



## SBS position paper on Standards Essential Patents, a new EU approach: what is at stake for SMEs?

May 2018

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On the 29 November 2017, the European Commission set out the new EU approach to Standards Essential Patents (SEPs). This long-awaited communication was the result of a public consultation and a continuous dialogue of the Commission with standards setting organisations, industry and a wider community of stakeholders.

**Small Business Standards (SBS) welcomes the Communication on Standards Essential Patents (SEPs) as a contribution to streamline patented standardised technologies by companies of any size and sector.** Many of the issues addressed in the Communication are highly relevant for SMEs that, differently from larger companies, are less used to work with SEPs. Standards and SEPs are necessary for the interconnection of an ever-growing number of products with an economic potential of the Internet of Things up to 9 trillion € per year<sup>1</sup>. It is evident that not only global tech companies, but also startups and SMEs have a big stake in such a huge economic market.

In particular, SBS welcomes and supports the measures set out in the Communication from the Commission and therefore urges that the following measures must be implemented in due time

- **the preservation of fair, reasonable and non-discriminatory (FRAND) conditions for SEP licensing by patent owners**, as to maintain a strong incentive for investment in innovation and sharing new technologies through standards;
- The recognition of the importance of integration between ICT standards and **Open Source** software implementation as drivers of innovation, especially for SMEs.
- **The inclusion of a non-discrimination element**, whereby the rightholders cannot discriminate between implementers that are 'similarly situated';
- The enhancement of **transparency** of the patent declarations database;
- The recommendation of **providing a certification of SEP portfolios against transparency criteria** that might improve the position of SMEs in licensing negotiations;
- **The incremental approach on the essentiality of declared patents**, where scrutiny should take

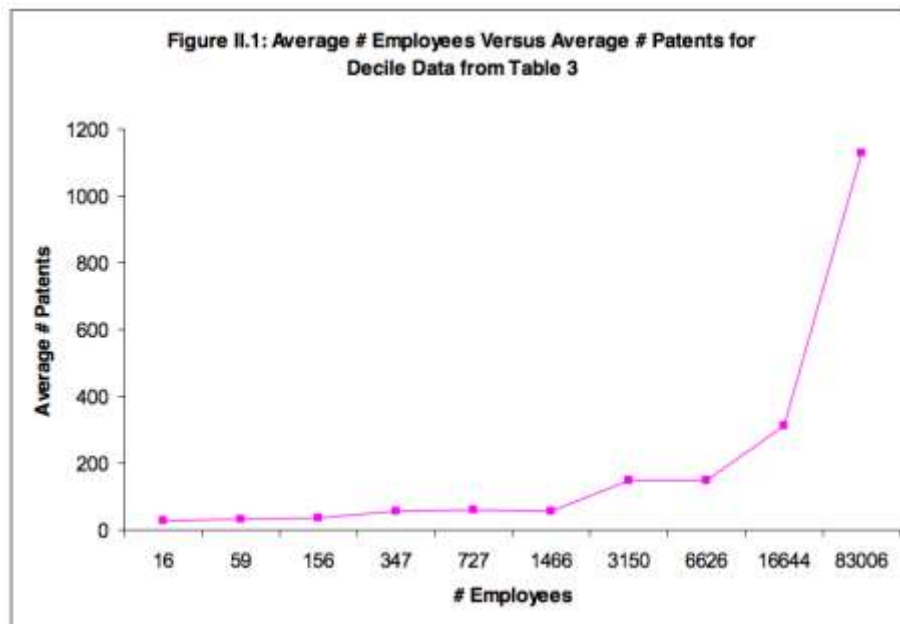
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<sup>1</sup> McKinsey, 2015. Unlocking the potential of the Internet of Things



place only at the request of either party and on a sample of patent portfolios;

- The recognition of the need to **raise awareness** of the licensing process and its implications, particularly for SMEs.
- **The identification of patent pools** and their relationship with standards organisations as a way to streamline and offer more clarity to SMEs, especially those newly exposed to SEP licensing disputes



*An Analysis of Small Business Patents by Industry and Firm Size by Anthony Breitzman and Diana Hicks (2008, Rowan University)*

## Technical note

All smartphones, tablets, computers and any other connected devices implement standards such as WiFi, Bluetooth, 4G wireless communications standards and soon 5G. These standards are based on patent protected technologies, the so called **Standards Essential Patents (SEPs)**. Standards and SEPs are necessary for the interconnection of an ever-growing number of products, the Internet of Things, which spreads from cars to smart house appliances, smart cities, factories and soon much more.

All companies that are responsible for goods and services in the Internet of Things depend on the availability of standardised technologies. Developing technologies that are standardised through SEPs is itself a very profitable business. For instance, patents for 2G, 3G and 4G standards are licensed to manufacturers of mobile phones and other economic operators; the royalties generated by those

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standards are around € 18 billion per year. With this in mind, it becomes more evident that not only global tech companies, but also startups and SMEs have a big stake.

Despite the high stakes of those companies that implement SEPs and those who generate them, the Commission took a balanced approach. The main objective was to create a smoother and more predictable framework for SEPs. On the one hand, conditions for the use of patented standardised technologies by companies of any size and sector were streamlined; on the other hand, fair, reasonable and non discriminatory conditions for SEP licensing by patent owners were preserved, as to maintain a strong incentive for investment in innovation and sharing new technologies through standards.

While licensing negotiations are autonomously conducted by the parties, the Commission did not validate the most controversial proposals that would likely undermine such balance: neither the **use-based** licensing approach that would have possibly inflated the value of SEPs, nor the “**licence for all**” principle advocated by implementers received an endorsement.

If the Commission decided to be neutral on the balance of interests that concerns mostly large players, is the EU approach positive for SMEs?

In our opinion, the answer is yes. **The EU approach, in particular, focuses on some issues that are highly relevant for SMEs, perhaps even more than for larger companies.**

In fact, whether the company is an SEP owner or an SEP implementer, an SME is much more likely to have a worse negotiating position than a large company in licensing negotiations and, later, to have less chances of enforcement.

For a start, while licensing conditions have to be fair, reasonable and non discriminatory, it is hard for SMEs to know what this means in practice. Compared to larger companies, SMEs have typically little or no information on the actual value of patents, so they have fewer chances to evaluate if the conditions offered by the other party are fair, reasonable and non discriminatory. It should be noted that large companies, which are used to negotiate licensing agreements, normally impose non-disclosure agreements to the other parties, so for an SME it is very difficult to obtain information on licensing conditions in the market. Also, the negotiation among large players is often an exchange, where each company, whether SEP implementer or owner, has a large patent portfolio and can at the same time be licensor and licensee. This is not the case for SMEs that generally don't have patents or have very few.

In this regard, the Commission makes conditions more balanced and predictable, thus potentially improving the capacity of an SME to negotiate better a deal. An important principle introduced in the EU approach concerns the **non-discrimination element**, whereby the rightholders cannot discriminate between implementers that are 'similarly situated'.

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Enhancing **transparency** of the patent declarations database is also a useful provision for small and medium sized undertakings. With thousands of patent declarations, many of which of uncertain value, checking the claims of patents owners, or even predicting them when designing a new product, becomes extremely difficult for SMEs. User friendly interfaces, search functions, avoidance of incomplete declarations and stricter links to patent offices to provide additional information on the patent status are cost effective elements that can greatly help SMEs.

SEP holders are usually large companies with very big patent portfolios. When SMEs want to implement standards that contain SEPs, they are confronted with claims that often relate to a high number of patents. The EU approach recommends providing a **certification** of SEP portfolios against transparency criteria. This cost effective measure might indeed improve the position of SMEs in licensing negotiations.

Another difficulty for SMEs, as well as for anyone who has not directly participated in the drafting of a specific standard, is to check the essentiality of declared patents. In other words, whether a declared SEP is such or it is just a claim. It is normal that, since a patent holder is to generate substantial revenue from licensing a proprietary technology used in a standard, he/she would have to prove that the patent is essential to that standard. However, large companies with thousands of declared SEPs complained that it would be too costly for them to provide essentiality checks for each of their SEPs. Indeed, the case of SME patent holders is quite different, since most of them have very few SEPs, so proving their essentiality would certainly be less burdensome.

Against this background, the Commission indeed recognised the problem, but took a compromise position. While not imposing blanket **essentiality checks** to all declarations, the Commission took an incremental approach, where scrutiny should take place only at the request of either party and on a sample of patent portfolios. Despite not entirely addressing the problem, the solution proposed by the Commission seems to offer considerable improvement, while being cost effective for all the parties involved. However, in the future neutral evaluation process is needed to fully address the problem. Standards Development Organisations should be responsible for making those SEPs identified as really essential for the standard public in order to allow all stakeholders, esp. SMEs to be on a level playing field.

In assessing these elements of the EU approach, one must take into account that SME implementers would have obvious benefits from more clarity and transparency of SEP declarations. On the other hand, burdens imposed on rightholders would impact SMEs much less than larger companies. Even if the company is small, having one or two SEPs, each of which has chances to generate high royalties, justifies the burden of providing a more accurate SEP declaration including essentiality checks.

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**Patents ownership is highly concentrated:**

- **Data from the US patent office in 2015 shows that 26% of all new patents were owned by 50 companies.**
- **SME patent owners account for approximately 10% of the patent owners population.**

**Patent pools** and their relationship with standards organisations are also identified by the Commission as a way to streamline and offer more clarity to SMEs, especially those newly exposed to SEP licensing disputes. Indeed, pools can be instrumental in providing a one-stop-shop for essentiality checks. They can also aggregate large numbers of SEPs and offer comprehensive licensing fees to SME and other implementers that need standards connectivity features in their devices.

With regard to the enforcement of SEPs, SMEs may indeed face difficult disputes with their larger counterparts. SMEs often do not have sufficient expertise and resources to be successful in such dealings. In this respect, the Commission makes reference to the **HUAWEI vs ZTE judgment** (CJEU Case C-170/13) and provides guidance on behaviors during licensing negotiations.

Finally, the EU approach set out by the Commission recognises that there is a need to **raise awareness** of the licensing process and its implications, particularly for SMEs, both patent holders and implementers of the standards. In this respect the Commission indicates its intention to support actions by the relevant stakeholders.