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Intellectual Property
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Competition and Markets Authority

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Date

11 January 2022

Subject: Open consultation - Retained Horizontal Block Exemption Regulations

Ladies and Gentlemen,

In response to the Call for Inputs concerning the *Retained Horizontal Block Exemption Regulations – R&D and specialisation agreements*, Continental wishes to make the following submission concerning standardisation agreements and Standard Essential Patents (SEPs) as they relate to questions HGL7 and HGL8.

General impact assessment questions

IA1: Continental AG and its affiliates (Continental) develop pioneering technologies and services for the sustainable and connected mobility of people and their goods. Within the listed industries, Continental operates in the manufacturing industry (c).

IA2: Many of Continental's technologies and services implement standards and are affected by Chapter 7 of Horizontal Guidelines¹. In the past, this Chapter was mainly of interest to the telecommunications and entertainment industries. However, the development of the Internet

¹ Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ C 11/1 of 14.1.2011.

of Things (IoT) means that standardisation agreements are relevant for all manufacturing industries, be it automotive, agriculture, healthcare or consumer goods.

IA3: Continental is a large business and employs approximately 200.000 people.

IA4: The provisions on standardisation agreements of the Horizontal Guidelines concern and affect business of all sizes. Large corporations as well as small and medium-sized enterprises (SME) use standardized technologies. In future, it is expected that SEPs will be enforced against a range of businesses of all sizes which have limited experience of SEP-licensing and patent litigation (or patent litigation in this field).²

Summary

The existing Horizontal Guidelines have largely been successful in enabling both business and consumers to benefit from hundreds of useful standards, in the UK and around the world. We thus urge the CMA to maintain the substance of these regulations. However, they have done little to help address the restrictive effects on competition that abusive licensing practices and patent litigation in relation to standards can bring about.

There have been certain standards which are consistently the subject of patent litigation, especially ETSI standards for telecommunication³. The Horizontal Guidelines have had little impact on such disputes, as they are either ambiguous or provide little guidance on the questions that are important in practice. Therefore, we make the following suggestions for clarification and amendment, as detailed below, to help ensure that all standards can be easily used without fear of litigation. We believe the proposed clarifications will maintain the

² Henkel, How to License SEPs to Promote Innovation and Entrepreneurship in the IoT, Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3808987.

³ See e.g. https://www.iplytics.com/wp-content/uploads/2017/04/Pohlmann_IPlytics_2017_EU-report_landscaping-SEPs.pdf, Figure 17.

substance while eliminating sources of discord and even litigation, thus allowing business and consumers to benefit even more in the future.

Discussion

In response to question HGL7 (a), it is generally easy to apply the provisions of the Horizontal Guidelines on standardisation agreements in practice. However, there are some areas that provide little guidance to questions that are highly relevant in practice.

In response to question HGL7 (b), the provisions in the Horizontal Guidelines that describe the role of FRAND (fair, reasonable, and non-discriminatory) terms, and the example given of how FRAND terms could impact the analysis of a standard essential patent license, generally provide little helpful guidance that would support good-faith negotiations and avoid litigation.

For example, the statements on excessive fees (point 289 of the Horizontal Guidelines) have had very little practical effect in negotiations or litigation. In particular, IPR policies that follow the principle of the Horizontal Guidelines, of providing very little guidance on what FRAND-commitments entail and how parties with different economic objectives should arrive at FRAND terms (see no. 267 of the Horizontal Guidelines), have led to a large number of licensing disputes that ended up in expensive litigation, not only in the English courts but multi-jurisdictionally (in particular, in Germany, the United States and China, but also in a range of other jurisdictions including France, the Netherlands and India).⁴ Worse still, that cross-border litigation has typically settled shortly before trial or judgment, meaning that innovators incur significant financial and management distraction without guidance for future disputes being laid down by the courts. We therefore believe further clarifications ought to be introduced to achieve some greater clarity to the key principles which already exist in the Horizontal Guidelines.

⁴ See e.g. https://www.iplytics.com/wp-content/uploads/2017/04/Pohlmann_IPlytics_2017_EU-report_landscaping-SEPs.pdf, Figure 17.

We encourage the UK CMA to consider whether improved Horizontal Guidelines in the UK could provide clearer guidance on the meaning of a FRAND-commitment. We believe that such provisions should provide clearer guidance on how parties are to arrive at FRAND-terms and what principles such FRAND-terms should adhere to. One major point is that licenses should be available at all levels of the supply chain, which we address further below. We also believe that such provisions should provide clear statements on the available remedies and should adhere to the principle of “no injunction without prior proper rate setting”, which we outline below. Such further clarifications would also take into account recent developments in case law and policy that have followed since the adoption of the Horizontal Guidelines.

In response to question HGL7 (c), we submit that Chapter 7 of the Horizontal Guidelines should be clarified in particular on the following two points:

- the level of licensing in the supply chain; and
- no injunction without prior proper rate setting (hold-up problem).

In response to question HGL8, we submit that, to the extent our answers to question HGL7 indicate clarifications to the Horizontal Guidelines, the impact these would have would be minimal, apart from reducing wasteful costs from unnecessary disputes, allowing management to focus on innovation.

Level of licensing

The first clarification concerns the level of licensing, where it is important for implementers of innovative products to be sure that they can get licenses for the standards they use on FRAND terms and conditions. This can easily be accomplished by guaranteeing the right to a license for all who seek a license. Indeed, the EU Horizontal Guidelines⁵ clearly state [emphasis added]:

⁵ Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements, OJ C 11/1 of 14.1.2011 (Horizontal Guidelines), Para. 285.

285. In order to ensure effective access to the standard, the IPR policy would need to require participants wishing to have their IPR included in the standard to provide an irrevocable commitment in writing to offer to license their essential IPR to **all third parties** on fair, reasonable and non-discriminatory terms ('FRAND commitment')...

Unfortunately, the interpretation of "all third parties" has recently been twisted away from its plain-language meaning. By way of example, ETSI policy has been recently interpreted^{6,7} to mean "Access without a License", which in turn is interpreted to mean that SEP owners will only license end products, and innovative companies deep in a supply chain get no license, but may supply (only) to licensed customers. This restriction brings business and legal uncertainty for a company which builds a product on a standard, since it establishes a dependency on the license held by another party, namely the customer. For truly innovative products, the markets may not yet exist, and the customers typically will not have a license. This is a particular problem for SME producers of end products who are barred from sourcing licensed components, but also for SME companies in the supply chain.

A true "FRAND License Offer to All" guarantee makes market planning possible: an innovative product can be developed without knowing which specific customers – with a license – will purchase. It suffices to analyse market demand, and what the costs of development and production (including licenses) will be. This is particularly relevant to start-up companies, who do not yet have a product nor customers, but who must invest based on estimates for both.

Access without a License, on the other hand, makes planning almost impossible. The first step in securing a market must be to find a licensed customer! Innovative products which

⁶ Layne-Farrar, Anne and Stark, Richard, License to All or Access to All? A Law and Economics Assessment of Standard Development Organizations' Licensing Rules (September 10, 2020). *George Washington Law Review*, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=3612954> or <http://dx.doi.org/10.2139/ssrn.3612954>.

⁷ Borghetti, Jean-Sébastien and Nikolic, Igor and Petit, Nicolas, FRAND Licensing Levels under EU Law (February 5, 2020). *European Competition Journal* (2021), Available at SSRN: <https://ssrn.com/abstract=3532469> or <http://dx.doi.org/10.2139/ssrn.3532469>.

build on and extend existing standards will need to use SEPs. Developing an innovative new product is always a risk, and not knowing whether licenses will be available and to whom, or not knowing at what price, only adds to that risk. There would always be the threat that an originally successful business would subsequently turn into a destructive loss-making business. The net effect is to stifle innovation, particularly for SMEs who are unable to bear the risk of multi-jurisdictional patent litigation.

Most of the companies in the field of IoT are pure implementers who have little experience with standards, and even less experience with SEPs and the specific technology covered by such patents. These companies are very much capable of developing innovative applications using the standards and building on them. Their technological expertise is in the field of such applications, not of the standards, which are just a necessary background.⁸ Therefore, these companies should not have to invest their resources in SEP disputes or in developing a deep understanding of standardized technology. For these companies it would be beneficial to acquire a legally complete component with standard compatibility and all needed licenses from their suppliers, in order to be able to exploit the full potential of a limited development budget.

If we look at the entire IoT market, we are talking about tens of thousands of companies (from small to large), all of which are potential implementers. For purely practical reasons, and also for reasons of fairness, chipset level licensing would be by far the best solution to avoid conflicts that end in litigation.

We anticipate that the entire application field could be licensed with 10 to 15 license agreements on chipset level (per SEP owner or pool). This would guarantee that every end-product would be SEP licensed, allowing SEP owners to achieve the maximum number of licensed products, which would in turn ensure an appropriate total licensing revenue and a fair return on investment – while protecting SMEs in particular from hold up and abusive license terms, allowing them to innovate without undue risk. With a clear market position,

⁸ Henkel, How to License SEPs to Promote Innovation and Entrepreneurship in the IoT, Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3808987.

every manufacturer of such products would also bear its fair share of the overall license fees, meaning there would no longer be any market distortion or “free riders”. Market-distorting effects in the downstream supply chain could thus be effectively prevented, enabling innovation to prevail.

Injunctive relief

The second clarification is that there should be no injunction before a proper rate-setting process has taken place, where a company (or its supplier) has stated its willingness to take a license but does not agree on the royalties demanded by the SEP owner.

A proper process is one where both sides have the chance to present arguments on validity, infringement and value, and both sides transparently explain their rate-setting methodology and calculations. The rate setting must be based on the *ex-ante* technical value of a patent, and neither on some hold-up value because the patent is essential to a standard nor the market success of a multi-component end-user product.⁹ In arriving at FRAND terms, it is important to identify the appropriate common base that is “best suited for accurately valuing the invention [and] [t]his may often be the smallest priceable component containing the invention” or otherwise infringing the relevant patent.¹⁰ A proper rate setting should also occur in the appropriate venue. An implementer should not be forced to accept a global license set by a national court if there is a closer connection of the dispute to other jurisdictions.

It is impossible to negotiate a fair and reasonable deal under the threat of an injunction, and this is just as true if the customer is threatened by an injunction while the supplier is trying to negotiate a license. Equally, an implementer should not be obliged to commit to a global license set by the English court without a fair opportunity to test the validity of the global

⁹ See e.g. “Core Principles And Approaches For Licensing Of Standard Essential Patents”, Section 3.4, <https://2020.standict.eu/sites/default/files/CWA95000.pdf>.

¹⁰ *Id.*



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SEPs being asserted first, particularly if those patents are held by multiple owners (a patent pool) and are being asserted collectively.

Conclusion

Continental thanks you for the opportunity to present these views. We believe the substance of the Horizontal Guidelines should be maintained, but that certain clarifications concerning SEPs and SEP licensing would benefit business and consumers.

Kind regards,

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