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FRAND Ambush?

Law360, New York (July 09, 2014, 10:29 AM ET) -- Unlike in the United States and Europe, where standard-essential patent holders voluntarily commit to license on fair, reasonable and nondiscriminatory terms, SEP holders (as well as non-SEP holders) in China may be subject to FRAND commitments even when they do not voluntarily agree to license on FRAND terms.

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The U.S. and EU Approach

U.S. and EU competition agencies have addressed breaches of FRAND licensing commitments in cases when the SEP holder (or its predecessor in interest) has made a voluntary commitment to license on FRAND terms, or when an SEP holder knowingly and deceptively failed to disclose patents essential to a standard, resulting in competitive harm. In the latter case, the SEP holder may be required to license on FRAND terms as a remedy for the anti-competitive conduct. The agencies have not imposed liability for breach absent voluntary FRAND commitments (for example, because their owners did not participate in formulating the standard).

China

In contrast with the approach taken in the United States and Europe, recent developments in China suggest that patent holders may be required to license SEPs on FRAND terms even in the absence of a voluntary commitment to do so.

The clearest example is the State Administration for Industry and Commerce's latest version of its Draft Rules on the Prohibition of Abuses of Intellectual Property Rights for the Purpose of Eliminating or Restricting Competition, which were released for public comment on June 11, 2014.[1] Article 13 of the draft rules covers SEPs and prohibits two types of conduct by dominant firms without justifications: first, intentionally failing to disclose their intellectual property rights to the standard-setting organization or expressly waiving their rights, but later asserting them against those implementing a standard that incorporates the IPR when the patent holder is aware that its patents may be included in relevant standards; second, violating FRAND terms after a patented technology becomes essential to a standard.

Neither prohibition requires that the patent holder have voluntarily submitted its patents to a standard or voluntarily committed to license its patents on FRAND terms. Rather, Article 13 would impose liability for failing to offer FRAND terms even in the absence of a voluntarily commitment to license on FRAND terms, or the patent holder's consent that its patents be included in a standard. Under SAIC's proposed rule, liability under the Anti-

Monopoly Law could be found when someone other than the patent holder proposes that an SSO include its patents in a standard. Indeed, a potential licensee might do this in an effort to force the patent holder to offer its patents on FRAND terms.

In addition, Article 17(1) of the AML prohibits dominant firms from charging "unfairly high prices," and Article 17(6) prohibits applying dissimilar prices or other transaction terms to counterparties with equal standing. Such provisions may be used to impose FRAND-like terms on both SEPs and non-SEPs in the absence of a voluntary commitment to license on FRAND terms. Indeed, the National Development and Reform Commission is reportedly investigating Qualcomm based in part on allegations that Qualcomm is charging (1) "unfairly high prices" by basing royalties on the entire device instead of at the chip level, and (2) higher prices to Chinese and Korean companies than others.[2]

Similarly, on Oct. 28, 2013, the Guangdong High People's Court, in Huawei v InterDigital, concluded that InterDigital was required to license its Chinese SEPs to Huawei on FRAND terms, despite the absence of any explicit commitment to do so.[3] The court reasoned that, despite the fact that IDC is not involved in setting Chinese telecommunication standards, IDC is nonetheless held to the obligations to license its standard-essential patents to Huawei in compliance with FRAND terms because: (1) as an active participant in standard-setting activities of relevant international SSO such as ETSI, IDC has "anticipated" that its patents will be adopted by Chinese standards; and (2) according to Chinese laws, IDC also has obligations to license its standard-essential patents to Huawei.

In other words, IDC's commitments to one SSO to license its patents on FRAND terms to implementers of that standard could be used to imply a FRAND commitment to license patents deemed essential to a separate Chinese standard to implementers of that standard, absent a voluntary commitment to that organization.

Discussion

Imposing FRAND commitments in the absence of a patent holder's voluntary commitment to license on FRAND terms could seriously harm incentives to innovate. Patents create exclusive rights that allow the patent owner to appropriate the value of its invention, either by retaining the patented technology for exclusive use, or by licensing to others. This promotes innovation by protecting investment in new products and services.

When a patent holder voluntarily commits to license its intellectual property on FRAND terms, however, it chooses to forego some of these rights in exchange for the benefits of inclusion in a standard.[4] These benefits also promote innovation. Consequently, it is difficult to see how a decision by the patent holder not to choose to incorporate its intellectual property in a standard and make a FRAND commitment constitutes anti-competitive conduct. The patent holder alone should have the choice whether to make a licensing commitment or to retain the patent for its own (or another) use.[5]

In addition, absent a voluntary commitment to refrain from discrimination, discriminatory refusals to license or licensing on different terms to different parties may serve legitimate, pro-competitive ends, and can, under certain circumstances, enhance consumer welfare.[6] "For example, it can enable price-sensitive consumers to be served when they otherwise would be priced out of the market if uniform pricing were mandated."[7] Where there are two distinct customer groups, one that is highly price sensitive and another that is not, without allowing for price discrimination, firms will price relatively high for the latter group to maximize their profits.

As a result, the first group will be foreclosed from the market. And, "for certain market structures, price discrimination can also lead to lower overall prices for consumers in comparison with uniform prices."[8] Businesses may also have legitimate pro-competitive justifications for discriminatory licensing. For example, a business may grant licenses to some, but not all, interested potential licensees to ensure that licensees have incentives to promote the licensor's technology. Or, a business may require higher royalties from a company that has less sales volume in order to maximize his income from the patent, or offer lower royalties to licensees that can offer valuable consideration in trade, such as cross-licenses for their intellectual property, which may be netted against the price of a license.

Conclusion

In general, U.S. and EU competition authorities have investigated breaches of FRAND commitments only when the patent holder (or a previous owner) voluntarily committed to license on FRAND terms. In contrast, SAIC's draft rules would seem to impose liability even when someone other than the patent holder submits patents for inclusion in a standard in an effort to force the patent holder to offer its patents on FRAND terms. Such prohibitions may harm incentives to innovate and substantially impinge upon an IP rights-holder's core right to exclude.

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[1] The Consultation Draft was published for comment at http://www.chinalaw.gov.cn/article/cazjgg/201406/20140600396223.shtml. The SAIC is one of three agencies with concurrent enforcement of China's Anti-Monopoly Law (AML). SAIC is responsible for non-price related anticompetitive conduct, the Ministry of Commerce (MOFCOM) is responsible for merger review, and the National Reform and Development Committee (NDRC) is responsible for price-related anticompetitive conduct.

[2] Qualcomm Form 10-Q at 12 (Mar. 30, 2014), available at http://investor.qualcomm.com/secfiling.cfm?filingID=1234452-14-154.

[3] April 2014 Public decisions, available at http://www.mlex.com/China/Attachments/2014-04-18_AXRC879FW8P38IO7/guangdonghpc_IDChuawei_SEP_18042014.pdf (in Chinese) and http://www.mlex.com/China/Attachments/2014-04-17_BT5BM49Q967HTZ82/GD%20verdict.pdf (in Chinese).

[4] These benefits are separate from the royalty revenue that the participant can collect from licensing its patented technology. Such non-royalty benefits "can include increased demand for participants' products, advantages flowing from familiarity with the contributed technology, potentially leading to shorter development lead times, and improved compatibility with proprietary products using the standard." Microsoft Corp. v. Motorola, Inc., 2013 WL 2111217 at *5 (W.D. Wash. April 25, 2013).

[5] See generally Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 427-30 (1908); Standard Oil Co. v. United States, 283 U.S. 163, 179 (1931); United States v. United Shoe Mach. Corp., 247 U.S. 32, 57-58 (1918); United States v. Westinghouse Elec. Corp., 648 F.2d 642, 647 (9th Cir. 1981); SCM Corp. v. Xerox Corp., 645 F.2d 1195 (2d Cir. 1981).

[6] See, e.g., Anne Layne-Farrar, "Non-Discriminatory Pricing: What is Different (and What is Not) About IP Licensing in Standard Setting," J. of Competition Law & Econ. 1, 1, 4-7 (Aug. 5, 2010) (the existing literature on price discrimination in traditional markets for goods and services and on licensing intellectual property establishes that "price discrimination is not necessarily harmful, and in some cases can even increase consumer welfare; most IP licensing is characterized by 'discrimination' in that rates and terms tend to differ across licensees; proof of market power must remain the first step in any inquiry on allegations of anticompetitive IP licensing discrimination; and as of yet, no widely applicable benchmarks or rules for distinguishing harmful from beneficial or non-harmful licensing discrimination have emerged, meaning that a careful, quantitative effects-based analysis remains the best approach.").

[7] Id. at 5 (citing Benjamin Klein & John Wiley, Jr., "Competitive Price Discrimination As an Antitrust Justification for Intellectual Property Refusals to Deal," 70 ANTITRUST L.J. 599 (2003); Lars A. Stole, Price Discrimination and Competition, in 3 HANDBOOK OF INDUSTRIAL ORGANIZATION 2223 (Mark Armstrong & Robert Porter eds. Univ. of Chicago 2007); Hal R. Varian, Price Discrimination, in HANDBOOK OF INDUSTRIAL ORGANIZATION 597 (Richard Schmalensee & Robert D. Willig eds., North-Holland 1989) (surveying price discrimination theory and practices); Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination," 71 AM. ECON. REV. 242 (1981)).

[8] D. Fudenberg & J. Tirole, "Customer Poaching and Brand Switching," 31 RAND J. ECON. 634 (2000)); Layne-Farrar, "Non-Discriminatory Pricing" at 6 (citing Jacques F. Thisse & Xavier Vives, "On the Strategic Choice of Spatial Price Policy," 78 AM. ECON. REV. 122 (1988);.