

Is SEP licensing up to standard?

The landscape around SEP licensing has changed considerably in recent years thanks in large part to key court decisions. As courts and regulators around the world continue to frame the debate around SEPs, there is much for patent owners to consider

By Richard Lloyd

In many ways standard-essential patents (SEPs) represent the gold standard in intellectual property in various different sectors. However, how they should be licensed under fair, reasonable and non-discriminatory (FRAND) terms is the subject of much debate between licensors and licensees, and in recent years has been the subject of several key court decisions in the United States, Europe and Asia.

To assess how the SEP landscape has changed in recent years *IAM* has brought together experts from leading firms in the United States and Europe – Pete Damerell and Zoë Butler from Powell Gilbert, Volkmar Henke of Eisenführ Speiser and Mintz Levin’s James Wodarski and Michael Renaud. Together they offer an invaluable insight into recent changes and spell out what licensors and licensees need to know.



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James Wodarski is a partner in the IP section and leader in Mintz Levin’s patent monetisation and litigation practice. He is a patent strategist who helps clients to generate revenue from their patent holdings through traditional litigation and licensing approaches, as well as by creating markets for and brokering sale or acquisition of portfolios, including portfolios containing SEPs. Mr Wodarski has a successful track record litigating cases at the ITC, the Court of Appeals for the Federal Circuit and federal district courts.

Q: We have seen a number of key SEP licensing decisions – particularly in the mobile sector – in recent years in both Europe and the United States. Overall do you think that those have provided licensors and licensees with greater clarity?

James Wodarski (JW): Yes and no. What *TCL* and *Unwired Planet* made clear is that licensors ideally should support their proffered FRAND rates with multiple methodologies. In *TCL* Ericsson elected not to offer its own top-down analysis – apportioning the royalty stack for the standards in question among the SEP owners – and to rely instead on some of the licences it struck as part of its highly successful, ongoing licensing programme. This was certainly a defensible position at the time, given that SEP owners had for years and without court involvement relied solely on that methodology when negotiating FRAND licences. However, the *TCL* court penalised Ericsson for declining to offer a FRAND calculation based on the top-down approach, in addition to its comparable licences, insofar as the court’s apportionment was based on the number of SEPs that *TCL* identified. With regard to the issue of the number of SEPs, Judge Birss in *Unwired Planet* explicitly split the difference between the two parties’ positions, further underscoring how advisable it is for SEP owners to engage in the analysis.

Michael Renaud (MR): Birss’s decision essentially to average the parties’ respective proffered numbers of SEPs

illustrates how the rulings have enshrined imprecision into the FRAND analysis. Both he and Judge Selna, at various points in their respective rulings, acknowledge the imprecision in their analysis, even as they ultimately arrive at an artificially precise FRAND rate.

Volkmar Henke (VH): To a large degree, yes – the courts at the two main venues for patent litigation in Germany (Dusseldorf and Mannheim) are converging on key issues of SEP licensing and litigation.

From the substantive perspective, it appears to be accepted meanwhile that the owner of several radio mobile communications patents may demand that a global licensing agreement be concluded for its entire portfolio. From the procedural perspective, the obligations (in respect of negotiations) incumbent on the parties and laid down as standard in *Huawei v ZTE* do not necessarily have to be fulfilled before any action is brought or even during the infringement proceedings. Further, the two courts of instance both focused sharply, and in equal measure, on the run-up to court proceedings and on how the first offer on FRAND terms by the patent owner must be supported by transparent statements and explanations.

None of that was quite as clear a year ago; from the German perspective one can say that a measure of clarity has been accomplished in this regard. However, no ruling has been handed down as yet by the Federal Court of Justice, in which judgments by the lower courts are reviewed.

Pete Damerell (PD): The increasing number of court decisions has undoubtedly provided greater clarity on certain issues relating to SEP licensing but a degree of divergence remains between jurisdictions on some key points, such as the ambit of the non-discrimination element of FRAND. Also, although there is a growing body of case law in the United States (and, at least insofar as *Huawei v ZTE* is concerned, in Germany), in other countries the law remains in its infancy and cases are often subject to appeal. As such, some of the available clarity is somewhat provisional.

That said, there is now quite a lot of guidance for both licensors and licensees as to the approach the European courts consider should be taken in licensing negotiations (what Mr Justice Birss termed the “FRAND approach” in *Unwired Planet*). Also in *Unwired Planet* we have seen the first indication that the European courts may align with the US view of the ETSI FRAND undertaking (as enforceable by an implementer as a matter of contract

law) – although of course the French courts have yet to consider the point. Finally, parties now have a degree of insight into the types of rate-setting exercises that might be conducted based on thorough, reasoned decisions from courts in the United States, China, Japan and the United Kingdom.

Q: In *TCL v Ericsson* and *Unwired Planet v Huawei* we saw both judges use a top-down methodology to help determine the royalty rate. To what extent is that now the accepted means of calculating a rate?

VH: Even though many judgments have already been handed down in Germany, in which the principles of *Huawei v ZTE* are applied, the substantive question of whether a particular offer is FRAND or not has played a relatively minor role in Germany. Most cases so far could have been decided merely by looking at the parties' negotiating behaviour.

It can nevertheless be said that the German view differs from the top-down approaches referred to in this question. The courts in Germany prefer to apply the concept of 'comparable licences', if possible: if the terms offered are similar to those of licences already negotiated, then this is generally considered to be a reliable indicator for the reasonableness of an offer. In addition, to evaluate compliance with the non-discriminatory criterion, it is necessary (from the German perspective) to look at licensing agreements that have already been concluded.

However, that does not mean that German courts will dispense entirely with a top-down approach. Such approaches can provide a valid cross-check; one day there will also be cases involving new technologies where the concept of comparable licences will not be available. A top-down analysis would then be the means of choice.

PD: I would say that a top-down approach is an accepted (rather than the accepted) means of determining a royalty rate. While it is true that a top-down methodology was used in both *TCL* and *Unwired Planet* (and even more recently by the Shenzhen court in *Huawei v Samsung*), the analysis was used in different ways. In particular, the UK court did not employ a pure top-down methodology. Instead, as the *Unwired Planet* portfolio was obtained from Ericsson, the top-down data was primarily used to convert unpacked Ericsson licence rates into *Unwired Planet* ones, and also as a cross-check to ensure that the total royalty stack inferred from those rates was not too high. As such, I would characterise *Unwired Planet* as a case in which comparable licences were the key factor in determining a FRAND rate.

Of course, comparable licences were also used by the US court in *TCL* as a cross-check and when non-discrimination was considered. In my view, where they are available, it is highly likely that comparable licences will form an important part of the analysis conducted, particularly where non-discrimination issues are raised.

MR: The top-down approach is gaining momentum. We see implementers more frequently ask SEP owners to justify their FRAND offers using that methodology and, on rare occasions, even grapple with it on their own. That said, there is still no single accepted means of calculating a FRAND rate.

JW: A condition precedent to using the top-down approach is a reliable measure of the aggregate royalty stack for a standard or some other evidence of the value of the technology contributed to the standard (as opposed to value the technology gained from inclusion in the standard). For certain standards, there is no such reliable measure or at least reasonable parties may reach that conclusion and decline to employ the top-down approach as a result.

Q: In *Unwired Planet*, Mr Justice Birss introduced the concept of a FRAND injunction. Do you see other courts around the world adopting something similar?

PD: As a concept the FRAND injunction was designed to address the potential long-term consequences of the fact that the FRAND licence settled by the UK court would expire before the SEPs in respect of which the injunction had been granted. Mr Justice Birss considered it foreseeable that the award of a normal, permanent injunction in such circumstances could distort any licence renegotiation process in favour of the SEP owner: in effect, the grant of an injunction could enable that SEP owner to engage in hold-up at that time.

To me, these concerns appear legitimate, particularly in the context of what appears to be a growing consensus in Europe that *Huawei v ZTE* should be understood as requiring a period of negotiation unconstrained by the presence of legal proceedings (see *Unwired Planet* itself as well as *Sisvel v Haier* in Germany). However, I find it difficult to predict how the issue will be addressed by courts in other jurisdictions as and when similar situations arise – especially where the applicable procedural rules may not provide the court in question with the same sort of flexibility as that enjoyed by the courts in England.

VH: Certainly. The focus in the vast majority of German patent infringement disputes is still on injunctive relief. A claim to this has been asserted in almost all the court actions brought on the basis of an SEP in the wake of *Huawei v ZTE*. In general, the German courts also understand this case to be specifying the conditions under which the SEP owner can assert a claim to injunctive relief.

So there have already been several judgments in which the SEP owner was awarded its claim to injunctive relief – whether because it had not been proven in the specific case that the patent in suit granted market power for the specific accused product or because the infringer had failed to comply with the obligations imposed on it by the judgment (eg, because it had failed to express, within a reasonable period, its willingness to license). In still other cases, the dispute could be resolved by a settlement, after the judges' clear indication that an injunction is all they are prepared to consider.

MR: It is unlikely that the United States will follow suit. Mechanically, there is little precedent for an injunction that terminates without judicial action upon certain conditions being met. Statutorily, such a remedy could only come from the district courts, and not the US International Trade Commission (ITC). However, under the *eBay* standard, the extraordinary remedy of an injunction is rarely available in district courts for patent infringement writ large. Some courts, such as that in *Realtek*, have questioned whether injunctions are even available for SEPs.



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Q: Which other parts of recent SEP court decisions do you think might become accepted worldwide by courts and licensing practitioners?

JW: Several courts and administrative bodies across the world have, in recent years, invented a definition of ‘FRAND’ that differs greatly from what SEP owners agreed to when participating in standard setting. Judge Selna, for example, found that the FRAND rate was informed by the actual effective rates of Ericsson’s lump sum licences (ie, the actual unit sales that a licensee realised during the term of the licence) – what Ericsson and the licensee believed at the time they struck the licence was irrelevant. This approach imparts an element of competition law into the FRAND encumbrance that no one considered during standard setting. It also raises many questions that have no apparent answer, such as whether, in the name of maintaining an even playing field, an SEP owner would have to refund a licensee that paid a lump sum under one estimate of covered unit sales, then underperformed.

If SEP owners have no insight into what rights they are giving up in the course of participating in standard setting, they will stop participating, to the detriment of the standardisation process. For this reason I expect that judges will soon decline to offer their own definitions of ‘FRAND’. The model for this approach is the US ITC, which has – at least since Judge Essex’s initial determination in the 868 investigation – approached FRAND issues as matters of contract law. Germany’s *Huawei v ZTE* ruling sets out some mechanics of FRAND negotiations, which could be consistent with how SEP owners traditionally struck FRAND licences.

VH: It is likely that the concept of comparable licences will become more important at the international level.

The comparable licence concept raises a number of questions which lead to conceptual problems and which cannot always be answered with final certainty, especially when applied to individual cases. For example, there is a lack of clarity (and a need for further debate) about what is ‘comparable’ in the first place: does it include licences in related technologies? What about the historical perspective and past technologies? Further, the “unpacking” of licences, referred to by Birss, is also likely to cause disputes in many cases. How can a complex cross-licence agreement be compared with a relatively simple licence agreement?

Nevertheless, the concept of comparable licences refers to the notion of justice at its core – namely to how parties meet on the free market and on an equal footing and how these parties attach value to intellectual property. This nucleus of our free market economy should be transferred as far as possible into SEP licensing law. Dirigiste and patronising approaches should be treated with scepticism, particularly since these methods also tend to involve some dubious rules and stipulations.

PD: In due course, I think that a global consensus will emerge as to the meaning of the non-discrimination aspect of FRAND. At the moment there is divergence between jurisdictions with the UK court deciding in *Unwired Planet* at first instance that there is no standalone non-disclosure obligation arising from licences that have already been granted (and, even if

there is, a distortion of competition would be required before it took effect), while other courts have taken the opposite view (eg, the US court in *TCL v Ericsson*). This aspect of *Unwired Planet* is currently under appeal. Given the global nature of the FRAND obligation, I suspect that a uniformity of approach will eventually emerge. Time will tell whether that is the *Unwired Planet* approach or the *TCL* approach.

Q: What was your reaction to the recent European Commission Communication on the Licensing of SEPs? What impact might it have on Europe’s position as a forum for SEP disputes?

VH: We were delighted. On the one hand we note that the European Commission is listening to a wide range of opinions and is trying not to adopt a position prematurely, given the opposing interests that are involved. That is not something to be taken for granted. In our view, some earlier opinions issued by it indicated a certain bias, which leaned heavily towards antitrust law only.

Further, we believe that the commission’s view is based on some valuable insights, namely the lack of transparency (in the existing practice) and the need for an efficient licensing framework including the refusal of country-by-country-licensing and the acceptance of patent pools and other licensing platforms.

On the other hand, it is also clear from the communication that there is still a long way to go before the opposing interests are actually balanced. It will be up to all of us to inform the commission what the situation before the infringement courts really is. For instance, the idea that patent offices should be the natural candidates for a more thorough analysis of essentiality seems naïve and, at the very least, impracticable.

Zoë Butler (ZB): I thought that the communication was interesting, both in terms of what was squarely addressed (in particular the behavioural framework set out by the European Court of Justice in *Huawei v ZTE* and the need to consider proportionality in the granting of injunctive relief) and what was not (notably use-based licensing and where in the chain to license).

The availability of injunctive relief for SEP owners is a contentious issue and I agree with the commission that proportionality is an important factor that should be considered carefully on a case-by-case basis. Proportionality is always relevant in the UK courts – where an injunction is a discretionary remedy – but may become more of a factor in civil law jurisdictions on the basis of the commission’s guidance.

From a practical point of view, I agree with the commission that improving the quality and accessibility of information recorded on the databases of standard-setting organisations (SSOs) is desirable. I understand that the commission has been liaising with ETSI on this issue and I look forward to the results of their collaboration.

As to its impact, I do not believe that the communication will have a significant impact on how Europe is perceived as a venue for SEP licensing disputes, although it confirms that the European approach strives to balance the interests of both licensors and licensees.

MR: The EU communication has positive and negative elements. It provides some guidance on the mechanics of a FRAND negotiation, which is helpful and can be useful for resolving questions about whether a party is an unwilling licensee or licensor. On the other hand, it enshrines some aspects of Birss's *Unwired Planet* ruling, which could dissuade SEP owners from litigating there. Specifically, it accepts the proposition that the non-discrimination element of the FRAND encumbrance has some over-arching meaning not necessarily present in the terms of the contract giving rise to the encumbrance, the SSO governing documents. SEP owners will tend to enforce in the forums that offer the most leverage. Leverage depends in large part on predictability in outcome, which, in turn, is informed greatly by whether the parameters of the encumbrance are actually knowable without litigation. The EU communication injects policy considerations into what should be a contractual obligation and thereby introduces uncertainty into what the encumbrance actually means.

JW: It is also worth noting that Europe comprises several independent jurisdictions. It is unlikely that the EU writ large will be a significant forum for adjudicating FRAND disputes, at least until the Unified Patent Court gets off the ground, but it is certainly conceivable that Germany and possibly the United Kingdom will continue to be such forums.

Q: To what extent is the approach taken by the courts and regulators to SEP disputes in Europe more balanced than that in the United States or jurisdictions in Asia?

ZB: It is clear from *Huawei v ZTE* and from the recent commission communication that the express aim of the European approach is to weigh the interests of SEP owners, which are entitled to be rewarded for their innovation, against those of implementers (including, indirectly, consumers), which should be permitted access to essential technology.

I am not convinced that this stated aim necessarily translates into an approach which is more balanced than that adopted by other jurisdictions. As I discuss in response to the next question, my view is that the European approach outlined in *Huawei v ZTE* is consistent with a renewed global focus on the importance of balancing competing interests – perhaps addressing a perception that dealing with hold-up may have allowed the pendulum to swing too far in favour of implementers.

JW: In my view, rather than a balanced approach, SEP owners should look for predictability in outcome. An approach that simply splits the difference between what implementers and SEP owners propose is balanced in some sense but does not really provide a conducive environment for licensing.

Germany and the United Kingdom have taken steps towards predictability in outcome. Germany, in particular, has enunciated some formalistic requirements for FRAND negotiations that give the parties pre-litigation insight as to whether the courts will look at the situation as patent hold-up or hold-out.

MR: Still, the forum that provides the most predictability in outcomes for FRAND disputes is the US ITC. The administrative law judges there acknowledge that the FRAND encumbrance results from the contract between an SSO and an SEP owner. Questions about the metes and bounds of the encumbrance, therefore, should be resolved based on principles of contract law. Ultimately, those principles attempt to determine where the meeting of the minds occurred (ie, what the parties understood the encumbrance to mean when the agreement was struck). The practical effect of the ITC's approach is a focus on the contractual language and less emphasis, generally speaking, on issues of antitrust and competition law. In contrast, those issues are key to the FRAND approach of other forums, particularly in Asia, and impart a significant amount of unpredictability in outcome.

VH: It seems to us, on the whole, that entitlement to injunctive relief enjoys a higher status in European law (and specifically in German law) than in US or Asian law. That also holds true for the special constellation of SEPs, where the claim to injunctive relief must be limited by antitrust considerations (and rightly so).

The patent owner must be given a fair chance to exploit the opportunity provided by the patent – namely to reap the reward for its technological innovation. We often experience situations in which the patent owner fails in that endeavour unless there is a real chance of asserting a claim to injunctive relief. Otherwise it is too easy for implementers to rescue themselves by entering into proceedings which take years to resolve, without having to fear any disadvantages (other than legal expenses).

Most importantly, the entitlement to injunctive relief provides the chance (also out of court!) to bring the parties to the negotiating table. Without injunctive relief, the parties to an SEP dispute would not be dealing with each other on an equal footing in many cases. This equal footing seems to us to be more prevalent in Europe.

Q: In recent months the head of the Department of Justice's (DoJ) antitrust division has signalled a change in approach to the overlap of intellectual property and antitrust, with more focus now on possible harm by implementers rather than patent owners. How might his comments affect the environment for SEP licensing?

VH: We welcome these signals and hope that they will provide some tailwind for standardisation in this respect. The comments by the DoJ may help first, in a very general sense, to strengthen the belief that playing an active role in technological advancement is worthwhile. Scepticism seems to be taking hold too much in this regard, and the DoJ is appealing for companies (indirectly, at least) to resume and intensify their efforts in standardisation.

MR: Assistant Attorney General Delrahim's remarks were appropriate and welcome. That said, the benefit of his remarks will be their translation into action. That we have yet to see noteworthy action is unsurprising.



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The push for the patent reform we have experienced in the United States over the last 10+ years began years earlier with policy discussions, of a kind with Delrahim's remarks. The patent reform policy statements of years ago eventually translated into executive, judicial and legislative action over time. There is hope that Delrahim's policy statements will lead to a counter-reform but that will also take time and ongoing focus.

ZB: Viewed from the United Kingdom, these statements seem to indicate that the environment for SEP owners may become more favourable in the United States than was perhaps previously the case. However, I do not think that the United States is unique in this change of emphasis. Whereas historically hold-up was typically of greater concern than the conduct of implementers, and injunctive relief was difficult to obtain (even in jurisdictions perceived to be patentee-friendly, such as Germany), more recently a number of courts globally have shown a willingness to scrutinise the conduct of the potential licensee and/or to recognise the phenomenon of hold-out (eg, the Chinese courts in *Huawei v Samsung*).

It remains to be seen how the DoJ's comments translate into alterations in SEP licensing practices and judgments, but I see them as consistent with the direction of travel in other jurisdictions, rather than, an indication that the United States might be taking a different path.

Q: At the start of the year the first SEP injunction was handed down by a Chinese court in *Huawei v Samsung*. To what extent do you think Chinese courts will become significant venues for global SEP disputes?

JW: Whether justified or not, some commentary suggests that China has not yet demonstrated its viability as a forum for foreign firms to enforce against domestics, particularly with regard to SEPs. Still, China will inevitably be a significant venue for global SEP disputes, simply by virtue of its large unit sales and large manufacturing sectors. Further, considering the sophistication of China's IP sector and the country's level of investment in building its IP infrastructure, one would reasonably expect it to become a viable venue for enforcement in general.

On top of that, SEP owners are (justifiably) searching for the most efficient ways to license intransigent implementers. Chinese enforcement is, for most SEP owners, likely to be part of that strategy going forward, for two reasons. First, for many of the most intransigent implementers, the lion's share of their unit sales is in China, meaning that SEP owners almost have to sue there to get any leverage. Second, given the large manufacturing presence, the prospect of a Chinese injunction would offer significant leverage.

ZB: Given the importance of the Chinese market to global sales, the fact that it is the domicile and domestic market of key industry players and taking account of the Shenzhen Intermediate People's Court's experience in FRAND disputes – notably *Huawei v InterDigital* (where a FRAND rate for InterDigital's Chinese portfolio was set) and *Huawei v Samsung* (where the

court considered whether Huawei's licensing offers were consistent with its FRAND obligations) – I think that Chinese courts will become a significant FRAND venue.

VH: That is one of the most interesting and exciting questions in this field! We see growing trust in Chinese courts and can only welcome the idea of another venue establishing itself (alongside European and US courts).

Q: The last 12 months have seen some significant changes in the SEP landscape – how might the environment change further over the next year?

ZB: For me the next significant developments in SEP litigation and licensing are likely to be the determination of outstanding appeals and the broadening of the SEP environment as connectivity continues to expand out of the traditional telecoms field.

As to the first development, the UK Court of Appeal heard the *Unwired Planet* appeal at the end of May. Judgment on the issues of global licensing and non-discrimination (as well as the application of *Huawei v ZTE*) is expected in the second half of this year.

As to the second development, the increasing preponderance of connected devices – including cars – will result in a large number of new entrants to the SEP licensing marketplace. While SEP licensing practices in the telecommunications sector are generally well established, new types of licensee may not fit well within established industry norms and may lead to the development of different licensing practices and models.

VH: From the German perspective, the forthcoming judgment from the Federal Court of Justice will certainly be the main highlight of the next year. The first SEP case is pending there now and we expect a decision in early 2019.

The question is where to go from there? The ductus of the judgment and its depth of detail need to be known before any predictions can be made. It is quite possible that the Federal Court of Justice will bolster the requirement for transparency, as developed by the courts in Dusseldorf and Mannheim. However, it is equally likely that the court will focus on the *Huawei v ZTE* judgment again and on that basis define the obligations regarding negotiations before court action. It is also conceivable that the judgment will provide the parties with new (perhaps unexpected) ways to resolve their dispute – out of court, as far as possible.

MR: The appeal of *Unwired Planet* will issue within the next 12 months. If the ruling is affirmed in material part, the United Kingdom promises to become a destination for SEP enforcement. The prospect of a FRAND injunction precluding imports into or sales in a jurisdiction with a large addressable market unless the implementer takes a worldwide licence is considerable leverage. The leverage of UK SEP enforcement will significantly increase if the appellate opinion clarifies how the non-discriminatory element of the FRAND encumbrance is informed by the contract giving rise to the encumbrance. **iam**