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A welcome statement of diverse views or a damning indictment of a hopelessly fractured system? On the EU SEPs Expert Group report and the state of SEP licensing

Enrico Bonadio (City, University of London) and Dr. Luke McDonagh (London School of Economics) · Tuesday, March 2nd, 2021

The report issued in January 2021 by the EU Group of Experts on Licensing and Valuation of Standard Essential Patents (EU SEPs Expert Group) was long-anticipated and followed two years of debate and discussion within the group. The published document is very long and wide-ranging (229 pages). Given the scope of the report, it certainly deserves critical attention. This is the first of two blog posts summarising and critiquing the report's findings – this first post considers the proposals for licensing while the forthcoming second post will focus on transparency.

Standard essential patents (SEPs) and the need for interoperability – a recipe for conflict

Patents covering standards – Standard essential patents (SEPs) – offer their owners R&D incentives/rewards in the form of time-limited monopolistic rights; in contrast, technology standards must be used widely by all players in the market to ensure interoperability. The relationship between patents and standards is thus one of potential, and often actual, conflict.

In the absence of a framework to promote harmonious licensing, SEP owners could, if they wish, use the patent enforcement system to 'hold up' or prevent their competitors from launching rival products that use the same standards. There is a related risk that the exercise of monopoly power by SEP owners could lead to the need for implementers to obtain multiple licences (known as the problem of 'royalty-stacking').

The need to obtain multiple licences is particularly evident when it comes to multi-component 'Internet of Things' (IoT) products that contain many parts, including home devices, game consoles, personal computers, smartphones, and automobiles. In these circumstances a variety of manufacturers are involved in the production process, forming a hierarchical supply chain. The risk of 'hold-up' is high in these industries.

To minimise risks SEP owners typically must commit to licensing their SEPs on 'FRAND' terms (fair, reasonable, and non-discriminatory). Of course, it occurs frequently that the parties cannot agree on what the FRAND terms should be, which can lead to acrimonious disputes and costly litigation. Guidelines on FRAND from independent policy-makers or courts can be useful to provide a measure of clarity to negotiating parties.

The EU SEPs Expert Group View of Licensing – No Consensus

The EU SEPs Expert Group featured a mixture of academics, lawyers, judges and industry representatives. Failing to reach an agreed view, the group's report puts forward a range of individual views, with no consensus (and, seemingly, not a little friction between the various parties). The report focuses (correctly) on licensing as the key issue for resolving disputes centring on SEPs – but the lack of agreement between the group's members demonstrates that the issue remains highly political and contentious.

In what can only be described as an extraordinary move, one of the panellists – Monica Magnusson of Ericsson – even published a scathing, dissenting opinion as an annex to the report. Magnusson argues 'the final report does not fulfil its purpose' (p. 187). Even more forthright is her comment that it is 'disturbing' that the proposal includes a suggestion that standard development organizations (SDOs) should encourage their members 'to join opposition proceedings against patents for which a licensing commitment has been made to the extent that they are essential' (p. 189). It is a point of interest that Magnusson, as one of the key representatives of the SEP owners, dissented from the report, while one of the key representatives of the implementers, Matthias Schneider of Audi, supported the report's conclusions. At the same time, it is important not to read too much into this, as the report, due to its scattered nature, puts forward a wide range of views, some of which are more favourable to SEP owners than implementers (and some where the opposite is true).

Key questions on SEPs have yet to be answered

The questions remain: at what level of the value chain of a product should licences be granted? Should such SEP licences be available to all in the chain from microchip to final manufactured product, e.g. car? The EU Court of Justice will, in due course, have to issue a ruling in *Nokia v Daimler* – and that looming dispute certainly haunts the EU SEPs Expert Group's report.

In that key dispute, Nokia, as licensor, and carmaker Daimler, as implementer, are at odds with one another. In the ongoing battle Nokia and Daimler have accused each other of not making FRAND-compliant licence offers/responses during negotiations. Nokia has requested that Daimler pay SEP royalties based on each car sold instead of giving auto-part makers licences for the components they manufacture. Daimler has argued that these fees would be far too high, demanding instead that Nokia license the SEP technology to the suppliers of the equipment used to integrate mobile devices in its cars (and such suppliers would then charge Daimler). Some of these suppliers, such as Robert Bosch and Continental, support Daimler in the ongoing litigation.

Thus, SEP owners like Nokia and Ericsson tend to favour product-level licences, seeking to attribute value to their patents at the product's highest cost level (the finished device, object or vehicle); while the implementers along the chain, and companies like Daimler, seek licences valued at the component level.

The report shows understanding of the perils of getting this wrong – namely, the under-compensation of patented innovation if the licensing solution ends up pushing the royalty rate down substantially (with those further up the chain seeking to put the responsibility for licensing on those earlier in the chain). At the same time, even a basic understanding of competition rules would indicate that putting most costs onto the final end-product implementer could be prohibitive and burdensome.

So, what does the report actually recommend? Due to the lack of agreement between panellists, the report hedges its bets:

"It is important to note at the outset that there may be no single answer to the question at which level of the value chain FRAND licences should be offered/taken and this Part should not be interpreted as suggesting that one approach is necessarily superior to the other." (p. 77).

Despite this it is possible to glean some general principles on licensing. Three are flagged up in the executive summary:

- licensing at a single level in the value chain of a product (which should, in theory, reduce transaction costs);
- a uniform FRAND royalty for a particular product irrespective of the level of licensing is suggested (which should improve certainty for parties); and
- the FRAND royalty is a cost element in the price of a component and should be passed on downstream (a complex suggestion that the report admits could lead to price increases at the product level and thus requires continual coordination between all parties).

It is not clear that these three particular suggestions are entirely compatible (again, an indicator of a lack of consensus among the panellists as to solutions). The report admits this, noting on page 11-12 that even with these three principles in mind a certain amount of mitigation may need to take place if either the SEP owner or the implementer loses out substantially from the set price of the licence. Negotiations in good faith remain vital.

Proposal for new collective licensing mechanism

One of the most interesting and, arguably, practical recommendations in the document is proposal 75 for collective Licensing Negotiation Groups (LNGs). The report suggests (at page 169) to create an 'appropriate mechanism and controls to allow licensee negotiation groups (industry associations representing member implementers or groups of individual implementers) to jointly negotiate licences with individual SEP holders and SEP patent pools without the risk of getting in conflict with antitrust regulation'.

The report recommends that such groups be scrutinized carefully by (EU) competition authorities and that opportunities for 'hold out' are minimised. According to the report, this option promotes large-scale, organised negotiations, which ultimately are the preferred route to preventing costly and time-consuming licensing disputes occurring in the first place.

Conclusion

The report provides evidence that, at present, there seems little appetite among the main players for compromises on FRAND licensing of SEPs. The report's conclusions – such as they are – do not bind the EU Commission but provide plenty of food for thought. The Court of Justice will, in due course, have to issue a ruling in *Nokia v Daimler* – and that looming dispute certainly haunts the group's report. For now, while we await that decision in the hope that a degree of legal certainty on licensing will emerge at the judicial level, the EU SEPs Expert Group report does at least chart several possible future courses for resolving (and preventing) licensing disputes over SEPs.

Dr Enrico Bonadio (City, University of London) and Dr Luke McDonagh (London School of Economics) are IP law academics. For 2020-21 they are Fellows of the Innovators Network

Foundation.

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