8 March 2023

CMA DRAFT GUIDANCE ON HORIZONTAL AGREEMENTS[1]
APPLE'S COMMENTS ON PART 9 ON STANDARDISATION AGREEMENTS

1. INTRODUCTION AND EXECUTIVE SUMMARY

(1) Apple Inc. appreciates the opportunity to contribute to the CMA's consultation on the draft Guidance on Horizontal Agreements (the "Draft Guidance"). This position paper focuses only on Part 9 on standardisation agreements.

(2) We have actively participated in the various consultations on the European Commission Horizontal Guidelines, as well as the CMA's review of the Horizontal Guidelines. Most recently we have suggested to the European Commission that it further refine its guidance on issues that are crucial for promoting innovation, competition, and consumer welfare.[2] We have also responded to the call for views on SEPs by the UK Intellectual Property Office ("IPO").[3]

(3) We welcome the CMA's desire to provide guidance to companies and standard development organisations ("SDOs") about competition issues that may arise when competitors cooperate to develop standards, and engage in the licensing of standard essential patents ("SEPs").

(4) UK businesses are seriously affected by SEP licensing issues. More than 200 of the approximately 2,800 global IoT device manufacturers that use cellular SEPs are based in the UK.[4] But UK companies are not major SEP owners. Royalty outflows from the UK are thus significant (estimated to amount to £108 million for smartphones alone).[5] Strong safeguards are needed to protect against abuses of the power that SEP licensors acquire through standardisation as many industries in the economy move to incorporate connected devices.

(5) We support the CMA's adoption of its own guidance on standardisation agreements to ensure a clear and balanced approach to SEP licensing issues to the benefit of all. Adopting safe harbours for SDOs that include policies to promote and strengthen standard setting and licensing on FRAND terms will send a strong signal that will further innovation in the UK.

(6) **We are however concerned that some aspects of the Draft Guidance may be misinterpreted and yield opposite results**. We focus in particular on two key issues:

1. **The Draft Guidance currently implies that *Unwired Planet v Huawei* [2020] UKSC 37 ("*Unwired Planet*") immunises from UK competition law scrutiny two related licensing practices that have historically been subject to competition law scrutiny across the globe: (1) SEP asserters obtaining leverage against licensees by "tying" licences to one or more essential SEPs to the licensee's agreement to pay royalties for a multi-national or worldwide portfolio of patents (para 9.25); and (2) SEP asserters *mandating* that any dispute over FRAND licensing terms be resolved on a global portfolio basis only, through international arbitration or litigation in a favoured forum (para 9.29).** These practices produce at least two principal anticompetitive effects that should be assessed on a case-by-case basis: they force licensees to pay for dozens,

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1 Guidance on the application of the Chapter I prohibition in the Competition Act 1998 to horizontal agreements [DRAFT] (CMA174).

2 *See* Apple's Response to the European Commission's Consultation on the Revised Horizontal Guidelines, 26 April 2022.

3 *See* Apple Inc. Response to the UK Intellectual Property Office Call for Views on Standard Essential Patents and Innovation, 1 March 2022.

4 *Ibid.*, Annex 2.

5 *Ibid.,* Annex 3.

hundreds, or even thousands of patents (across numerous standards) that the licensee does not need, and they immunise weak or non-essential patents from scrutiny in national courts.

Unwired Planet did not confront, let alone resolve, these and other important competition law issues. Instead, the decision was directed to the issue presented to the UK Supreme Court—the interpretation of the intellectual property rights policy before it under principles of contract law. We submit that the CMA should provide the competition law guidance that the court in *Unwired Planet* was not called upon to give. By instead allowing SDOs to endorse these two licensing practices, as the Draft Guidance seems to imply, negative effects on competition will be amplified. Indeed, we anticipate that large SEP asserters will cite the Draft Guidance as grounds to compel these terms upon licensees by means of SEP injunction threats around the globe, including through UK courts. We urge the CMA to reconsider the position in the Draft Guidance on these issues.

2. **The Draft Guidance implies that so-called "*de facto access*" to a standard is an acceptable substitute for having a FRAND licence to a SEP (para 9.33). It is not. At the very least, SDO IPR policies should require SEP owners to offer a FRAND *licence* to all third parties *at any level* of the supply chain before they can benefit from any safe harbour under Chapter I**. To protect against SEP abuses, including abuse of a dominant position, a SEP owner must provide an irrevocable undertaking to grant licences to all third parties on FRAND terms. The CMA itself previously adopted this principle in its guidance on sustainability agreements, which states that if standard-setting involves intellectual property rights, participants, "*<u>must</u> also offer to <u>licence</u> their essential IPR <u>to all third parties</u> on fair, reasonable and non-discriminatory terms*" to comply with competition law.[6] This principle is also recognised by longstanding practice and case law, including the ECJ judgment in *Huawei v ZTE*, the European Commission's decisions in *Motorola* and *Samsung*, and the European Commission Horizontal Guidelines.[7]

   We are concerned that, as currently drafted, the Draft Guidance is flatly inconsistent with the CMA's prior guidance and the other sources of precedent. The Draft Guidance suggests that it might not be anticompetitive to license just at the end product level, with only "*de facto access*" given to component suppliers higher up in the value chain (*e.g.,* through "have made rights"). This implication is not in line with the FRAND commitment, nor with competition principles or commercial realities. This is because "have made rights" are not an actual licence. They cover a company only insofar as it develops and/or supplies a product to a licensed customer. They do not enable component manufacturers to freely operate in the market: only a licence can do so. The CMA should avoid a policy reversal and instead follow its sustainability agreements precedent to require offers to *license* all third parties. At a minimum, IPR Policies that do not require SEP owners to license their SEPs to all third parties should be presumed to fall within the scope of the Chapter I prohibition unless SEP owners can affirmatively demonstrate countervailing efficiencies.

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6 CMA, 'Guidance on Environmental Sustainability Agreements and Competition Law (*GOV.UK*, 27 January 2021), <https://www.gov.uk/government/publications/environmental-sustainability-agreements-and-competition-law/sustainability-agreements-and-competition-law> accessed 7 March 2023.

7 Case C-170/13 *Huawei Technologies Co Ltd v ZTE Corp* ECLI:EU:C:2015:477; Case AT.39985 *Motorola—Enforcement of GPRS Standard Essential Patents* C(2014) 2892 final; Case AT.39939 *Samsung—Enforcement of UMTS Standard Essential Patents*, C(2014) 2891 final; Communication the Commission—Guidelines on the applicability of Art 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2011] OJ C11/1 (European Commission Horizontal Guidelines); European Commission, 'Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements (Draft)' (*EU Commission Competition Policy*, 1 March 2022) <https://competition-policy.ec.europa.eu/public-consultations/2022-hbers_en>.

(7) We provide more details on our positions on the scope of *Unwired Planet* and on the anticompetitive harms caused by mandating global portfolio SEP licensing and multinational adjudication of FRAND rates in Section 2, and why FRAND requires SEP holders to license to third parties at any level of the supply chain in Section 3. Finally, we offer comments on other aspects of the Draft Guidance in Section 4.

2. *COMPULSORY* GLOBAL LICENSING AND SDO LICENSING PROCEDURES WERE NOT CONDONED BY *UNWIRED PLANET* AND CAN HARM COMPETITION

2.1 The CMA should not expand the holding of *Unwired Planet*—which did not address the relevant competition issues—to permit any SEP holder to demand that licensees take a global or multi-national portfolio licence.

(8) While global portfolio licences are often mutually beneficial when parties *voluntarily* agree to them, the Draft Guidance implicitly seems to suggest that SEP holders may unilaterally, or even potentially on a coordinated basis through an SDO IPR policy (paras. 9.25, 9.29),[8] condition licences to one or more SEPs on the licensee's agreement to pay for the entire global patent portfolio. These suggestions risk significant anticompetitive harm. While we believe that the better course of action would be to delete the new language in these provisions, we respectfully urge the CMA at least to clarify that such conduct must be addressed on a case-by-case basis under competition law. Among other things, forcing licensees to take a global licence to what may be hundreds or even thousands of patents can be a form of anticompetitive tying that can insulate weak or non-essential patents from patent challenges in the appropriate national courts, and may also result in licensees being compelled to take a licence for patents in jurisdictions in which they are not even operating (which is often the case with SMEs who have smaller geographic footprints). Those patent challenges represent a necessary check on the unwarranted exercise of monopoly power in various technology markets or downstream product markets.

(9) For these reasons, as detailed below, we believe that paragraph 9.25 in the Draft Guidance should be modified to accurately reflect these risks and the scope of *Unwired Planet.*[9] We propose that the CMA consider removing the relevant language on *Unwired Planet* from paragraph 9.25. But if it is not deleted, we propose to edit the language as follows (additions in **bold**):

> "*In addition, the UK Supreme Court has found that, where doing so is in accordance with standard practice in the relevant industry and appropriate (such as because it avoids unreasonable delays in negotiating licences or reduces transaction costs),* ***it may be appropriate for*** *IPR holders* ~~***may require***~~ ***to seek*** *that a FRAND licence to their standard-essential IPRs be taken on a global or multi-national portfolio basis*." Citing *Unwired Planet* at para. 168-169. ***Such practices, however, fall outside the scope of any safe harbour under Chapter I, and would be subject to a case-by-case assessment of potential anticompetitive effects and any procompetitive rationales.*****"**

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8 *See* para 9.29: "*The IPR Policy may also provide for a[] . . . tribunal . . . to determine the terms of a FRAND licence on a worldwide basis in cases of dispute.*"

9 A further revision to para 9.25 is proposed below in Section 4.4 in relation to SEP royalties and incentives.

(10) We offer below suggested edits to paragraph 9.29 to address both this issue and concerns with SDOs specifying the choice of forum.

2.1.1 *Unwired Planet* deals with contract law and made no pronouncements creating safe harbour from Chapter I scrutiny

(11) As currently drafted, the excerpted portion of paragraph 9.25 seems to imply that the Supreme Court's decision in *Unwired Planet* creates a safe harbour from Chapter I scrutiny for IPR policies that allow SEP holders to mandate global portfolio licensing. In doing so, the Draft Guidance expands the holdings of *Unwired Planet* beyond its narrow limits. In that case, the parties did not raise challenges under Chapter I and therefore the Court did not consider such competition law issues at all.[10] The FRAND analysis as to global portfolio licensing in *Unwired Planet* was conducted *exclusively through the lens of contract law* (the SEP owner's contractual obligations under the ETSI IPR Policy). *Unwired Planet* cannot be read to mean that demands for adjudicated global royalty rates *never* harm competition, whether unilateral or coordinated.

(12) Nor can the decision in *Unwired Planet* be read to define the complete contours of a patentee's rights under UK patent law. In fact, the Court expressly acknowledged that "*in the absence of the IPR Policy,*" patentees could *not* petition UK courts to require global licensing or to set a global royalty, much less to deprive a licensee its right to challenge validity or infringement of any foreign patent in the appropriate national courts.[11] The Supreme Court in *Unwired Planet* merely construed the contours of the contractual provisions in the specific IPR Policy before it.

(13) Whatever the merits of the Supreme Court's contractual analysis—and we maintain it erred in many ways—that analysis cannot replace independent assessment of the *effects* of a given contract by applying the elements of competition law. To the extent the Court construed provisions of the IPR Policy at issue (ETSI's) to reflect agreement among SDO participants on certain practices (e.g. that in certain circumstances it may be permissible for a SEP holder to seek a global portfolio licence) as being FRAND, that would be only the beginning—not the end—of a Chapter I analysis.

(14) Agreements among market participants, even if properly concluded under contract or patent law, are routinely condemned when they produce unjustified restrictions on competition. *See Generics Ltd. v Competition and Markets Authority* [2021] CAT 9 paragraph 74 (concluding that a settlement agreement in a patent dispute can violate competition law if it "*constitutes a restriction of competition by effect*"). In these "exclusion payment" cases across a variety of jurisdictions, pharmaceutical companies claimed that patent litigation settlement agreements could not violate the competition laws because the companies had the patent right to exclude allegedly infringing generic versions of their products through patent expiry. But courts in the UK and elsewhere have found that even if the agreements are valid under contract and patent law, they may still violate the antitrust laws.[12] Even the lower courts in *Unwired Planet*, to the

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10 Any competition law analysis in *Unwired Planet* was limited to (1) whether Unwired Planet's licensing terms to Huawei violated the "non-discriminatory" element of FRAND, specifically focusing on whether Huawei was entitled to the same, lower, rates as that agreed by and Samsung (Samsung was a co-defendant in the Unwired Planet proceedings but agreed a licence with Unwired Planet before the FRAND determination); and (2) the interaction of competition law and principles under *Huawei v ZTE* regarding the grant of injunctive relief.

11 *Unwired Planet International Ltd v Huawei Technologies Ltd* [2020] UKSC 37 at [58], [63].

12 For example, the European General Court in *Lundbeck* explained that even if an agreement restricted competition only "*within the scope of the patent, it could still not be accepted that the [agreement] was compatible with Article 101 TFEU.*" Case T-472/13 *H Lundbeck A/S v European Commission* ECLI:EU:T:2016:499, para 118. The court stressed that while a Member State may grant a patent right, "*the conditions under which those rights may be exercised may nevertheless fall within the prohibitions*

extent they did consider certain competition claims, recognised that the effect on competition from a global portfolio licensing demand would depend upon the circumstances pertaining to each particular agreement and licence.[13] Statements in the guidance that say or imply that there is such a generally applicable principle would be contrary to established precedent.

2.1.2 Expanding *Unwired Planet* beyond the Supreme Court's narrow holding will permit anticompetitive conduct

(15) Allowing any SEP asserter to condition access to a standard on a licensee's agreement to a global portfolio licence would likely produce anticompetitive results. The conduct effectively constitutes patent tying which, in many cases, would satisfy well-established prohibitions under Chapter I.[14] That tying would not only constitute an exercise of dominance with respect to the tying SEP, but it would effectively immunise the tied patents from challenge and thereby preserve invalid or truly non-essential patents. Finally, permitting SDOs to implement IPR policies that encourage or even mandate global licensing potentially facilitates collusion among SEPs holders as to the terms they offer for SEP licences, and as a result may reduce beneficial competition among standards.

(i) Tying

(16) Tying involves certain practices where a seller forces a buyer to purchase one product or service as a condition for buying another product or service. In the context of SEPs, tying can occur if SEP holders condition a licence to one or more SEPs (which the licensee desires) on the licensee's agreement to take licences for other patents that are not essential to the standard, are invalid, or are otherwise not infringed or unenforceable. This type of coercion often produces anticompetitive harm, as licensees would be forced to pay for unnecessary patents, thus increasing costs to licensees and ultimately harming consumers.[15]

(17) The fact pattern of SEP asserters making SEPs available only through global portfolio licences would, in many cases, satisfy the traditional elements of anticompetitive tying under UK law.

> First, there are two separate "products"—namely the SEP or SEPs (to which the licensee needs access) and patents that comprise the remainder of the portfolio (which may include non-essential, invalid, and/or unenforceable patents).

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contained in the article." *Ibid* para. The U.S. Supreme Court reached a similar conclusion in *FTC v Actavis*, *Inc*, 570 US 136, 148 (2013), explaining that "*it would be incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well*"); *see also King Drug Co of Florence, Inc v SmithKline Beecham Corp*, 791 F.3d 388, 407 (3d Cir 2015) ("[*T]he question is not one of patent law, but of antitrust law, the latter of which invalidates 'the improper use of [a patent] monopoly … [W]e believe the fact that the Patent Act expressly authorizes licensing does not necessarily mean it also authorizes [the uses of such licences as] reverse payments to prevent generic competition*").

13 The lower courts, which did engage to a certain extent on competition issues, recognised that the effect on competition from a global portfolio licensing demand "*would depend upon the circumstances pertaining to each particular agreement and licence*." *Unwired Planet International Ltd v Huawei Technologies Ltd* [2018] EWCA Civ 2344 at [34] (emphasis added); *see also ibid* [39] (noting that the lower court "was not prepared to assume that the tying by UP of a SEP licence in one country to a SEP licence in another country had, by its nature, a competitive foreclosure effect. *He thought that close analysis of the actual effects of such tying activities would be required and that had not been done*.") (emphasis added).

14 This is an acute problem in the context of standardised technologies given that SEP holders typically have market power and supracompetitive royalties are likely to cause anticompetitive effects.

15 *See* footnote 52 for a discussion on the consumer harms of excessive or un-deserved royalties.

Second, a global licence would condition the sale of tying SEP(s) on the purchase of the tied patents.

Third, the SEP asserter will often have market power in the "tying" SEP(s), as those patents are purportedly essential to make or sell a standard-compliant product.

Fourth, the practice affects competition in the market for the tied patents that comprise the remainder of the portfolio, as SEP asserters would enforce their tying arrangements to require licensees to pay unnecessary royalties, which would increase their costs and in turn ultimately harm consumers. Alternately, potential licensees could remove products or product features, or reduce research and development—reducing product quality, choice, and innovation, and also ultimately harming consumers.

(18) As with any tying arrangement, these elements must be considered on a case-by-case basis. The Draft Guidance, however, implies instead that this type of patent tying would receive safe harbour protection.[16]

(ii) Insulating patents from challenge

(19) In addition to allowing SEP asserters to impose an unwarranted tax on standardised products, SEP asserters that force global portfolio licences effectively use the dominant position they hold in the technology markets covered by the tying SEP(s) to insulate other patents from challenge. Those tied patents can number in the thousands, and span dozens of jurisdictions. SEP asserters often compel licensees to accept no-challenge provisions as part of these global licence agreements. At a minimum, the global licence effectively disincentivises those challenges.

(20) Agreements insulating invalid patents from challenge can be anticompetitive and harmful to consumers. As the UK Supreme Court noted, the "patent bargain" implicit in the grant of patent rights provides "*an inventor ... the reward of a time-limited monopoly of the industrial use of its invention.*"[17] But those "patent monopolies" are necessarily limited in several respects. First, patents are "*national in scope and are usually conferred by national governments.*"[18] Second, those that are accused of infringement are entitled to challenge in the appropriate national courts the validity or enforceability of those patents, and patent owners have the burden to prove claims of infringement.[19] These are important limits on the ability of patentees to restrict or tax competition. The European Commission in its technology transfer guidelines stresses, for example, that "*[i]n the interest of undistorted competition and in conformity with the principles underlying the protection of intellectual property, invalid intellectual property*

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16 Apple stresses that it has no objection to companies offering or requesting global portfolio licences, which companies may do for any number of legitimate business reasons. The objection here is focused on SEP asserters demanding or otherwise coercing licensees into accepting a global portfolio licence that the licensee does not want.

17 *See, e.g., Unwired Planet* (n 10) at [2] (citing *Actavis Group PTC EHF v ICOS Corp* [2019] UKSC 15 at [53] ("*The 'patent bargain' is this: the inventor obtains a monopoly in return for disclosing the invention and dedicating it to the public for use after the monopoly has expired*".).

18 *Ibid.* See also for instance *Chugai Pharmaceutical Co Ltd v UCB Biopharma SA* [2017] EWHC 1216 (Pat) at [73(v)] ("*Patents are local monopolies which involve local policies and local public interest. Their effect is territorially limited. Their validity should be matters for the local judges of the country in which the patent right was first created*".); Paris Convention on Protection of Industrial Property of 20 March 1883 (amended 28 September 1979) 828 UNTS 305 art 4bis.

19 *See, e.g., Unwired Planet* (n 10) at [3].

rights should be eliminated. Invalid intellectual property stifles innovation rather than promoting it […]."[20]

(21) Courts and competition authorities across the world stress that patentees may not frustrate or limit others' right to challenge the patent claims they assert. The Court of Justice of the European Union, for example, has observed that "*it is in the public interest to eliminate any obstacle to economic activity which may arise where a patent was granted in error*".[21] The European Commission subjects "non-challenge clauses" to scrutiny precisely because invalid patents can produce competitive harms, and "*licensees are normally in the best position to determine whether or not an intellectual property right is invalid*".[22] The U.S. competition authorities similarly urge: "*[i]nvalid patents impair competition, and as a matter of patent policy, challenges to their validity are encouraged*".[23] The U.S. Supreme Court likewise has long held that preserving the right to challenge patents represents "*an important public interest*" because if such challenges "*are muzzled, the public may continually be required to pay tribute to [the patentee] without need or justification*".[24]

(22) The statement in paragraph 9.29 of the Draft Guidelines that "*nothing in this Guidance should be taken to suggest that a licensee is unwilling to take a licence on FRAND terms on the basis that it challenges the essentiality, validity or infringement of IPR forming part of a standard*" is important, but does not insulate against the concern above. If global portfolio licensing is forced under threat of injunction, the burden of proof in patent infringement cases in effect shifts to licensees to prove that they do not infringe on a patent-by-patent, jurisdiction-by-jurisdiction basis. This burden is no more viable for licensees than the Supreme Court believed it was for SEP owners in *Unwired Planet*, and indeed much less so in light of the profound informational asymmetry that impacts licensees. Licensees lack detailed knowledge of the asserted patent portfolio and how they are said to be mapped to the relevant standard (that information is with the SEP owner), and licensees often lack the details of the allegedly infringing chips they use (that information is upstream with the chipset manufacturers).

(23) The FRAND commitment exists to place restrictions on SEP licensors, not to grant them more rights than "ordinary" patent owners who also have large, global portfolios that they could choose to assert. A patent's exposure to validity or non-infringement challenges in national courts is therefore an important limitation on the "patent monopoly," and a critical aspect of the delicate balance between patent law interests and competition law interests. SEP asserters should not be in a position to unilaterally immunise their portfolios from such challenges. Furthermore, those patent challenges should not be something that SDO participants collectively may simply contract away through adoption of IPR policies that allow SEP holders to demand global licences. The Draft Guidance, however, implies that SDO participants and SEP asserters may adopt policies that leverage SEPs to insulate potentially hundreds of

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20 Commission's Guidelines on the application of Art 81 of the EC Treaty to technology transfer agreements [2004] OJ C101/2, para 112.

21 Case T-492/13 *H Lundbeck A/S v European Commission* ECLI:EU:T:2016:449, para 119 (citing Case 193/83 *Windsurfing International Inc v Commission* [1986] ECR 611, para 92).

22 Commission's Guidelines on the application of Art 81 of the EC Treaty to technology transfer agreements [2004] OJ C101/2, para 112.

23 US Dept of Justice and Federal Trade Commission, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* (2007) 90.

24 *Lear, Inc v Adkins*, 395 US 653, 670 (1969); *see also Blonder-Tongue Laboratories, Inc v University of Illinois Foundation*, 402 US 313, 349-50 (1971) ("*[T]he holder of a patent should not be insulated from the assertion of defenses and thus allowed to exact royalties for the use of an idea that is not in fact patentable or that is beyond the scope of the patent monopoly*").

thousands of patents (including throughout Europe and the United States, despite the above-referenced guidance in those nations), and to utilise UK courts to accomplish that end.

(iii) Facilitating collusion among SEP asserters and SDOs

(24) Finally, the Draft Guidance also creates a risk that IPR policies will incorporate these global licensing provisions in a way that facilitates collusion among SEP asserters on licensing practices, and potentially even reduces competition among competing standards.

(25) SEP asserters are in a position of market dominance by virtue of holding patents covering features of standards to which licensees are locked in. Those SEP asserters, unless constrained by the risk of competition enforcement, have the dominance to demand global portfolio licences, with all the anticompetitive effects described above. When licensees have access to other competing standards, they can walk away from a standard if licensors make unreasonable demands. Under these conditions, the competitive environment may force SEP holders to abstain from demanding global portfolio licences or global portfolio rate determinations under the threat of injunction. Thus, one dimension of competition that is critical to preserve is competition among SEP licensors, especially in the context of competition among competing standards. That competition typically incentivises licensing with lower royalties and less restrictive terms that, in turn, can facilitate more active competition in downstream product markets and, above all, lower pricing to consumers.

(26) If IPR policies encourage, or even mandate, global licensing, this action may "standardise" the terms of the licences SEP holders make available. Large SEP holders may be emboldened by the Draft Guidance and influence IPR policies across competing standards to incorporate these global licensing provisions. Effectively this guidance could result in collusion among SEP holders, even between competing SDOs, to offer only global licences. That collusion would therefore insulate SEP holders from pressure to offer more flexible terms.

2.1.3 Any pro-competitive benefits of global licences will often be outweighed by other inefficiencies

(27) Even if there were any efficiencies to be gained from a global licence agreement coerced under the threat of a UK injunction, they can be lost if there are large enough countervailing inefficiencies. *Unwired Planet* did not undertake a detailed balancing of these considerations and outcomes. In many cases, the added transaction costs of forced global portfolio licensing will dwarf any alleged benefits. For example, efficiencies gained from avoiding country-by-country litigation are only pro-competitive if the patents in a SEP owner's portfolio are mostly essential, infringed, valid, and enforceable. If they are not, then coercing a manufacturer into a licence does not remove the transaction costs of an inevitable royalty—it simply adds additional costs for manufacturers and ultimately for consumers. As discussed below, the data shows that SEPs often are not essential, infringed, valid, or enforceable. In such cases, coercing a manufacturer into a licence can be anti-competitive and harmful to consumers, as it may increase their costs and reduce the incentives for innovative firms to participate in standard-setting activities.

(28) Studies show that between 70-90% of the alleged SEPs tested in court are found to be either non-essential, invalid or not infringed.[25] Non-practicing entities that asserted SEPs were

[25] David Goodman and Robert Myers, '3G Cellular Standards and Patents' [2005] International Conference on Wireless Networks, Communications and Mobile Computing 415, 420 <https://patentlyo.com/media/docs/2009/03/wirelesscom2005.pdf> accessed 7 March 2023; RPX Corporation, *Standard Essential Patents: How Do They Fare?* (2014) 9 <https://www.rpxcorp.com/wp-content/uploads/2014/01/Standard-Essential-Patents-How-Do-They-Fare.pdf> accessed 7 March 2023; Jay Jurata and David Smith, 'Turning the Page: The Next Chapter of Disputes Involving Standard-

successful in establishing essentiality, validity, and/or infringement for only about 6% of their alleged SEPs.[26] These statistics are all the more remarkable because SEP owners likely litigate and seek to enforce SEPs that they perceive to be the strongest.

(29) Multi-national or global SEP portfolio licences can be appropriate and effective on a voluntary basis. But if a licence to a SEP is conditioned upon agreeing to license the rest of the SEP holder's portfolio on a global basis—especially under threat of injunction if a licensee does not comply—the licensee may act against its own self-interest and pay for technology rights it does not need or would otherwise challenge. For example, a SEP asserter's cellular portfolio may include SEPs that are not applicable to components in end products and are instead directed to network infrastructure components. The size of the SEP asserter's portfolio is therefore artificially inflated—but this is information that a SEP asserter may not make available to potential licensees.

2.2 The CMA should not permit SDOs to make rules permitting licensors to mandate international tribunals to resolve FRAND disputes

(30) While international arbitration or litigation in a particular forum may be a mutually beneficial way of resolving FRAND disputes when parties ***voluntarily*** agree to them, the Draft Guidance's implicit suggestion that a standard-setting organisation's IPR policy may ***mandate*** that a licensor can unilaterally demand one of these methods to reach a global licence agreement risks significant anticompetitive harm. In addition to all the harms detailed above which are attendant to allowing mandatory global, portfolio licensing, a requirement that a licensee forfeit its rights to adjudicate particular patent claims in the relevant national court would again allow SEP holders to insulate potentially non-essential, non-infringed, invalid, or unenforceable patents from challenge.

(31) We propose to modify paragraph 9.29 in the Draft Guidance to reflect these risks, ideally by removing the first sentence, and first clause of the second sentence (changes in **bold**):

> ~~**"*The IPR Policy may also provide for an international tribunal (alternatively, it may identify respected national IP courts or tribunals to determine the terms of a FRAND licence on a worldwide basis in cases of dispute. In the absence of such a provision,***~~ *~~n~~* ***N****othing in this Guidance prejudices the possibility for parties to resolve their disputes about the level of FRAND royalties by having recourse to competent national courts or alternative methods of dispute resolution. Moreover, nothing in this Guidance should be taken to suggest that a licensee is unwilling to take a licence on FRAND terms on the basis that it challenges the essentiality, validity or infringement of IPR forming part of a standard in parallel with licensing negotiations, reserves the right to*

Essential Patents' [2013] CPI Antitrust Chronicle 1, 5, <http://s3.amazonaws.com/cdn.orrick.com/files/CPI.October2013JurataSmith.pdf> accessed 7 March 2023; Matthew Rose, Jay Jurata and Emily Luken, 'The UK High Court of Justice Issues an Injunction Prohibiting an Undertaking from Selling Wireless Telecommunications Products in Britain Due to Its Failure to Enter into a Worldwide Patent Licence (*Unwired Planet / Huawei*)' [2017] e-Competitions National Competition Laws Bulletin 1, 6 <http://s3.amazonaws.com/cdn.orrick.com/files/eCompetitions-August-2017.pdf> accessed 7 March 2023.

26 Mark Lemley and Timothy Simcoe, 'How Essential Are Standard-Essential Patents?' (2017) 104 Cornell L Rev 607, 625.

do so in future, or if it requires that the licence provides a mechanism to alter the royalty rates taking account of the result of such challenges."

(32) If this is not possible, we propose to edit the language as follows (changes in **bold**):

"*The IPR Policy may also provide for an international tribunal (alternatively, it may identify respected national IP courts or tribunals)* ***that IPR holders and licensees may voluntarily elect to use*** *to determine the terms of a FRAND licence on a worldwide basis in cases of dispute.* ***~~In the absence of such a provision, n~~ N****othing in this Guidance prejudices the possibility for parties to resolve their disputes about the level of FRAND royalties by having recourse to competent national courts or alternative methods of dispute resolution. Moreover, nothing in this Guidance should be taken to suggest that a licensee is unwilling to take a licence on FRAND terms on the basis that it challenges the essentiality, validity or infringement of IPR forming part of a standard in parallel with licensing negotiations, reserves the right to do so in future, or if it requires that the licence provides a mechanism to alter the royalty rates taking account of the result of such challenges.*"

(33) As currently drafted, the excerpted portion of paragraph 9.29 implies that an IPR policy may mandate an international tribunal or identify a national IP court to determine worldwide FRAND licences. As previously explained, there is no basis for mandating such an adjudication and such a requirement presents material risk to competition. While *Unwired Planet* noted that UK courts could mandate a global licence in the absence of an ETSI IPR Policy that "provide[d] for any international tribunal or forum to determine the terms of such licences,"[27] it did not address whether such a provision in an SDO IPR policy would be permissible. Under competition law, it is not.

(34) Forcing potential licensees into an SDO-selected forum will certainly limit the ability of licensees to challenge the validity, essentiality, infringement, and enforceability of SEPs. It would be in the SEP holders' interests to select a forum that is less inclined to investigate the validity, essentiality, or enforceability of the patents, as well as more inclined to grant injunctive, in particular, preliminary injunctive relief. This selection could lead to anti-competitive outcomes, such as excessive royalties or barriers to entry for innovative firms. Ultimately, an SDO-selected forum to adjudicate global rates presents all of the problems with a compulsory global licence, including tying, insulating patents from challenge, and facilitating collusion.

(35) Additionally, an SDO mandated forum would constitute an illegal boycott agreement. Standardisation carries inherent risks of collusion[28], which is why intellectual property rights policies like the FRAND requirement are necessary to limit SDO participants from abusing their market power. These limitations are designed to prevent participants from imposing their will on the market and creating anti-competitive conditions. An SDO IPR policy that requires

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27 *Unwired Planet* (n 10) at [90].

28 *Allied Tube & Conduit Corp v Indian Head, Inc*, 486 US 492, 500 (1988) ("*There is no doubt that the members of such associations often have economic incentives to restrain competition and that the product standards set by such associations have a serious potential for anticompetitive harm*").

manufacturers to adopt the licensors' procedural framework as a condition of use not only inverts this dynamic but would constitute an illegal group boycott.[29]

(36) There are three elements to an illegal group boycott: (1) a group of firms acting together, (2) an agreement or concerted practice with the aim of excluding other firms, and (3) an exclusionary effect or anti-competitive object, such as preventing or restricting competition in the relevant market. An IPR policy that permits any SEP holder to require licensing procedures as a condition of accessing the standard satisfies these elements. An SDO's IPR policies are a group agreement and a provision permitting members to compel arbitration with licensees would exclude companies that never agreed to arbitration from using the standard.

(37) This IPR policy would be illegal even if some members did not enforce it: once a group of firms have agreed upon the boycott measures, they have impaired competition even though they may not have participated in implementing the boycott. The European General Court, for example, has explained that "*a boycott may be attributed to an undertaking without there being any need for it actually to participate, or even be capable of participating, in its implementation. Where that is not so, an undertaking which approved a boycott but did not have the opportunity to adopt a measure to implement it would avoid any form of liability for its participation in the agreement*".[30]

(38) Moreover, there is no pro-competitive justification for why SDO participants can agree as a group to require manufacturers that adopt the standard to use an SDO-specified tribunal for determination of FRAND rights rather than access to national courts as a condition of use. Even if there are some efficiencies to be gained through global licensing, there is no benefit in permitting a rule that invests in licensors the power of forum choice and denial of access to national courts.

(39) Ultimately, licensees would likely face greater royalty rates as their ability to negotiate with SEP holders diminishes. These costs would be paid by consumers either directly through higher prices, or through inferior products as manufacturers have less resources to invest into research and development.

3. THE FRAND COMMITMENT REQUIRES SEP OWNERS TO OFFER A FRAND LICENCE TO ALL THIRD PARTIES, NOT JUST ACCESS

(40) SDO's rules should require an irrevocable commitment in writing to <u>license</u> essential IPR on FRAND terms to <u>all</u> third parties irrespective of their position in the value chain from every participant wishing to have its IPR included in the standard.[31]

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29 *See* Construction Recruitment Forum, Case CE/7510-06, 29 September 2009, para 3.94 et seq <https://assets.publishing.service.gov.uk/media/555de2a2ed915d7ae5000014/CE7510-06_Decision_290909_N1.pdf> accessed 7 March 2023.

30 Case T-9/99, *HFB Holding für Fernwärmetechnik Beteiligungsgesellschaft mbH & Co KG v Commission*, EU:T:2002:70, para 280.

31 In a 2021 decision, Mr. Justice Meade held that, as a matter of contract interpretation, the ETSI IPR Policy entitles ***any*** party to take a license on FRAND terms: "*In my view, the right interpretation of clause 6.1 is that any person interested in implementing an ETSI standard must be entitled to have a licence on FRAND terms on demand to a patentee which has given the relevant undertaking. That is the class of beneficiaries, and it is a very broad one. It is consistent with the ETSI regime of making standards widely available that there should be no restriction in terms of what the beneficiary wants to do commercially, as to manufacture, sales or the like – the acts which in the absence of a licence would be an infringement*". *Optis Cellular Technology v Apple Retail UK Limited* [2021] EWHC 2564 (Pat) at [278]. Note, there are other aspects of this decision which Apple is appealing to the Supreme Court.

(41) The Draft Guidance (para 9.10) recognises refusal to license as a hold-up practice, explaining that SEP owners can behave in anti-competitive ways, for instance by "*by refusing to license the necessary IPR or by extracting excess rents by way of discriminatory or excessive royalties thereby preventing effective access to the standard ('hold-up')*". The Draft Guidance (para 9.22) also identifies FRAND commitments as the key safeguard designed to protect against hold-up. Indeed, FRAND commitments are intended to prevent SEP holders from withholding licences or demanding unfair, unreasonable, or discriminatory royalty fees after the industry has been locked-in to the standard. Refusal by a SEP holder to license a standard user would be incompatible with the very purpose of standardisation and the FRAND commitment.

(42) It accordingly should not suffice for paragraph 9.22 of the Draft Guidance to state that an IPR policy "*could be drafted*" this way, and for paragraph 9.33 to state that "*an IPR Policy will not fall within the scope of the Chapter I prohibition if it ensures that de facto access to the standard is provided to third parties at each level of the supply chain.*" "*De facto*" access cannot provide sufficient protection to competition because the status of being a licensee is a necessary, if not always sufficient, legal protection that is typically even explicit, in the bargain of the FRAND commitment. As just one example, declarations under the ETSI IPR policy refer to granting "irrevocable *licences*," not just granting access.[32]

(43) We invite the CMA to update the Draft Guidance by stating that the IPR policy <u>must</u> be drafted in a way that requires SEP owners to offer FRAND licences to all third parties to fall outside the Chapter I prohibition in order to avoid abusive hold-up behaviour. At a minimum, IPR Policies that do not require SEP owners to license their SEPs to all third parties should be presumed to fall within the Chapter I prohibition unless SEP owners can affirmatively demonstrate countervailing efficiencies.

(44) The specific amendments we propose are the following (proposed changes marked in **bold**), together with the deletion of footnote 364 and paragraph 9.33:

> 9.22: "*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 on fair, reasonable and non-discriminatory terms ('FRAND commitment'). The FRAND commitment* ***must*** ~~*could*~~ *be drafted so as to require the IPR holder to offer a licence to any third party seeking a licence in order to implement the standard. [...]*"

(45) If these changes are not made, we invite the CMA at least to make the following amendments (proposed changes marked in **bold**):

> 9.33 "*If an IPR Policy does not provide for licensing to third parties at all levels of the supply chain then the assessment of access to the standard will need to consider whether or not de facto access to the standard at each level of the supply chain can be provided (e.g. whether 'have made' rights for upstream component suppliers will be adequate in the relevant industry context).* ~~***An IPR Policy will not fall within the scope of the Chapter I prohibition if it ensures that de facto access to the standard is provided to third parties at each level of the supply chain.***~~ ***If an IPR Policy does not***

[32] ETSI IPR policy, Section 6. *See also, e.g.,* Section 8 ("Non-availability of *Licences*") (emphasis added).

provide for licensing to third parties at all levels of the supply chain, each SEP owner should decide independently how to license. From a competition law perspective, providing licences to all parties is the preferred option. Whether providing de facto access can be a suitable alternative will depend on whether it is capable of resulting in anticompetitive effects. This may be the case in certain factual scenarios. It is the SEP owner's burden to show efficiencies for their conduct that outweigh any potential anticompetitive effects."

3.1 Wide-ranging precedent, including the CMA's own competition guidance, requires owners to offer a FRAND licence to all third parties, not just access

(46) A broad and authoritative set of caselaw and guidance supports requiring licences to all third parties, not just access.[33] As an initial matter, the CMA already adopted this approach in its own guidance on sustainability agreements,[34] which states that "*if the standard-setting involves intellectual property rights (IPR), participants must disclose in good faith their IPR that might be essential to the implementation of the standard. They must also offer to licence their essential IPR to all third parties on fair, reasonable and non-discriminatory terms. This should be provided for in an IPR policy from the standard-setting organisation*" [emphasis added]. The guidance states that SDOs should take this step to "*comply with competition law*."

(47) A contrary approach would be confusing to industries and consumers relying on the CMA's prior guidance. We see no substantive reason why the CMA's guidance on standardisation agreements related to sustainability would be different from its guidance on standardisation agreements more generally. Not only are sustainability agreements a class of horizontal standardisation agreements, but other types of standardisation agreements advance goals in other important policy areas, to include emergency communications, national security applications, and myriad Internet-of-Things applications with medical and safety benefits.

(48) Similarly, the Court of Justice of the European Union held in *Huawei* that:

> "*[T]he case in the main proceedings may be distinguished by the fact […] that the patent at issue obtained SEP status only in return for the proprietor's irrevocable undertaking, given to the standardisation body in question, that it is prepared to grant licences on FRAND terms.*" […] "*In those circumstances, and having regard to the fact that an undertaking to grant licences on FRAND terms creates legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licences on such terms, a refusal by the proprietor of the SEP to grant a licence on those terms may, in principle, constitute an abuse within the meaning of Article 102 TFEU.*"[35]

(49) The European Commission Horizontal Guidelines (both current and draft new versions) also state that "*[i]n order to ensure effective access to the standard, the IPR policy would need to*

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33 *See, e.g., Huawei v ZTE*; Case AT.39985 *Motorola—Enforcement of GPRS Standard Essential Patents* C(2014) 2892 final; Case AT.39939 *Samsung—Enforcement of UMTS Standard Essential Patents*, C(2014) 2891 final; European Commission Horizontal Guidelines; Draft European Commission Horizontal Guidelines.

34 CMA, 'Guidance on Environmental Sustainability Agreements and Competition Law (*GOV.UK*, 27 January 2021), <https://www.gov.uk/government/publications/environmental-sustainability-agreements-and-competition-law/sustainability-agreements-and-competition-law> accessed 7 March 2023.

35 *Huawei v ZTE* (n 6) paras 48 et seq.

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'). That commitment should be given prior to the adoption of the standard." [emphasis added][36] The quoted sentence in the EC's horizontal guidelines initially mentions "access," but it goes on to explain that "access" needs to be ensured by requiring participants to offer to "license" IPR to all third parties.[37]

(50) Likewise, the Competition & Consumer Commission of Singapore has more generally recognised that "*[w]here an owner of an SEP has a dominant position in a market, its refusal to license its SEP on FRAND terms to any applicant for a licence (irrespective of its position in the value chain) may give rise to competition concerns*".[38]

3.2 "Have made rights" and indemnification cannot provide sufficient protection

(51) There is a critical difference between having "*de facto access*" to a standard and having a licence to the necessary IPR to implement the standard in that the former does not convey full usage and sales rights. *De facto* access can include "have made rights" which are not an actual licence: they cover a company only in so far as it develops and/or supplies a product to a licensed customer. A company with "have made rights" is not free to operate on the market, and is not a true competitor.

(52) Granting customers mere "have made" rights rather than licensing their suppliers negatively affects the ability of component manufacturers to research, innovate, and operate in the relevant market. Indeed, "have made rights" relegate manufacturers of intermediate components to serving as the extended workbench of the licensed end-product manufacturer. The range of products and services that they may develop is limited by the scope of the licence that is obtained by the end product manufacturer. Further, they are limited to developing products or services for that particular licensed end product manufacturer, affecting their ability to operate on the market, serve different potential customers, and develop new products.

(53) To give a practical example: in the automotive sector, certain SEP owners insist on only licensing OEM car producers. The subcomponents that in fact comprise the related technology are manufactured by smaller (often SME) Tier 1 and Tier 2 suppliers. The suppliers work on the innovations that brought us connected cars and soon may bring us autonomous vehicles. They supply their modules, which include the related connectivity technology subject to IPR, to OEMs.

(54) The terms between OEMs and direct and indirect Tier 1 and Tier 2 suppliers will include warranties/indemnities as to title. These terms are normal in any supply of goods, and usually implied by law, and there is no prospect for suppliers to negotiate them away especially where the customers have market power and the suppliers do not. However, the consequence of the SEP owners' refusal to license Tier 1 and Tier 2 suppliers is that those title indemnities expose the suppliers to liabilities to the OEMs over which the suppliers have no control.

(55) When SEP licences are agreed, perhaps with a substantial payment for past sales, the OEM may claim indemnity from its suppliers for the costs that arise. That claim may arise long after the supply has been made, and long after investment in setting up future supplies has been committed. The amount involved is negotiated between the OEM and the SEP owner, without

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36 European Commission Horizontal Guidelines (n 6) para 285.

37 *Ibid*

38 Competition Commission of Singapore, *CCCS Guidelines on the Treatment of Intellectual Property Rights* (2022) para 4.11. *See also, e.g.,* Commerce Commission of New Zealand, *Draft Guidelines on the Application of Competition Law to Intellectual Property Rights* (19 December 2022) para 38.1.

reference to the party that bears the liability. This transaction can act as a substantial break on the ability, especially of SMEs, to enter the business, to invest in it, and to enter long term supply contracts.

(56) Providing suppliers with "have-made rights" does not solve the indemnity issue—it amplifies it. Suppliers will need to decide whether to only work with OEMs that have secured a licence, as otherwise they could face lawsuits for allegedly infringing SEPs. They may thus abandon working for an OEM altogether, which in turn can reduce their R&D budgets due to reduced revenues, and affect their ability to bring to market the innovations for connected and autonomous vehicles. Moreover, critical suppliers refusing to sell components to unlicensed OEMs will block OEMs from accessing the market. Ultimately, this can give SEP licensors leverage to force OEMs to accept non-FRAND terms which will also harm prices and innovation.

3.3 The consequences of expressly allowing the potential for "access" would further harm competition

(57) These issues exist today due to the unilateral behaviour of certain SEP owners. If SEP owners are allowed to agree to only offer "*de facto access*", the anticompetitive effects would be amplified, as virtually all SEP owners could claim that they provide "*de facto access*" and stop offering licences through the value chain. Instead of having only a few dozen of suppliers impacted, all industries relying on SEPs would be negatively impacted.

(58) Agreeing to only offer "*de facto access*" and to not provide licences to certain players in the supply chain is also an anticompetitive form of coordination. It would result in the collective boycott by SEP owners of those players in the supply chain they decided not to license. It would amplify the anticompetitive effects we have seen in the automotive industry.

(59) SEP owners attempt to justify end-product licensing policies by arguing that it is the most efficient licensing model. But it is estimated that around 99% of potential licensing transaction costs in the IoT sector would be avoided if licensing is done at the component level. Even if all transaction costs were entirely passed through and ultimately shared among end device manufacturers, the cost per manufacturer when licensing at the component level would be only around 1% of the transaction cost borne under device level licensing. The average transaction cost per UK downstream OEM in this case is estimated to be around £8k if licensing takes place at the component level – an amount that could still be borne by most start-ups and SMEs.[39]

(60) For these reasons, we invite the CMA to update the Draft Guidance by stating that the IPR policy must be drafted in a way that requires SEP owners to offer FRAND licences to all third parties for the standardisation agreement to fall outside the scope of the prohibition of Chapter I. If the IPR policy does not follow this requirement, it is for the SDO and SEP owners to claim lack of anticompetitive effects and/or efficiencies to fall outside the scope of the Chapter I prohibition.

4. COMMENTS ON OTHER PROVISIONS OF THE DRAFT GUIDANCE

(61) We also provide below comments on aspects of the Draft Guidance that align with the European Commission's Draft Horizontal Guidelines generally in line with the feedback that we provided to the EC.

39 *See,* Annex 2, *supra* note 4.

4.1 The CMA should follow the European Commission and recognise each SEP as the relevant product market when determining market power

(62) The Draft Guidance (para 9.11) states that while "*the establishment of a standard can create or increase the market power of IPR holders possessing IPR essential to the standard, there is no presumption that holding or exercising IPR essential to a standard equates to the possession or exercise of market power*" and that "*[t]he question of market power can only be assessed on a case-by-case basis*", citing the European Commission's *Motorola* decision.

(63) However, this statement no longer seems appropriate in light of the reference by Advocate General Wathelet in *Huawei v ZTE* to a presumption that the holder of a SEP enjoys a dominant position, which is rebuttable only with specific, detailed evidence. Indeed, the European Commission has defined each SEP as the relevant product market in competition law cases, because by definition there are no alternatives or substitutes,[40] which means that the SEP owner generally holds market power and is dominant on the relevant market for the licensing of each SEP.

4.2 SEP holders that seek injunctions to extract concessions are engaging in anticompetitive hold-up

(64) Standardisation is intended to, and should be, a collaborative exercise that offers many potential pro-competitive benefits, including promoting innovation, increasing competition, lowering barriers to entry, and decreasing prices. The Draft Guidance (para 9.5) correctly recognises those benefits. At the same time, the Draft Guidance lists three "*main*" channels through which standardisation agreements can give rise to restrictive effects on competition, namely "*(i) reduction in price competition; (ii) foreclosure of innovative technologies; and (iii) exclusion of, or discrimination against, certain undertakings by prevention of effective access to the standard*".

(65) Potential exclusion or discrimination is the most significant issue affecting potential licensees today. There is extensive evidence that SEP hold-up is a pervasive problem that damages the competitive process and innovation. As the U.S. Department of Justice has observed, "*economic bargaining model underlying claims of holdup has been studied extensively*" across a wide array of economic activity, and there is no reason to conclude that it is not equally applicable to standard setting.[41] Further, it is incorrect to suggest that there is no evidence of hold-up. For example, the European Commission concluded that Motorola used the threat of an injunction on a cellular SEP in Germany to coerce Apple to accept "*disadvantageous licensing terms*": "*faced with the enforcement of the injunction, Apple had the choice of either having its products excluded from the market or accepting the disadvantageous licensing terms requested by Motorola as a condition for not enforcing the injunction*".[42] This is the very definition of hold-up. Similarly, when Microsoft faced the prospect of a German injunction on H.264 (Advanced Video Coding) SEPs, it undertook the burden of relocating its distribution center from Germany to the Netherlands as a protective measure at a cost exceeding $11

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40 See Case COMP/M.6381—*Google/Motorola Mobility* C(2012) 1068, para 61: "*[t]he Commission considers that each SEP can be considered as a separate market in itself as it is necessary to comply with a standard and thus cannot be designed around, i.e. there is by definition no alternative or substitute for each such patent. The relevant market in this case is thus the (at least) EEA-wide market for the licensing of each of the relevant SEPs that Google will acquire from Motorola Mobility following the transaction*".

41 Letter from Renata B Hesse, Acting Assistant Attorney General, US Dept of Justice, to Michael A. Lindsay, Esq, Dorsey & Whitney LLP, re Business Review Letter, (2 February 2015) 6 n 28 <https://www.justice.gov/atr/page/file/1386871/download> accessed 7 March 2023.

42 Case AT.39985 *Motorola—Enforcement of GPRS Standard Essential Patents* C(2014) 2892 final.

million.[43] A recent empirical study found "*opportunistic behavior by the SEP enforcer in approximately 75% of patent-party level SEP assertions*".[44] We refer to our previous submission, in particular to paras. 31-39 for more information on the detailed evidence of harm caused by SEP hold-up.

(66) The Draft Guidance (para 9.9) also currently suggests that obtaining or threatening to obtain an injunction can be a form of hold-up: "*If an undertaking is either completely prevented from obtaining access to the result of the standard, or is only granted access on prohibitive or discriminatory terms, there is a risk of an anti-competitive effect*." The law and economics literature has also long identified the threat of a preliminary injunction as a form of hold-up that enables a SEP owner to exert pressure on companies accused of patent infringement. We consider that the Guidance should explicitly recognise seeking injunctions as a form of hold-up.

(67) We suggest the following change to paragraph 9.9 (proposed changes marked in **bold**):

> "*When the standard constitutes a barrier to entry, the undertaking could thereby control the product or service market to which the standard relates. This in turn could allow undertakings to behave in anti-competitive ways, for example by refusing to license the necessary IPR or by extracting excess rents by way of discriminatory or excessive royalties thereby preventing effective access to the standard,* ***or by inappropriately seeking or threatening to seek injunctive relief*** *("hold-up")*"

4.3 Hold-up and hold-out are <u>not</u> symmetric problems

(68) The Draft Guidance (para 9.10) introduces the concept of hold-out after defining hold-up, as follows

> "*[t]he reverse situation may also arise if licensing negotiations are drawn out for reasons attributable solely to the user of the standard. This could include for example a refusal to pay a [FRAND] royalty or using dilatory strategies (i.e. deliberately delaying licensing negotiations with the licensor) ("hold-out").*"[45]

(69) Hold-up cannot be equated to hold-out. Hold-up is a competition concern. The anticompetitive behaviour by SEP owners is (i) enabled by agreements between actual or potential competitors, and (ii) it involves holders of SEPs exercising market power acquired by virtue of having their IP included in a standard and placing them into a dominant position.

(70) Hold-up is based on well-established economic theory regarding bargaining and transaction costs. Once a standard becomes widely adopted, product developers will have no alternative

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43 *Microsoft Corp v Motorola Inc*, 795 F.3d 1024, 1030-31 (9th Cir 2015).

44 Brian J Love, Yassine Lefouili, and Christian Helmers, 'Do Standard-Essential Patent Owners Behave Opportunistically? Evidence from U.S. District Court Dockets' (2020) (Toulouse School of Economics Working Paper No. 20-1160, 41, <https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/wp/2020/wp_tse_1160.pdf> accessed 7 March 2023 (further noting that "*opportunistic behaviors are likely to be particularly effective in the SEP licensing context due to a general lack of adequate substitutes to standardized technology*").

45 This seems to follow the new language included in the revised European Commission Horizontal Guidelines at paragraph 484 on which we have commented on in our previous submissions.

but to use essential patented technology. The cost of designing and producing products that use the standard makes it prohibitively expensive for industry participants to switch to another standard.[46] Based on these investments and the high cost of switching, SEP holders will be "*in a position to demand more for a license than the patented technology, had it not been adopted by the [standard], would be worth*".[47]

(71) These dynamics give SEP holders additional and undeserved leverage in licensing negotiations. Typically, "*[o]ne of the key elements of countervailing buyer power is the buyer's ability (or credible threat) to switch to competing suppliers*".[48] This is not the case with SEPs, as a potential licensee wishing to use a standard generally has no alternatives to technologies made essential by the standard. This SEP holder threat is thus notably asymmetric as "*the holdup problem and accompanying lock-in value exist only on one side of the exchange*".[49]

(72) While certain aggressive SEP licensors argue that hold-up is merely theoretical and that there is no empirical evidence it exists, that is simply not the case, as described above in paragraph (65).

(73) In contrast to demonstrated harms of hold-up, the premise of hold-out is that SEP holders are vulnerable to parties who use the standard underpaying for licences after SEP holders have already invested in developing their patented technologies. But this concern is not unique to SEPs. Every patent holder faces this risk while SEP licensees, as discussed above, face an enhanced risk. There is no market power obtained by users of SEPs that they can exploit. Thus, it is not a "reverse" situation, as currently articulated at paragraph 9.10.

(74) The concern of alleged hold-out also is greatly overstated. First, the chance that a patent holder will not recoup its investment in developing patented technology is a normal aspect of a market economy where investment in innovation—including in the form of patents—is risky because it is rewarded after the fact based on its demonstrated worth.[50] Standardisation actually enhances the prospects that patent holders will benefit from their patents "*because the inclusion of its technology in the standard can still greatly increase the volume of licensing opportunities available to the SEP holder*".[51] Second, SEP holders have recourse to the legal system to pursue monetary damages if they cannot reach agreement with potential licensees, and so SEP holders can obtain the FRAND royalties they voluntarily promised to accept for use of their SEPs.

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46 *See* Herbert Hovenkamp, 'FRAND and Antitrust' (2020) 105 Cornell L Rev 1683, 1690 ((adopting a standard "*encourages firms to develop their own technology in ways that ensure interoperability but that can be costly to reverse after the fact*"); A. Douglas Melamed and Carl Shapiro, 'How Antitrust Law Can Make FRAND Commitments More Effective' (2018) 127 Yale LJ 2110, 2116 ("*Basic economic principles instruct that ex post monopoly pricing by SEP holders harms consumers by raising the cost of products that comply with the standard*").

47 *Microsoft Corp*, 795 F.3d at 1030-31 (citing *Ericsson, Inc v D-Link Systems, Inc.*, 773 F.3d 1201, 1209 (Fed Cir 2014)).

48 Case AT.39985, *Motorola—Enforcement of GPRS Standard Essential Patents* C(2014) 2892 final, para 243.

49 Letter from 77 Former Government Enforcement Officials and Professors to Makan Delrahim, Assistant Attorney General, US Dept of Justice, regarding *Patents and Holdup*, (17 May 2018) 2.

50 *Ibid*; *In re Innovatio IP Ventures, LLC Patent Litigation*, No 11 C 9308, 2013 WL 5593609, at *11 (ND Ill 3 October 2013) ("*the court is not persuaded that reverse hold-up is a significant concern in general, as it is not unique to standard-essential patents. Attempts to enforce any patent involve the risk that the alleged infringer will choose to contest some issue in court, forcing a patent holder to engage in expensive litigation*").

51 Melamed and Shapiro (n 45) 2134.

Third, there has been little to no empirical evidence indicating that holdout is a widespread problem for SEP holders.[52]

(75) The proposed definition of hold-out is also problematic, as it could be interpreted to include delays resulting from good faith negotiation and the potential licensee's need to understand the strength of the patent holder's portfolio. The Draft Guidance should clarify that legitimate negotiation conduct that delays resolution—such as questioning the validity or essentiality of the patents—does not to constitute "unwilling[ness]" on the part of the potential licensee. Negotiation of complex portfolio licences can simply take time with the timetable slowing down or speeding up due to variety of factors on both sides. There can be no one-size-fits-all timetable for these transactions. Such negotiations are legitimate efforts by prospective licensees to understand the scope of claimed SEPs and, if needed, to ask a court or arbitrator to determine a FRAND royalty for the asserted SEPs. It is also not clear how one could establish that a licensee has refused to pay a FRAND royalty. This determination could only occur if a FRAND royalty has been established by an independent court of competent jurisdiction in a final judgment that the patent(s) at issue are essential, infringed and not invalid or otherwise unenforceable, and the licensee has been held to have to pay that royalty. Otherwise any SEP owner could always claim that a potential licensee is engaging in hold-out conduct during the course of negotiations, as there are often disputes as to the merits of the SEPs, and whether the SEP owner's offer is indeed FRAND.

(76) We suggest the following change to paragraph 9.10 (proposed changes marked in **bold**):

> "***~~The reverse~~ A different*** *situation may also arise if licensing negotiations are* ***unreasonably*** *drawn out for reasons attributable solely to the user of the standard. This could include for example a refusal to pay a fair, reasonable and non-discriminatory ("FRAND") royalty* ***as set forth in a final judgment of patent infringement from a court of competent jurisdiction*** *or using dilatory strategies* ***without other legitimate aim than to unreasonably delay negotiations ~~(i.e. deliberately delaying licensing negotiations with the licensor)~~*** *("hold-out")*."

4.4 Monetising patents to recover research costs is only one of many reasons that firms contribute to standards

(77) We are concerned with the sentences at 9.25 that read: "*FRAND commitments allow IPR holders to monetise their technologies via FRAND royalties and obtain a reasonable return on their investment in R&D which by its nature is risky. This can ensure continued incentives to contribute the best available technology to the standard*".

(78) While investment in R&D, inside or outside the context of standard development, is inherently risky, it also means that a return is not guaranteed. Indeed, risky investments often fail to earn an attractive return on capital. Some technologies that are essential to standards might be highly valuable, while others might have little incremental value and are simply chosen as one of many ways in which to solve a technical issue. In some instances, the value of the invention could also be zero if there is a competitive alternative available for free.

(79) Because FRAND valuation reflects the *ex-ante* competitive value of the invention, it is accordingly appropriate that a return on investment in essential IPRs is not guaranteed.

52 *See* Brian J Helmers and Christian Love, 'An Empirical Test of Patent Hold-Out Theory: Evidence from Litigation of Standard Essential Patents' (2021) Santa Clara University Legal Studies Research Paper 3, <https://ssrn.com/abstract=3950060> accessed 7 March 2023.

Footnote 374 seems to already recognise as much, since it states that cost-based methods for valuation (*e.g.*, methods that compensate SEP owners for the costs of their investments) may distort the incentives to innovate, and are in essence not best suited for FRAND valuations.[53] Accordingly, we would suggest to either delete or amend the language as we have suggested during the EC's review of the draft Horizontal Guidelines.

(80) Moreover, the Draft Guidance language implies that royalties are the primary incentive for companies to contribute technology to standards. But that is simply not true. There are many different incentives to participate in standard setting apart from the ability to obtain licensing revenue. Bluetooth, for example, has become one of the most ubiquitous standards in mobile devices thanks to the Bluetooth Special Interest Group's long-standing policy of requiring its members (almost 30,000 companies, including major players such as Ericsson, Samsung, Apple, Intel, Microsoft, and Toshiba) to grant royalty-free licences to their SEPs.[54] Contributing allows firms to develop and be at the forefront of new markets, reduce technology related risks—such as a standard adopting a technology that is incompatible with a firm's product—and develop institutional technical knowledge of the standard.[55] And contributing additional technology to the standard increases the likelihood that the standard will continue to succeed.

(81) We propose the following changes to paragraph 9.25 (proposed changes marked in **bold**):

> "*FRAND commitments allow IPR holders to monetise their technologies via FRAND royalties and* ***can be an incentive for participants to contribute the ~~best available technology~~ to the standard*** ***~~obtain a reasonable return on their investment in R&D which by its nature is risky. This can ensure continued incentives to contribute the best available technology to the standard~~***."

4.5 The Draft Guidance correctly recognise FRAND royalties must be based on the *ex-ante* value of the incremental improvement offered by a SEP over the next best alternative but some inconsistencies should be resolved to avoid ambiguity

(82) In order to fall within the scope of the safe harbour, SDO IPR policies should require FRAND licensing based only on the value of the patented invention, and not the added value of standardisation or the end product which are not attributable to patented invention.

(83) Valuation at the smallest component where all or substantially all the inventive aspects of the SEP are practiced offers the most fair, reasonable, and representative value base for this purpose. It would be unfair if, for example, the common base related to the end product, or even some arbitrary percentage of the end product, as it would inappropriately reward licensors for features or technologies they have not developed, and would vary based on other factors,

53 Melamed and Shapiro, (n 45) 2116 (explaining that excessive SEP royalties harm consumers by (1) increasing the cost and reducing the output of standard implementing products, (2) delaying innovation by taxing follow-on inventions that build or improve the technologies claimed by the SEP, and (3) delaying the standard setting process by encouraging firms to jockey for inclusion of their patented technologies in standards regardless of their technical merit)

54 Bluetooth Special Interest Group, "*Patent Copyright License Agreement*", (2016) <https://www.bluetooth.com/about-us/governing-documents/> accessed 7 March 2023.

55 Knut Blind and Axel Mangelsdorf, 'Motives to Standardize: Empirical Evidence from Germany' (2016) 48-49 Technovation 13, 15.

such as quality and brand. It also makes most economic sense and follows the objective of the patent laws to reward the invention claimed in the patent.

(84) The text in paragraph 9.27 of the Draft Guidance helpfully clarifies that the economic value of the covered IPR "*should be irrespective of the market success of the products which is unrelated to the patented technology*" [emphasis added].

(85) However, the use of the phrase "*the present value added of the covered IPR*" is imprecise. Present value analysis is an economic method used to account for the time value of money and thereby to enable accurate comparisons of payments made at different times. For example, present value analysis might be used to discount the value of a future payment so that it could be compared to the value of a payment made today.[56]

(86) We presume that because the Draft Guidance states that the present value added should be irrespective of the market success of the product, it intends to convey that valuation of the covered IPR should take place *ex-ante*, before the standard is set, and that the objective is to determine whether there is an increase in the value that is specifically attributable to the covered IPR in products that use the standard.[57] We generally agree with this approach.

(87) To convey that meaning more clearly, we suggest the following edit to paragraph 9.27 (proposed changes marked in **bold**):

> "*The economic value of the IPR* ~~***could***~~ ***should*** *be based on the* ~~***present***~~ ***ex-ante*** *value added of the covered IPR and should be irrespective of the market success of the products which is unrelated to the patented technology*".

(88) It is important that the Draft Guidance state clearly that the economic value of the IPR should be assessed with regard to a hypothetical *ex-ante* negotiation between the essential IPR holder and a prospective licensee that takes place before the standard has been developed and before the industry has become locked-in to the IPR and thus vulnerable to hold-up.

(89) First, this interpretation of FRAND is widely endorsed by academics and competition regulators.[58] Second, an *ex post* assessment of the economic value of the IPR would not achieve

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56 It should also be noted that a problem with present value-added analysis, which is often used in conjunction with economic tools like demand estimation and conjoint analysis, is that these tools can typically only be used to estimate the value of a feature of a product that uses covered IPRs and cannot directly estimate the value of the technology covered by the IPRs. This distinction is important for two reasons. First, the value of the feature typically provides no information about the value of the technology claimed in the IPR because it does not account for potential alternative technologies that could have constrained royalties during an *ex-ante* competition to be the technology selected for the standard. Second, the value of features often derives from multiple factors unrelated to covered IPRs, such as brand value and other IPRs, and for this reason the estimated value of the feature must be carefully interpreted to understand how it relates to covered IPRs.

57 It should also be understood *ex-ante* that as the standard ages and future versions of the standard are developed, and as patents expire, the value of a SEP can decrease over time.

58 Stanley M Besen, 'Why Royalties for Standard Essential Patents Should Not Be Set by the Courts'[2016] Chicago-Kent Journal of Intellectual Property 19, 23; Dennis W Carlton and Allan L Shampine, 'An Economic Interpretation of FRAND' [2013] Journal of Competition Law and Economics 531, 545; Daniel G Swanson and William J Baumol, 'Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power' [2005] Antitrust Law Journal 1, 10–11; US Federal Trade Commission, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* 194 (2011) <https://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-

the stated aim of the Revised Guidelines that SEPs should be valued "*irrespective of the market success of the products which is unrelated to the patented technology*."

(90) Paragraph 9.27 lists methods by which *ex-ante* valuation may be accomplished. It explains that the licensing fees that were charged for the SEPs in question in a competitive environment before the industry had developed the standard may be compared with "*the value/royalty of the next best available alternative (ex-ante)*". Indeed, the "next best available alternative" is a well-established economic concept that has been applied frequently in court cases and other settings to determine FRAND rates.

(91) The revised language could be improved, however, in several ways. First, the language suggesting that *ex-ante* licensing fees can be compared to *ex post* licensing fees should clarify the reason for the comparison. That reason is to determine whether royalties demanded *ex post* are aligned with those that would have resulted from an *ex-ante* negotiation. Second, language still appears to refer only to actual "*licensing fees charged by the undertaking in question*". In practice, a common method of *ex-ante* valuation involves comparing licensing fees that hypothetically would have been charged *ex-ante* with the value of the next best available technology *ex-ante*.

(92) We interpret the existing text to correctly recognize that a unilateral *ex-ante* royalty *declaration* of intended rates by a SEP holder is not a reasonable basis for establishing the actual value of SEPs. These declarations are simply wish lists. They do not reflect the outcome of a hypothetical (or actual) negotiation with prospective licensees, and do not reflect a comparison with the next best available technology to determine the incremental value of the SEPs. We nevertheless suggest replacing the word "charged" with "negotiated", along with the other proposed changes below, to make this reasoning more explicit.

(93) We accordingly suggest the following edit to paragraph 9.27 (proposed changes marked in **bold**):

> "***For example, i****t may be possible to compare the licensing fees* ***that were negotiated*** *~~charged~~* ***or would have been negotiated*** *by the undertaking in question for the relevant patents in a competitive environment before the industry has developed the standard (ex-ante) with the value/royalty of the next best available alternative (ex-ante) or with the value/royalty charged after the industry has been locked in (ex post)* ***to determine whether the ex post royalty demanded aligns with the royalty that would have been agreed to ex-ante in a hypothetical negotiation between the undertaking and a prospective licensee****. This assumes that the comparison can be made in a consistent and reliable manner.*"

(94) We also appreciate the reference in paragraph 9.28 to the method of "*determining, first, an appropriate overall value for all relevant IPR and, second, the portion attributable to a particular IPR holder*." As we has stated on our website, a SEP licensor's *pro rata* share of declared SEPs is an objective reference point in a FRAND negotiation, and an objective reasonable royalty rate protects against SEP licensors being unjustly enriched through excessive royalties (royalty stacking) to the detriment of both SEP licensees and other SEP licensors and

marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf> accessed 7 March 2023;: European Commission Horizontal Guidelines (n 6) para 289.

contributors, as well as consumers.[59] Particularly when applied to a common royalty base for SEPs that is no more than the smallest saleable unit where all or substantially all of the inventive aspects of the SEP are practiced,[60] this method is important to prevent SEP licensors from discriminating between licensees, charging different royalties for the same SEPs, and to capturing value attributable to licensee innovations.

(95) We accordingly suggest the following edits to paragraph 9.28 (proposed changes marked in **bold**):

> "*[…] These methods assume that the comparison can be made in a consistent and reliable manner and are not the result of undue exercise of market power.* ***These Guidelines do not seek to provide an exhaustive list of appropriate methods to assess whether the royalty fees are excessive or discriminatory under Chapter 2***."

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59 *See* Apple, A Statement on FRAND Licensing of SEPs, <https://www.apple.com/legal/intellectual-property/frand/> accessed 7 March 2023.

60 This royalty base should be further apportioned to isolate the SEP value, separate and apart from prior art, non-patented features, other patented technologies, standardisation itself, and contributions and innovations of others (*i.e.,* materials, manufacturing, marketing, etc.). *See* Apple's Statement on FRAND Licensing of SEPs.