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Contribution to the public questionnaire for the 2019 Evaluation of the Research & Development and Specialisation Block Exemption Regulations

4iP Council is a research council made up of 25 supporters and ecosystem partners, whose aim is to develop high quality academic insight and generate empirical evidence on topics related to intellectual property and innovation. Patent rights are where the main competence of 4iP Council research has focused, including on research & development and standardisation.

We wholeheartedly support that the current consultation should seek to deliver a high-quality evaluation of whether the existing guidance regime requires updating or not. In the context of the Evaluation, 4iP Council wishes to make the following points specifically relating to the Chapter on standardisation in the Horizontal Co-operation Guidelines (HCG). We have referenced our research as relevant.

1. The European Commission should ensure that its evaluation creates a framework to assist European standardisation to develop the best solutions. Competition policy should support this objective, notably by not undermining the positive aspects of European standardisation, led by European Standards Development Organisations (SDOs). The HCG should support this. In reviewing the HCG, it is important that the resulting guidance does not cause revolution in standardisation policies.

2. This phase of evaluation is important to ensure that the HCG are principally based on a **solid legal, empirical foundations** necessary to provide guidance and legal certainty. The Consultation process should provide the Commission with a deep understanding of the functioning of standardisation, based on sound research. It is only against this background that concerns or theories of harm can be tested. Research help the Commission to understand if there is in fact an actual problem that needs to be addressed; it can then help to quantify and define the true extent of that problem, based on real-world examples and empirical data, and then to assess a proportionate solution, that avoids unintended consequences.[1] These steps are the foundation of sound policy-making.

   We would like to draw your attention to the newly published research paper "FRAND Licensing Levels under EU Law" (February 5, 2020) written by Prof. Jean-Sébastien Borghetti, Dr. Igor Nikolic and Prof. Nicolas Petit available at SSRN: https://ssrn.com/abstract=3532469

   "This paper investigates whether EU or national law provide legal authority to impose a direct or indirect obligation on Standard Essential Patent ("SEP") holders to license at all levels of the value chain, including at component level ("license to all", hereafter LTA). Extensive analysis of EU text and case-law (general principles of EU law, patent, contract and competition laws) suggests that there are only very limited doctrinal grounds to impose an LTA obligation on SEP holders that made a FRAND commitment. Similarly, French contract law – which applies to FRAND-committed SEP before the European standard setting organisation ETSI – does not give rise to a legal basis for the introduction of a LTA regime. In the rare cases where licensing obligations might be imposed on SEP holders, these would effectively be akin to compulsory licensing, where public policy calls for restraint."

   An executive summary and a presentation of the research paper created by the authors are also available:
   Executive Summary
   https://www.4ipcouncil.com/download_file/732/155 (included below for your convenience)
   Presentation
   https://www.4ipcouncil.com/application/files/5215/8149/3962/FRAND_Licensing_Levels_under_EU_Law_-_Presentation.pdf

3. The underlying principles of HCG, to create a safe harbour for SDOs and their participants, in order to avoid or prevent possible exclusionary effect from occurring. If SDOs and participants are to undertake self-assessment with any certainty, **the HCG cannot contain controversial elements** that undermines the self-assessments. This would not exclude the Commission from testing such theories through case law. The evaluation should seek to eliminate

[1] See 4iP Council's "Principles for Research in Patent Markets".

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contentious theories. We make this point because over the last two decades there has been much theorizing about potential antitrust harm in the standardisation context, yet comparatively little agreement on these theories or even case law. One obvious area of current contention is whether there is evidence that the FRAND commitment requires access to the standard or an access to a license. This is an area where further evidence is needed in order to establish whether exclusionary effects are occurring, whether legal principles are sufficiently clear to be incorporated into guidance and whether the ramifications are proportionate.

4. There needs to be an **appropriate weighting for the consultation**. It will logically be the case that technology contributors will tend to be far outnumbered by standard implementers. As a result, one would expect many more responses to the consultation from the users of standards than those that take part in standards development and even less from those who develop the technologies contributed to standards. It would therefore be unbalanced to take a simple proportionality or quantitative approach to assessing responses on that basis, because the impact on the development of technology solutions would be significantly undermined.

5. An increase in understanding is positive, as the rules and policies governing standardisation, as well as the development of standards, have increased in complexity. The HCG aims to provide certainty on the standardisation process as relates to the application of Art 101(3). Certain non-EU SDOs have seen significant IPR rule changes that have resulted in an identifiable reduction in the efficiency of that SDO.[2] In particular any revision of the HCG should seek to reduce the danger that the standardisation process or rules are used to exclude participants, or to undermine the efficient functioning of standardisation.

6. The current HCG recognize the **tension between different business models**. However, it may not be the case that companies seeking to contribute and/or to select a technology solution or standards are strict competitors, but rather that different non-rivalrous levels of the value chain are involved. The selection of technology may therefore in itself complicate an Art 101 analysis, especially if this affects competition analysis on the downstream market. The Commission should undertake a rigorous exercise to assess the future impact of industrial policies to understand both the intended and unintended impact of policy choices on the whole ecosystem and value chains.[3]

7. Revision of the HCG to expand into the area of Art 102, notably relating to licensing conditions, is unclear especially where unproven and controversial theories are involved.

8. The Commission is right to review the **effectiveness of the current system**. One way of doing so is to see whether the adoption of the current HCG resulted in significant reforms in SDOs practices. From a cursory review, it would appear that there were some incremental changes (e.g. ensuring the transferability of the FRAND commitment) but in general the HCG did not result in a radical overhaul of the functioning of SDOs. This would imply that the HCG reflected current practice. This is positive as the HCG do not, and should not, seek to change SDOs' standardisation policies unless there is concrete evidence for change. The HCG are not the appropriate vehicle to drive SDOs practice.

[2] See Kirti Gupta, Georgios Effraimidis "IEEE Patent Policy Revisions: An Empirical Examination of Impact" May' 18 and Keith Mallinson "Development of innovative new standards jeopardised by IEEE patent policy" Sept.' 17

[3] Indeed, as academic research shows that implementing companies may seek to use regulatory uncertainty to engage in commercial scale infringement and in particular, in the standardization context. See Bowman Heiden and Nicolas Petit, Patent Trespass and the Royalty Gap: Exploring the Nature and Impact of "Patent Holdout", August 2017. Accessible here.

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FRAND Licensing Levels Under EU Law

Summary

The Internet of Things will see 5G and other interoperability standards deliver a new wave of digitization to many industries. Automotive, health, home appliances, industrial robots, defence industries and many more will be connected to internet and have products communicating with each other. In this changed environment the proper licensing framework of standard essential patents (SEPs) and the meaning of commitments taken by SEP owners at the request of Standard Setting Organisations (SSOs) to license their SEPs on fair, reasonable and non-discriminatory (FRAND) terms will grow even more important.

The question at which point to license in the production chain is becoming topical in the IoT debate. On the one hand, current industry practice is for SEP owners to choose at which level of the production chain to license, which is usually the end-product device ("**access to all**" or **ATA**). ATA has been justified by arguments that functionality of the standard is realised in end-product devices, as well as on efficiency grounds: i) transaction costs savings in negotiating with one group of licensees; ii) the ease of monitoring and compliance with royalty payments and use of products; iii) the possibility to obtain mutual cross-licenses and iv) to ensure non-discrimination between similarly situated licensees. Under ATA approach, SEP holders exercise their patent rights by choosing the level of the supply chain at which they want to conclude licenses, and firms located elsewhere in the value chain indirectly benefit having access to standard without the need to directly obtain a license. On the other hand, there are arguments that SEP owners must license at all levels of the value chain to any company that requests a license ("**license to all**" or **LTA**). LTA approach considers that components (such as baseband chip) best reflect the value of a standardised technology and, therefore, that licences should be concluded with component manufacturers, or some other intermediate supplier. Basing royalties on end-products has been likened by some to a "tax on innovation" that inappropriately overcompensates SEP holders for the value of multiple inventions and components unrelated to the standardised technology.

The paper provides doctrinal analysis about what value chain licensing requirement the FRAND commitment actually does impose under EU law. Most of the existing literature on LTA v ATA is focused on *normative* arguments, while there is no comprehensive legal survey of the actual requirements imposed by a FRAND commitment under European and national law.

We look at various sources of law that may impact the obligation SEP owners to license at different points in the value chain:

- **<u>General principles of EU law</u>**

  Legitimate expectations

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In *Huawei v ZTE* the CJEU held that FRAND terms "create legitimate expectation on the part of third parties" that such licenses will be given. We examine the argument that this reference to general principles of legitimate expectations be interpreted as imposing an LTA obligation.

Upon closer reading of the case we find that the court does not interpret FRAND as a specific price level, but conveys a procedural understanding of FRAND that arises out of good faith negotiations. Importantly, under pre-existing case-law on legitimate expectations only "precise, unconditional and consistent information" can lead third parties to entertain legitimate expectations. However, third parties' expectations will very much depend, in each case, on the content of the specific FRAND commitment given to the specific SSO in question, which in turn depends on the latter's specific IPR policy (no one size fits all). Finally, to date the EU principle of legitimate expectations has applied exclusively to vertical relations between the State and economic agents. Its introduction in the context of horizontal licensing practices between SEP owners and implementers would be unprecedented and *Huawei v ZTE* does not cite any other case law in support of such reading.

Non-discrimination

We further examine whether general principle of non-discrimination under EU can be applied. An argument could be made that by refusing to license, certain SEP owners make a discrimination based on the position in the value chain. However, we find that the EU principle of non-discrimination would be difficult to apply in this horizontal setting. Moreover, in *Huawei* v ZTE, the CJEU implicitly admitted that the SEP holder enjoyed the possibility to differentiate FRAND terms across levels of production. It held that the patent holder's obligation to equal treatment only applies to the licensee and its "competitors", that is players located at the same level in the value chain and in the same product and geographic market.

- **Patent Law**

Under basic principles of patent law only those who infringe patent claims need to take a licence and then only if the patent holder so requires. Therefore, from a patent law perspective, the first step is to analyse the claims of SEPs. We looked at publicly available analysis and information on litigated cases where SEPs have been found to be valid and infringed.

We found that SEPs typically claim combination of components and whole networks, which means that SEPs cannot be subsumed to only to one component – i.e. a chip. Therefore, under patent law, implementers could potentially request a license only for a subset of SEPs that read on components. However, under patent law, they would not have an active right to force licensing, as patent law permits patent owners to choose whether they want to enforce their patents (or not).

A doctrine of patent exhaustion prevents licensing across multiple production levels – since the same patent can be licensed only once. Accepting LTA approach would lead to portfolio splitting – some SEPs that claim components would be licensed by component makers, while other SEPs that have wider claims would continue to be licensed by end-device manufacturers. ATA effectively resolves this by licensing only at a single point in the supply chain.

- **Contract Law**

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FRAND commitments given to various SSOs are widely recognised as being of contractual nature. Therefore, whether a FRAND commitment imposes a LTA duty depends on the particulars of that specific commitment given to a specific SSO. We analyse in depth ETIS's FRAND commitment, which is governed by French law, as well as commitments given to other prominent SSOs.

ETSI's FRAND commitment

ETISI's FRAND commitment applies to "equipment' defined as "any system, or device fully conforming to a standard". Thus, the core question is whether the word "equipment" covers all types of devices, or only end-user devices. Under French law, a contract should be interpreted in accordance with the parties' intention when entering the contract, but when the intention cannot be discerned, then interpretation should be carried out in accordance with what a reasonable person placed in the same situation would have given to the disputed terms.

In the literature, there are different accounts on the intention of the parties at the time of the adoption of the initial ETSI's IPR Policy. However, elements that are posterior to the conclusion of the contract, such as behaviour of the parties, can be used to shed light on parties' intention. The fact that ETSI has apparently resisted proposals to modify its IPR Policy in order to explicitly endorse the LTA approach would suggest that the initial intention of ETSI members was indeed to grant licenses only at the end-device level.

Moreover, a reasonable person would probably pay attention to the fact that ETSI IPR Policy uses the word "device", and avoids words such as "element", "component", "part", or "unit". Also at the time when the ETSI IPR Policy was adopted, the common practice in the telecom industry was to grant licenses at the end-user device level, and not at the component level. It can therefore be assumed that, absent a clear indication that the ETSI IPR Policy intended to depart from this practice, a reasonable person familiar with the industry would have interpreted the Policy as simply confirming this practice, and thus seeking only to guarantee licensing at the end-device level.

Other SSOs

We analyse FRAND commitments given at other SSOs and find that they typically come in two variants.

The first category is to directly and clearly impose an LTA obligation, as is the case with IEEE's IPR Policy that defines "Compliant Implementation" as "any product (e.g., component, sub-assembly, or end-product) or service that conforms to any … IEEE standard". Such wording leaves no doubt that SEP owners are under a contractual duty to license to any company in the supply chain that so requests.

The second, and most common, category of SSOs require licences to be available to "unrestricted number of applicants" or to "all applicants." (such as ITU-T, ISO and IEC). However, who can be considered as an "applicant" is often not clearly defined and it is unclear whether LTA duty can be imposed by such contractual wording. In our view, it would be wrong to impose a wide LTA obligation in case of unclear contractual interpretation because: i) SSOs could change their policies to clearly provide for LTA obligation as IEEE did; ii) the wide industry practice in case of

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SEPs appears to be licensing at downstream level, and iii) SEPs have wide claims that are not necessarily implemented in one single chip.

- **<u>Competition Law</u>**

Abuse of dominant position

Finally, we look at whether EU competition might impose a LTA duty to SEP owners. We first analyse whether refusal to license to component makers might represent an abuse of dominant position under Article 102 TFEU and doctrines established by CJEU in *Magill*, *IMS Health* and *Microsoft*. We find the abusive refusal to license doctrine inapplicable in cases where the SEP holder adopts a policy of licensing at the end-device level, and thus indirectly licensing component makers.

This is because licensing directly to component makers is not indispensable for carrying on their activities. It is important to stress that refusal to grant a license does not mean denying access to the standard. Component makers and other producers situated upstream will normally be protected by "have made" rights resulting from the licenses granted to the end-device producers to which they sell their products. And if this is not the case, SEP owners cannot seek an injunction against them without first offering them a licence, according to the rule set by the CJEU in *Huawei v ZTE*. It should also be added that, in practice, SEP licensing agreement are often concluded *after* companies have started bringing a product to the market, and not all SEP holders are able to license and/or willing to sue, owing to transaction costs of both licensing and litigation.

An abusive refusal to license would require an extreme set of facts: a SEP holder refuses to license all and any third party, and reserves for itself the manufacture of standard-compliant products. This has never happened in practice. And for good reasons. Given the repeated nature of standard setting, a SEP holder of this kind would likely be punished by exclusion from most standardisation organisations.

Horizontal Cooperation Guidelines (Article 101 TFEU)

Finally, a possible policy argument for LTA could be para 285 of the European Commission's Guidelines on Horizontal Cooperation Agreements (HCG) which provides that "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*."*

However, a careful examination of the scope, letter and spirit of the HCG calls into question that idea. First, the HCG do not prescribe an antitrust obligation. They provide a safe harbour whereby specific competitor's agreements can be deemed presumptively lawful, but there is no antitrust presumption of liability outside of that safe harbour.

Additionally, the term "all third parties" is not further defined. As seen, however, SEPs have wide claims covering end-devices, networks and combination of components. Therefore, this question will often be industry and depend from industry to industry.

Finally, the goal of the HCG is to ensure effective *access* to the standard, which is mentioned throughout the text, and not to set an LTA duty. For instance, paragraph 283 of the HCG provides that "the standard-setting organisation's rules would need to ensure effective access to the standard on fair,

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reasonable and non-discriminatory terms". Then in paragraph 287 the HCG continue to explain that FRAND commitments "are designed to ensure that essential IPR protected technology incorporated in a standard is *accessible* to the users of that standard…" Finally, the assessment of whether the SSO IPR policies restrict competition will focus on "access to the standard".

In conclusion, we demonstrate that EU law (general principles, patent, contract and competition law) does not require LTA from SEP owners. An LTA duty may exceptionally exist only if a specific SSO IPR Policy expressly requires so.

What the EU law requires is access to the standard. Access to the standard can be achieved in various ways: i) by having a direct license; ii) by indirectly benefiting from a license by selling components to licensed end-device manufacturers; iii) by concluding non-assertion agreements; iv) or not having a license at all if the patent owner does not monetize patents and does not have licensing program

SEP owners, if they decide to monetise their patents, should adopt a licensing strategy and choose the level of the production chain at which to license. Patent exhaustion doctrine prevents licensing the same patents further downstream, while upstream manufacturers are be protected by "have made" rights.