Rigorous empirical research on intellectual property

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SEP Regulation: proposed mechanisms in determining a reasonable aggregate royalty

Page of the webinar with full recording, research paper, and executive summary
Video of the Q&A session only

Dr. Justus Baron is a Senior Research Director at the Center on Law, Business, and Economics at Northwestern University's Pritzker School of Law. His area of expertise is the empirical economic analysis of technological innovation and markets for technologies. His main research interests are technology standards, patents, and licensing schemes. He is a member of the European Commission's group of experts on licensing and valuation of standard essential patents (link). He is one of the authors of the European Commission impact assessment accompanying the proposal for a SEP regulation (link).

1. **Some believe that the European Union would benefit from such a regulation as the EU is a region of implementers. Do you agree with that?**

Dr. Justus A. Baron: I think that I would disagree both in specifics and on a more general level. I would disagree in specifics because I think that it's based on pure arithmetic where you say "Okay do we currently pay more than we receive from SEP licenses?" I think that this is heavily biased, or heavily skewed, by the fact that the largest recipient of royalty payments in the world is a U.S. company. However, I believe that this U.S. company is not going to be significantly affected by this proposal because they do not rely on litigation in the EU to enforce their royalty rates. So, if you take this one licensor out the remaining licensors that will be heavily affected by the proposal are dominated by EU companies. So, if you only focus on those licensors that rely on enforcing their SEPs in European courts then I believe that European interests are clearly overrepresented on the licensors' side so this is a specific point where I would say that the proposal actually shoots the European companies, that are currently at the table, in the foot. I think the broader and more important point is that we should not make this kind of industrial policy arithmetic at all: we should look at what is good for our future, what is good for the technologies that are developed, to be developed, 20, 30, 40 years from now. We should not start to develop an industrial strategy / industrial policy strategy that is more typical of developing countries where we basically say we try to free ride on other regions' innovations this cannot be a model for Europe that we want to follow. I think we want to encourage innovation in Europe, we want to be a region that innovates, we want to be a region that not only proposes new regulations but also develops new technologies. Therefore, we cannot make policy based on the belief that we, as Europeans, will no longer be significant on the side of innovation.

2. **On slide 7 you mentioned that the 'reasonable aggregate royalties' idea is based on the Expert Group Report proposals 42-44. You were a member of this Expert Group too. Was this proposal unanimously supported by the Expert Group?**

Dr. Justus A. Baron: All these proposals were proposals made by individual experts; they were discussed in the group. They were all then collected in a list of proposals I think we had a system of voting on these proposals where these different parts of proposals 42, 43 to 44 were received very differently and I think that this makes a lot of sense. So, the initial idea is to encourage SEP licensors to make statements / offer reassurance to the other side (e.g., what are the maximum rates that they would charge) there's nothing wrong with that. That's already legal and companies can elect

to do that if they wish. And if they do so that has the potential to be useful but then as we move forward in the proposal especially when it comes to the intervention of an expert panel that would basically take this decision out of the company's hands and says “Okay since you are not capable of coming up with a rate now, I will do that for you” this proposal has not been very favourable. It is one of the less favourably received proposals out of the almost 80 proposals in the report.

3. You touched upon geopolitics on slide 18. Would you be able to tell us more about this?

Dr. Justus A. Baron: I fear two things in a way: at first, I fear obviously the short-term pain that undermines European efforts to protect your company's rights internationally in particular in front of the WTO with China. I mean it's very difficult to square the position that on the one hand, we're upset with other world regions being insufficiently protective of European companies' patent rights and at the same time having a proposal of an administrative process intervening in the formation of prices for royalty for licenses. So, I think that the most immediate effect of the proposal is to basically undermine this effort, and the other thing which I think is much more significant, that I'm much more concerned about is that we are already at a parallel stage in the standardisation ecosystem. We still have a global standardization ecosystem to some extent, and we have a global SEP licensing ecosystem, but I think it's very clear that this is increasingly fragile. And now, coming out from Europe these assertive regulatory proposals are like “Okay forget everything that is being done right now, from now on this is what we're going to do”. This is going to clearly drive a wedge between Europe and the rest of the world, and I think we, as Europe, have the most to lose if this global standardization ecosystem disintegrates. I think we are way overrepresented in the international standardization ecosystem compared to our wages economically or technologically. I think this international standardization ecosystem has served Europe extremely well so anything that would lead to international fragmentation is absolutely against European interests. And, I believe that this current proposal, as it is drafted right now, has the potential to increase fragmentation.

4. On slide 19 you referred to a “Chilling effect on ongoing licensing negotiations”, would you be able to further explain why?

Dr. Justus A. Baron: I think there are two ideas also and one is to say “okay let's just wait, we are in the process of negotiation, and then negotiations take on average three to four years or so” you say “Okay maybe this regulation will become law before our negotiations conclude and maybe I can take some benefit out of that and maybe it will improve my bargaining position in this negotiation so why don't I drag this out a little bit longer to see whether I can achieve a more favourable outcome at a later point in time”. So I think that the current licensing negotiations are just being impacted. The other idea is that there is this notion that the regulation says that these pronouncements should be made for future standards but it's not very clear what that means: if that really means standards for which no patented technology already exists then of course this regulation would only become meaningful in decades from now, and I don't think it's a good idea to regulate the far distant future if we're already having difficulty to foresee what the needs of this technology will be. So, I think that it's much more plausible to expect that some of the patented technologies that already exist will be impacted and will be covered by this regulation proposal. Then it's the question “Okay if we sign the license today and if other licensees benefit from an aggregate royalty statement, if it comes out, if it calls for much lower rates and so other license fees will be offered at much lower rates and probably…”. That means that they would need to renegotiate the rates with the licensees that currently have one. There's significant uncertainty with

respect to our existing lights so it's just infusing a whole lot of confusion and uncertainty in negotiations around 5G in different industries which, and that's kind of the sad part of it, were progressing quite well I think in the absence of this proposal, so it seems a bit uncalled for.

5. **On slide 19, you highlighted 'SEP licensing disputes have decreased', the figures provided by the EC Impact Assessment study confirm this – so why does the EC still says that there are many SEP disputes in Europe?**

Dr. Justus A. Baron: I can't really speak for them I don't what specifically these beliefs are based upon. One interpretation is that simple licensing disputes have relatively recently begun to impact industries that had not traditionally been impacted. So, maybe these industries have been more vocal or more successful in getting the Commission's attention, and so the Commission's perception is that it has increased because industries that the Commission cares more about have recently been more impacted than in the past. So this is one possible interpretation but I think it's just a descriptive effect that the number of disputes overall in the world has not increased. There's a clear shift in where these disputes take place: where there is a decrease in the number of disputes in the US, there's an increase in China over time. But Europe is stable and so is the global number of disputes. If you compare that with an increasing number of licenses and an increasing number of SEP portfolios then I would say any kind of reasonable assessment of the share during this period or the relative number of disputes is on the decline and I believe that it is difficult to argue with.

6. **The EU has challenged China at the WTO to defend its high-tech sector especially European SEPs enforcement – how is it compatible with this proposed regulation?**

Dr. Justus A. Baron: Difficult to square with the proposed regression I mean when I'm saying this proposed regulation I'm also always referring to this particular proposal because I believe that this particular proposal is particularly intrusive in the determination of rent rates whereas I don't see similar problems with the proposal to create a register or was a proposal to have a non-binding consolidation process I believe these are perhaps easier to reconcile with some of these principles but I believe that the proposal to have a FRAND determination from an expert panel appointed by an administrative body of the European Union and then with the underlying belief that this expert's opinion would carry weight in court proceedings in the dispute between parties: I think that any foreign party would legitimately view this as very problematic. I think that if China had done something like that, I think the EU would have protested against this. So, I think that it's difficult to reconcile with the EU's efforts within the WTO.

7. **Would you be able to mention the types of companies benefiting from such a proposed regulation?**

Dr. Justus A. Baron: I mean it's clear that we are talking about the maximum aggregate royalty rate so it can only be the implementers' side that benefits because there's absolutely no obligation on the licensee side to actually pay these aggregated rates. So, if that was not the case then we would have to discuss this proposal in a different way but given that it's a maximum rate with absolutely no obligation on the other side we only have companies on the licensee side benefiting. Which companies benefit particularly? I believe that it's clear that it's not the companies that only take very few licenses because they are very far away from hitting the aggregate royalty and then it's also not the company that has very high profit margins because these are the companies for which the aggregate royalty is of least concern. So, the companies that are most likely to benefit are

probably those that have large volumes and low-profit margins, so I think that high-volume discount devices would probably be the ones that pay the highest rates on total aggregate and these companies would then also have more or more to gain from a cap on the aggregate rates.

8. Why, in your opinion, this proposed regulation will not help European SMEs, and what would help SMEs?

Dr. Justus A. Baron: All the other mechanisms in this proposal only really come into play once there is litigation and EU courts, and I haven't seen much evidence of litigation in EU courts against SMES. I just believe that there's very little assertion of SEPs against SMEs in any EU courts, but also in courts more generally and so this is the first comment. Then the other comment is I think that SMEs might benefit from more clarity, from more pedagogy in a way, and basically from really predictive and objective information and this is something that could be provided and produced but I just don't believe that calling upon stakeholders to populate a database with their obviously partisan views of what the royalties wage should be, will be useful to companies that are new to this or that need some kind of first insights because these companies will view this and they will say “Oh well there's so much disagreement here and they're so high rates and then it's all over the place” and I think it's more of a distraction than anything else. I think that if one wanted to provide this kind of information to companies that really have limited previous experience, one would be better advised to just collect case laws, collect all the evidence that is available from the public domain about licenses and licensing rates, and make these available in a significant and standardized way and that would maybe attenuate some of these concerns that SMEs might have. Because SMEs might learn that what has been in the past profitable for most implementers to implement these standards. So they should not be discouraged from implementing the newest generation of standardised technology. Unfortunately what I think is going on to some extent is that some of companies that are not SMEs but that have an interest in bringing rates down, create a narrative that SMEs are at risk of paying exorbitant rates. This narrative is chilling investments by SMEs much more than the actual rates are chilling investments. So I think something that could help SMEs is just objective descriptive evidence about the truth, about what we know about the truth.

9. Could you explain simply what is the top-down approach and why it differs from the current commonly used method?

Dr. Justus A. Baron: Sure. I mean top-down is an approach where you first determine an aggregate royalty for all aspects of a standard for all portfolios included in a standard and then you devise an apportionment strategy to apportion this aggregate royalty to one particular licensor and that would then be your indication of what would be a FRAND rate for that particular licensor royalty rate. So, this has been done not very often but it has been done, usually in combination with other methods, usually in combination with what is by far the most common method which is comparable licensing method. I believe that the striking fundamental, conceptual, difference between comparable licenses and top-down is basically the posture that the economist adopts in top-down: it's basically the economist saying “Okay, here's what I believe the value is and based on that I tell the rest of the world what the price should be”, and in comparable licenses, it's a much more traditional role for an economist: so we study a particular market, in this case, it's a market for licenses and we observe prices in that market and then we say “Okay based on empirical data the price in that market is X and we can then apply that to a particular case” I think it's a more humble exercise for an economist but I also believe it's more appropriate than this more normative role where it's the economists postulating what prices should be.

10. You conclude that FRAND determination and reasonable aggregate royalties must be removed from the SEP proposed regulation. If the policymakers follow this advice, do you believe it would increase the chance of success of the proposed regulation or further fine-tuning would be required?

Dr. Justus A. Baron: I think that there has been, worldwide, some experience with regulatory initiatives where the regulator strongly came out on one side or the other of the debate. Usually, these proposals have been short-lived and have not survived long. They have created more confusion than help, therefore I think that this particular aspect of a proposal is very far removed from currently observable SEP licensing practices, and it also seems very one-sided to the benefit of one side at the expense of the other. This clearly undermines the success of the regulation in general. If anything else has to be changed, I mean I think that my personal view is that the Commission's Proposal with respect to SEP transparency is philosophically on the right track, I think that overall the idea of having a combination of self-registered patents with samples to be checked – not in view of counting patterns – but in view of having a register that is more informative than what we currently have, I think that this is the right philosophy. There are certainly tweaks but I think that these tweaks can be done through implementing regulations after the regulation has been adopted. On the conciliation part, I think there's more work to be done, I think that there's a legitimate concern that this obligation to first consult a conciliator before being able to access court proceedings in the EU would generate a delay and that this delay would produce holdout incentives. I believe that this would need to be addressed, but once this concern has been addressed, I believe there's promise in having a reconciliation process that courts can choose to rely upon if parties do not agree with the outcome of the consolidation. So I think that if we focus on these other two aspects of the regulation we improve the specifics of the transparency aspects through implementing regulations and we address legitimate concerns with respect to the delay generated, that potentially is generated, by the conciliation I think that it's potentially a proposal that might garner support from both sides of the debate and that could be much more sustainable and also gain international attraction in a way that would be beneficial.