

European Commission's Approach to Developing a Framework to Resolve SEP Related Issues in IoT

1. INTRODUCTION

The revolution in the information communication technologies (ICT) sector has immense potential to interconnect other sectors and enable other products and services to develop in a significant way. Developments like Bluetooth, 3G, LTE and WiFi over the last decade has powered the growth in the ICT sector. These technologies have the potential to be adopted and integrated in to other sectors that can provide seamless access to consumers regardless of where and how they are operating conventional products. For instance, concepts like Smart Homes, Smart Cities, Smart Cars and other similar electronic appliances have not only transcended as mere futuristic gadgets but have changed the way we engage with products that are digitally interconnected.

In the hyperconnected world, it is necessary that there is seamless interconnectivity between products and that means better interoperability. This can only happen when patent owners of such technologies engage with Standard Setting Organizations (SSOs) to declare such technologies as standards. Thereby ensuring that a standardized technology is widely adopted and there is wider dissemination and interoperability of such technologies. Therefore, Standard Essential Patents (SEPs) become vital in enabling a seamless integration between various products in the hyperconnected world.

The European Commission envisages this situation as an opportunity that can be utilized to power growth in the near future. Smart cities, Smart homes and other such interconnected products have the estimated economic potential of up to € 9 trillion by 2025. This economic potential is seen as the next force that is going to drive the economic growth in Europe as Internet of Things (IoT) will drive homes, offices, factories, automobiles, and cities in most parts of the world. The European Commission views this as an opportunity to ensure that Europe remains the top player for making such devices provided the patent holders continue to develop technologies that can be declared as standards by SSOs. This is essential not merely from the point of interoperability and wide dissemination but also from the perspective of committing to giving out licenses that are based on fair, reasonable and non-discriminatory (FRAND) terms. However, the European Commission in its Communication issued to the European Parliament in 2017 (EC Communication) identifies several concerns related to SEPs that require immediate attention so that the potential growth seen in this sector is not hindered due to the issues that have emerged in the ICT sector.¹

Brief

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The EC Communication identifies that implementers who intend to utilize SEPs for integrating their products (vehicles, medical equipment, home appliances, etc.) are not necessarily from the ICT sector which is predominantly contributing existing and new technologies to the hyperconnected world. This in itself is a problem as most of these players are unaware of the licensing practices within the ICT sector. Existing licensing practices within the ICT sector might be incommensurate with the business interest and practices of the other industrial sectors who will primarily be seeking licenses from SEP holders in the ICT sector. EC communication has already identified that SEP holders in the ICT sectors are primarily unhappy with implementers due to the delaying tactics adopted during negotiating of licenses. The unwilling licensees have also compounded the problem of SEP holders by using the underlying technology without seeking licenses. The implementers, on the other hand, complain that SEP holders in the ICT sector tend to lay down conditions and demand royalties that are not based on FRAND terms. Further, the threat of injunctive relief sought by SEP holders forces implementers to accept non-FRAND terms to ensure that they are not stopped from manufacturing and marketing their products. Therefore, the EC Communication seeks to address three major concerns: lack of transparency in terms of essentiality of SEPs; lack of clarity in the valuation of patents and understanding as to what constitutes FRAND; and the risk of uncertainty in the enforcement of SEPs.

2. CONCERNS OVER LACK OF TRANSPARENCY

While it is a given that standardizing technologies increases interoperability and allows adoption of such technologies by telecommunication and mobile manufacturers it has always been a matter of grave concern as to what exactly has been subject to standardization. Lack of such information tends to delay negotiations of SEPs. Barring the declaration databases made available by SSOs, there is lack of transparency in terms of relevant patents that are subject to standards. This essentially raises the risks for Small and Medium Enterprises (SME) and start-ups, companies having limited market reach and entities that have limited or no experience in dealing with SEPs. Such entities may not be in a position to anticipate the extent to which royalties have to be negotiated, and to understand the need to separate or not separate essential and non-essential patents. This situation results in instances where implementers are ignorant of patents that they are infringing. It can also result in mistrust between negotiating parties which may ultimately frustrate the interests of both the parties. Such an environment is neither conducive for the SEP holder nor for the implementers. The EC communication seeks to address the problem of transparency by outlining a set of measures that could reduce information asymmetry and as such enable faster negotiation of licenses between the parties.

EC communication particularly identifies that the SSO declarations of standards are not user friendly especially with start-ups and businesses that are not necessarily associated with the telecommunication sector but are primarily integrating such technologies in other devices or technologies. Another key concern is related to how declarations lack any information as to which of those patents are essential to the declared standard. Improving information about the essential patents to a standard and providing user friendly and accessible information about patented technology that has been declared as a standard would facilitate faster negotiations and will increase confidence and trust amongst implementers. Access to such information can be further enhanced by linking patent information to patent office databases, adding updates about the status of the patents, information about transfer of patents and strict scrutiny of the declarations made by patent holders.

Enhanced information about the patents that are essential to a standard would reduce the burden on willing licensees as the current practice requires them to identify essential patents from other patents that are usually associated with a standard. EC Communication suggests that burden on the implementer can be reduced if an independent party with technical know-how can scrutinize the patents declared as part of a standard and identify essential ones. Further, EC communication insists for the need to updated declarations. This is vital as at the time of declaring standards many patents may not have been granted and might be at the stage of being examined in the patent office or merely a patent application might have been filed. Updated information can contain grant of patent and any change in the scope of the claims made in the patent applications. This can have significant implications especially if the scope of the claim has been reduced at the time of grant of the patent. Additionally, linking the patents declared in the standard process to patent families can also aid the prospective licensees in scrutinizing the patents. The patents that are part of standards have also been subject to litigations. However, it is important to note that only a few patents associated with a standard are the subject matter of litigation. Any update on the progress of such litigation, and the verdict in such cases that can be easily traced and linked to a particular standard is especially useful to implementers who may not necessarily be equipped with such information at the time of negotiating licenses.

While EC communication has undeniably emphasized on the need to increase transparency, it has also acknowledged that the burden should not be disproportionately placed on any one stakeholder. Instead, it has suggested a gradual approach to increase transparency which should begin with new standards declared by SSOs. It has advocated a system wherein SSOs could seek a modest fee from the members and create a system of issuing transparency rating or certification for each newly declared standard.

3. EVOLVING PRINCIPLES TO UNDERSTAND FRAND

When patent technologies are declared as standard it creates a legitimate expectation amongst third parties that the SEP holder will license the technology on FRAND terms. However, multiple disputes and cases have been filed across multiple jurisdictions to determine whether terms and conditions in the licensing agreements are fair and reasonable and whether the royalty rate charged by the SEP holder is discriminating in nature. Added to that, multiple cases in various jurisdictions have been decided to determine whether the parties to the licensing agreement are negotiating in good faith. An unwilling licensee can prolong the duration of negotiations and frustrate the SEP holder by denying or delaying the fruits of his labour. Similarly, a SEP holder who seeks unreasonably high royalty rate might be delaying a willing licensee from introducing his product in the market. To ensure greater efficiency in negotiating SEPs the EC Communication seeks to create an environment of good faith negotiation, which is also based on fair rates and fair licensing conditions.

As stated in earlier cases like *Huawei Technologies*² and *Unwired Planet v Huawei*³ both the parties need to approach the process of negotiating the licensing agreement in good faith. In *Huawei v ZTE* the CJEU laid down the expected behaviour from the parties to the licensing agreement. Whether the parties to the licensing agreement negotiated in good faith depends on whether the guidelines laid down by the CJEU is followed by the parties. CJEU stated that the SEP holder has to inform in writing to the implementer about the use of the relevant SEP technology as the implementer may not be aware of the relevant SEP. As stated above lack of transparency related to declared standards is one of the reasons behind this requirement. The implementer needs to willingly express that he intends to negotiate a licensing agreement based on FRAND terms. The SEP

holder needs to clearly inform the implementer about the terms of the license along with the specific royalty amount and the basis for calculating it. The implementer needs to respond to the offer in good faith without employing delaying tactics. While it is not necessary for the implementer to accept the offer made by the SEP holder, a counter offer should be made on FRAND terms in writing to the SEP holder. If an implementer is already using the SEP, then he needs to provide adequate bank guarantee or deposit money to assure the SEP holder that it intends to willingly negotiate the licensing agreement. A third party may be requested to determine the royalty rate in case no agreement is reached between the parties. Further, the EC communication indicates that established licensing conditions must be adopted to determine the FRAND rates. In order to do so, it is necessary to keep in mind that there is no 'one-size-fits-all' solution.³ It is necessary to bear in mind that what is fair and reasonable differs from sector to sector and it cannot be pre-determined what works in one sector is fair in other sectors. It is paramount to keep in mind the need to ensure efficiency in negotiating licenses as well as the need to increase diffusion of technology. Therefore, FRAND needs to be determined on the basis of the value of the patented technology. Value has to be determined on the basis of technology and not on the basis that it has been declared or included in a standard. It is necessary to keep in mind the relative importance of the patented technology. FRAND itself may be determined on the present value added by the technology instead of relying on the relative success of technology in the market. While determining the value it is necessary to ensure the incentives necessary for the SEP holder to invest and contribute to developing new technologies. While a low royalty rate may be beneficial to the implementer, it may nevertheless be a disincentive to the SEP holder to invest and develop new technologies. Therefore, a fair valuation of the technology is necessary. FRAND cannot be determined by isolating the SEP, instead, parties have to take into account the overall added value of the technology.

Further, it is necessary to consider that while determining whether the licensing agreement is non-discriminatory, the SEP holder is treating similarly situated implementers in a similar manner. Sectoral differences and varied business models must be considered while determining whether the practices are discriminatory. The EC Communication takes into account the jurisprudence developed in *Unwired Planet v Huawei* wherein the UK High Court concluded that global licences may not be anti-competitive or abusive. This is primarily based on the rationale of convenience and efficiency. It would be expensive and time consuming for parties to enter into licenses based on each jurisdiction. SEP holder having a large portfolio of licenses would also be similarly inconvenienced if it were to enter into license based on each SEP. It would be rather practical to enter into a global portfolio license unless it amounts to an anti-competitive behaviour. The EC Communication further recommends patent pools and cross licensing where possible as long as it is within feasible competition norms.

4. PREDICTABLE ENFORCEMENT FRAMEWORK

EC Communication identifies the lack of predictability in resolving SEP related disputes as a hinderance for developing a robust market in new and emerging technologies. Uncertainties in resolving disputes have serious implications as it results in an entry barrier for new entrants. The EC communication has specifically noted that there are numerous disputes involving SEPs. To ensure that there is increased diffusion of emerging technologies and higher participation of implementers and start-ups, it is necessary to develop a balanced and predictable enforcement environment that can resolve SEP related disputes. A balanced and predictable enforcement framework will create confidence amongst investors, reduce risks and create a

positive effect on all stakeholders. Therefore, the EC Communication seeks to create a clear dispute resolution framework by ensuring that it is balanced and neutral (that is neither favourable or burdensome on the SEP holders or implementers). Towards that end, it identifies negotiations in SEP licensing as an important step in furthering the above objectives. Any potential delays in such negotiations might delay the use of standard technologies. This may result in hampering the development of interconnected products in Europe further affecting the competitiveness of the EU economy. Failed negotiations have been identified as one of the major reasons towards the increase of SEP disputes. Pointing both possibilities of hold-up and hold-out, the EC Communication gives credibility to the idea of hold-out, which has often been ignored alongside the popular hold-up argument.

The EC Communication suggests that injunction is the only measure available to a technology holder when the implementer is unwilling to proceed with negotiation. In fact, the EC communication identifies the 'behavioural criteria' as established in the *Huawei* judgement discussed above as a parameter for measuring unwillingness in the conduct of a prospective licensee.⁴ Subsequent cases following the *Huawei* judgement have further clarified the parameters related to the behavioural criteria. The EC believes that it is necessary for the SEP holder to provide sufficient and relevant information to the implementer describing the essentiality for a standard, the alleged infringement of the SEP, proposed royalty calculation and the non-discrimination element of FRAND. Likewise, any counter-offer from an implementer according to the EC Communication should be concrete and specific. While there is no general benchmark about the timeliness of a counter-offer, it should be matched against transparency of the initial communication from the SEP holder. In fact, the security fixed for a SEP user against an injunction should be set in a way to deter any hold-out strategies. Further, the EC Communication insists upon providing an injunctive relief that is based on the assessment of the impact on the businesses, consumer welfare and public interest in the digital economy.

Relying upon the decision of the *Huawei* judgment, which recognises commercial practices in the field, the EC Communication allows SEP holder to issue portfolio licenses that includes all SEPs as well as non-SEPs, that licensee needs to produce and market and is primarily based on the rationale of complementarity and economic efficiency. Further, the EC Communication recognises that mediation and arbitration could provide swift resolution of disputes between SEP holder and implementers as court-room litigation tends to be time consuming and resource intensive. However, it is also aware of the problem of lack of transparency of previous decisions made through such alternative dispute resolution. Quality of such decision is also entirely dependent on the quality of the experts involved in deciding or mediating such disputes as well as the fair procedures adhered during the process of dispute resolution.

The Patent Assertion Entities (PAEs) are regarded as entities that barely invest in developing new technologies as their primary business model is to maximize revenue through increased royalty collection. This could result in a behaviour wherein PAEs might hold out by aggressively enforcing injunctive relief in the instance of failure of negotiations. However, the EC Communication states that European litigation system has enough safeguards to protect itself against harmful practices evolved by PAE and as such they should be treated at par and subject to same rules as any other SEP holder. Further, the EC Communication states that the SSOs and all other stakeholders like the SEP holders and implementers should increase awareness about FRAND licensing process as this would encourage SMEs and start-ups to actively seek SEP licenses without any hesitation.

5. CONCLUSION

The EC Communication seeks to develop a framework to strike a balance wherein the interests of both the SEP holder and the implementers are considered. It seeks to address the information opaqueness associated with declaration of standards by developing and evolving mechanisms within the SSOs that can provide updated and accessible information about patents related to declared standards and clearly stating the patents that are essential to the standard. It recommends a system of evolving a methodology to calculate FRAND based on value added to the technology thereby recognizing the fact that there is no 'one-size-fits-all' solution.⁵ The EC also advocates and encourages both the parties to resolve disputes through alternative mechanisms like mediation and arbitration while at the same time recommending both the parties to negotiate licenses in good faith. It has endorsed the jurisprudence developed in the cases mentioned above to determine whether the parties are behaving in good faith and willingly seeking to negotiate licenses. The EC has called upon all the stakeholders to contribute and provide suggestions to improve the existing mechanisms.

The EC Communication is also significant given that India has evolved policies to encourage the development of Smart Cities and Digital India. Interconnectivity will be a significant aspect in the development of Smart Cities and growth of IoT in India. Some of the observations made in the EC Communication would be directly relevant even in the Indian scenario where several local and foreign manufacturers are operating. The nascent jurisprudence on SEPs in India could create uncertainties for new entrants and existing players. Such uncertainties can be resolved if India can evolve a framework which is similar to the EC Communication while at the same time recognizing the nuances and needs of a developing economy.

¹ European Commission, 'Setting out the EU approach to Standard Essential Patents' COM (2017) 712 final <<https://ec.europa.eu/docsroom/documents/26583>> accessed 10 January 2018.

² Case C-170/13, *Huawei Technologies Co. Ltd v ZTE Corp.*, EU:C:2015:477.

³ *Unwired Planet v. Huawei* [2017] EWHC 711 (Pat).

⁴ European Commission (n 1).

⁵ *Huawei v ZTE* (n 2).

⁶ European Commission (n 1).

ABOUT O.P. JINDAL GLOBAL UNIVERSITY

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ABOUT JIRICO

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