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Erlangen, 11 January 2022

Sent by email hbersreview@cma.gov.uk

Fraunhofer IIS Contribution to the CMA Consultation on the Retained Horizontal Block Exemption Regulations – R&D and specialisation agreements

Fraunhofer expresses its thanks for the opportunity to engage with the Competition and Markets Authority (CMA) of the United Kingdom on its future recommendation to the Secretary of State regarding the retention, post-Brexit, of the European Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements ("Horizontal Guidelines") and the two EU Horizontal Block Exemption Regulations (HBERs) on R&D agreements ("R&D HBER") and specialization agreements ("Specialisation HBER").

1. About Fraunhofer

Fraunhofer-Gesellschaft, headquartered in Germany, is the world's leading applied research organization. With its focus on developing key technologies that are vital for the future and enabling the commercial exploitation of this work by business and industry, Fraunhofer plays a central role in the innovation process. Founded in 1949, the Fraunhofer-Gesellschaft currently operates 75 institutes and research institutions in Germany. Fraunhofer UK Research and the Fraunhofer Centre for Applied Photonics were established in 2012.[1] The majority of the organization's 29,000 employees are qualified scientists and engineers, who work with an annual research budget of 2.8 billion euros. Of this sum, 2.4 billion euros are generated through contract research.[2]

As a developer and owner of all types of intellectual property, Fraunhofer actively participates in many forms of international technical cooperation to deliver global technology solutions with industry, to ultimately serve societal benefit and advancement. It is active in the fields of communications, health, security, environment, mobility and transport, energy, and production and services.

Fraunhofer is also an active contributor to several standard development organisations (SDOs) in the ICT sector. Fraunhofer IIS participates in a number of SDOs, such as ETSI, ITU-T, ISO, MPEG, and DVB to help deliver world-class technical standards. Fraunhofer is the owner of

1 https://www.fraunhofer.co.uk/
2 https://www.fraunhofer.de/en.html

the largest portfolio of standard essential patents in Germany and has launched many licensing programs to enable implementation of global technology solutions.[3]

2. Introductory remarks

Fraunhofer respectfully invites the CMA to retain the Horizontal Guidelines, HBERs and Specialisation HBER without significant divergence from the current framework absent compelling evidence that the characteristics and needs of the UK post-Brexit are distinctly different compared to the respective characteristics and needs of the pre-Brexit UK.

Overall, it is considered this framework has fostered and preserved competitive markets at the UK and EU levels, allowed for legal certainty on compliance with competition law, and has enabled consistency and efficiency in business practices.

Unless clear benefits from divergence can be safely assumed, it is considered that maintaining a close connection between the respective competition framework in the UK and the EU would more likely benefit UK consumers, businesses, innovation and economy overall.

3. Standardisation agreements

The following considerations on standardisation agreements and the R&D HBER are highlighted as relevant to the CMA review of the retained Horizontal Guidelines and HBERs:

1. As a preliminary remark, it is noted that international standards development is governed by a detailed regulatory framework at the international level. Specifically, Annex 3 of the WTO Agreement on Technical Barriers to Trade (TBT),[4] and the 'Six Principles for International Standardization'[5] issued by the WTO TBT Committee in 2000, provide the overarching framework for the development of international standards by SDOs.

2. Under the WTO framework, SDOs are required to adhere to the principles of transparency, openness, impartiality and consensus, effectiveness and relevance, coherence, and a development dimension. Fraunhofer's experience as both a participant in and contributor to numerous SDOs indicates that compliance with the WTO and current EC framework generally reduces the risk of anticompetitive conducts arising from collaborative standardisation.

3. Fraunhofer, therefore, encourages the CMA to recommend that the retained Horizontal Guidelines maintain the safe harbour from antitrust enforcement for SDOs that preserve high standards of governance, and operate in accordance with the WTO framework.

Fraunhofer respectfully encourages the CMA to recommend to the Secretary of State to acknowledge in the retained Horizontal Guidelines:

(a) the central role of collaborative standardisation in developing cutting-edge technologies;
(b) the substantial investments necessary to develop these technologies and contribute to standards development procedures and bodies;
(c) the importance of incentives which encourage contribution to innovation; and

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3 For more information on Fraunhofer, see https://www.iis.fraunhofer.de/en.html

4 WTO, Agreement on Technical Barriers to Trade (1995) [TBT Agreement].

5 WTO, Second Triennial Review of the Operation and Implementation of the Agreement on Technical Barriers to Trade, WTO Doc. G/TBT/9 [Six Principles for International Standardisation] (13 November 2000), Annex 4.

(d) the importance of secure and enforceable intellectual property rights.

In this regard, we also highlight the need SDOs to provide IPR policies that (a) allow innovators and contributors to earn a fair and adequate reward, and (b) reassure SDOs that standard essential patents will be accessible and subject to a negotiation taking place on fair, reasonable, and non-discriminatory (FRAND) terms.[6]

Fraunhofer considers that it is vital for sustainable and globally competitive innovation that FRAND remain the basic principle of licensing standard essential patents so that there is no specific preference for any type of contributing entity or licensing model in SDOs. This business-model neutral approach enables participation by SMEs, research organisations, universities and large companies in SDOs – thus reflecting open participation as set out in the TBT Agreement.

Retention of the current FRAND provisions is therefore requested to remain as a condition to benefit from a safe harbour from antitrust enforcement, except that any reference to an element of US economic theory of "patent holdup" should be removed. US Courts have stated that there is no assumption at law of patent hold up, patent hold out or royalty stacking – all licensing negotiations are to be assessed on their own facts and circumstances. Indeed, it was recently acknowledged by the US Department of Justice Economics Director of Enforcement, '[t]hrough a FRAND licensing commitment, SEP holders forgo the ability to exercise any market power gained from standardization'.[7]

It is considered that the detailed framework for licensing negotiations provided by the Court of Justice of the European Union (CJEU) in the 2015 *Huawei v. ZTE* judgment,[8] and incorporated into the body of UK case law on standard essential patents by UK courts,[9] is sufficient to address any potential for abuse of standard essential patents.

If a reference to patent holdup in retained, then reference to patent hold out should be included. The UK Supreme Court defined the 'the mischief of "holding out"' as a practice

> *by which implementers, in the period during which the IPR Policy requires SEP owners not to enforce their patent rights by seeking injunctive relief, in the expectation that licence terms will be negotiated and agreed, might knowingly infringe the owner's Essential IPRs by using the inventions in products which meet the standard while failing to agree a licence for their use on FRAND terms, including fair, reasonable and non-discriminatory royalties for their use. In circumstances where it may well be difficult for the SEP owner to enforce its rights after the event, implementers might use their economic strength to avoid paying anything to the owner. They may unduly drag out the process of licence negotiation and thereby put the owner to additional cost and effectively force the owner to accept a lower royalty rate than is fair.*[10]

Hold-out has serious negative effects on dynamic competition and the proper functioning of standards development processes. In particular, we note the increased transaction and litigation costs, reduced returns on investment for developing standardised technology, and eventually diminished incentives to innovate and contribute to standards.

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6 See, European Telecommunications Standards Institute (ETSI), Annex 6 ETSI Directives, ETSI Intellectual Property Rights Policy, Clause 3 (v.44, 2021) https://portal.etsi.org/directives/44_directives_dec_2021.pdf.

7 https://www.justice.gov/opa/speech/antitrust-division-economics-director-enforcement-jeffrey-wilder-iam-and-gcr-connect-sep

8 Case C-170/13, *Huawei Technologies Co. Ltd. v. ZTE Corp.* [2015] ECLI:EU:C:2015:477.

9 See in particular *Unwired Planet International Ltd v. Huawei Technologies (UK) Co Ltd* [2020] UKSC 37.

10 ibid, at [10].

A concept of licensing negotiation groups (LNGs) is currently promoted.[11] If this proposal is adopted, LNGs would be formed by competitors seeking to collectively negotiate and engage in price fixing, rather than participate in and conclude a FRAND negotiation in a timely manner. If an LNG incorporated a substantial portion of operators in the downstream market, it will be in a position to exercise collective market power on the buying side (monopsony). Because these arrangements have an obvious anticompetitive object and lack any redeeming virtues, they should be considered anti-competitive by object. Any argument of licensing efficiency does not appear supported. Pursuant to Article 101 TFEU, efficiencies are understood as objective economic and technical benefits accruing from the agreement in question, and not the private gains to the parties to the restrictive agreement.[12] The European Commission, in its Guidelines on the Application of Article 101(3) TFEU, has emphasised that cost reductions that 'arise from the mere exercise of market power by the parties cannot be taken into account'.[13]

4. R&D Horizontal Block Exemption Regulation

As Europe's largest applied research organisation with extensive experience in R&D collaboration, Fraunhofer respectfully submits that, overall, the EU R&D HBER has had a positive impact on R&D collaboration.

Preliminarily, we note that R&D agreements allow the combination of parties' complementary assets and capabilities and to jointly undertake R&D that could not, or would not, have been otherwise undertaken separately. In Fraunhofer's experience, competition concerns might arise only in rare circumstances, in particular where an R&D agreement covers a price-fixing or market allocation arrangement in the downstream product market, and these arrangements do not benefit from the block exemption provided in the retained R&D HBER as it now stands.

Cooperation between research organisations and universities is considered highly beneficial and important for a vibrant innovation ecosystem. R&D cooperation arrangements between research organisations and universities facilitate the use of complementary assets (e.g., use of specialised research equipment in joint labs) and capabilities to deliver high quality research and accelerate knowledge transfer from upstream R&D operators to the downstream industry, bridging the gap between academia and industry.[14]

Because R&D agreements generally have a positive impact on competition by enabling the cooperative development and commercialisation of new technologies and can increase innovation, output, choice, quality, and price competition to the benefit of consumers,

Fraunhofer encourages the CMA to recommend the retention of the R&D HBER as is, or with only minor adjustments.

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11 Group of Experts on Licensing and Valuation of Standard Essential Patents, *Contribution to the Debate on SEPs* [SEP Expert Group Report] (January 2021) 168-9 (concept suggested by unknown proponent).

12 See Joined Cases C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P, *GlaxoSmithKline Services Unlimited v. Commission (Glaxo Spain)* [2009] ECLI:EU:C:2009:610, para 92 (holding that Article 101(3) requires 'appreciable objective advantages of such a kind as to compensate for the resulting disadvantages for competition.' According to the Court, such advantages are not identified with the private gains of the undertakings participating in the agreement or concerted practice). Similarly, under US antitrust law and §1 Sherman Act, 'cost savings that arise from anticompetitive output or service reductions are not treated as cognizable efficiencies.' See US DOJ and US FTC, *Antitrust Guidelines for Collaboration Between Competitors* (2000) 24.

13 Communication from the Commission, Guidelines on the applicability of Article 81 (3) of the Treaty [2004] OJ C101/97, para 49.

14 For an example of a successful cooperation between four leading European RTOs (CEA, CSEM, Fraunhofer, VTT), see the Heterogeneous Technology Alliance (HTA) < https://www.hta-online.eu>.

Specifically, an area of improvement could be the requirement, in Article 3 of the retained R&D HBER, of joint full access to R&D results. Fraunhofer's experience with R&D agreements indicates that full access can be complex, cumbersome, and potentially inappropriate, if the cooperation was for a limited purpose or a specialised technology.

Although under certain circumstances joint full access to R&D results might make sense (e.g., terms and conditions attached to public funding, certain EU funded R&D consortia, certain R&D arrangements with other RTOs or Universities), it has been observed that R&D agreements that assign the exploitation of the R&D results to one party is simpler from a legal, commercialisation and management perspective. They can thus be more efficient and attractive to the parties.

It is noted that although the current R&D BER provides that the requirement of full access to R&D results may be not applicable in certain circumstances, including where academic bodies and research organisations are involved, we consider that removing this requirement for exemption is sensible from a legal certainty standpoint and is also currently being considered by the European Commission.

Fraunhofer suggests removal of the requirement of full access to and joint exploitation of the R&D results from the retained R&D HBER.

5. Conclusion

Fraunhofer remains at the CMA's disposal for further engagement on the important topic of the UK competition law framework for horizontal cooperation, in particular as regards standardisation agreements and R&D collaboration.

Yours sincerely,

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