

SEPs: The West Need Not Cede to China

FEBRUARY 2024

tl;dr

Background: Policymakers on both sides of the Atlantic are contemplating new regulations on standard-essential patents (SEPs). While the European Union (EU) is attempting to pass legislation toward that end, U.S. authorities like the Department of Commerce and U.S. Patent and Trademark Office are examining the issues and potentially contemplating their own reforms to counteract changes made by the EU.

But... These efforts would ultimately hand an easy geopolitical win to rivals like China. Not only do the expected changes risk harming U.S. and EU innovators and the standardization procedures upon which they rely, but they lend legitimacy to concerning Chinese regulatory responses that clearly and intentionally place a thumb on the scale in favor of domestic firms. The SEP ecosystem is extremely complex, and knee-jerk regulations may create a global race to the bottom that ultimately harms the very firms and consumers they purport to protect.

KEY TAKEAWAYS

EUROPEAN LEGISLATION, GLOBAL REACH

In April 2023, the EU published its “[Proposal for a Regulation on Standard Essential Patents](#).” The proposal seeks to improve transparency by creating a register of SEPs (and accompanying essentiality checks), and to accelerate the diffusion of these technologies by, among other

things, implementing a system of nonbinding arbitration of aggregate royalties and “fair, reasonable, and non-discriminatory” (FRAND) terms.

But while the proposal nominally applies only to European patents, its effects would be far broader. Notably, the opinions on aggregate royalties and FRAND terms would apply worldwide. European policymakers would thus rule (albeit in nonbinding fashion) on the appropriate royalties to be charged around the globe. This would further embolden foreign jurisdictions to respond in kind, often without the guardrails and independence that have traditionally served to cabin policymakers in the West.

CHINA'S EFFORTS TO BECOME A 'CYBER GREAT POWER'

Chinese policymakers have long considered the SEPs to be of vital strategic importance, and have taken active steps to protect Chinese interests in this space. The latest move came from the Chongqing First Intermediate People's Court in a dispute between Chinese firm Oppo and Finland's Nokia. In a controversial [December 2023 ruling](#), the court limited the maximum FRAND royalties that Nokia could charge Oppo for use of Nokia's SEPs pertaining to the 5G standard.

Unfortunately, the ruling appears obviously biased toward Chinese interests. In calculating the royalties that Nokia could charge Oppo, the court applied a sizable [discount](#) in China. It's been reported that, in reaching its conclusion,

the court defined an aggregate royalty rate for all 5G patents, and divided the proceeds by the number of patents each firm held—a widely discredited metric.

The court's ruling has widely been seen as a protectionist move, which has elicited [concern](#) from western policymakers. It appears to set a dangerous precedent in which geopolitical considerations will begin to play an increasingly large role in the otherwise highly complex and technical field of SEP policy.

TRANSPARENCY, AGGREGATE ROYALTY MANDATES, AND FRAND DETERMINATIONS

Leaving aside how China may respond, the EU's draft regulation will likely be detrimental to innovators. The regulation would create a system of government-run essentiality checks and nonbinding royalty arbitrations. The goal would be to improve transparency and verify that patents declared "standard essential" truly qualify for that designation.

This system would, however, be both costly and difficult to operate. It would require such a large number of qualified experts to serve as evaluators and conciliators that it may prove exceedingly difficult (or impossible) to find them. The sheer volume of work required for these experts would likely be insurmountable, with the costs borne by industry players. Inventors would also be precluded from seeking out injunctions while arbitration is ongoing. Ultimately, while nonbinding, the system may lead to a *de facto* royalty cap that lowers innovation.

Finally, it's unclear whether this form of coordinated information sharing and collective royalty setting may give rise to collusion at various points in the value chain. This threatens both to harm consumers and to deter firms from commercializing standardized technologies.

In short, these kinds of top-down initiatives likely fail to capture the nuances of

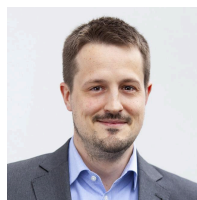
individualized patents and standards. They may also add confusion and undermine the incentives that drive affordable innovation.

WESTERN POLICYMAKERS MUST RESIST CHINA'S INDUSTRIAL POLICY

The bottom line is that the kinds of changes under consideration by both U.S. and EU policymakers may undermine innovation in the West. SEP entrepreneurs have been successful because they have been able to monetize their innovations. If authorities take steps that needlessly imbalance the negotiation process between innovators and implementers—as Chinese courts have started to do and Europe's draft regulation may unintentionally achieve—it will harm both U.S. and EU leadership in intellectual-property-intensive industries. In turn, this would accelerate China's goal of becoming "[a cyber great power](#)."

For more on this issue, see the ICLE issue brief "[FRAND Determinations Under the EU SEP Proposal: Discarding the Huawei Framework](#)," as well as the "[ICLE Comments to USPTO on Issues at the Intersection of Standards and Intellectual Property](#)."

CONTACT US



Dirk Auer
Director of Competition Policy
dauer@laweconcenter.org



Kristian Stout
Director of Innovation Policy
kstout@laweconcenter.org

ICLE



International Center
for Law & Economics