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INTELLECTUAL PROPERTY AND STANDARD SETTING

-- Note by Finland --

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FINLAND

1. Standards and the economy

1. Standards are becoming increasingly important to many sectors of the economy. Standard-setting is a necessary part of technology development, since compatibility and interoperability across devices and networks is vitally needed. Information and communication technology are literally based on standards. Without technology standards, many things that we take for granted, such as access to Internet, would not be possible.

2. Standards are a consequence of systems in which complementary products work together. Standards provide many benefits for consumers, such as lower product costs and increased price competition. There may be direct network externalities, as consumers value a product more highly when it is compatible with other consumers' products. The broader the implementation of a standard, the greater the interoperability benefits.

3. In contrast, competition between standards is often costly, because consumers tend to wait until the standard is established to avoid the choosing of a losing standard. Therefore, both suppliers and consumers of network goods tend to prefer a single standard. Standards enable consumers to switch more easily between products of different manufacturers. Moreover, standardisation allows producers to exploit economies of scale in production.

4. However, standard-setting may raise different antitrust issues, since the need for standards necessitates undertakings to work together. Most standard-setting takes place in various standard-setting organisations, which have formal processes for their members, but standard-setting also takes place in informal co-operative arrangements between undertakings. The boundary between co-operation and collusion may be put under review when horizontal competitors agree on a certain specification of a product in standard-setting. There may be anti-competitive discussion in the context of standard-setting, which aims at reducing price competition. Furthermore, once a standard is set, competing technologies may be excluded from the market.

5. Abuses have occurred in the standard-setting process and in the enforcement of standard essential patents that have triggered the application of competition law. These problems have related to the mobile telecoms sector, in particular, which is characterised by an increasing number of patents. It has been said that a so-called global smartphone war is evolving, in which the world's communication and information technology giants are involved. Competition within the market can be fierce and sometimes the means used may constitute an abuse of a dominant position. In particular, the possibility of imposing injunctions in standard essential patent cases is an important question, since telecommunication and IT standards are critical to interoperability.

6. The Finnish Competition and Consumer Authority is of the opinion that standards and standard-setting are usually beneficial to competition, efficiency and consumer welfare. Indeed, standards serve the public interest in many ways. Moreover, standard-setting is an area which is suitable to private ordering. However, standards are not free from abuses and sometimes antitrust intervention may be needed.

Therefore, it is vital that standards, essential patents and their effects to competition are analysed within competition policy.

2. Standard essential patents, holdup and injunctions

7. Finland has recently been involved in three cases that are relevant to this hearing (Huawei v. ZTE, Motorola and Samsung). The Regional Court of Dusseldorf (Landgericht Dusseldorf) has referred questions to the European Court of Justice (Huawei Technologies v. ZTE) on whether there exists an abuse of a dominant position if a standard-essential patent holder which has given a FRAND commitment seeks an injunction against a potential licensee that has been alleged to infringe the patent.

8. Moreover, the EU Commission has given a decision in Motorola and a commitments decision in Samsung, which both deal with the right to seek injunctions. In addition, various national courts have dealt with the issue in Europe. Finally, commentators have emphasised the need for a clear EU precedent confirming the nature of a FRAND commitment, because otherwise there will be inconsistent national court decisions.

9. Participation in standard-setting organisations is typically voluntary, but members are often required to make a commitment about their patents as a condition of their participation. One such commitment is the FRAND royalty. FRAND refers to an undertaking's *ex ante* commitment to make its technology available at fair, reasonable and non-discriminatory terms if it is adopted as the standard. FRAND terms aim at creating a situation in which patent holders, implementers of the standard and consumers can all benefit from a standard. The FRAND commitment allows standard-setting organisations to select a standard based upon performance characteristics on the assumption that it will be reasonably priced. However, a FRAND commitment typically leaves open the exact royalty rate and the base upon which the royalty rate must be calculated.

10. When the standard is adopted, the patents that write on that standard become standard essential patents. A standard essential patent does not necessarily imply market power, since products covering a standard may compete against other products that do not comply with the standard. However, standard-setting frequently involves leading undertakings, and the creation of a new standard can lead to network effects and market tipping. As a result, a valid standard essential patent tends to create market power after the standard is adopted, if it subsequently becomes impossible for implementers to invent or design around the patent. A single essential patent may be enough to prevent the use of a standard. The holders of standard essential patents may have significant market power, and without a FRAND commitment they can – at least in theory – extract unreasonably high royalties from suppliers of standard-compliant products or prevent the supply of standard implementing products by obtaining an injunction.

11. This phenomenon has been defined as a patent holdup. Holdup tends to arise when an undertaking makes an investment specific to a relationship before all the terms and conditions of the relationship are agreed. In the standard-setting context, there is a real threat that without a FRAND commitment, patent holders can demand sums of money that significantly exceed the inventive contribution that they have made. Indeed, it is evident that the threat of injunction enhances a patentee's negotiating power.

12. In contrast, innovators who have made irreversible investments in the development of new technology found out that patent holders have used those investments against them as a bargaining chip. There are not many options available, because it is difficult to change an already adopted standard; standard-setting organisations rely on consensus and are thus slow to move. Redesigning a standard is costly and sometimes even impossible. Once a standard is set and implementers have invested money, they

become locked into the standard. As a result, there is a real risk that they are forced to agree to non-FRAND terms.

13. The standard holdup is not merely a private problem facing those implementing the standard who do not want to be overcharged. It is also a public policy concern, because excessive royalties, strategic delays or other burdensome terms imposed in patent licenses tend to be passed to downstream consumers. A standard essential patent holder who seeks an injunction tries to take out products from the market, and exclusion from a fast-moving market may prevent the development to the detriment of consumers. Indeed, the holdup appears to be an antitrust problem, because it may concern inefficient acquisition of market power that may harm consumers. Such conduct is not based on competition on the merits and may require rapid intervention before the anticompetitive effects of this strategy materialise.

14. The FRAND rules are a means by which standard-setting organisations address patent holdups. The EU Horizontal Guidelines state that “FRAND commitments can 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) after industry has been locked-in to the standard or by charging discriminatory royalty fees.” Although the adoption of a standard does not by itself limit the right to seek injunctions, the promise to license on FRAND terms does. After a FRAND commitment, the patentee’s reasonable expectation is the right to obtain FRAND royalties, not to exclude.

15. In Motorola, the EU Commission held that in exceptional circumstances and in the absence of an objective justification the seeking of an injunction based on standard essential patents may constitute an abuse of a dominant position if a standard essential patent holder has given a voluntary commitment to license its standard essential patents on FRAND terms and where the company against which an injunction is sought is willing to enter into a license agreement on such FRAND terms. The seeking of an injunction against a willing licensee was construed as an independent form of abuse. It is not unusual that new abuses are created in EU competition law, since the notion of abuse is open-ended and it may cover anything that hampers competition, including injunctions. Another possibility could have been to treat the seeking of an injunction as one form of refusal to license or constructive refusal to license, as Finland proposed in the hearings of Huawei Technologies v. ZTE. Finland took the view that an injunction can in certain circumstances be a competition law infringement but is not automatically that. One must always carry out a detailed competition law analysis before concluding one way or the other.

16. Moreover, the EU Commission created a safe harbour for all licensees who accept binding third party determination for the terms of a FRAND license: they are held as willing licensees. Injunctions against willing licensees may constitute an abuse of dominant position. Finally, a potential licensee who challenges the validity of a patent cannot be held unwilling, since it is in the public interest to be able to challenge the validity of patents.

17. Many commentators have suggested that following a FRAND commitment, an injunction is an inappropriate remedy for infringement of standard essential patents. If standard essential patent holder is allowed to seek and obtain an injunction against a willing licensee, it may be permitted to hold up locked-in implementers by a refusal to license or by licensing only unfair terms, which are totally contrary to the FRAND commitment.

18. Basically, a patent provides its holder the legal right to exclude others from practicing the invention. The patent holder can decide to license its technology or refuse to do so. Consequently, mere enforcement of patent by means of seeking an injunction to bring the infringement to an end normally does not raise competition concerns. Standard essential patent holders, however, are different from ordinary patent holders, because by giving a FRAND commitment they have voluntarily committed to forgo a part of their patent right in return for allowing their technology to be used in the standard. These rights are the

right to decide whether or not to license standard essential patents and the right to charge more than reasonable royalties. The limitation to the right to seek an injunction against willing licensee does not often harm the standard essential patent holders' incentives to innovate or access to court, since the FRAND commitment implies that they have chosen to monetise their patents through broad licensing rather than through exclusion.

19. However, there is a risk that an overly narrow focus on holdups may overestimate its social costs and lead to rules that are counterproductive. There are circumstances in which an injunction is justifiable; it may be needed to prevent a reverse holdup. For example, an implementer may be unwilling to accept FRAND terms, refuse to bargain in good-faith or be unable to pay the royalty.

20. Innovators must have incentives to innovate and to participate in standard-setting. Consequently, inventions that have become part of standardised technologies must be fairly rewarded. If injunctions were totally forbidden, it would give licensees incentives and ability to free ride. From this perspective, a limited right to an injunction can have a balancing effect between the negotiating parties. A mechanical approach should be avoided: a FRAND commitment is not a waiver of all injunction rights, nor is an injunction automatically a refusal to license. Consequently, seeking injunctions against unwilling licensees should remain lawful.

21. Moreover, it may not be excessive to require a potential licensee to fulfil certain conditions, as is done in the so-called the 'German Orange Book Standard Test'. For example, the potential licensee could be required to make an unconditional offer to the standard essential patent holder to conclude a license agreement which the patent holder cannot reject. Moreover, the potential licensee could be required to comply with the obligations on which the use of the licensed subject matter depends. This means that once the offer is made, the potential licensees must behave as if they were licensees and pay the royalties resulting from the licensing contract.

22. The Finnish Competition and Consumer Authority is of the opinion that in the context of standard essential patents the presumption rule should be that the patentee who has made a FRAND commitment should primarily obtain royalties, and injunctive relief should be a remedy of last resort. However, injunctions should not be totally denied, because that could lead to a reverse holdup.

3. The role of standard-setting organisations, courts and competition authorities

23. The two common categories of deceptive conduct are failures to disclose patents and violations of FRAND promises once a standard has been adopted. In general, it appears that solving standard essential patents-related problems requires a combination of antitrust and non-antitrust solutions. Since private ordering is suitable to standard-setting, it is logical to start from standard-setting organisations.

24. Standard-setting organisations are in part responsible for ensuring that their policies prevent abuses. It is their actions which often create the market power of standard essential patents, and the organisations are responsible of ensuring that this market power is constrained. However, their rules on patent disclosure and licensing have been considered too vague and weak to create a concrete obligation. As a result, these issues are now brought before courts and competition authorities.

25. The standard-setting organisations' IPR policies appear to be diverse. Although there is no general solution that would apply to all cases, it is evident that the standard-setting organisations should have a clear and balanced IPR policy. They could impose disclosure rules, as many already do, requiring the disclosure of patents and patent applications. Early disclosure is a well-reasoned response to patent holdups and patent ambushes, rather than letting the courts to decide what licensing terms should have been negotiated before a standard was set.

26. Moreover, the standard-setting organisations could have licensing rules, as many already have, obligating their members to license standard-essential patents to others on FRAND terms. In addition, they could benefit from the better clarified meaning of FRAND commitments. An obligation to license on FRAND terms should be clear to the members of standard-setting organisations, and it should not be merely an unclear promise to negotiate a license later on. Finally, the content of FRAND licenses should be specified preferably at an early stage, because otherwise there is a risk that irreversible investments in a particular standard are made without a proper knowledge of the final costs. To sum up, the Finnish Competition and Consumer Authority believes that standard-setting organisations could – and even should – play a bigger role than today to avoid FRAND disputes.

27. These suggestions may not be easy to meet. Although strict rules can prevent holdups, they may also unintentionally prevent certain patent holders from joining the standard-setting organisations. As a result, the best technology may not be chosen to a standard, which could reduce welfare. Moreover, the need of contractual flexibility implies that terms that are too detailed may also be harmful. Standard-setting organisations are rarely explicit about royalty negotiation practices, and the negotiations before a standard is set are often difficult. The problem is that parties tend to disagree on what is reasonable royalty. The negotiations on detailed terms could slow down the standard-setting process to the detriment of consumers.

28. Furthermore, detailed terms may also become old too quickly due to changes in standard technology and markets. Incomplete standard-setting contracts may therefore sometimes be efficient, because complete contracts may be more costly to society than the cumulative costs of the holdups. As a result, vague FRAND commitments do not always indicate the failing of the system.

29. The parties of the dispute are primarily responsible for defining FRAND terms. The most complex cases appear to come up when both parties accept FRAND terms, but have different opinions on whether certain terms are FRAND. Consequently, it is likely that courts and competition authorities may have to define FRAND terms in practice sometimes. This implies that concepts such as ‘fair’, ‘reasonable’ and ‘non-discriminatory’ and their relationship to the Article 102 TFEU may become assessed. It will not be easy either; for example, assessing cases which purely involve the unfair pricing of IPRs are notoriously complex. However, the holdup problem appears to be a bigger problem than possible court errors in setting reasonable royalties. Nevertheless, litigation may not be the best process for determining FRAND terms. Arbitration and other alternative dispute resolution within standard-setting organisations could be faster and more cost-effective way than court litigation.

30. It appears that courts, competition authorities and standard-setting organisations all have their role in solving these problems. The standard-setting organisations can tailor their rules so that they respond to the needs and problems of the industry in question. They have rules that can be and have been utilised as a salient benchmark for abuses in legal disputes. These rules can give guidance on what conduct may be forbidden, though competition policy should not completely defer to them, because the standard-setting organisations’ IPR policies may be insufficient, for example, to prevent patent holdup. Consequently, there also appears to be a role for competition policy and law to solve standard essential patent licensing problems that have detrimental effects to competition.