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Intellectual Property
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European Commission

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Subject: Public consultation on the draft revised Horizontal Block Exemption Regulations and Horizontal Guidelines

Ladies and Gentlemen,

In response to the Public consultation on the draft revised Horizontal Block Exemption Regulations and Horizontal Guidelines, Continental wishes to make the following submission concerning the Draft revised Horizontal Guidelines, and particularly standardisation agreements and standard essential patents (SEPs) as addressed in Section 7.

Summary

The existing Horizontal Guidelines have largely been successful in enabling both business and consumers to benefit from hundreds of useful standards, in the EU and around the world. We thus urge the European Commission to maintain the substance of these regulations and recognize that the majority of the previous Horizontal Guidelines of 2011 have been maintained. However, we remark that the existing Guidelines have done little to address the restrictive effects on competition that abusive licensing practices and patent litigation in relation to standards can bring about. We welcome individual statements and certain clarifications to that effect in the Draft revised Horizontal Guidelines. At the same

time, we suggest that the European Commission consider providing further guidance in these key areas during the further process of revising the Horizontal Guidelines: litigation and injunctions, the level of licensing, and disclosure.

Litigation, Injunctions and Valuation of SEPs

Certain standards are consistently the subject of patent litigation, especially ETSI standards for telecommunication¹. The existing Horizontal Guidelines have had little impact on such disputes, as they are either ambiguous or provide little guidance on the questions that are important in practice. We recognize and welcome that Paragraph 487 has been expanded, particularly with the addition of further recognition that so-called “hold-up” practices (broadly opportunistic behaviour by SEP holders such as using their market power to extract excessive royalty rates or terms from implementers) have anticompetitive effects, and therefore, are not appropriate in determining a FRAND rate (“...are not the result of undue exercise of market power.”) We would caution, however, that the comparative approach risks to enshrine rates which are set using an undue exercise of market power, and would welcome an explicit clarification that license agreements (with other implementers of the same standard or even for other comparable standards) should not serve as a benchmark once they are the result of such undue exercise of market power.

The coupling between undue exercise of market power and comparable licenses is a particular risk when FRAND rates are negotiated with selected parties under threat of injunction, and then imposed on all other licensees by the operation of the comparative approach. Yet, it is impossible to negotiate a fair and reasonable deal under the threat of an injunction as the European Commission itself and Advocate-General Wathelet stressed.² This is just as true if the customer is threatened by an injunction while the supplier is trying to

¹ See e.g. https://www.iplytics.com/wp-content/uploads/2017/04/Pohlmann_IPLYtics_2017_EU-report_landscaping-SEPs.pdf, Figure 17.

² European Commission, Motorola, AT.39985, decision of 29 April 2014 marg. no. 486.; Opinion of Advocate General Wathelet in Huawei v ZTE, C-170/13 marg. no. 11 and 74.

negotiate a license. Therefore, we make the following suggestions for clarification in paragraph 487, to help ensure that all standards can be easily used without fear of litigation:

Similarly, it may be possible to compare the licensing terms in agreements of the IPR holder with other implementers of the same standard, *provided that the agreements are not the result of undue exercise of market power, and were not negotiated under the threat of injunction or any other form of market exclusion*. The royalty rates charged for the same IPR in other comparable standards may also provide an indication for FRAND royalty rates. These methods assume that the comparison can be made in a consistent and reliable manner.

Equally, an implementer should not be obliged to commit to a global license set by a local court based on a finding of infringement for one national SEP without any assessment as to the validity, essentiality or value of the global SEPs being asserted, particularly if those patents are held by multiple owners (a patent pool) and are being asserted collectively. Therefore, Continental strongly advocates for a process of licensing and enforcing SEPs where there can be **no injunction before a proper rate-setting process has taken place**, especially where a company (or its supplier) has stated its willingness to take a license but does not agree on the royalties demanded by the SEP owner. A proper process is one where both sides have the chance to present arguments on validity, infringement and value, and both sides transparently explain their rate-setting methodology and calculations. The rate setting must be based on the *ex-ante* incremental technical value of a patent, as indicated by Paragraph 486, not on some hold-up value because the patent is essential to a standard nor the market success of a multi-component end-user product.³ In arriving at FRAND terms, it is important to identify the appropriate common base that is “best suited for accurately valuing the invention [and] [t]his may often be the smallest priceable component containing the invention” or otherwise infringing the relevant patent.⁴ A proper rate setting should also occur in the appropriate venue. An implementer should not be forced to accept a global license set

³ See e.g. “Core Principles And Approaches For Licensing Of Standard Essential Patents”, Section 3.4, <https://2020.standict.eu/sites/default/files/CWA95000.pdf>.

⁴ Id.

by a national court if there is a closer link between the dispute and another national jurisdiction.

Under such circumstances, the often-raised allegation of so-called “hold-out” (broadly opportunistic behaviour by SEP implementers such as delaying the conclusion of a licence for as long as possible) is particularly baseless given that the implementer has stated that he is willing to take license on FRAND-terms, and has taken the necessary steps to acquire such license. Rather, the parties are merely in disagreement as to what such FRAND terms are. In general, the suggestion that so-called hold-out is a major problem of SEP licensing and SEP enforcement proves not to be supported by facts: On the contrary, empirical data provides little support for such accusation and the general theory of hold-out,⁵ while the existence of **hold-up by SEP-holders is indeed backed up by empirical research**⁶. In this context, concerning the undue exercise of market power, we note that Paragraph 470 describes such market mechanisms resulting from hold-up. On the other hand, the newly added sentences at the end of the paragraph do not seem to describe any market mechanism, but instead describe individual behaviour. It is not clear why these points are addressed in a paragraph concerning anti-competitive results, because the points do not have a relevance to competition. It should be made clear in the sentences that such behaviour is anti-competitive if it is a concerted action:

The reverse situation may also arise if *users collaborate to draw out* licensing negotiations ~~are drawn out~~ for reasons attributable solely to the users of the standard. This could include for example a refusal to pay a FRAND royalty fee or using dilatory strategies (“hold-out”).

With regards to the further statements in Paragraph 486 and 487 for conducting the assessment of whether a proposed licensee fee is FRAND, we first of all welcome that

⁵ *Love et al.*, Do Standard-Essential Patent Owners Behave Opportunistically? Evidence from U.S. District Court Dockets, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3727085.

⁶ *Helmers/Love*, An Empirical Test of Patent Hold-Out Theory: Evidence from Litigation of Standard Essential Patents, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3950060.

Paragraph 500 provides valuable guidance to the ex-ante disclosure of a maximum accumulated royalty rate by all IPR holders. With regard to the further parameters set out in Paragraph 487 besides ex-ante disclosures, we think it is important to stress once again that the technical, incremental value of the patents should be decisive and should not include the value of standardization, as the European Commission pointed out in its communication on SEPs in 2017. Already for consistency reasons, we would suggest using the wording the European Commission itself used in said very communication:

The economic value of the IPR primarily needs to focus on the technology itself and in principle should not include any element resulting from the decision to include the technology in the standard.

We believe the proposed clarifications will maintain the substance while eliminating sources of discord and even litigation, thus allowing business and consumers to benefit even more in the future.

Level of licensing

Another important issue concerns the level of licensing, where it is important for any implementer of innovative products to be sure that they can get licenses for the standards they use on FRAND terms and conditions. This can easily be accomplished by guaranteeing the right to a license for all who seek a license. Indeed, the Draft revised Horizontal Guidelines have kept the important clarification what access for third parties to the standard means by stating [emphasis added]:

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

Unfortunately, the interpretation of “all third parties” has recently been twisted away from its plain-language meaning. By way of example, ETSI policy has been recently interpreted^{7,8} to mean “Access without a License”, which in turn is interpreted to mean that SEP owners will only license end products. Innovative companies deep in a supply chain get no license of their own, but may supply (only) to licensed customers. The restriction brings business and legal uncertainty for a company which innovates a product on a standard, since it establishes a dependency on the license held by another party, namely the customer. For truly innovative products, the markets may not yet exist, and the customers typically will not have a license. This is not only a problem for suppliers in deep value chains but also for SME producers of end products who are thus barred from sourcing licensed components, and also for start-ups in a new supply chain.

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

“Access without a License”, on the other hand, makes planning almost impossible. The first step in securing a market must be to find a licensed customer! Innovative products which build on and extend existing standards will need to use SEPs. Developing an innovative new product is always a risk, and not knowing whether licenses will be available and to whom, or not knowing at what price, only adds to that risk. There would always be the threat that an originally successful business would subsequently turn into a destructive loss-making

⁷ *Layne-Farrar/Stark*, License to All or Access to All? A Law and Economics Assessment of Standard Development Organizations’ Licensing Rules (September 10, 2020). *George Washington Law Review*, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=3612954> or <http://dx.doi.org/10.2139/ssrn.3612954>.

⁸ *Borghetti/Nikolic/Petit*, FRAND Licensing Levels under EU Law (February 5, 2020). *European Competition Journal* (2021), Available at SSRN: <https://ssrn.com/abstract=3532469> or <http://dx.doi.org/10.2139/ssrn.3532469>.

business. The net effect is to stifle innovation, particularly for SMEs who are unable to bear the risk of multi-jurisdictional patent litigation.

Most of the companies in the field of IoT are pure implementers who have little experience with standards, and even less experience with SEPs and the specific technology covered by such patents. These companies are very much capable of developing innovative applications using and building on the standards. Their technological expertise is in the field of such applications, not of the standards, which are just a necessary background.⁹ Therefore, these companies should not have to invest their resources in SEP disputes or in developing a deep understanding of standardized technology. For these companies it would be beneficial to acquire a legally complete component with standard compatibility and all needed licenses from their suppliers, in order to be able to exploit the full potential of a limited development budget. For all these reasons, we suggest using “access to the standard through licenses on FRAND-terms to all third parties” consistently throughout the Draft revised Horizontal Guidelines, whenever the issue of *access to the standard* is discussed, given that other paragraphs of the Draft revised Horizontal Guidelines use a more generic wording.

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

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

⁹ Henkel, How to License SEPs to Promote Innovation and Entrepreneurship in the IoT, Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3808987.

meaning there would no longer be any market distortion or “free riders”. Market-distorting effects in the downstream supply chain could thus be effectively prevented, letting innovation prevail.

Disclosure

We welcome the European Commission’s attempt to create more transparency in the SEP ecosystem in e.g. paragraph 483 and paragraph 492. Yet, we note that transparency is only one piece of the puzzle, and should not replace specific guidance on FRAND-principles and strict scrutiny whether SEP-holders adhere to said FRAND-principles. Therefore, we urge caution that certain statements on transparency as one helpful tool to make standards more accessible should not create the impression that transparency alone will ensure access to all third parties through a right to a license. Rather, compliance with and enforcement of FRAND principles, in particular the right of anyone to obtain its own license on FRAND terms and conditions, should be at the heart of the European Commission’s effort to ensure proper access to standards.

Conclusion

Continental thanks you for the opportunity to present these views. We believe the draft maintains the substance of the Horizontal Guidelines, which is very positive, but that certain clarifications concerning SEPs and SEP licensing would benefit business and consumers.

Kind regards,

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