IAM

DG GROW seeks to replace established FRAND valuation and licensing practices with top-down rate setting

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WiseHarbor founder Keith Mallinson provides his analysis of the draft Proposal for Regulation of the European Parliament and of the Council establishing a framework for transparent licensing of standard essential patents, including an associated Impact Assessment report (IA) that were leaked ahead of their anticipated public launch on 26 April.

DG GROW is proposing various ill-conceived interventions — processes that have not yet even been designed or properly budgeted, let alone tested. These will upset a standards development and patent licensing system that has been effective in enabling the world's fastest growing and largest ever technology ecosystem serving more than **five billion people** and **16 billion connections** with cellular worldwide.

I have feared but **anticipated in my publications that the EC might try to build some kind of Ministry of Patent Counting** with the purported aim of helping SEP implementers including SMEs in particular in Fair Reasonable and Non-Discriminatory (FRAND) licensing. DG GROW now proposes to do that in spades by building a large "competence centre" bureaucracy at the European Union Intellectual Property Office (EUIPO). No, this is not the non-EU European Patent Office (EPO) that 63% of respondents to a DG GROW survey last year stated they preferred conduct the checks. This EU organisation has no expertise in patents, let alone in SEPs. It was selected because "the body needs to be aligned with the EU's overarching political values and current policy priorities (e.g. support for SMEs)","accountable to the EU Public and European Parliament", and "subject of a review by the CJEU".

The new centre will become a white elephant, even if it can acquire the required competences and get away with making the industry, and ultimately consumers, pick up the tab.

A recipe for hold-out and short-changing SEP owners

DG GROW's unconscionable mission, which will undermine SEP licensing and enforcement (eg in Germany), is without legal or evidential support. The status quo purportedly exposes European companies to more litigation than "foreign producers that might fly under the radar", however patent infringement and exposure to enforcement occurs in both the location of manufacture and of sales. Unlicensed products manufactured outside Europe are more susceptible to being excluded through customs seizures as well as injunctions in Europe than are unlicensed European manufacturers. The Impact Assessment presents much anecdotal rather than quantitative evidence that European implementers are systematically and significantly

disadvantaged. Rather than racing to the bottom by crushing European royalties and enforcement to level-down with foreigners' alleged infringing sales, all suppliers in and to Europe should be held to the same high standards of patent protection.

If the reforms proposed in the leaked draft are accepted, this will do **more economic harm to licensors, including EU's leading innovators Ericsson and Nokia** — that are highly dependent on SEP income to fund R&D — than it will to speculatively benefit implementers including SMEs who are purportedly those most in need of these changes. DG GROW also complains of "insufficient transparency on SEP ownership and essentiality; lack of information about FRAND royalties; and a dispute settlement system not adapted for FRAND determination".

And yet, for most European implementers, including SMEs in particular, there is only limited exposure to unexpected SEP licensing or litigation costs because virtually all phones are manufactured outside of the EU and most SEP patents are exhausted in, for example, IoT modules that are also overwhelmingly manufactured elsewhere. The significant exception is cars. Avanci has very successfully created a solution that is licensing all European manufactures at the modest cost of up to $20 per car for the vast majority of patents declared essential to 2G, 3G and 4G, while its upcoming 5G program is in the works.

A centre of insufficient competence for DG GROW

DG GROW is unsatisfied with ETSI's IPR database of declared essential patents. Its declaration process exists only to ensure technology standards are not blocked by unavailable IPRs. Essentiality of declared patents is not checked, let alone updated to reflect whether declared patents end up staying or becoming essential through patent prosecution and to finalisation of standards. ETSI also refuses to participate in commercial matters, such as setting royalty rates — even in aggregate, let alone for individual licensors and licensees — because its members do not want to compromise ETSI's technically-focused functions, because ETSI does not have that competence and because it would be a violation of competition law.

Consequently, DG GROW apparently wants to expand administrative scope by edict through the EUIPO with new competences including:

- Registration of SEPs and access to the electronic database established by the competence centre. It seems this will largely duplicate what the ETSI IPR database does for patents declared essential to cellular standards, while also providing updates on patent status.
- Essentiality checks, including peer evaluation. The proposed process is fraught with all kinds of issues that will lend to manipulation, favouritism, bias and also subject checks or patents to subsequent challenges. SEP owners have shunned a system like this in Japan.
- Aggregate royalty determinations. Despite many claiming expertise, there is no consensus on methodology, let alone on applicable figures. The *Unwired Planet* Decision assumed patent value proportionality only to imply — not set — aggregate figures in cross-checking comparable license valuations due to the uncertainties. Even defining *aggregate* is debateable: is this total a theoretical maximum that nobody would ever pay, a typical or average figure actually paid after caps and discounts, or something in between?
- FRAND determinations. DG GROW is incredibly abandoning the industry's prevailing comparable licenses valuation method. Its proposed top-down approach is unsubstantiated and has floundered in the courts. The recent ***InterDigital v Lenovo* Judgment** in the UK "f[ound] no value in InterDigital's Top-Down cross-check in any of its guises", despite huge amounts of expert work. The entirety of the *TCL v. Ericsson* FRAND Decision including its **shaky top-down valuation** was unanimously vacated on appeal. The IA acknowledges "persistent differences of opinion on key aspects of the FRAND concept such as royalty evaluation methods". The EUIPO's experts will have to build trust in their top-down competence from the ground up.

DG GROW advocates exemptions from royalty payments for low sales volumes in FRAND licensing. This is appropriate and already common practice in many bilateral and pool licenses. However, while DG GROW calls this "royalty-free licensing", its ambiguous use of this term, while also referencing examples of Bluetooth and USB standards, dangerously implies reciprocity that prevents counter-parties from generating any royalties. This undermines the business model neutrality in an open and competitive market DG GROW should be preserving.

Disregarding facts

It's staggering that DG GROW disregards plain facts and maths. No wonder it's being **accused of being so one-sided.** While it professes to cherish transparency and balance, and claims to conduct literature analysis, it has not cited any of my articles among the hundreds cited in its IA. This is despite mine being widely cited elsewhere for my seminal research on key SEP issues including **aggregate royalties** and **inaccuracies in patent sampling and essentiality checking**. On the latter, **in 2021, I identified a mathematical howler in a 2016 report for the EC by CRA** that is cited eight times in the IA. CRA hugely understates — by a factor of much more than 10 — the estimated sample size of only 30 it claims provides "quite a good precision". Neither a rebuttal to my claim, nor erratum has ever been produced. Sample size and time spent per patent are the two biggest cost drivers in essentiality checking.

And, **as highlighted by FOSS Patents**, DG GROW is also wrong to assert that "false positive and false negative random errors tend to cancel each other out" because **more of the former creates systemic bias**.

Nevertheless, **my findings that accurate samples of several thousand are required** have got through. The IA anticipates the need to check 10,000 to 99,500 patents at a cost of €4,000 or €5,000 each for a total of €40-498 million, plus claim chart, office IT, administration and depreciation costs. Ouch!

This empire-building framework defies common sense and smacks of agency capture by Big Tech and Auto lobbyists seeking to minimise licensing charges. It disregards the proven efficacy of standard-essential technology development, established licensing FRAND practices, economic realities and the interests of innovators. Bureaucratised and centralised essentiality checking, patent counting and rate setting will be burdensome and costly. Internal processes and external challenges to what these deliver will only exacerbate existing patent hold-out and further delay licensing payments.

The technology standards ecosystem has evolved and flourished in a free market. European SEP licensing is overwhelmingly a European net export worth billions of Euros per year including major earners Ericsson and Nokia. Its reckless to jeopardise that and saddle the European industry with the additional costs of these proposals. These set a terrible example that will encourage jurisdictions seeking to benefit from erosion of SEP value. Rather than having most of EU's estimated 1,500 experts in the field check others' patents at an estimate cost of €500 per hour, it would be more fruitful for them to spend their time innovating and patenting themselves.

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