

FRAND Commitments

The Case For Antitrust Intervention

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What Are Standards?

- Typical EU handset – GSM (2G) and UMTS (3G)
 - > GSM: > 5,000 patents declared essential by > 40 companies
 - > UMTS: > 10,000 patents declared essential by > 60 companies
- Cannot manufacture a handset without infringing all essential patents
- Key issue: can holders of essential patents charge whatever they want?
- Should competition law intervene?

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Current European Commission FRAND Disputes

Qualcomm (unreasonable royalties and discriminatory licensing terms)

- Complaints filed by Broadcom, Ericsson, NEC, Nokia (withdrawn July 2008), Panasonic and Texas Instruments in October 2005 (complaints also filed with KFTC and JFTC)
- Alleged breach of FRAND commitments and Articles 81 and 82 EC in relation to patents claimed essential to WCDMA (3G)

Rambus (patent ambush)

- Statement of Objections sent to Rambus in August 2007
- Alleged intentional deception through non-disclosure of DRAM essential patents and claiming unreasonable royalties

IPCom (unreasonably royalties and ambulatory FRAND)

- Action filed in Germany by Nokia in December 2007 against Robert Bosch for failure to license on FRAND terms - IPCom joined to action following transfer of patents
- Nokia lodged a formal complaint against IPCom, January 2009

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Standards Generate Important Consumer Benefits (In Particular Mandated Single Standards E.g. GSM)

- Interoperability (use your handset everywhere)
- Lower barriers to entry in downstream markets
- Lower costs and prices for downstream products (through economies of scale)
- Reduced risk for downstream customers (through elimination of inter-technology competition)
- Increased downstream competition (through reduced switching costs for consumers)
- Increased incentives to invest in R&D (through reduced risks)
- Increased network effects (more users, the greater the network's value to consumers)

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But Standards Can Create / Enhance Market Power

- Eliminate / reduce competition
 - > Inter-technology (between competing technologies)
 - > From future technologies (once implemented, locked into the standard for many years)
 - > Undermine the ability of customers to wait and see - skip a technology generation
- Enhances essential IPR holders' market power *ex post* which can be unfairly exploited by licensors (causing "hold-up")

"Once an essential technology is included... in a standard... the owner of the IPR... occupies in most if not all situations a dominant position... vis-à-vis manufacturers requiring licenses on that IPR"
(European Commission letter to ETSI, February 1994)
- Huge switching costs once operator has invested in infrastructure ("lock-in")
- A mechanism is therefore required to prevent consumer harm while preserving the economic benefits of standardisation

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Standard Setting Organisations – Promote FRAND / RAND Commitments

- ETSI IPR Policy
 - > Companies claiming to own essential IPR are requested to notify these to ETSI in a timely fashion
 - > Director-General of ETSI requests FRAND commitment
- Commitment to license subject to reciprocity. Licenses to be on fair, reasonable and non-discriminatory terms
- ETSI cannot enforce FRAND; its role is limited

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Alternative Approaches To FRAND

- Weak FRAND:
 - > Essential IPR owners have the right to refuse to license
 - > But have the obligation to negotiate in good faith
 - > And the right to seek injunctive relief
 - > Have the right to charge whatever the market can bear
- Strong FRAND:
 - > Essential IPR owners have the obligation to license subject to reciprocity
 - > No right to injunction where a licensee in good faith is willing to take a license on FRAND terms and conditions
 - > "Fair" and "reasonable" = a constraint on the amount of royalties

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Weak FRAND – Patent Trolls' Charter

- FRAND commitments are meaningless
- No constraints on royalties
- No system for allocation of royalties
- Trolls are a serious threat

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Strong FRAND – Supported By Most Of The Telecoms Industry

- A FRAND commitment is a commitment not to exploit the market power obtained through standardisation
- FRAND is a compromise:
 - > IPR owners get substantial benefits from inclusion of their IPR in a standard (enhancing the value of essential IPR)
 - > IPR holders agree to moderate their behaviour – fair, reasonable and non-discriminatory royalty rates
- FRAND must be enforced by competition authorities and courts

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Why Must FRAND Be Enforced? Substantial Public Interest

If FRAND commitments are not enforced:

- Substantial consumer harm of US\$ billions
- E.g., Press reports on Qualcomm case:
 - > Qualcomm's royalties for UMTS (3G) patents claimed to be 5%
 - > Reasonable rate for Qualcomm's UMTS patents should be 1%
 - > Consumers estimated to be overpaying by €4 billion+ 2004 - 2012

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Why Must FRAND Be Enforced? Legal Framework Requires Enforcement

Legal Framework:

- Standardisation typically leads to infringement of Article 81 EC – exempt under Article 81(3) EC, provided it:
 - > Contributes to economic progress
 - > Allows a fair share of benefits to consumers (e.g., reasonably priced downstream products)
 - > Does not allow undertakings the possibility of eliminating competition
 - > Allows "access to the standard... for third parties on fair, reasonable and non-discriminatory terms" (Horizontal Cooperation Guidelines, para 174)
- Participation in standard setting organisations such as ETSI (GSM and UMTS) is likely to be illegal absent FRAND licensing

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Why Must FRAND Be Enforced? Legal Framework Requires Enforcement

Legal Framework:

- Standardisation can make each essential patent a monopoly under Article 82 EC
"Although a patent confers a lawful monopoly over the claimed invention, ... its value is limited when alternative technologies exist. ... That value becomes significantly enhanced, however, after the patent is incorporated in a standard. ... Firms may become locked in to a standard requiring the use of a competitor's patented technology. The patent holder's IPRs, if unconstrained, may permit it to demand supracompetitive royalties."
Opinion of the US Court of Appeals, 3rd Circuit, in *Broadcom Corp v. Qualcomm Inc.*, *op.cit.*, p.23
- IPR owners who acquire market power through standardisation and give FRAND commitments are constrained by Article 82 EC to license on FRAND terms:
 - > Fair and reasonable: not excessive, i.e., no monopoly rent (Case 27/76 *United Brands v. Commission*)
 - > Non-discriminatory: equal treatment of customers – cannot discriminate against downstream customers without objective justification (*Tight Head Drum case* – Federal Supreme Court of Germany (2004))

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What Does Fair And Reasonable Mean?

- Competition authorities are well versed in interpreting what is "fair" and "reasonable"
- Workable benchmarks include:
 - > Negotiated outcomes *ex ante*
 - > Royalties charged by other essential IPR holders for the same standard
 - > ART and proportionality
 - > Effective *ex ante* auctions for off-the-shelf technologies with clear patent landscape

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"Aggregated Reasonable Terms" (ART) And "Proportionality"

- Joint press release of 14 April 2008 by Alcatel-Lucent, Ericsson, NEC, NextWave Wireless, Nokia, Nokia Siemens Networks and Sony Ericsson:
 - > Reasonable maximum aggregate royalty rates based on the value added by the technology in the end product (ART)
 - > Flexible licensing according to the licensors' proportional share of all standard essential IPR for the relevant product category (Proportionality)
- A view of FRAND incorporating ART and proportionality is supported by many others in the telecoms industry (including Fujitsu; Panasonic; Mitsubishi; Siemens; BenQ; KPN; NTT DoCoMo; Orange/France Telecom; and Telefonica)

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"Aggregated Reasonable Terms" (ART) And "Proportionality"

- Strengths include:
 - > Can be applied *ex post* when patent ownership clearer
 - > Preserves incentives to innovate *ex post*
 - > Does not depend on availability of evidence of competitive rates pre-standardisation
 - > Limits aggregate rate and therefore promotes market entry
 - > Fair system of allocation between multiple patent owners
 - > Could be readily applied by regulators / courts

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Conclusion – The Way Forward

- FRAND works and can be strengthened through enforcement
- FRAND must be interpreted in a way which gives rise to clear, justiciable rules
- Competition law should be used to enforce FRAND commitments in the interests of consumers

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