Global Issues In EU's Licensing Plans For Essential Patents

By **Eliana Garces, Joshua White and John Jarosz** (June 1, 2023)

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Around the world, the licensing of standard-essential patents, or SEPs, has become increasingly common but increasingly thorny.

In April, the European Commission attempted to address some of the emerging issues by publishing a regulatory proposal to establish a competence center under the auspices of the EU Intellectual Property Office.

The proposed regulation, though far from final, aims to shift SEP licensing from a somewhat inconsistent and secret set of bilateral negotiations to one that is open and governed by a central body that will apply understandable and predictable guideposts.

It represents an attempt to impose a speedy, transparent and predictable process governing the licensing of SEPs — one which the commission hopes will serve as a model across the world and establish the EU's position as a center of innovation and a global standard setter.

It is certainly the case that the perfect is often the enemy of the good. Here, the commission's attempt, while perhaps laudable, is not perfect. Sadly, for some it may not even be good enough.

In fact, a group of former U.S. federal officials, including several from the U.S. Department of Justice and the U.S. Patent and Trademark Office, protested that the proposal would "work great harm to the European and American innovation economies and permit our global competitors to continue to erode the value of our intellectual property rights."[1]

Although the proposed regulation will surely undergo alterations when it is debated in the European Parliament and the European Council, the principles underlying the framework for the proposal are likely to remain unchanged.

This article summarizes several key aspects of the new process being proposed and discusses questions around the framework and the commission's goals that may influence discussions of similar issues in the U.S. and elsewhere.

Commission Objectives for the New Competence Center

The proposed competence center will manage a centralized register of EU standards and a database containing information on the SEPs applicable to those standards. The center will also provide a platform for the negotiation of SEP licenses.

The commission's intention is to facilitate the licensing of SEPs in the EU, with the hope of greatly reducing the costs and uncertainties associated with the growing volume of SEP litigation.

The commission has made the development of standards in Europe an integral part of its industrial policy, and it has been working toward an acceptable SEP licensing framework for many years. Its overarching goal has been to balance the interests of large European patent holders with a need to foster digital transformation and innovation, often perceived as requiring easy and affordable access to technology.

The Need for a New Framework

An SEP is a patent that is required for an associated standard to be practiced — i.e., implemented in a practicing product.

Standards and designations of essentiality primarily are developed through voluntary participation of a variety of stakeholders with various standard development organizations or standard setting organizations.

Typically, patent owners committing their patented technology to a standard declare the ownership of the patents during the standardization process and agree to license these patents on fair, reasonable and nondiscriminatory, or FRAND, terms to willing licensees — that is, persons or companies looking to implement the technology standard.

Historically, this standardization process worked well in Europe when ownership of SEPs remained concentrated in a few large telecommunications and network companies that were both technology providers, or innovators, and implementers.

These companies frequently cross-licensed their patent portfolios to each other and bypassed the need for cumbersome licensing negotiations. Moreover, cross-licensing minimized the problem of royalty stacking, and the resulting high implementation costs.

The structure of the technology industry began to change with the advent of the internet, the privatization of state-owned telecommunications providers in the EU and the increase in mobile network providers and handset manufacturers.

These factors contributed to an exponential increase in the number of SEPs declared for a given standard; recently declared standards may now incorporate thousands of patents.

Incorporating next-generation connectivity into everything from automobiles to appliances also has resulted in a fragmented population of smaller nascent businesses and start-ups that implement the patents.

A new set of pure implementers has sprung up, requiring separate licensing agreements with multiple patent holders to integrate connectivity into a wide variety of new products.

In addition, some large technology companies divested their intellectual property portfolios altogether and spun them off into pure patent-owning entities, of which the primary business was to license to implementers.

These changes increasingly stressed the established SEP licensing system in the EU. The divergence of interests between pure innovators, pure implementers and differently positioned businesses has made it extremely difficult, if not impossible, to align positions on requirements for declarations, checks, FRAND terms and the rights to assert.

The result has been a massive increase in very costly disputes and litigation between

licensors and licensees in the EU, with allegations of abuse of dominance in licensing, often called hold-up by licensors, on the one hand; and patent infringement, sometimes called hold-out by licensees, on the other.

Basics of the Proposed Regulation

The proposed regulation is the EC's attempt to respond to the need to implement rapid and radical technological changes across sectors. The commission hopes to accelerate the deployment of standards with the acceleration and facilitation of SEP licensing.

In brief, the regulation proposes creating a competence center within the European Union Intellectual Property Office to register standards and maintain a database of applicable SEPs containing available public information relating to these patents. The center will also administer essentiality checks and provide a conciliation process and an expert opinion on the determination and allocation of aggregate royalties for registered standards.

In addition, the center will provide a nonbinding conciliation process for FRAND determination in bilateral negotiations. Any party may request a nonbinding conciliation process before a trained, appointed conciliator. If the parties fail to agree on FRAND terms in the course of a conciliation but one of the parties stays committed to the process, the conciliator will make public the final proposals of each party, as well as his or her own determination.

Crucially, registration and conciliation will be prerequisites for asserting an SEP in a European court. The publicly recorded nature of the parties' own proposals and, more importantly, the conciliators' own determination may serve as material information in any subsequent court proceedings, at the discretion of the respective courts.

However, if the parties agree on a FRAND determination during the conciliation process, that information will not become public. This provides an incentive to settle disputes outside of litigation.

In addition to the public information from its own conciliation processes, the center's database will aim to contain all information on an SEP, such as essentiality determinations, public licensing arrangements and public information on the FRAND determinations resulting from worldwide rulings relating to SEPs.

In short, the center is envisioned to be a one-stop shop for all publicly available information on essentiality, royalty and FRAND rates and licenses that may be applicable to standards and SEPs being practiced in the EU.

Pursuit of Efficient, Predictable Process for FRAND Determination

Moreover, the regulation attempts to develop a generally accepted FRAND methodology. Under the proposed regulation, the competence center will train conciliators in FRAND determination exercises to promote a common methodology.

The regulation does not define the methodology to be used in assessing FRAND licenses, but instead mandates that the conciliators take into account the FRAND valuation principles previously described in a commission policy document.[2]

The proposal seeks to tether the FRAND licensing terms to the value of the patented technology rather than the overall value of the product or the standard. The proposed

principles recommend that the licensing terms bear a clear relationship to the economic value of the patented technology, abstracting from value from the inclusion of the technology in the standard.

The proposal mandates that the evaluation of a FRAND license should focus on the elements of the patented technology itself and its marketplace success, not on the merits of the standard or the success of the product due to other patented and unpatented features of the product. A relevant inquiry may include consideration of the relative contributions of the patented technology to the standard.

The proposed regulation also implies that these considerations must be accounted for when assessing an aggregate royalty rate for the standard, that is, the maximum royalty burden that practicing products should carry across all contributions to the standard.

What to Expect for Implementers and Innovators

The proposed framework is intended to offer benefits to both innovators and implementers. For implementers, the higher level of transparency regarding the ownership and relevance of SEPs, and the conciliation process for FRAND valuations, are intended to reduce the risk of hold-up and of costly litigation of overdeclarations or unmeritorious claims.

In addition, the process to generate an aggregate royalty rate for a standard, while nonbinding, may impose some constraints on individual negotiations and protect implementers from uncontrollable royalty stacking costs resulting from piecemeal, disconnected negotiations.

The regulation also forces patent holders to start early licensing negotiations if requested by an implementer. Currently, it is not uncommon for patent holders to wait years for the wide implementation of a standard before they start asserting their patents, which puts implementers under considerable uncertainty and may increase the cost of the royalty if the standard is implemented in more mature and valuable devices.

The regulation also seeks to decrease costs of participation for small and medium-sized enterprises, or SMEs, as either technology contributors or implementers. The proposal requires patent holders to consider offering more favorable FRAND terms and conditions to SMEs and includes several measures to help SMEs navigate the SEP licensing process.

Together with the increase in the transparency of FRAND terms contained in public rulings and decisions, this may decrease the advantages gained by large implementers with stronger bargaining positions.

But the regulation is not unambiguously favorable only to implementers. It maintains that FRAND valuation should ensure continued incentives for SEP holders to contribute their best available technology to the standard.

The registration and database rely to a certain extent on the degree of patent holders' compliance, so their buy-in will be key. The conciliation processes are also nonbinding, and their results will have to be balanced if they are to be considered reasonable and valid by courts or in other proceedings — e.g., arbitration.

The center could also be a useful tool for patent holders. In a world with an increasingly fragmented implementer space, the competence center and the information it provides may facilitate requesting and obtaining SEP licenses, thereby increasing the number of licensees

in Europe. And, as envisioned, the process will obviate the need to pursue full-scale litigation and its associated costs.

The Road Ahead

The goals and mechanics of the commission's proposal are laudable. Addressing the proliferation of technology, reducing costs and increasing certainty all would be commendable outcomes. We wonder, however, whether several of the proposal's elements, both implicit and explicit, are wise, intentional, or even likely to be achieved.

First, the choice of the EUIPO as a host of the competence center is surprising, as it has no expertise in patent determinations and has not previously dealt with technology issues. It is not clear how efficiently an institution with no previous history in the field will be able to collect very dispersed data and to build and maintain a register of all public information relating to European standards and applicable SEPs.

Moreover, with little previous experience in the field of SEPs or technology patents, the EUIPO may find it challenging to identify, onboard, train and field effective conciliators and experts for the assessment of patents and FRAND determination.

Second, the objective to anchor the FRAND terms and conditions on perceived objective factors such as the economic value of the technology may be overly ambitious. The determination principles proposed by the EC lead to a number of questions about their utility and applicability in today's IP landscape.

For example, is economic value easily determined and largely objective? Moreover, isn't value largely driven by the use to which the asset will be put? And is it not the case that value can change over time and across users?

Moreover, FRAND terms do not consist of just a rate but a whole set of licensing terms. Will those be covered by a common methodology, and what principles will be applied?

Third, the proposed process is intended to minimize the likelihood and costs of litigation. As designed, however, such a goal may not be achieved. Strategic declarations, partial disclosures or game playing in the conciliation processes cannot be fully excluded under the current proposal.

One can imagine patent holders may remain reticent to release a large amount of information in the public domain. In fact, we expect that few patent holders will be willing to open their books and records to the whole world.

Fourth, in light of the transparency of the commission's process, it is not clear that innovators will regularly avail themselves of the new process — in the U.S. and other jurisdictions, similar disputes continue to be resolved by litigation, with jurisprudence serving in place of policy.

Moreover, a number of jurisdictions are enabling the adjudication of global licenses and could serve as alternative forums for companies seeking to avoid the EU process. Innovators, therefore, may forgo commission policy altogether and seek to litigate even EU-specific issues in other jurisdictions instead.

Finally, one goal of the commission's proposal appears to be the creation of a model that serves as a guidepost across the world. It remains to be seen the degree to which

adjudicators and courts in other jurisdictions are open to considering the patent information produced by the competence center and FRAND proposals of the appointed conciliators.

And the extent to which the principles established for FRAND determination will give rise to a generally accepted methodology is still unclear.

In sum, the new competence center is a worthy attempt at solving real problems created by an excessively litigious licensing space for SEPs. It is an important development that will certainly have an impact on standardization and SEP licensing in the EU.

But it is still unclear whether the proposed solution will resolve the current issues in SEP licensing in the EU. The approach of providing transparency and information is efficient and balanced, but the administrability of the process will greatly depend on the quality of the process and conciliators, and on stakeholder buy-in. In this, it may not be much different than existing mechanisms.

What may set the process apart is the timeframe. The proposed regulation calls for implementers to have access to licensing negotiations shortly after the standards are published.

The FRAND determination is also supposed to last only nine months, a shorter timeframe than typically is seen in litigated matters. It remains to be seen whether these are realistic timeframes, especially with the limited experience of the EUIPO in such matters.

If implemented, stakeholders and, in particular, patent holders will ultimately determine the success or failure of the commission's proposal. Balance and competence will certainly be needed to achieve the hoped-for goals.

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[1] Law360.com, "Ex-US Officials Slam EU Standard-Essential Patent Draft Rules," April 21, 2023.

[2] European Commission Communication, "Setting out the EU approach to Standard Essential Patents," November 2017, COM/2017/0712 final.