

Morgan Lewis

2021

YEAR IN REVIEW

AUTOMOTIVE INDUSTRY



In 2021, the automotive industry was awash in change—driven by investment trends, new goals set by the Biden-Harris administration, and international electric vehicle-focused developments. Looking back, 2021 will be viewed as a transformational year in which the ways that automobiles are—and will be—designed, manufactured, powered, sold, and regulated evolved.

President Biden’s Executive Order 14037, titled “Strengthening American Leadership in Clean Cars and Trucks,” set a goal that 50% of all new passenger cars and light trucks sold in 2030 would be zero-emission vehicles, including battery electric, plug-in hybrid electric, or fuel-cell electric vehicles. The Executive Order also directs new pollution and fuel-economy standards for light-, medium-, and heavy-duty vehicles starting in model year 2027. This Executive Order coincides with the US Infrastructure Investment and Jobs Act, which aims to infuse capital into American roads and railways, and to enhance the growth of clean energy alternatives for human mobility. These investment and incentives are designed to, among other things, facilitate increased manufacture, sale and use of EVs.

In a related development, there has been a marked growth in investment, and interest in investment, in automotive and mobility companies. Special purpose acquisition companies (SPACs) have emerged as a primary tool for investment in connected, autonomous, shared, and electrical technologies. Investment in these automotive companies and technologies is anticipated to remain a continuing area of growth. Given the scope of this infusion of capital funds, it should also be expected that these areas will invite government interest, support, as well as scrutiny.

The investment in, and development of, connected vehicles emphasizes the tensions between intellectual property law and competition law that have existed for years in both the United States and Europe. Government agencies and European courts, in particular, are increasingly scrutinizing intellectual property and competition issues as they relate to the automotive and mobility sectors.

In this high-level 2021 auto industry overview, Morgan Lewis lawyers provide more detail into these developments. For more information and updates in the automotive and mobility space, check out our

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BIDEN-HARRIS ADMINISTRATION ACTIONS

BOOST EV OPPORTUNITIES

President Biden signed the Infrastructure Investment and Jobs Act on November 15, which allocates \$550 billion in new spending over the next five years to improve US infrastructure, including critical investments in the energy sector. These investments will cover power grid infrastructure, electric vehicles and charging stations, renewable energy, nuclear power, hydropower, and cybersecurity with the goal to strengthen the energy industry, support emission-free power generation, and bolster emerging technologies.

The Act earmarks \$7.5 billion to build a national network for EV charging to accelerate the adoption of electric vehicles.

Along with the funds, the Act establishes a 25-member EV working group, which will be led by the Secretaries of Transportation and Energy, to provide federal guidance and strategy for the development, adoption, and integration of electric vehicles into the US transportation and energy systems. As part of this group, the Secretary of Energy will conduct a study on the cradle-to-grave environmental impact of EVs and on the impact of forced labor in China on the EV supply chain.

The Act also directs the Secretary of Energy to establish a demonstration project for second-life applications of EV batteries as aggregated energy storage installations. This will provide services to the electric grid for the purposes of demonstrating power safety and the ability of EV batteries to provide ancillary services for grid stability and management as well as reduce the peak loads of homes and businesses, extending the useful life of EV batteries, and increasing the acceptance of and participation in the use of second-life applications of EV batteries by utilities. The Energy Information Administration will also expand data collection on EV integration with the electricity grid.

States are also asked to consider measures to promote greater electrification of the transportation sector, including the establishment of rates that promote affordable and equitable electric vehicle charging options, improve the customer experience associated with EV charging, accelerate third-party investment in public EV charging, and recover the marginal costs of delivering electricity to EV and EV charging infrastructure.

EXECUTIVE ORDER

Equally important to this sector is President Biden's August executive order, which underscored his stated commitment to encouraging the development and deployment of EVs as part of his administration's clean energy agenda. The executive order aims to increase the production of zero-emission vehicles by 2030 and directs new pollution and fuel economy standards for light-, medium-, and heavy-duty vehicles for model years 2027 and later.

The executive order, supported by the EV-related aspects of the infrastructure bill, may well serve to facilitate increased deployment of EVs in US markets. These major efforts are a clear signal that the federal government intends to make good on Biden's campaign promises to work toward electrification in the automotive sector. We can expect more movement down that path, as there is now money earmarked for more EVs and charging stations.

It sets a nonbinding goal that 50% of all new passenger cars and light trucks sold in the United States be zero-emission vehicles by 2030. The order includes a nonexclusive list of zero-emission options, such as battery electric, plug-in hybrid electric, and fuel cell vehicles. In the last three years, around 2% of new car sales would have qualified as zero emissions, with more than 40% of those sales coming from California.

To meet this goal, the order provides generally that the Biden-Harris administration will prioritize clear standards, infrastructure development, and innovation. Specific proposals include installing a national network of EV charging stations and creating point-of-sale incentives for consumers. Major domestic auto manufacturers have previously indicated their intent to have 40% to 50% of total new vehicles sales be for EVs by 2030.

The order also directs the US Environmental Protection Agency (EPA) to establish new multipollutant emission standards, to include greenhouse gas emissions, for light- and medium-duty vehicles for model years 2027 through at least 2030. The order sets the EPA's goal for its final rulemakings as December 2022.

For heavy-duty engines and vehicles, the EPA will also establish new nitrogen oxide standards for model years 2027 through at least 2030; must consider updating existing greenhouse gas standards for model years 2027 through at least 2029; and must establish a new greenhouse gas standard for model year 2030. The order sets the EPA's goal for these other final rulemakings as July 2024.

Further, the order directs the US Department of Transportation to establish new fuel economy standards for passenger cars and light-duty trucks for model years 2027 through at least 2030, and for heavy-duty pickup trucks and vans for model years 2028 through at least 2030. The order sets the goal for these final rulemakings as July 2024. Though imposing stricter standards on conventional internal combustion vehicles does not directly relate to EVs, stricter standards will make EVs more economically competitive.

LEGAL IMPLICATIONS AND OPPORTUNITIES

The Biden-Harris administration has emphasized the concept of "buying American," including American-sourced EVs. Initially, that commitment was meant to include sourcing from US mines of the minerals that are needed for the creation and manufacturing of battery packs in EVs.

But in May 2021, the administration indicated it wouldn't focus on sourcing the minerals in the United States, but instead would focus on having all substantive manufacturing occur within US borders. The materials needed could be sourced from other countries, including Canada, Australia, and Brazil. The administration also indicated it would conduct a yearlong review of supply chain and national security issues to determine the best path forward in procuring minerals from outside the United States.

The focus on producing more EVs and charging stations within the United States opens up opportunities for automakers. We are seeing partnerships between automakers and network charging service providers that are looking at long-term opportunities beyond the manufacturing of EVs.

This also opens some new sources of revenue for the automakers, which can provide fee-based services beyond auto sales of EVs, e.g., for charging stations, over-the-air updates, potential assisted or self-driving capabilities, ability to monitor drivers of fleets, and ability to monitor if a car breaks down. The push for more EVs and charging stations is also spurring development of regional utility alliances. The electric highway coalition includes 14 utility members working together to develop an EV charging network. A utility coalition in the Midwest is expected to comprise 10 members. This is a welcome development for consumers hoping for a collaborative approach to developing charging stations.

EV penetration in the US market has increased year over year for several years now, but some threshold issues must be resolved to facilitate widespread adoption—namely, issues concerning the ownership, jurisdictional status, and rate impacts of network charging stations, and the impact of the electrification of transportation on the electric grid. Both the infrastructure bill and President Biden's executive order address some of these threshold considerations.

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ENFORCEMENT ISSUES AND TRENDS AFFECTING THE US AUTOMOTIVE AND MOBILE INDUSTRY

As the automotive and mobility industry continues to grow under the watch of the Biden-Harris administration, it is important for key players to better understand the government agencies charged with enforcing the rules governing the market's potentially criminal activities and the administration's existing enforcement priorities. The Biden-Harris administration's enforcement priorities are likely to impact the automotive and mobility industry, as well as focus on special purpose acquisition companies (SPACs), possibly the newest frontier for parallel criminal and civil enforcement.

THE ENFORCERS

The US Department of Justice (DOJ) encompasses myriad divisions and offices. A survey of enforcement actions announced in recent years—including a series of cases involving emissions control manipulation and product safety concealment—indicates that automotive and mobility companies are most likely to interface with the following:

- The Criminal Division's Fraud Section: The Fraud Section, often in parallel with the other Main Justice authorities and in partnership with Eastern District of Michigan, has been at the forefront of prosecuting both companies and individuals primarily in connection with emissions cheating and associated conduct.
- Civil Division: The Civil Division's Commercial Litigation Branch played a major role in early emissions matters alongside its environmental colleagues at DOJ.
- Environment & Natural Resources Division: The ENRD Enforcement Section has played a leading role in emissions and other automotive-related matters over the past several years, working in conjunction with the Environmental Protection Agency (EPA)—and its injunctive powers—and the Civil Division.
- US Attorneys' offices: Sometimes working on their own, and sometimes in partnership with Main Justice, these sophisticated districts have made repeat appearances in recent cases in the Eastern District of Michigan and the Southern District of New York.
- FBI: Along with criminal investigators from the EPA, the FBI has been involved in virtually all emissions and product safety cases brought over the last several years and can be expected to remain active.

NEW ADMINISTRATION ENFORCEMENT PRIORITIES

Emphasis on Climate

The Biden-Harris administration has voiced its commitment to combating climate change, which will impact the auto industry, through these proposed actions:

- Potential plan to create an Environmental and Climate Justice Division within the DOJ
- Legislation requiring polluters to bear the full cost of their climate pollution and reinstating emission regulations
- Plan for a clean energy revolution and environmental justice
- Pledge to create new jobs in clean tech and increase the presence of electric vehicles

Pro-Enforcement Antitrust Policy

The Biden-Harris administration has signaled its pro-enforcement stance toward antitrust in several ways, including the following:

- Appointment of Big Tech critic Lina Khan as the chair of the Federal Trade Commission
- Executive Order announcing initiatives to increase antitrust enforcement and to promote competition
- Hiring Tim Wu as a special assistant to the president for technology and competition policy and nominating Jonathan Kanter to the DOJ Antitrust Division
- More aggressive merger enforcement by antitrust agencies across all sectors, including technology and transportation

Global Corruption Stance

The Biden-Harris administration has announced its offensive stance on anticorruption enforcement, with intentions to do the following:

- Establish anticorruption as a core US national security interest
- Increase proactive methods and rely less on self-policing within DOJ Foreign Corrupt Practices Act (FCPA) investigations
- Aggressively enforce anticorruption from the US Securities and Exchange Commission (SEC) under Chair Gary Gensler
- Collaborate with international partners and assist foreign countries to reduce corruption abroad

EXISTING ENFORCEMENT PROGRAMS

As enforcement actions against individuals and companies in the automotive and mobility space have persisted over the past several years, the importance of a company's compliance program—both at the time of any alleged misconduct as well as at the time of any resolution—has increasingly been emphasized by the DOJ and can play a critical role in interactions with the government.

On June 1, 2020, the DOJ Criminal Division updated its Evaluation of Corporate Compliance Program guidance, which had been issued roughly a year prior to set forth a framework for how prosecutors should evaluate corporate compliance programs, consistent with the Filip Factors. The 2019 guidance incorporated and expanded upon the sample question format from the earlier Fraud Section guidance, providing examples of how prosecutors would probe compliance program adequacy. In parallel with the guidance, the Criminal Division trained its prosecutors (rather than relying on a single compliance counsel role), bringing in outside experts to provide a range of perspectives and insights on difficult compliance topics.

The 2020 update to the Evaluation of Corporate Compliance Program guidance brings greater emphasis to the following:

- The need for compliance programs to be "adequately resourced and empowered to function effectively"
- The evolution of compliance programs based on lessons learned, measuring the effectiveness of training and the appreciation of risk
- The compliance function's ability to access relevant sources of data to allow for timely and effective monitoring and/or testing of controls
- How effectively a company has integrated acquired operations into its compliance structures and controls
- The accessibility of policies and the tracking of hotline reporting

Lessons Learned

Recent resolutions involving the industry have largely focused on emissions and product safety, with investigations into the alleged misreporting of emission test results to the sale of defective airbag inflators. The increasing emphasis on DOJ's evaluation of a company's compliance program can be seen in many related statements of facts found in the resolutions. These resolutions provide helpful lessons for the industry, such as the following:

- A problematic corporate culture can undermine otherwise reliable compliance program structures, i.e., the knowledge plus inaction paradigm (the compliance department initially did what it was supposed to—identifying potentially suspicious orders by applying preset metrics—but the failures came later, when the corporation's executives chose to ignore the suspicions and failed to conduct any investigation or due diligence).
- Unless a compliance program and its reinforcing controls are reassessed from time to time, they may be allowing problematic transactions to slip through undetected, despite an outward appearance of effectiveness.
- A corporation's failure to sufficiently empower and support its compliance function; e.g., in one instance, despite the company having \$1 billion in annual revenue, it did not hire a dedicated compliance officer, but instead added the compliance function to an existing employee who already had a number of other time-consuming tasks, such as managing the warehouse and tracking inventory.

- The biggest transactions deserve the same level of scrutiny and controls—if not more—than more routine transactions.
- Prompt remediation matters, especially when it comes to monitoring risks.

SPAC MOVEMENT IN THE AUTO INDUSTRY

There has been an increase in electric vehicle startups and auto tech companies going public through SPACs. There are a number of benefits to going public through a SPAC, including that the marketing process provides an avenue to discuss projections and forward guidance. This is especially helpful in justifying future revenues because the market for electric vehicles has untapped potential. Despite their popularity, however, it is important to note that the fast-moving nature of SPACs may make them targets for investigations, as we recently have seen. The accelerated timeline to go public creates pressure for investors to move at a fast pace. This, coupled with the risk of having to return the seed money to investors if the company does not become public, may result in inadequate due diligence. There may also be potential securities fraud charges resulting from representations made to potential or actual investors about the health of the newly merged company.

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IMPORTANT CONSIDERATIONS FOR SPAC INVESTMENTS IN THE AUTOMOTIVE AND MOBILE SECTORS

Special purpose acquisition companies (SPACs) have been around for decades, but have grown in size and prominence in recent years. In 2020, 237 SPAC IPOs raised approximately \$80 billion. Q1 2021 eclipsed that entire year's total, counting 300 SPAC IPOs in a single quarter, raising \$88 billion. And by October 2021, that number had risen to nearly 500 SPACs. Many of the transactions behind the SPAC uptick were driven by companies investing in connected, autonomous, shared, and electrified technologies, with a noticeable increase in green transactions.

- During the boom of 2020, many de-SPAC targets had little to no operating history with a focus on projections. In the more recent past, many targets have been more mature companies with clear operating histories that substantiate the deal valuation. In part this is due to many de-SPAC transactions trading down after the deal is effectuated, so the market is looking for more mature companies where they can more accurately validate financials and forecast how the companies will perform.
- The private investment in public equity (PIPE) market has gotten increasingly more difficult with (i) increased downward pressure on valuation by PIPE investors, (ii) PIPEs taking longer to get fully subscribed, if at all, and (iii) anchor PIPE investors expecting more from sponsors in consideration for being anchor investors. There have also been increasing levels of SPAC redemptions as many SPACs are trading below their redemption value. While deals are getting done, in the automotive space and otherwise, there is an increased focus on financial fundamentals to ensure that a deal ultimately will be successful.
- Although fairness opinions, which are provided by an independent financial adviser to a board of directors, had traditionally been rare for buyers in de-SPAC transactions, they are becoming increasingly common. Stockholder litigation had also been rare in SPAC transactions. However, such litigation is becoming increasingly common as the plaintiff's bar has turned more attention to the SPAC market.
- While deSPAC transactions do offer some advantages over a traditional IPO, including what is oftentimes a faster timeline, access to additional funds beyond what the SPAC raised in its IPO, and confidentiality in the event a deal falls through, interested investors should take into account the new SEC rules and increased litigation when evaluating potential acquisitions.

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BIDEN-HARRIS ADMINISTRATION PROMOTING LONGER TERM REDUCTIONS IN TAILPIPE EMISSIONS STANDARDS

In a move that the Biden-Harris administration is promoting as a partial fulfillment of a campaign promise to cut US greenhouse gas emissions (GHGs) at least in half by 2030, President Joseph Biden signed an executive order in August setting a goal of 50% of all new passenger cars and light trucks to be zero emissions vehicles by 2030 and building on Environmental Protection Agency (EPA) proposed tailpipe emission standards that are set to begin with the 2023 car model year.

EPA's proposed rules are a rollback of Trump-era standards and are generally more in line with prior Obama-era standards at least through 2026; however, they build in some flexibility for automakers. The executive order picks up where the proposed rules leave off: directing federal agencies to propose increasingly stringent emissions standards starting in model year 2027 for light-, medium-, and certain heavy-duty vehicles. Both the proposed rules and the executive order push the administration's overall goal of reducing GHGs and incentivizing a shift from internal combustion engines to electric vehicles (EVs).

BACKGROUND

Under the Obama administration's rules, automakers were required to improve fuel economy 5% per year from 2021 through 2026. However, the Trump administration lowered the standard to a 1.5% improvement annually. The Trump administration also repealed California's historic waiver under the Clean Air Act, whereby the state was authorized to set its own emission standards for new vehicles—which were generally more stringent than federal standards. Despite repealing the California waiver, in 2019 California and five automakers reached a deal wherein the automakers agreed to voluntarily increase fuel economy by 3.7% annually. In April 2021, the Biden-Harris administration suggested it was prepared to allow California to set its own emission standards once again, however EPA has yet to formally act on the reinstatement of the California waiver. While a formal action by EPA may continue to be at the center of a political tug of war—with democratic members of Congress pulling one way and republican AGs pulling another, the EPA rules are being promoted as an effort to harmonize the federal standards to the California deal.

PROPOSED TAILPIPE EMISSIONS STANDARDS

EPA released in 2021 a prepublication version of its proposed, and more stringent, emission standards for light-duty vehicles for 2023 to 2026 model years. These standards rescind Trump-era emission standards and were drafted in response to President Biden's "Day 1" executive order, which directed EPA to consider revising vehicle fuel economy and emissions standards. The proposed rule has yet to be published in the Federal Register, but EPA is already set to hold virtual hearings regarding the proposal and will accept written comments from the public and industry stakeholders.

EPA's proposed GHG emissions standards for model years 2023 and later increase the stringency of the requirement to improve fuel economy from the 1.5% required under the Trump-era rules to nearly 10% for model year 2023, followed by approximately 5% annual increases through model year 2026. While these increases are more stringent than the existing requirements, EPA has built in some flexibility for automakers by way of compliance options. For example, EPA proposes to retain existing GHG credit-based emissions averaging, banking, and trading flexibilities. The agency has also proposed new compliance flexibilities and incentives—largely due to the lack of lead time and the regulatory stringency—including carrying over previously earned compliance credits, advanced technology vehicle multiplier credits, and hybrid full-size pickup truck incentives, as well as increasing the off-cycle credits menu cap.

EXECUTIVE ORDER

While most of the attention on President Biden's August 5, 2021 executive order was centered around the goal that 50% of all new passenger cars and light trucks sold in 2030 be zero-emission vehicles, the order also sets forth a policy of aggressive emission targets beyond model year 2026. The executive order directs EPA and the Secretary of Transportation to establish new emissions and fuel efficiency standards for all vehicles beginning with the model year

2027 and extending at least until model year 2030. The agencies are strongly encouraged to issue their final rulemakings by December 2022 and are required by the order to issue final rulemakings by July 2024. While the executive order is silent as to specific targets that these standards will require, it is expected that any new future emissions and fuel efficiency standards will be more stringent than the recently proposed standards for model years 2023 through 2026. The agencies are directed to engage with California and other similar states in proposing the new standards and are further required to secure input from industry, labor, environmental justice, and public health organizations.

LOOKING AHEAD

EPA has been pursuing a rulemaking and regulatory effort that is likely to add complexity to the planning for new vehicles. The pressure on EPA to pursue these technology forcing efforts is unlikely to abate during this administration, and all stakeholders should be carefully tracking EPA's proposed rulemaking.

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RECENT DEVELOPMENTS IN COMPETITION LAW AND SEP LICENSING IN EUROPE AND THEIR EFFECT ON THE AUTOMOTIVE INDUSTRY

The development of connected automobiles crystallizes the tensions between intellectual property law and competition law that have existed for years, particularly in the area of standard essential patents (SEPs). These SEPs are essential to standards that set the technical specifications defining requirements for products, production processes, services, or test-methods, and which cannot be designed around. European courts, legislatures, and regulatory bodies have been engaging in an evolving debate, often centered on the issue of what constitutes a “fair, reasonable, and non-discriminatory (FRAND)” license.

A typical SEP dispute involves the patent holder suing the user for infringement. In other cases, the user alleges that the SEP holder is violating its market dominant position by not issuing a license on FRAND terms. Courts and competition authorities in Europe have taken different approaches in protecting the interests of the SEP holder and the user.

In the era of connected automobiles, these questions take on additional importance and complexity given the nature of the supply chain, the number of players involved, and the enormous financial stakes. Critical issues include the question of what constitutes a willing licensee, what is fair remuneration, and at what level of the supply chain a license should or must be granted. Some of these questions has the chance to be answered by the European Court of Justice (ECJ), to which a German court had referred several significant questions. However, the German court withdrew its questions, as the parties settled the corresponding SEP litigation.

Here’s what we’re seeing.

ANTITRUST AUTHORITIES HAVE TAKEN A STEP BACK

- The more complex the supply chains and detailed the FRAND issues at stake, the less relevant is initial case law involving vertically integrated companies and procedural issues.
- The European Commission and the German Federal Cartel Office (FCO) are reluctant to intervene in what they perceive as commercial issues and do not want to act as price regulators.
- The European Commission and German FCO have encouraged industry negotiations and mediation as well as recourse to courts.

COURTS HAVE BECOME INCREASINGLY INVOLVED

- The rising number of SEPs has produced a similar rise in SEP litigation, including invalidity and infringement actions. Within Europe, most of these actions are handled in German courts.
- Between 2018 and 2020, SEP litigation activity related to the automobile industry increased at the EU Commission and in courts particularly in Germany.
- In August 2020, the UK Supreme Court issued a ruling that a UK court can grant an injunction against infringement of a UK SEP patent if the infringer does not take a global license on FRAND terms. The ruling effectively allows a party to obtain a determination on a global license provided that a UK patent is contained within a patent portfolio and an intellectual property rights policy is in place.
- In November 2020, the Regional Court of Düsseldorf, Germany, referred a new case to the ECJ. In the action, the SEP holder was seeking an injunction against the OEM for SEP patent infringement. In its referral, the Regional Court asked:
 - Whether it constitutes an abuse of a dominant position by the SEP holder if it refuses to grant a license to an automotive supplier, in particular if an obligation exists for the SEP holder to give licensing priority to the supplier of the OEM that manufactures components using an SEP and where such component will be installed in the end-product eventually.
 - Whether and to what extent the industry practice for SEP licensing has to be taken into account.

- Whether the scope of such a supplier license would have to be such that the supplied company would in turn require no license, so whether there would be any exhaustion if the patent was licensed upstream of the end-product distributor.
- Where the refusal to grant a license to a supplier does not constitute an abuse, the court asks whether there are any restrictions on the SEP owner's decision to initiate injunction proceedings at a specific level of the supply chain.
- However, the Court withdrew its referral application in June 2021 as the parties to the SEP litigation reached a settlement. Therefore, these legally challenging questions will likely remain unanswered for quite a while.

REGULATORY AND LEGISLATIVE BODIES ARE ALSO ENGAGED

- The EU Commission published its IP Action Plan in November 2020 that it has started to execute during 2021. Major topics include better protection of IP, promoting the effective use and deployment of IP, especially SMEs, easier access to, and sharing of IP protected assets, fighting intellectual property rights infringements, as well as fair play at the global level. The plan appears to continue to favor industry-led solutions to resolve disputes in specific sectors and to keep disputes out of courts. The EU Commission has now issued an expert report on SEP licensing that sets out some ideas on how to address some of the underlying tensions here, including greater disclosure of licensing terms at the standard-setting stage, use of patent pools for licensing, independent third-party assessment of essentiality, and use of arbitration to resolve disputes.
- German lawmakers have adopted amendments to existing modernized patent law in June 2021. The main pillars of the amended law include a better procedural synchronization between patent infringement proceedings in the civil courts (which take typically one year) and the invalidity proceedings at the Patent Court (which on average take two years). Further, a fiercely debated provision clarifies that the claim for injunctive relief in infringement proceedings shall be excluded if it would lead to disproportionate results.

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