of buyer’s cartel, what economists call a monopsony effect. When implementers act together within a standard-setting organization as the gatekeeper to sales or products including a new technology, they have both the motive and means to impose anticompetitive licensing terms. At the extreme, they can shut down a potential new technology in favor of the status quo, all to the detriment of consumers.”

34 It is unclear whether licensee-side collusion could effectively coerce a SEP owner, which could use the threat of patent infringement cases to combat hold-out tactics. Indeed, both in the U.S. and the EU there is no documented instance of collective hold-out by putative licensees. See Melamed & Shapiro, supra note 10.

35 DOJ speech, supra note 10, at 10, 13.


37 DOJ speech, supra note 10, at 8.

