

FRAND licensing obligations and industry standards

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Why is antitrust law concerned about standardisation?

- Standardisation, if properly executed, generally leads to economic efficiency and substantial consumer benefits
 - Compatibility and interoperability – particularly important for IT, telecom and other network industries
 - Rationalisation of production, economies of scale, network effects for introduction of new technologies, unified platforms for the development of new products, R&D efficiencies, *etc.*
 - Increased competition and lower prices in the markets for the standardised products and components
- But, the creation of important standards eliminates technology competition and creates entry barriers upstream
 - All competition between alternative technological formats or substitutable technologies may be excluded
 - Could give patentee a de facto monopoly, or at least create market power that the patentee did not have before

Antitrust enforcers are well aware of the need for safeguards

- Standards “lock out” alternatives

“Thus, ex post, the owner of a patented technology necessary to implement the standard may have the power to extract higher royalties or other licensing terms that reflect the absence of competitive alternatives. Consumers of the products using the standard would be harmed if those higher royalties were passed on in the form of higher prices.”

DOJ and FTC, Antitrust Enforcement and Intellectual Property Rights, April 2007

- Elimination of alternatives by a group of competing firms is accepted by antitrust law because of substantial efficiencies relative to harm, provided conditions are met
 - To ensure benefits outweigh risk of harm, SSOs typically impose constraints on members:
 1. Obligatory ex ante disclosure of essential patents
 2. Optional commitment to license on royalty-free or fair, reasonable, and non-discriminatory (FRAND) terms

Particular antitrust concern: patent ambush and holdup

- Commission investigation to ETSI rules on IPR disclosure (December 2005).
- FTC opinion and order in the *Rambus* matter (February 2007)
- Patent ambush and holdup (“royalty ambush”) have the same economic effect
- DOJ/FTC clarifications that rule of reason applies to multilateral *ex ante* royalty negotiations and SSO requirements to disclose model licensing terms (April 2007)
- EC Commission officials have made similar, although not as detailed, statements (Banasevic, January 2007)
- Conclusion: Enforcers recognise the potential need to apply competition law sometimes and recognise the possibility of holdup

Importance of FRAND obligations

- Actual ex ante licensing negotiations often not practical:
 - Dynamic standard-setting is a moving target
 - Limited information before the technical features of the standard has been agreed
- FRAND terms and conditions for ex post licensing required by 81(3) and 82 EC:
 - “...an industry standard [can lead] to a situation in which there is little competition in terms of the technological format. Once the main players in the market adopt a certain format, network effects may make it very difficult for alternative formats to survive. [...] in order for the agreement to comply with Article 81(3), it must be ensured that the agreement does not unduly restrict competition and does not unduly restrict future innovation. EC 2003 Technology Transfer Guidelines, para 152
 - It will normally be required that the technologies which support such a standard be licensed to third parties on fair, reasonable and non-discriminatory terms.” *id.* para 164
 - “Where the pool has a dominant position on the market, royalties and other licensing terms should be fair and non-discriminatory and licences should be non-exclusive.” *id.* para 226
- FRAND obligations are vital; it is₅ important to know what they mean.

Meaning of FRAND

- Economic principle underlying FRAND is well understood: essential patent holders should not exploit the added power gained as a result of being included in the standard
 - “A reasonable royalty 'is or approximates the outcome of an auction-like process appropriately designed to take lawful advantage of the state of competition existing ex ante ... between and among available IP options.'” (FTC remedy decision in *Rambus*, at 17 (quoting Swanson & Baumol))
 - Regional Court of Dusseldorf in the *Siemens v. Amoi* case (13 February 2007) examined reasonableness of licensing terms against what could have been achieved in negotiations “under the conditions of an open market”
- Various facts and benchmarks can be used to determine whether a particular royalty is “reasonable”:
 - The existence and viability of technical alternatives ex ante to determine value. Royalties should not exceed incremental value compared to next-best alternative;
 - Other relevant benchmarks: Royalties charged by other companies for essential patents of comparable number and value; Royalties charged by the licensor in similar but competitive markets

Meaning of FRAND (cont'd)

- FRAND requires that holders of essential patent do not discriminate, and do not restrict competition downstream. Licensors must avoid discriminating:
 - against and between other technology providers (e.g., by requesting unremunerated grant-backs, discriminating against IP-rich licensees and diminishing innovation incentives and technology competition)
 - against and between rival firms in downstream markets (e.g., by refusing to provide reciprocal licences to rival manufacturers of standardised components or products)
 - against and between licensees in downstream markets (e.g., by offering royalty rebates and incentives, particularly when such discrimination is linked to exclusive or preferential supplies - resulting in “primary line” antitrust injury)
- Patent holders cannot impose non-FRAND royalty levels or terms by threat of injunction against licensee that is willing to accept FRAND conditions (see e.g. Miller 2006; Shapiro 2006)
- Contractual FRAND obligations and Article 81 and 82 requirements have similar or identical legal effects

FRAND licensing under Article 81 EC

- Industry standards often restrict access to the market for products and technologies that do not comply with the standard.
- Conditions for exemption in Article 81(3) EC must be met
 - Must not include any indispensable restrictions
 - Must allow a fair share of benefits to consumers (non-FRAND terms allow patent holders to appropriate the benefits of standardisation)
 - No elimination of competition in substantial part of the products. *“To avoid elimination of competition in the relevant market(s), access to the standard must be possible for third parties on fair, reasonable and non-discriminatory terms.”* Horizontal Cooperation Guidelines, para 174.
 - Legal duty to license on non-discriminatory and reasonable terms where patent pool, joint venture or other group of companies agree on substantial restriction of competition, such as a standard. *Salora-IGR Stereo Television (1981); British Interactive Broadcasting-Open (1999).*

FRAND licensing under Article 82 EC

- Particularly where a standard was adopted in reliance on FRAND commitments, and several viable alternative technologies were available, a dominant position in the licensing of an IP holder's essential patents is a direct result of its FRAND promise.
- Article 82 obligations are substantially similar to the contractual obligations under FRAND commitments.
 - prohibits unfair, exploitative, licensing terms, such as excessive royalties or the imposition of royalty-free grant-backs / non assertion provisions.
 - prohibits restrictions or foreclosure of competition through exclusionary licensing practices (e.g. exclusivity provisions, raising rivals' costs, margin squeeze).
 - the strict non-discrimination obligation applies in particular where discrimination would favour the dominant company's own downstream operations or shield the licensor from competition in innovation and technology licensing.



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