The antitrust/standardization nexus in the eyes of the European Commission

Carl Mair LLM & Mrs. Yvonne Maasdam

The importance of standardization to the promotion of innovation in the EU is widely acknowledged.[1] In the words of the European Commission, 'standards tend to increase competition, lower costs, ensure interoperability, [and] maintain and enhance quality'.[2] However, as a number of recent high-profile cases have shown,[3] the standardization process is also vulnerable to abuse.

In the high-technology sector, this usually occurs when the licensor of an 'essential patent' to a standard chooses to take advantage of the resulting industry lock-in by either refusing to license, charging unreasonable licensing fees, or by failing to declare its patents over the standard in the first place in what is known as "patent ambush".

In the EU and the US, such behavior is increasingly becoming the target of strong antitrust measures, in the form of compulsory licensing of patents or by enforcing commitments to severely reduced licensing fees and royalty rates.[5] The precise scope of legitimate antitrust intervention in the field of standardization involving intellectual property rights ("IPR") is an area of considerable controversy.

This article will examine the antitrust/standards nexus through the lens of the European Commission´s Draft 'Horizontal Guidelines´[6] ('Guidelines'), which are expected to be finalized by the end of this year. The new Guidelines- which aim to indicate the scope of EU competition law´s application to Standard Setting Organizations[7] ('SSOs') under Article 101 of the Treaty on the Functioning of the European Union[8] ('TFEU')- will include a substantially updated chapter on standardization. The Draft Guidelines suggest the Commission's position will be unique among global competition authorities in that it will define a 'safe harbor' for SSOs, setting out detailed 'do's' and 'don't's' which if kept to, will move the SSOs outside the ambit of Article 101 TFEU. As numerous commentators have noted[9], the Draft Guidelines contain the definite traces of a number of recent high-profile and controversial Commission cases, involving the issues of patent ambush and the meaning of 'FRAND' pricing. Before exploring the competition law components of these two issues and how the new Guidelines might deal with them, a brief introduction is necessary.

1 See COM (2008) 133 final, Towards an Increased Contribution from Standardization to Innovation in Europe
2 Case COMP/C-3/38 636 Rambus, C(2010) 150, at para 33
3 See Case T 201-04 Microsoft, which concerned a de facto standard. Also see COMP/38.636- Rambus which was a Commission 'commitment´ decision
4 i.e a patent to which there are no viable technological substitutes.
5 See the cases mentioned in note 3 above, which were dealt with, respectively, by these remedies.
6 For the Draft version of these new Guidelines, see SEC (2010) 528/2, 'Guidelines on the applicability of Article 101 of the Treaty of the Functioning of the European Union to horizontal co-operation agreements'. It should be noted that although Guidelines are not binding in anyway on member states, they are usually given considerable weight by the national judicature.
7 "SSOs" is used here to denote both formal standard-setting organizations, such as the European Standardization Bodies under Directive 98/34/EC, as well as informal consortia and fora focusing on industry specifications. Standardization Bodies under Directive 98/34/EC are only subject to competition law to the extent that they constitute an 'undertaking'.
8 This provision aims to catch co-operative or collusive conduct between competitors which lead to a restriction of competition.
9 R. Schellingerhout and P Cavicchi Patent ambush in standard-setting, Competition Policy Newsletter 2010-1, at p 8

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Introduction

The purpose of antitrust (i.e competition) law is to protect the competitive process by controlling concentrations of market power. This market power is often in the form of multilateral agreements between competitors (eg. cartels) or in the form of unilateral conduct by dominant undertakings. The purpose of standardization is the adoption of common specifications to facilitate interoperability, increase quality, and in some cases, to avoid the enormous sunk costs involved in inter-technology competition. Despite the fact that an SSO involves competitors getting together to discuss and agree on terms and technology, competition authorities have until now recognized the pro-competitive effects[10] of standardization, provided the SSO adheres to certain minimal criteria such as transparency and open participation. However, recent cases involving patent ambushes and claimed violations of FRAND pricing have focused competition authorities' attention on the anti-competitive concerns associated with standardization.

Patent Ambush and the duty of disclosure

SSOs generally request if not require[11] members to disclose any patents which are essential to the standard or technical specification in a timely fashion.[12] This policy has been interpreted by the Commission as aimed at 'preventing one member company from secretly capturing the standard.[13] Indeed, standard capture can lead to considerable market power.[14] After a standard is agreed which includes an essential patent all companies wishing to comply with it will potentially owe royalties or licensing fees to the essential patent holder(s).This market power can lead to what competition authorities call a 'dominant position', where a company is able 'to behave to an appreciable extent independently of its competitors, its customers, and ultimately of the consumers'.[15] Although dominant positions are not illegal in themselves, they do place special responsibilities on the companies which inhabit them not to engage in exclusionary or exploitative conduct. In the case of 'patent ambush', a patent holder achieves a dominant position by 'deception', since it chooses not to disclose its essential patent in violation of SSO IPR policy. Some SSOs have strict sanctions for policy violations, such as mandatory licensing on a royalty free basis [16], but many are 'toothless' with little sanctioning power, if any. However, once a dominant position is established, competition authorities start to take an interest. According to Thomas Kramler,[17] EU competition law is not well-equipped to deal directly with the problem of patent ambush. Article 102 TFEU requires undertakings to be in a position of dominance before 'abuse' can be said to take place. In the case of patent ambush, the "deceptive conduct" of failing to disclose occurs before the company in question achieves dominance. In the US, patent ambush can be addressed directly, since Section 2 of the Sherman Act includes the offense of 'unlawful monopolization' which is broad enough to cover it. In the EU context the Commission can only take action if the licensing terms of the deceptively non-disclosed essential patent are 'unreasonable' to the point of being 'excessive'.

10 Such as increased intra-technology competition which push prices down for consumers
11 Some SSOs such as VITA (VMEbus International Trade Association), mandate disclosure, see Article 10.2.1 of the VITA Patent Policy. Others, like the ETSI (European Telecommunications Standards Institute) ask for "reasonable endeavors" to disclose, a duty which is limited further by the lack of an obligation to perform patent searches. See Art 4, generally, of the ETSI IPR policy
12 See for example, Article 4 of the ETSI IPR policy, also para 1 of Common Patent Policy for ITU-T/ITU-R/ISO/IEC
13 See note 2 above, at para 40
14 However, not all essential patents result in their owner's having a dominant position, due to the presence of various other horizontal, vertical and dynamic constraints.
15 Case 85/76 Hoffman-La Roche, at para 38
16 See Article 10.4 VITA Patent Policy
17 Deputy Head of the Information Industries, Internet and Consumer Electronics Unit of DG Competition, European Commission, Brussels. He was a speaker at the WIPO Symposium on Intellectual Property and Competition Policy , 25 October 2010. His views are personal.

This is what occurred in the EU case of Rambus[18], where on 30 July 2007, the Commission sent Rambus a Statement of Objections setting out the preliminary finding of an abuse of dominance in the market for 'Dynamic Random Access Memory chips' ('DRAMs'). This case was finally settled by the Commission in making binding on Rambus certain 'commitments' [19] designed to neutralize the competition concerns. These included granting 'royalty holidays' to licensees of the essential patents, as well as royalty caps on several others.[20]

The Draft Guidelines address the problem of patent ambush in an ex ante fashion by providing a safe harbor only for those SSO IPR policies which "require good faith disclosure of [essential] intellectual property rights"[21]. This requirement is tougher than the current practice in many SSOs which often only 'encourage' disclosure or require "reasonable endeavors"[22] to disclose essential IPRs. However, the efficacy of this disclosure duty in preventing patent ambush is limited by the extent to which companies participating in the SSO are required to do a 'patent search' (an inquiry into their patent portfolios to see if any of their patents 'read' onto the standard). A large number of SSO IPR policies do not require a strong duty of patent search[23], perhaps for the reason that some companies have patent portfolios of tens of thousands, if not more, and the cost of such a search would be both severe and disproportionate. The Draft Guidelines seem to be silent on the question of the patent search obligation, though the "good faith" requirement of disclosure might go to this point, meaning, perhaps, that only a 'reasonable search' is required. In any case, the Draft Guidelines would seem to be a good ex ante instrument for preventing mala fides non-disclosure of an essential patent, and would thus address the problem of patent ambush.

The meaning of FRAND and 'excessive' licensing.

The FRAND ("Fair, Reasonable And Non-Discriminatory" licensing terms) commitment (or "RAND" in the US) is found in the IPR policies of many SSOs, and is designed to address the problem of 'patent holdup'. Patent holdup is when owners of essential patents hold licensees to ransom by refusing to provide licenses except at significantly inflated royalty rates or fees, using the fact that once the standard is adopted, licensees have extremely reduced bargaining power. What FRAND actually means in practice is unclear. It may also vary from industry to industry. For instance, according to Heinz Hamman from *Boehringer Ingelheim*,[24] R&D costs in the pharmaceutical sector tend to outstrip other sectors, and FRAND pricing may well be acceptably high. But in what way is a breach of the FRAND commitment by an essential patent holder a competition concern? Indeed, FRAND is a commitment which forms part of SSO IPR policy, and it is arguably not the job of a competition authority to enforce such policies. This territory is very uncertain, but one perspective is that competition authorities take an interest in a violation of FRAND only if the following conditions are met: the essential patent holder to the standard is a member of an SSO which requires FRAND licensing in its IPR policy; the essential patent holder inhabits a dominant position; breach of FRAND is such that it constitutes 'excessive pricing' under Article 102 TFEU. This interpretation of FRAND is reasonably

18 See Commission Press Release IP/09/1897, 9 December 2009
19 Under Article 9 of Regulation 1/2003
20 Para 49 Commission Decision 9 December 2009 in Case Comp/38.636- Rambus
21 See the Draft Guidelines at para 281
22 See ETSI patent policy at Article 4.1
23 See ETSI patent policy at Article 4.2.
24 Responsible for Corporate Patents. He was a speaker at the WIPO Symposium on Intellectual Property and Competition Policy , 25 October 2010. His views are personal

conservative, but it also embodies an important paradox.If a breach of FRAND is indeed the same thing as 'excessive pricing' under Article 102 TFEU, then, at least in the EU [25], the concept of FRAND is unnecessary, since excessive licensing fees or royalties can already potentially be captured by antitrust authorities without any recourse to the notion of the FRAND commitment.[26] If, on the other hand, the FRAND commitment is stricter than the test for excessive pricing under Article 102 TFEU, then only the most flagrant violations of the commitment would meet the very high standard under the antitrust 'excessive pricing' test. Moreover, in such a case, there is no need for the essential patent holder charging the excessive fee to belong to an SSO, or to have committed to FRAND pricing, since the obligation not to abuse a dominant position is a central tenet of EU competition law.

So, on this view, either FRAND is unnecessary or competition authorities are unable to enforce it.[27] It is manifestly clear that in the Draft Guidelines the Commission views a breach of FRAND as equivalent to 'excessive pricing' under Art 102 TFEU:

FRAND commitments are intended to prevent IPR holders from making the implementation of a standard difficult by refusing to license or by requesting unfair or unreasonable fees (in other words excessive fees)...and/or charging discriminatory fees...[28]

Furthermore, the test for 'excessive fees' as given by the Commission is exactly equivalent to the test for excessive pricing under Article 102 TFEU: that they bear no reasonable relation to the economic value of the patents/products.[29] However, the above excerpt also highlights two other consequences of the FRAND commitment: that it prevents the refusal of essential patent holders to license, and it stops discriminatory price setting. With respect to the first point, the 'refusal to supply' or license essential IPR is a well-established field of Article 102 TFEU jurisprudence, and was in fact determinative in the 2007 decision of *Microsoft*.[30] Again, provided the essential patent holder inhabits a dominant position, no recourse to FRAND seems necessary to deal with refusals to license.

The second point of non-discriminatory pricing is more difficult. Superficially, it simply involves comparing the royalty rates or licensing fees for the patent for one company with those of its competitors to see if there is a difference. The problem here however is that licenses are generally bi-lateral confidential contracts between licensors and licensees, and the terms cannot therefore be easily compared. Furthermore, such contracts often involve 'side-deals', such as cross-licenses, which makes putting a price on the whole transaction extremely difficult. It is interesting to note that the only Commission case that these authors are aware of that concerned a breach of FRAND- the Qualcomm case [31] - was closed due to a retraction of the complaint by the complainants. The character of ex post enforcement of FRAND by competition authorities is still, therefore, uncertain territory in the EU.

25 In the US, for example, there is no such rule against excessive pricing.
26 Of course, if the essential patent holder did not have a dominant position, then the competition authority cannot intervene under Art 102 TFEU in any case, regardless of how excessive the fees are.
27 Some commentators argue that Article 101 (3) TFEU requires FRAND pricing in order to ensure 'pass-on' to consumers. This point seems to overlook the fact that the licensing contract often occurs very high up in the supply chain, and that it is the competition in the downstream market that really determines the ability to price.
28 See para 283 of the Draft Guidelines
29 See para 284 of the Draft Guidelines, which refers to Case 27-76 United Brands, at para 250. This case leads the case law on 'excessive pricing' under Art 102 TFEU . How the economic value of patents is determined in practice is a matter of incredible complexity and controversy which we cannot go into here
30 See Case T-201/04 Re Microsoft
31 See DG COMP Memo/09/516 Antitrust: Commission closes formal proceedings against Qualcomm