

June 4, 2019

## Continental Automotive v. Avanci: Wireless SEP Licensing Presents Challenges for Automotive Industry

As new devices become wirelessly connected, the importance of fairly licensing cellular standard essential patents (SEPs) has become increasingly important. This addition of wireless connectivity into new types of products, however, has created conflicts, as new market participants face unfamiliar licensing demands rooted in historical wireless licensing practices. The complexity of this situation is highlighted by a complaint filed recently in the Northern District of California ([Case No. 5:19-cv-02520](#)), in which Continental Automotive Systems, a supplier of cellular components to car manufacturers, sued both Avanci, LLC—a company that pools and licenses cellular SEPs on behalf of member companies—along with some of Avanci’s member companies. In its complaint, Continental alleged that Avanci, when acting on behalf of its member companies, breached FRAND commitments for the SEPs that it was offering to license. Interestingly, some of Continental’s complaints relate to the issues decided in the *FTC v. Qualcomm* case, which was recently tried before Judge Koh in the Northern District of California.

**Attorneys**  
[Steven Pepe](#)  
[Kevin J. Post](#)  
[Alexander Middleton](#)

### Continental’s Allegations of Breach of FRAND Commitments

According to Continental’s complaint, Continental is a Tier 1 supplier for the automotive industry. Tier 1 suppliers like Continental supply devices with wireless connectivity, such as telematic control units (TCUs), to automotive manufacturers. A TCU provides safety and infotainment services to drivers, and will often use wireless networks when providing these services (for example, to automatically report an accident). Inside the TCU is a network access device (NAD), which Continental purchases from Tier 2 suppliers. As Continental describes it, the NAD in turn includes a baseband chip that the Tier 2 supplier purchases from what Continental refers to as Tier 3 suppliers. According to Continental’s complaint, it is this baseband chip that provides the wireless functionality implicated by Avanci’s SEPs.

Continental alleges that Avanci first sought to license patents directly to car manufacturer customers in 2017. In early 2018, Continental itself sought a license from Avanci, but was apparently informed that Avanci exclusively licenses car manufacturers. According to Continental, Avanci would not license directly the Tier 1, Tier 2 or Tier 3 suppliers. In this way, by attempting to license only the automobile (i.e., the end product), Avanci was adopting traditional cellular licensing practices, in which the “end user” cell phone was the licensed product (as opposed to the cellular chipset). Continental alleges that, by dealing exclusively with car manufacturers, Avanci is attempting to extract (and has extracted) exorbitant royalties for the patents it licenses. In particular, Continental argues that given the cost of automobiles (i.e., thousands of dollars), by basing its licensing demand on that higher-priced end product, Avanci can charge a much larger license fee per vehicle than if the much lower-cost TCU or baseband chip were the product that was licensed. Specifically, Continental alleges that Avanci charges a flat license fee of \$15 per vehicle. But Continental contends that the device that actually provides the cellular functionality is a baseband chip that costs only \$20. Thus, if the baseband chip was the licensed product, Avanci’s royalty rate would be 75% of its price. A TCU sold by Continental costs approximately \$75. This means that a \$15 license fee per unit on that device would result in a 20% royalty rate. On this basis, Continental alleges Avanci’s licensing program is not fair or reasonable given these facts and the fact that (1) Avanci licenses only a subset of all the cellular patents and (2) the TCU includes significantly more functionality than the cellular functionality being licensed. According to Continental, “such indemnity costs are disproportionate to Tier 1 suppliers’ margins and expose them, including Continental, to potentially ruinous liability.”

### Implications

This case illustrates an early example of the complexities involved when patent owners attempt to license cellular SEPs for products that are not traditionally thought of as cellular products—such as cars. And it highlights how the concerns

expressed recently by Judge Koh in the *Qualcomm* case about Qualcomm licensing only the end-user cellular device can create market problems.

It remains to be seen how these issues will play out in non-cellular industries, like the automotive industry. For these industries, questions will likely be raised about identifying the appropriate base product for a potential license for cellular SEPs (e.g., the cars, the TCUs or the baseband chips), and whether the final usage of technology (e.g., in an automobile) can result in an increase in FRAND rate. The *Continental* case may provide insight into the complexity of FRAND when new industries face SEP licensing demands that have not been presented before and may be one worth watching.