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### Leak of Draft Impact Assessment and Draft SEP Regulation

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**On March 24, 2023, a draft by the European Commission of a Regulation on Standard Essential Patents (“Draft SEP Regulation”) and a related document, a draft Impact Assessment Report (“Draft Impact Assessment”), were leaked. Both drafts quickly became a hot topic in the global patent community. Several blog posts, interviews, and social media posts, including by ETSI, the most important European Standard Setting Organization, widely criticized the drafts. Before assessing whether or not and, if yes to which extent, the criticism is justified, let us first have a look at the objective and the key concepts of the Commission’s draft.**

#### 1. Introduction

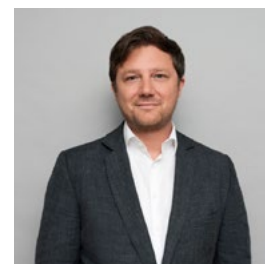
The Draft SEP Regulation is a draft of a full-fledged EU regulation. The Draft Impact Assessment outlines the Commission’s motives and the different options that were considered, and includes several Annexes with data and information on which the Commission’s approach is based.

Both the Draft SEP Regulation and the draft Impact Assessment Report make it clear that the Commission is concerned by what it considers a lack of transparency and efficiency in SEP licensing. The Commission also takes the position that no dispute resolution procedures suitable for resolving FRAND disputes are available<sup>1</sup>. The Commission seems particularly concerned about the growing relevance of IoT, connectivity and interoperability for SMEs and potentially increasing SEP litigation in that context. It states that transparency is missing with respect to the number of patents essential for a given standard<sup>2</sup> and the aggregate royalty due for the implementation of a standard<sup>3</sup>. Therefore, the main objectives are to provide transparency with respect to the number and ownership of SEPs<sup>4</sup>, the applicable royalties, and to avoid litigation by providing access to swift, fair, and cost-efficient ways of resolving SEP/FRAND disputes<sup>5</sup>.

Finally, the timeline of the Commission is quite ambitious: It intends to implement the Draft SEP Regulation including the establishment of a new “Competence Center” at the EUIPO within 24 months after its effective date.



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<sup>1</sup> Draft SEP Regulation, Recital 7.  
<sup>2</sup> Draft SEP Regulation, Recital 19.  
<sup>3</sup> Draft SEP Regulation, Recital 15.  
<sup>4</sup> Draft SEP Regulation, Recital 19.  
<sup>5</sup> Draft SEP Regulation, Recital 31.

## 2. Key Concepts and Provisions

The Draft SEP Regulation consists of two main parts: The building of a SEP register, including essentiality checks of the registered patents (Art. 7-35) and a procedure to determine FRAND rates for SEPs (Art. 36-60). Both tasks shall be assigned to the EUIPO – which currently administers Community Trademarks and Community Designs but does not yet have any patent expertise. As the EUIPO has experience with managing databases, electronic registers and alternative dispute resolution, the Commission still believes it to be in the best position to implement the Draft SEP Regulation<sup>6</sup>.

### a) SEP Registration and Essentiality Checks

According to Art. 7 of the Draft SEP Regulation, an EU-wide register for standard essential patents shall be established. It shall include any standard for which FRAND commitments have been declared (Art. 21) and patent owners shall register any patent they consider to be essential for any listed standard (Art. 22). The patent owner has to provide comprehensive information regarding the patent, the standard, and licensing terms for the registration. This includes not only the patent and its bibliographic information (grant date, priority, family members, etc.) but also the relevant standards, products and processes, the FRAND declaration, licensing terms and conditions, including royalties and discount policies as well as previous decisions on or evaluations of the patent's essentiality. The

patent owner is responsible for updating such information. Registration is subject to a fee, the amount of which is not mentioned in the draft. Yet, the registration with the EUIPO is of fundamental importance as Art. 22(5) and (6) state that, prior to its registration, a patent cannot be enforced at the UPC or a national court in the EU and the patent owner is not entitled to receive royalties or to seek damages for such patent.

Another key element of the SEP register are regular checks whether certain samples of patents are indeed essential. These checks shall be performed every year and include patents from each SEP owner and from each specific standard in the register<sup>7</sup>. SEP owners may also propose up to 100 of their SEPs for review<sup>8</sup>. Given the large number of standards and SEP owners, this is quite ambitious not least because every stakeholder can file observations on the essentiality of the patents selected for an essentiality check. In case the evaluator believes a patent might be not essential, the SEP owner shall be given the opportunity to submit observations. According to Art. 34, the results shall be published in the register and indicate only whether the essentiality check was positive or negative. The reasons of the decision will remain confidential and will only be disclosed to the SEP owner. No appeals are foreseen, neither by the SEP owner nor by any other stakeholders. According to Art. 29(4), the results are not legally binding. However, a negative essentiality check results in the removal of the patent from the register (Art. 26(1)(d)) which in turn means that the

<sup>6</sup> Draft SEP Regulation, Recital 11.

<sup>7</sup> Draft SEP Regulation, Art. 30(3).

<sup>8</sup> Draft SEP Regulation, Art. 30(2).

patent will not be considered as an SEP for royalty determination and can be enforced without limitations by the regulation (even if a court was to find that it was essential). The same applies if the patent is invalidated by a national court or office. Only a sub-sample of the evaluated patents shall be subject to a peer review, i.e. the essentiality check is reviewed by another evaluator only in that case. Anyone can request a peer review, but it is left to the discretion of the EUIPO to allow or dismiss such a request. The result of a peer review overrides the previous evaluation if the two differ from each other. No appeals are foreseen. Again, the patent owner and other stakeholders are allowed to file observations. Given the relevance of the essentiality checks for the licensing and enforcement of patents, it is highly likely that both SEP owners as well as implementers or other stakeholders will make use of their right to file observations. While the essentiality check is already in and by itself a complex task that requires profound technical expertise, the process will become even more complicated and time-consuming in case of substantial observations. This will require considerable human resources.

### **b) FRAND Determination**

The second pillar of the Draft SEP Regulation, and probably its most controversial part, is the mandatory but non-binding determination of FRAND terms by the

EUIPO. Such proceedings can be initiated upon request by the SEP owner or by a prospective implementer and shall be completed within nine months<sup>9</sup>. A preliminary recommendation of FRAND terms shall issue at least five months before the expiration of the nine months target<sup>10</sup>. 45 days before expiration, a reasoned proposal for a FRAND determination shall be made to the parties<sup>11</sup>. The decision will be made by two “conciliators” who shall be chosen by the parties from a group of five persons proposed by the EUIPO. If the parties cannot agree, the EUIPO will appoint the conciliators<sup>12</sup>. The procedure seems to be comparable to arbitration proceedings with the conciliators in the role of arbitrators defining deadlines by which the parties shall submit written observations. Written submissions including evidence and expert opinions can be submitted. The parties may request that certain information they submit be qualified as confidential. Unless the conciliators consider the information “indispensable for the other party” they will disclose only an abstract of the information or require the other party to sign an NDA. Upon request of a party, or if the conciliators consider it necessary, an oral hearing shall be scheduled. Such a hearing shall be held within 20 days after the submission of a written and reasoned FRAND offer<sup>13</sup>. If no settlement can be reached, the conciliators will issue a reasoned decision after they declare the proceedings terminated<sup>14</sup>. The written decision shall include, *inter alia*,

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<sup>9</sup> Draft SEP Regulation, Art. 36, 38.

<sup>10</sup> Draft SEP Regulation, Art. 52.

<sup>11</sup> Draft SEP Regulation, Art. 57(1).

<sup>12</sup> Draft SEP Regulation, Art. 40(1), (2).

<sup>13</sup> Draft SEP Regulation, Art. 54.

<sup>14</sup> Draft SEP Regulation, Art. 59(1), 58(1), 57.

(i) a confidential assessment of the FRAND determination, (ii) a confidential summary of the main issues of disagreement and (iii) a methodology and an assessment of the FRAND determination<sup>15</sup>. Only the latter will be publicly available. It is, however, unclear what the difference is between the confidential assessment of the FRAND determination in Art. 58(1)(b) and the non-confidential methodology and assessment of the FRAND determination.

### **c) Aggregate Royalty Determination**

The Draft SEP Regulation also stipulates the setting of a non-binding aggregate royalty for a standard. Any number of contributors (not necessarily SEP owners) to a standard can notify the EUIPO about the aggregate royalty they deem appropriate for a specific standard<sup>16</sup>. Further, 10% of the contributors to a standard can file a request with the EUIPO to appoint conciliators from the roster to assist the contributors in reaching an agreement on the aggregate royalty<sup>17</sup>. If no consensus is reached, the conciliators shall provide a written report including the reasons for the failure to reach an agreement. Another avenue is the determination of aggregate royalties by an expert. Such an expert opinion can be requested by 5% of the contributors or 5 (not 5%) prospective implementers<sup>18</sup>. It is not clear to which extent such aggregate royalties will be binding. The draft regulation expressly states that an expert opinion according to Art. 20 shall be non-binding. In the absence of such a statement

with respect to aggregate royalties set by contributors, one could think that they shall be binding. However, explicit provisions are missing in this context.

### **3. Assessment**

In this IP Report, we assess whether or not, and to which extent, the approach taken by the Commission is justified from a regulatory intervention perspective as well as from a legal and practical perspective. We will also provide a short outlook relating to upcoming consequences.

#### **a) Regulatory intervention necessary and expedient?**

To summarize: according to the Commission, there is a lack of transparency and efficiency in SEP licensing and dispute resolution procedures suitable for resolving FRAND disputes are not available.

From a practical perspective of lawyers with vast experience in SEP litigation and licensing, we agree that transparency is always desirable, but we are wondering whether there really is an issue that keeps products from being developed and marketed or causes litigation. To the best of our knowledge, no data is available that supports the Commission's assumption that a lack of transparency regarding the number of SEPs for a specific technology impairs the development or marketing of products. In our practice, in most if not all of our cases, products are developed and sold first and

<sup>15</sup> Draft SEP Regulation, Art. 59(2).

<sup>16</sup> Draft SEP Regulation, Art. 17.

<sup>17</sup> Draft SEP Regulation, Art. 19.

<sup>18</sup> Draft SEP Regulation, Art. 20.

only afterwards (often many years later) licensing discussions begin – only rarely resulting in litigation. The vast majority of licensing negotiations is settled out of court, often through pool licensing (expressly endorsed by the Commission). Litigation clearly is the exception to the rule. In all of these cases, because of the well-established case law of the CJEU in *Huawei v ZTE* and of the EU national courts, any license seeker can and will obtain the relevant information from the SEP owners, namely a list of the relevant SEPs, a list with the concerned products and/or services, technical information, and a license offer with certain explanations. It goes without saying that the provided information may be incomplete or even inaccurate. However, it is typically sufficient as a starting point for entering into good faith, meaningful and expedient negotiations. Additionally, a variety of dispute resolution mechanisms exist at the national and international level such as for instance WIPO mediation and arbitration or other ADR services at the national courts, the UPC, or other international organizations. The relevant standard setting organizations keep databases with declared SEPs. Thus, the envisaged EUIPO register seems rather redundant and may not add any significant value. In fact, given the risks associated with the Draft SEP Regulation and the EUIPO's register, it is not unlikely that innovative companies will turn away from contributing their inventions to ETSI, for example, and rather prefer other 3GPP / international organizations for such purposes.

When it comes to determining a global FRAND rate, it is true that certain courts are not (yet) inclined to do that, whereas others do. The hesitance of some courts

stems from a perceived lack of expertise as well as from the view that FRAND terms can be best determined by the market, i.e., by real-life negotiations between the parties concerned as long as the courts ensure that the parties engage constructively and do not abuse their positions in such negotiations. From the leaked documents it is not clear whether or not the Commission evaluated this current practice in detail. In any event, the Commission's proposal of a mandatory (but non-binding) FRAND rate determination is nothing new. Some courts have done exactly that in regular litigation (e.g. the UK and Chinese courts), and others are open to it if a case asking for a specific FRAND rate finding is brought to the court (e.g. Germany). Consensual arbitration and/or mediation is another available path. In our experience, the real issue is that parties – and in fact both SEP owners and implementers – may simply not be interested in using these possibilities in practice, be it because of the costs and efforts associated with it be it for strategic reasons. This raises the question whether any imposed FRAND rate determination by a panel of two conciliators (without appeals available) at an institution that has never dealt with patents before, leading to a non-binding result in a very ambitious timeline will be a better solution, i.e., a solution which will be accepted and respected by the market. In high-value litigation cases it is standard that the FRAND determination part fills hundreds if not thousands of pages, including substantial expert opinions, sometimes hundreds of allegedly comparable license agreements and their unpacking, over a period of more than a year. It is not apparent that the EUIPO will be able to work through such volumes of information arriving at better results than

highly specialized patent courts. Ultimately, it is likely that SEP owners will simply turn to jurisdictions outside the EU such as Brazil, Colombia, India, or the UK to litigate their SEPs.

Before that background, it is questionable how the regulatory intervention as presently envisaged by the Commission could add real value and therefore be justified.

### **b) Legal concerns**

Apart from the above, there are some legal concerns in addition. The following list is non-exhaustive and only highlights some important issues:

The Commission refers to SEPs without differentiating. However, not every SEP conveys a dominant market position as expressly established by the CJEU; thus, not all SEPs necessarily lead to a FRAND encumbrance. Absent a dominant market position, the legal basis on which the Commission intends to intervene is unclear. It cannot be EU anti-trust law.

Although the EUIPO FRAND determination is said to be non-binding, it may well be factually binding and serve as a safe harbor / factual precedent. It is doubtful how that could be compatible with the right to be heard of a third party which was not involved in the initial FRAND rate determination.

If the EUIPO finds a declared SEP non-essential, the patent is removed from the SEP register. If the patent is later enforced in court without prior FRAND determination at the EUIPO, the UPC or a national court might still consider the patent to be standard-essential and to

convey a dominant market position. It would be in conflict with constitutionally protected property rights to further suspend the SEP owner's access to justice (and to further deprive them of claims for past use) by making them go back to square one and ask for registration and a FRAND determination at the EUIPO again. If, in contrast, the SEP owner was free to continue to litigate without taking that step, there may be an incentive for SEP owners to trigger removals from the register which would contravene the intended transparency.

And finally, the various envisaged concepts may well be in stark conflict with globally accepted procedural rights such as the right to a fair trial, the right to be heard, the right to a legal judge, the right to effective access to justice and various other constitutional law issues, given that no appeals are available against the various "decisions" the EUIPO can make.

### **c) Practical concerns**

Additionally, there are some practical concerns. Again, this list is non-exhaustive:

If only one patent per family is reviewed for essentiality as planned, the register will not provide any transparency. According to the draft, the evaluation of one patent shall apply for the entire family, but a singular review does not allow any assumption as to whether or not other patents from the same family are standard essential. Similar problems apply with respect to different patent claims in the same patent.

It is further unclear how one would have to navigate through different findings on

validity. Does a patent have to be removed from the register for good as soon as one single first instance court has invalidated one patent claim? Partial invalidations happen all the time. Reversals of invalidating decisions on appeal are not rare but happen frequently. What to do in such situations?

After the envisaged system becomes operational, tens of thousands of SEPs will be declared and will have to be registered and hundreds, probably thousands, will be designated for evaluation by their owners. This will require enormous technical and human resources as well as a lot of diligence in a short period of time. It is hardly conceivable how that could work in an expedient manner without violating any stakeholders' rights or interests. The evaluation of SEPs requires profound technical expertise and knowledge about patent and anti-trust law. There are not many people with a respective skillset in the EU and it is certainly fair to assume that none or almost none of them are unemployed or bored in their current jobs. Even if many of them stopped doing what they are doing and focused on essentiality review for the EUIPO,

etc., it would take years to clear respective conflicts, and check thousands of declared patents while the applicable law relating to claim construction is not even clear.

Moreover, it is doubtful how a panel of two conciliators can determine FRAND terms within a time window of only a few months in a reliable and expedient manner. While implementers and SEP owners often cannot agree on much when it comes to FRAND, they will agree that FRAND determination is an extremely complex issue.

Finally, it is unclear how an aggregate royalty defined by a few contributors to a standard could be useful. It is not even clear what requirements must be met to qualify as such a contributor. What is halfway clear is that certainly not all contributors will be SEP owners and not all SEP owners will be contributors. Yet it is unclear whether the defined aggregate royalty would be non-binding or binding (see above). If it was binding, there would be substantial legal issues, an apparent risk of price fixing in violation of EU anti-trust law being only one of them.

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### Conclusion and Outlook

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In the light of all this, it seems clear that the Draft SEP Regulation is neither required nor helpful to achieve its objectives (transparency, efficiency, better dispute resolution). The Commission should go back to the drawing board to significantly improve the draft or even withdraw it in its entirety.

Apart from those aspects, many take the stance that the draft is unbalanced. Judging from a variety of initial postings, public

statements, and informal conversations, the implementer side appears to be quite happy with the draft whilst the SEP owner side is vigorously against it. This could indeed be a sign that the draft lacks the necessary balance between those conflicting interests.

Be it as it may: even those supporting the draft could well have second thoughts over time. There are reasons why both sides have been reluctant so far to ask courts or

arbitration tribunals to determine FRAND rates. Predictability could be a major concern considering that a panel of two more or less experienced conciliators should come up with FRAND terms, particularly a FRAND rate in a short time window without any right to appeal their decision. There is an unjustified inherent advantage of the requesting party which can prepare the case in all detail and time needed, whereas the responding party only has very limited time to defend. In addition, there are aspects of an *in camera* procedure where parties could not get access to all the information underlying a decision. No other control mechanisms are provided which could ensure harmonization among such panels, standards, technologies, FRAND rates, etc. at least over time. The conciliators may have an inherent incentive to find comparably high FRAND rates to attract SEP owners to make use of their services and thus protect their (likely attractive) jobs.

If that happens, the Commission would have done European SMEs in the IoT space and elsewhere a blatant disservice. If the opposite happens, SEP owners could well leave European standard setting and SEP

enforcement and simply go elsewhere where they see better chances to strike attractive global SEP deals. It is doubtful whether this would actually foster European innovation and market dynamics as intended or rather lead to the opposite. Even if SEP owners stayed, there may be many strategies to circumvent the gist of the Draft SEP Regulation, for example so-called “balkanization” of SEP portfolios, i.e. assigning small sub-portfolios to several, freshly created SMEs to profit from the intended protection for SMEs and potential FRAND synergies leading effectively to higher overall FRAND rates. Implementers could then be faced with a much less transparent SEP landscape and many more assertions by formally independent adversaries which would be contrary to what was intended by the Commission.

In conclusion: Nice try but please try again.

According to latest rumors from Brussels, DG Grow is working on some amendments but does not intend to withdraw the draft. The publication of the amended draft may be delayed by about a week which would take us into early May instead of the 26th of April.