

Innovators Network Foundation

Jim Beveridge

Response to the European Commission's

Proposed Regulation on standard essential patents COM (2023) 232 final

I hold a fellowship from the Innovators Network Foundation. The Innovators Network Foundation focuses on improving the environment for innovation and entrepreneurship around the world. Innovators Network Foundation's network of experts positively advance the public debate over law and policy important to global innovation.

The program's purpose is to progress the development of positions, writings, scholarship, and communications to positively advance the public debate over standard-essential patent law and policy.

The focus of this part of our policy work is considering the impact standard-essential patent law and policy is having on SME /start-up communities.

<https://innovatorsnetwork.org>

Overall Comments

I welcome the opportunity to comment on the proposed European Commission's regulation on Standard Essential Patents (SEPS).

This SEP Regulation is of great importance and benefit to Europe's SME and Start-Up communities from the perspective of innovation and competitiveness. It will facilitate the digital transformations being applied to the traditional vertical markets that increasingly rely on ubiquitous and reliable wireless connectivity to innovate.

In Europe, SEPs based Open Standards have been embraced by industry, providing a route to technical interoperability, enabling low cost open standardised components to be mass produced. However, the current licensing system for these patents is increasingly burdened with legal and financial problems.

In many cases, especially for wireless and audio-visual communication standards, the system is opaque, ineffective and subject to massive court disputes. The use of such standards is thus increasingly associated with considerable economic risks. This hinders innovation and fair competition.

The Commission's efforts are an important contribution to (i) increasing the transparency surrounding licensing negotiations, (ii) providing further clarification on FRAND terms, and (iii) promoting a consistent essentiality assessment of SEPs.

Open Standards are based on the fair, reasonable and non-discriminatory (FRAND) commitments SEP holders make to innovators relying on standardised solutions to support their innovations and businesses.

Unfortunately, some SEP holders are renegeing on their voluntary commitments to license in a FRAND manner, while still reaping the benefits of standardisation. These abusive practices¹ are anticompetitive, restricting the freedom of SMEs and Start-ups to innovate. The forthcoming Commission's SEP Regulation is an opportunity to rebalance the ecosystem for the benefit of all.

In addition, the SEP Regulation will promote technological progress in Europe by ensuring that companies across the value chains have access to essential technologies on fair terms. SEP Regulation will underpin the EU's SME led digital transformation by encouraging the application and further developments of new standardised technologies targeting sustainability and energy efficiency.

The Scope of the Regulation

The Commission is to be applauded, recognising the need for intervention and making the decision to move ahead with the proposed regulation. The increasing importance of wireless communication to the economic growth in Europe has led for greater demands on the efficient utilisation of spectrum and this in turn has increased the use of interoperable wireless and compression standards. In the early days of SDOs economic wealth was in the main generated by companies engineering the production of products that benefited the consumer. These companies generated the SEPS and took advantage of the time to market and global reach afforded by their participation in the process to increase their wealth. Today the economics has flipped with much more emphasis on maximising the financial payback of patents as a traded commodity to the detriment of the smooth roll out of digital pipes within the EUs vertical markets.

This push towards financial and legal engineering to maximise SEP returns leads a few bad actors to utilise ambiguous SDO definitions of FRAND to their advantage in SEP licensing negotiations.

These bad actors are pushing against any regulation that might limit their ability to pursue their supra-profits. Their retort is that the system is working well so no need for regulatory intervention. This is demonstrably not true as highlighted by the recent court cases around the globe.

¹ <https://actonline.org/wp-content/uploads/ACT-SEP-Gen-Position-Paper-sent-081619.pdf>

UK Courts recently held that in both *InterDigital v. Lenovo*² and in *Optis v. Apple*³, that the SEP licensor in question had a consistent practise of offering unreasonable and discriminatory licences to ‘smaller players’ and using those licences as comparable examples in disputes with larger licensees. Smaller licensees do not have the experience or resources necessary to determine what a reasonable royalty rate should be for a given SEP and they are additionally intimidated by the threat of litigation.

The threat of litigation is unfortunately now baked into the business model of the bad actors who own SEPs. It’s important regulators step in to restore balance and bring the stakeholders together to benefit innovation.

What needs to improve to benefit innovation?

Specifically, what needs to improve is transparency within the licensing process, this will lead to the removal of artificial barriers designed to obfuscate access to the real cost of the technology being licensed. Increase certainty for SME’s with a policy framework that encourages innovation in the EU. This can be achieved through reducing the threat of litigation and injunctions. Friction free procurement of components including associated licensing should be the goal of this initiative.

The proposed regulation is under attack so it is vital that the Commission provide the most effective version of the EU SEP Regulation and explicitly acknowledge the foundational principles of FRAND that been agreed upon by EU stakeholders:

Clarification of FRAND Principles

That the EU SEP Regulation acknowledges key principles of FRAND that can help SME innovators succeed in standardised technology-based industries, is most welcome. The Commission recognises that wide implementation determines the success of a standard. All stakeholders should be able to use standards. This is of particular importance with the advent of the European Chip Act. SEPs must be available to all chip manufacturers thus enabling them to include the necessary wireless and compresion building blocks in their implementations.

Some SEP holders refuse to licence to certain entities in a value chain, while instead licensing to downstream stakeholders, such as end product manufacturers, from whom the SEP holder can extract additional value for their patented technology from unrelated features.

² *Interdigital Technology Co. v. Lenovo Group Ltd.* [2023] EWHC 539 (Pat).

³ *Optis Cellular Technology v. Apple Retail UK* [2023] EWHC 1095 (Pat).

How can this aspect of the regulation be improved?

In order to enable wide implementation of a standard, the FRAND commitment must attach to the SEP regardless of the holder since the patented technology was contributed to the standard prior the transfer of patent ownership.

To provide the most effective version of the EU SEP Regulation, the Commission should explicitly acknowledge the foundational principles of FRAND important to the SME community.

1. all stakeholders should be able to use the standard no matter where they sit in the value chain
2. injunctions available only for specific circumstances,
3. no unnecessary forced licensing,
4. providing a structured analysis to determine a reasonable rate for a valid, infringed, and enforceable FRAND-encumbered SEP

SEP licensing has a long history that has unveiled foundational principles that underlie the FRAND commitment. These principles have been identified in the CWA 95000, *Core Principles and Approaches for Licensing of Standard Essential Patents* (CWA 95000), developed by a broad cross-section of European stakeholders through the CEN/CENELEC Workshop Agreement.⁴

It should be reinforced that during the FRAND determination process that no requests for injunctions may be heard in EU member States.

It will be helpful if the Commission clarifies that imposing licensing conditions that require a cross-license of non-SEPs, is non-compliant with the FRAND commitment and that it indicates a licensor being unreasonable.

Support measures for SMEs.

Most welcome is the European Commission's recognition of the vital role that SME's play in the innovation process and the growth of the European economy. The elements detailed the voluntary guidance section i.e. The establishment of non-binding guidance on SEP licensing with additional free advice and training for SMEs on licensing negotiations will lead to more informed decision making and help European SMEs and Start-ups make progress towards unicorn status. Most SEP portfolios are held by international companies, leaving

⁴ See <https://www.cencenelec.eu/media/CEN-CENELEC/CWAs/ICT/cwa95000.pdf>.

SMEs in the EU vulnerable to potential abuses of market power by well-funded and well-resourced entities. Currently, these entities make up a small group of stakeholders that benefit from the current system and are working to oppose the implementation of the EU SEP Regulation.

How can this aspect of the regulation be improved?

The regulation can be improved through reinforcing measures that increase transparency of the terms being offered and decrease the risk of litigation for the SME community.

The recent court case *Lenovo versus InterDigital*⁵ Mr. Justice Mellor noted that when it came to pricing SMEs were discriminated against when it came to pricing. He noted in paragraph 495 of his judgement *“Having considered all the evidence on the issue of volume discounts I have reached the clear conclusion that the volume discounts said to have been applied to the largest InterDigital licensees (i.e. in the range of 60%-80%) do not have any economic or other justification. Instead, their primary purpose is to attempt to shore up InterDigital’s chosen ‘program rates’. Their primary effect is discrimination against smaller licensees.”*

As per this example, the issue for SME’s is that the Fairness in FRAND has been undermined by a few abusive SEP holders who are intent on extracting supra-FRAND terms. This posturing is being reinforced with the threat of expensive litigation and ultimately the application of injunctions.

To support SME’s, clarification of FRAND should highlight that injunctive relief should rarely be granted and only under certain circumstances, such as when, e.g., the potential licensee does not express a willingness to negotiate a licencing agreement. Additionally, injunctive relief should not be granted in case the SEP holder does not provide a specific offer for a license or specific information about infringement of the SEP by the potential licensee.

SMEs will most likely be positioned at a point in a wider value chain. SEPs should be valued on the merit of licence itself at the smallest saleable patent practising unit (SSPPU) rather than based on their inclusion in a standard or their ultimate application.

As part of the training it would be helpful if a mechanism could be found allowing SMEs to inject their IP into the standards making process. This way SMEs could benefit by the evolving standards being more applicable to their vertical market applications and financially be in a position to benefit from future royalty streams.

⁵ <https://www.judiciary.uk/wp-content/uploads/2023/04/IDG-v-Lenovo-judgment-270423.pdf>

The Competence Centre

The establishment of a Competence Centre is necessary and welcome development particularly for the SME communities. With telecommunications expanding its sphere of influence, SEP based technologies being used as building blocks inside regional vertical markets, market power has shifted towards global SEP owners.

This shift disadvantages the EU SME vertical market innovator who, in the main, has not been present whilst the communication standard was developed and has no alternative source of telecom building blocks to apply to their innovations. The Competence Centre will be in position to build expertise that SMEs can leverage.

Most welcome is the proposal for the Centre to become involved with essentiality tests. The number of self-declared “essential” patents has grown considerably over the past years, the number of patents rising from 82,000 patents in 2010 to about 305,000 in 2021⁶.

The current systems have very few checks and balances and this leaves the SME community, who have little resources to check patent validity, are thus open to fraudulent behaviour by bad actors. E.g. In the field of AV Codecs, the IUT-T SEPs database include over 70% of so called “blanket” declarations Companies state to own video codec SEPs without providing lists of declared patents⁷. The intervention by the EU in the area of essentiality will reduce the number of spurious essentiality declarations and reduce the ability of bad actors to extort excessive royalties from SMEs.

Article 17 of the EU SEP Regulation also provides that the competence centre will facilitate agreements on aggregate royalty determinations for the SEPs covering a particular standard. This is helpful as the process as companies that innovate through developing products will be able to make more reliable cost calculations in support of their business models. Furthermore, it will likely reduce the ability for certain SEP licensors to extract excessive royalties for their SEP from the innovations of implementing standards users.

The competence centre will also handle a mandatory and non-binding FRAND determination process through expert evaluators and conciliators that have extensive experience in dispute resolution and the economics of licensing on FRAND terms. The procedure for determining the aggregate royalty rate is balanced and efficient as in addition to the independent expert representatives from the SEP holders, implementers are also involved.

The EUIPO is in the best position to preside over FRAND determination.

⁶ <https://www.iplytics.com/report/rise-standard-essential-patents/>

⁷ <https://www.iplytics.com/general/answering-sep-market-questions-part-3-how-to-gain-the-competitive-edge-for-wi-fi-and-video-codec-slides-and-recording/>

How can this aspect of the regulation be improved?

Regulation can be improved by augmenting and further clarifying the definition of the terms used in the regulation. SMEs are generally unsophisticated in consumption of regulation and new terms used such as Evaluator, Conciliator and even the term Standard Essential Patent would benefit from clarification in the text.

It's important for entities licensing SEP's to know of the validity and quality of each patent they are licensing. Article 28 should be modified to ensure that all patents registered with the EUIPO are checked for essentiality. Assertions made by patent pools require to be independently checked. The business model of patent pools, driven by patent licensors, is to maximise returns for their stakeholders. The Commission should be wary of EUIPO being used as a Trojan horse by accepting non-essential patents on non FRAND terms because of the unverified say so from a patent pool.

Royalty rate determination covered in Article 17 should be limited to the EU and not made global. The global situation is becoming a battle of jurisdictions. Citing a global rate, whilst understandable given recent court cases, adds an unwarranted layer of complexity to regulation that should focus on simplifying licensing for EU stakeholders.

Exceptions to the mandatory processes.

It's important for the integrity of the SEP regulation that the exceptions to the mandatory processes are revised.

In the area of injunctions, the FRAND determination should not be undermined by parallel proceedings leading to an injunction. Article 34(4) allows for provisional injunctions of a financial nature to be issued against an alleged infringer. This provision can be used by SEP owners to force SMEs, who cannot afford litigation, to settle before the end of a FRAND determination.

The Commission is additionally proposing grant exemptions to identified use cases. All European vertical markets are becoming reliant upon standards based wireless communications, and audio/video codecs.

These past, current and future standards are/will be used to transmit data from sensors to the cloud for processing. The processing of this data and the resulting information gleaned will underpin future innovations within the vertical markets.

This carve out could provide an obvious loophole for companies interested in avoiding the regulation. The most mature and litigious use cases for a standard lie in the wireless communications space, which the Commission cites as having well-developed commercial relationships and licensing practices. However, as witnessed in the recent UK Court cases, in these markets there are increasing inefficiencies that need to be addressed by the regulation.

How can this aspect of the regulation be improved?

Recital 4 Exceptions to the Competence Centre Proceedings needs to be deleted as it can cause valid implementations in areas of dispute to fall out with the scope of application. A criterion based on the number of license agreements already concluded is flawed as in many cases license agreements in the area of communications patents have been only concluded under threat of an injunction. The focus of the regulation should be to promote innovation, ease the process of licensing. To grant exceptions to heavily litigated areas or applications would undermine the purpose of the regulation. Propose deleting ART.1 (3) and (4) plus Recital 4.

Conclusion

I welcome the opportunity provided to comment on the proposed European Commission's regulation on the subject of Standard Essential Patents.

The Commission's efforts to (i) increase transparency in licensing negotiations, (ii) provide further clarification on FRAND terms, and (iii) promote independent essentiality assessments of SEPs will help create more predictable legal underpinnings for the Open Standards.

European Industry needs to be positioned for renewed growth post pandemic and Ukraine. Much of the innovation towards a greener, digital future will take place within the traditional vertical industries where European SMEs are best positioned to innovate and prosper.

With Open Standards communications technology underpinning the digitisation and the "greenification" of Europe's vertical markets, SME's and Start-ups are increasingly dependent on friction free access to predictable licensing terms.

More transparency and openness within the licensing process is likely to lower bureaucracy, reduce the level of litigation and potentially lower transaction costs for the smaller implementers.

Start-ups and SMEs generating IP will likely also benefit from a more transparent ecosystem, capitalising on the incorporation of their innovations into standards and the resulting semiconductor devices.

The European Commission's Chip Act designed to strengthen Europe's semiconductor ecosystem demands a properly functioning SEP ecosystem in order to operate. SEPs embedded at the component level will reap positive benefits for all the stakeholders.

The Commission's regulatory initiative is a positive step towards the goal of a more balanced, fairer and better functioning SEP licensing ecosystem.

I thank the Commission for its consideration of my comments and look forward to future engagement and discussion on the topic of standardisation.

Sincerely,

Jim Beveridge
Fellow, Innovators Network Foundation.
Southampton, UK.