Request for Comments for the Workshop on Standard Setting Issues – Project n. P111204

LICENSING POLICY RULES AT THE CORE OF THE HOLD-UP PROBLEM

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INTRODUCTION

Several authors have already dealt with the intersection between IPRs and competition in standard setting. The bulk of this economic and legal literature mainly focuses on the well-known ‘hold-up’ problem. Hold-up occurs when firms joining standard setting bodies hide the existence of their IPRs –essential to the standard under examination- in order to gain *ex post* supra-competitive royalties. In other words, after the standard has been selected, innovators may exercise the power given by the standard and charge licensees excessive fees.

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The concrete risk of patent hold-up should be carefully appraised and linked directly to the effectiveness of the various rules of standard setting organizations, *i.e.* search disclosure and licensing provisions. Indeed, the analysis of these rules may lead to the conclusion that hold-up is facilitated (rather than constrained) by the policy models widely adopted so far by SSOs. Therefore, in order to overcome a problem which has affected different industries, it seems crucial to identify a policy framework which clearly limits the risk of hold-up in the first place. Remedying the problem *ex post*, when the conduct has already occurred, may well be possible (*e.g.,* through competition authorities' intervention), but this does not appear to represent the most efficient solution. The effectiveness of standardization indeed is directly linked to the timing required to develop new innovative products. This short paper aims at suggesting antitrust authorities to set forth some 'best practices' for standard setters rather than developing legal challenges after hold-up has occurred. In particular, it will focus on the advantages and disadvantages of the different policy frameworks elaborated in the context of licensing terms, which seem to be at the core of the hold-up issue: a) FRAND commitments; b) *ex ante* negotiation of royalties; c) unilateral disclosure of the maximum cap. Brief comments will also be made on the other relevant obligations considered by SSOs policies, concerning both the duty to search and to disclose essential IPRs.

1. FRAND COMMITTMENTS

When examining the IPRs policies of standard setting organizations, it emerges that most part of them have implemented the so-called FRAND licensing model. Under this regime, members of the organizations are required –in case their technologies are selected- to license their rights under fair reasonable and non-discriminatory terms. Such a model has been interpreted as a valid ‘umbrella’ to limit the risks of excessive prices being charged by IPRs owners. Put differently, the FRAND commitment should have considered and preserved both the manufacturers’ desire of being charged reasonable prices and the interests of innovators in fair rewards for their investments. However, as attested by the U.S. jurisprudence (*e.g.*, see *Rambus v FTC*, 522 F.3d 456, D.C. Circuit – 2008; *Broadcom v. Qualcomm,* 501 F.3d 297, 3rd Circuit - 2007), the FRAND regime has finally put the effectiveness of standard setting processes under a serious risk. Indeed, the divergent interpretations of FRAND given by the literature have not clarified when licensing royalties may be deemed excessive or fair. The indefiniteness of the meaning of these conditions usually allows the owners of IPRs to defend any price ultimately charged as a fair and reasonable rate. Therefore, FRAND terms are not an efficient solution mainly because they leave potential implementers of a technology uncertain as to the economic terms on which essential patents will be licensed to them. Such uncertainty, increased by the divergent economic theories developed by the literature, may lead key market players to avoid SSOs processes, or to hesitate in developing technologies which may still be the subject of litigation among interested parties. These considerations may justify the view that a FRAND licensing model implies more questions than it gives answers. It probably incentivizes rather than constrains hold-up behaviors.

2. *EX ANTE* NEGOTIATION OF ROYALTIES

In order to avoid the risks of subscribing undefined FRAND terms and litigating their meaning before a court, SSOs' members could negotiate *ex ante*–before the formal adoption of the standardized technology- the specific price terms under which licensing any rights. This model would avoid uncertainty on the level of royalties patent holders may finally charge, and might thus function as an incentive for implementers to take part to the standard setting process. However, it has been said, under these circumstances SSOs' members would allegedly expose themselves to potential antitrust liability for price fixing, prohibited by both Article 101 TFEU and Section 1 of the U.S. Sherman Act. Similarly, firms could face antitrust liability for implementing an illegal group boycott, in case they conditioned the standardization of a proprietary technology on the IPR owner's acceptance of licensing fees specified in advance.

However, I believe, the criticism related to price fixing does not seem convincing, especially when considering the divergent interests of IPRs holders on the one hand (obtaining consistent rewards), and implementers on the other (keeping the fees level low). Further observations have then emphasized the risk that discussions on licensing terms may ultimately lead to exhausting policy battles between SSOs' participants, which may finally compromise the whole standardization process.

Perhaps, the most important reason for excluding the ex *ante* policy model from potentially optimal frameworks lies on the fact that negotiations might be interpreted by some innovators as dangerous and inconvenient. In other words, IPRs owners may well fear that negotiating licensing terms with implementers (representing usually the vast majority of participants) may force the price down. Indeed, as explained above, industry participants have usually an interest to obtain a low royalty rate. The immediate consequence could be a reduced participation in standard setting activities by innovators, to the ultimate detriment of dynamic efficiency and consumer welfare. In light of these arguments, it seems that ex *ante* negotiation of licensing terms, like FRAND terms, does not probably represent the most effective solution. What model could then be implemented to solve the hold-up issue?

3. UNILATERAL DISCLOSURE OF THE MAXIMUM CAP

A more effective licensing framework, I believe, may be based on a rule requiring IPRs owners to disclose unilaterally the maximum price or the most restrictive non-price conditions they would apply for any issued or granted patents they own covering the standard. Such a model has already been mentioned by the European Commission in its recent Guidelines on Horizontal Cooperation Agreements, and has also been considered by a few organizations. Under this framework, innovators would have to set ex *ante* and unilaterally the highest rate or most restrictive non-price terms to be applied in case their patented technology were included in the standard. The acceptance of a maximum cap regime may drastically reduce the concerns for patent hold-up and the related inefficiencies. Indeed, this option would avoid the risk of lengthy litigation on the meaning of unclear licensing policy, and would probably discourage IPRs owners from applying terms more burdensome than those established. This is because a maximum cap may potentially have a better chance to be enforced by a court than a FRAND model, and so may work as a deterrent to misleading conduct. A maximum cap regime may also prove to work better than the ex *ante* negotiation model. First, absent price discussions, an antitrust authority may seldom intervene to sanction cartelistic behaviors. Secondly, by eliminating the risk of low prices imposed by implementers, IPRs owners would be more encouraged to participate in standard setting.

In brief, this would explain why the model should be preferred to any other framework in the setting of IPRs licensing policies. It is true that IPRs owners would have to set maximum royalty/terms, without fully knowing at times the specific contribution their technologies may bring in terms of innovation. It is similarly true that problems may arise in case innovators, after disclosing the highest terms, obtain new essential IPRs related to the standards. This notwithstanding, in light of the more serious faults of the two other models, these appear to be minor concerns which may still find a proper solution.

4. SEARCH AND DISCLOSURE DUTIES

Beyond licensing terms, a proper compromise between IPRs owners' interests and SSOs' objectives also implies the setting of other relevant policy rules, regarding search and disclosure duties. In this context, it seems reasonable to support the view that disclosure of essential IPRs should only concern granted rights. By imposing the obligation on innovators to reveal also the existence of pending IPRs, there could be the risk to discourage their participation to standard setting. IPRs owners, indeed, are usually reluctant to disclose their pending patent claims as this may advantage competitors, which could try to infer the substance of the invention and claim IPR protection for a similar product. Furthermore, pending applications may still be subjected to further amendments, which may ultimately modify the essential function of a technology. Of course, the very existence of pending rights of firms taking part to standard setting may pose relevant questions. First, how to regulate the value of those rights -covering the standard- initially pending when finally granted? A solution, I believe, may consist in requiring innovators to set a cap which may reasonably reflect the contribution to the standard brought by both issued and potentially relevant pending rights. This approach, requiring complex but necessary evaluations of IPRs portfolios, would avoid the risk of conduct exploiting those rights which were not yet issued at the moment of disclosure.

Finally, on a further different ground, it seems also important to set the boundaries – if any- of the duty to search for relevant IPRs. In this context, I believe, SSOs should refrain from implementing search rules, due to the many difficulties and resources that exploring patent portfolios may entail, especially for those large firms with thousands of IPRs. A reasonable policy would instead be limited to require innovators to disclose only those relevant issued rights they are aware of. Pending IPRs, as mentioned above, would still be covered by the setting of the cap. Such a flexible approach would probably succeed in encouraging IPRs owners to take part in standard setting and in preserving the interests of all the other participants (*i.e.,* industry users and implementers).

CONCLUSION

The arguments made above have clarified the importance of effective licensing rules in order to solve the patent hold-up problem. The licensing provisions (*i.e.* FRAND/RAND terms) widely adopted so far by standard setting organizations have proved to be inefficient, mainly due to the indefiniteness of fair and reasonable terms. The *ex ante* negotiation model may potentially discourage innovators from taking part to SSOs, due to the risk of having low prices imposed by the majority of industry participants. Given these comments, a better approach to the issue may well consist in encouraging a licensing model which allows the *ex ante* unilateral disclosure of the maximum price level and most restrictive non-pricing terms. Such a model seems to strike a better balance between innovators' interests and SSOs' objectives. Of course, beyond licensing rules, it seems crucial to define also the other duties SSOs' members should comply with. Among these, the need to disclose the existence of relevant issued IPRs which may potentially conflict with the standard, and of which the IPRs owner is aware. These policy principles, in my view, would better ensure the achievement of the ultimate goals of standardization, *i.e.* the enhancement of consumer welfare and societal productivity. It should be clear by now the importance of tackling hold-up from an *ex ante* perspective, through a workable policy, rather than by proposals of *ex post* remedies to limit its negative consequences. This notwithstanding, more research on the issue seems to be needed, with particular reference to the enforceability before judicial authorities of SSOs' policies as legitimate contractual provisions.