A Comparative and Economic Analysis of Antitrust Approaches to FRAND-Assured SEPs

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I. Introduction/Background

Standard-Essential Patents (SEPs)

- SEPs are patents that are essential to a standard (e.g., 2G-4G, which allow mobile device users to experience worldwide interoperability and interconnectivity)
- Standard setting has become increasingly important to the economy, promoting R&D investments in "best of generation" technologies that enable and accelerate follow-on innovation, competition, and economic growth.
- Standards enable virtually all the products we rely upon in modern society, including mechanical, electrical, information, telecommunications, and other systems, to interoperate.

FRAND Assurances

- FRAND = fair, reasonable, and nondiscriminatory
- *Voluntary* assurance
  - I.e., it is ultimately within the patent holder's discretion whether to make a FRAND assurance, just as it is within the discretion of the SDO not to incorporate in its standard a patent as to which the patentee will not make an assurance (or offer a letter of assurance of non-assertion).

Contractual Nature of FRAND Assurances

- A FRAND assurance is a contractual commitment.
- In analyzing the contractual nature of the FRAND assurance, U.S. courts have held that:

  1. An assurance to an SDO to license on FRAND terms constitutes a binding contract between the SEP holder, the SDO, and its members;
  2. potential users of the standard are third-party beneficiaries of the agreements with standing to sue; and
  3. FRAND licensing "includes an obligation to negotiate in good faith," and that obligation is "a two-way street."

Specific FRAND Assurance

- As the U.S. Court of Appeals for the Federal Circuit recently explained in *Ericsson v. D-Link*, courts must analyze the specific IPR Policy or FRAND assurance at issue.

- Important because FRAND is not a monolithic promise, but instead important differences across SDO IPR Policies

  – See, e.g., Tsai & Wright – empirical evidence that SDO contract terms vary both across organizations and over time in response to changes in perceived risk of patent holdup and other factors.

II. SEPs and Market Power

Does standard setting create market power?

- Myth: standardization necessary, or at least generally, confers market power (competitors get in a room and "pick winners")

- Empirical work indicates that there are limited cases in which a standard makes a patent a "winner" in the market.

- Instead, more important technologies are natural candidates for inclusion in standards and therefore SDOs tend to "crown existing winners" as opposed to creating market power.

  – A recent study analyzing a database of patents declared as essential to a range of standards, including telecommunications technology and imaging standards, found that inclusion in a standard has no or negligible impact on the value or importance of a patent, measured by forward citations, suggesting that the inclusion in a standard in itself does not create market power (Layne-Farrar & Padilla).

Analyzing Market Power (Layne-Farrar & Wong-Ervin)

- Whether a particular SEP confers market power is a fact-specific inquiry
  - I.e., of whether a single SEP constitutes a well-defined relevant market, whether there are potential substitutes, and the degree to which market power is mitigated by complementarities.
- SEPs are self-declared to SDOs yet no SDO evaluates essentiality, which may change as the standard continues through development.
  - Thus, until an independent review (legal and technical) establishes that a particular declared patent is in fact essential, there can be no presumption of market power.

Analyzing Market Power (cont.)

- Even restricting the analysis to truly essential patents, we cannot conclude that an individual SEP or portfolio of SEPs constitutes a well-defined relevant market or that the owner possesses market power.

- SEPs are ***perfect complements***, which creates a connection among patents and patent holders such that SEPs cannot be licensed in isolation.

  – I.e., FRAND royalty rates are tied to the value the patented technologies contribute to the standard, which inherently accounts for all valuable contributions to the standard.

Analyzing Market Power (cont.)

- Thus, in contrast to monopolists, who can set prices without consideration of other firms, SEP holders must take into account the value of other SEPs when setting their royalty rates.

- In addition, because licensees know they must license all SEPs to be compliant with a given standard, they push back in negotiations if they think a SEP holder is attempting to ask for more than its share.

- This, too, lessens any market power that might be conferred by essentiality.

IV. Excessive Pricing and Injunctive Relief

Excessive Pricing – U.S. Approach

- Unlike the EU, U.S. antitrust law does not prohibit "excessive" or "unfairly high" pricing
- Instead, firms are free unilaterally to set or privately negotiate their prices
- Rational:
  - Rewards the risk-taking and entrepreneurial behavior that lead to innovation and economic growth
  - High or even "unfair" prices do not restrict or eliminate competition
  - Charging monopoly prices attracts new entry, which tends to *increase*, not decrease competition, which drives market prices down over time

Excessive Pricing – Issues Raised

- Particularly difficult to assess “fairness” of IPR prices
  - no marginal cost to which the price may be compared
  - IPRs are highly differentiated products making price comparisons difficult, if not impossible
- Requires agency to calculate a reasonable royalty range as a baseline.
  - *Georgia-Pacific* Factors
  - Intended for use by the courts
  - Sets *minimum floor*

Injunctive Relief

- Antitrust sanctions for seeking or enforcing injunctive relief amount to regulating price

- The main theory of harm is that an SEP holder is using injunctive relief to demand higher royalties than it could have otherwise due to lock-in (or sunk costs)

- In other words, there is no alleged exclusion or predation of a rival, but rather only extraction of higher prices

Concerns

- New antitrust regimes (e.g., in China and India) using excessive or unfairly high pricing prohibitions to lower royalty rates for foreign IP holders to benefit their local manufacturers or national champion
  - EU law providing cover as new jurisdictions look to the EU
- New jurisdictions basing such claims on factors such as allegedly “charging for expired or invalid patents” (which would essentially eliminate portfolio licensing with all its efficiencies) or using the end-user device as the royalty base without calculating a reasonable royalty as a baseline
- EU should continue to emphasize that excessive pricing is rarely used, especially in matters involving IPRs

V. Extra-Jurisdictional Remedies (e.g., imposing global portfolio-wide remedies including on foreign conduct involving foreign patents)

U.S. Approach

- It is the formal policy of the U.S. Antitrust Agencies to consider international comity when crafting remedies.

  - As set forth in the agencies' 1995 International Antitrust Guidelines, comity "reflects the broad concept of respect among co-equal sovereign nations and plays a role in determining 'the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation.' Thus, in determining whether . . . to seek particular remedies in a given case, each Agency takes into account whether significant interests of any foreign sovereign would be affected."

- *But see* FTC's consent order against MMI/Google, which imposes global portfolio-wide remedies

Extra-jurisdictional Remedies

- Extra-jurisdictional remedies, such as imposing conditions on foreign patents, can result in significant substantive conflicts given the dramatically different approaches taken globally on competition matters involving IP.

- Imposing worldwide portfolio licensing remedies may harm consumers elsewhere, for example, when the conduct at issue is recognized as procompetitive in other countries.

- Honoring principles of comity can mitigate a race to the bottom in competition law enforcement by preventing the lowest common denominator approach from governing across the board.

DG Comp and NDRC Approach

- The European Commission’s two recent SEP matters—one involving Motorola and the other involving Samsung—illustrate nicely the appropriate limits on remedies, consistent with principles of international comity.

- Specifically, the Commission’s decisions limit the parties’ ability to seek injunctive relief on FRAND-assured SEPs only with respect to the European Economic Area and only on patents issued in Europe. The decisions do not reach foreign patents outside the European Economic Area.

- Similarly, in China’s NDRC’s matter against Qualcomm, the agency limited its remedies to conduct in China pertaining to Chinese patents.