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Presentation

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50 Ways to Leave Your Lover…

Or the 10 most popular antitrust claims by licensees seeking to get out of paying royalties

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Overview

1. *“It’s all about money honey!”*
   - **The royalty rate is unreasonably high!**
2. *“This has become too much, Butch“*
   - **Maybe the royalty was reasonable at the time when the standard was set, but this is no longer the case due to a declining market price of the downstream product!**
3. *“Aren’t we’re all the same, Jane?“*
   - **The royalties charged to external licensees must be the same as those charged to pool members!**
4. *“Don’t let them run free, Lee!“*
   - **Licensors must take action against unlicensed producers of downstream product!”**
5. *“This is not really necessary, Gary!”*
   - **The patents in your pool are not essential!**

Overview (continued..)

6. *"This is outside of your domain, Wayne!"*
   - **Licensors should only offer pool licenses for territories where all pool members have rights!**
7. *"What you're doing is really bad, Brad!"*
   - **Your pool is nothing but a cartel in disguise!**
8. *"Gimme' something back, Jack!"*
   - **Your grant-back clause diminishes my incentives to innovate!**
9. *"I can never challenge you, Lou!"*
   - **Your no-challenge clause allows you to terminate the licensing agreement if I challenge the validity of your patents!**
10. *"This is a false truce, Bruce!"*
    - **This settlement "stinks"!**

It's all about money, honey! (I)

Claim No. 1: "*The royalty rate is unreasonably high*!"

When is a royalty rate of patents needed for compliance with a standard "too high"?

- Problem: Standards may create monopoly power and royalties may become entry barriers
- Solution: Fair, reasonable and non-discriminatory (FRAND) royalties (see, *e,g.*, TT-Guidelines, para 226)
  - *Fair* = equitable, taking account of all interest involved
  - *Reasonable* = moderate, taking into consideration of some relation to objective criteria
  - *Non-discriminatory* = equal treatment of all licensees

It's all about money, honey! (II)

Fair royalties and the standard for excessive pricing in IP licensing

- Generally, price not excessive in relation to economic value of product
  - **Art 82(a) EC: but not much case law: *General Motors, United Brands;* IP cases: *IGR II, ITT Promedia, CD case***
- Competition authorities have noted that no competition concern where royalties do not represent a large part of prices of downstream products (e.g., *6C DVD*)
- Possible criteria for evaluating fairness and reasonableness:
  - **Comparison of royalties and cost of R&D**
    - Very difficult; what R&D; cross-subsidisation between successful and failed projects
  - **Comparison of royalties for similar products**
    - In markets where no standard, using similar technologies
  - **Excessive profits analysis**
    - UK OFT approach (main problem is factoring in of R&D risk)
  - **Separate value of innovation from value of standardisation (network effect and "tipping" of markets)**

It's all about money, honey! (III)

Avoiding the claim from the outset:

- Avoid patent ambushes by insisting on timely IP disclosure
  - ETSI *GSM 03.19* case, *Rambus* proceedings in EU and US
- Avoid royalty ambushes by insisting on *ex ante* pricing
  - Set the price before the standard is fixed
  - Being considered in several SSOs

This has become too much, Butch!

Claim No. 2: "*Maybe the royalty was reasonable at the time when the standard was set, but this is no longer the case due to a declining market price of the end product!*"

- Is there a duty to reduce royalties for upstream IP if the margins of downstream producers become smaller?
  - Argued in many cases: *Tech Innovation v. Philips, CD Case..*
  - Harm to consumers? Difficult to argue if decreasing prices for product and continuing innovation at technology level
  - Legitimate recoupment of R&D expenditures *and* return on risk taking?
  - If limited to recoupment of R&D, is that not "changing the patent's life"?
  - "Responsibility" of licensors for factors outside their control?
  - Estoppel of licensees that agreed to royalty at the time of standard-setting?

This has become too much, Butch! (II)

- 82 EC – “Price squeeze” if licensor is active downstream?

  - Claim:
    - Licensor making it impossible for licensee to make money in the downstream market

  - Answer:
    - Is licensor dominant in both markets?
    - If downstream market is competitive, is not rational for licensor to maintain the royalty rate?

Aren't we're all the same, Jane? (I)

Claim No. 3: *"The royalties charged to external licensees must be the same as those charged among pool members!"*

- **81(1)(d) and 82(c) EC** prohibit the application of dissimilar conditions to equivalent transactions
  - TT Guidelines, para 226: "Treatment of licensees should not depend on whether they are licensors or not" -- What does this mean?

- **81(1)(d) EC –** Anticompetitive agreement to discriminate?
  - Agreement between pool members to discriminate against non-patent owners?

- **82(c) EC** – Non-discrimination obligation on dominant companies
  - No discrimination by jointly dominant companies in regard to individual pricing?
  - An obligation to align prices is effectively a "mandatory cartel"!
  - Application of 82(c) EC to licensing inside and outside of the pool would remove incentive to create pools

Aren't we're all the same, Jane? (II)

- **What are the elements of the 82(c) test:**
  - **Equivalent transactions?**
    - Pool licenses & individual portfolio licenses = different products (diff. packages)
    - Pool licensor can block entire standard by refusing to license patents
    - Royalty-free/lump sum cross-licensing are reciprocal payments in kind
  - **Dissimilar conditions?**
    - Value of "payment in kind" greater than value of payments? (Not in case of blocking patents which are effectively zero-royalties)
  - **Must individual patents offered outside of pool be competitive with the pool royalty rate?**
    - Or at least not exceed the rate by more than efficiencies (and double marginalization) – TT Guidelines, para 222(d)?
    - Would be a radical departure from past law and disincentive to cost-efficient licensing through pools

Don't let them run free, Lee!

Claim No. 4: "*Licensors must take action against unlicensed producers of downstream product!*"

- Can non-enforcement be unfair trading conditions under Art. 82(a) EC?
- General principle: IPR owner are entitled not to use/enforce their IPRs in most jurisdictions (e.g., see US Patent Act Section 271(d)(4))
- Is non-enforcing "imposing" of unfair trading?
  - Coercion by licensors?
  - Nexus to dominant position of licensors?
  - It is rational only to pursue winnable cases – so no Art 82 claim?
- **82(c) EC** – Is this discrimination?
  - applying dissimilar conditions to equivalent transactions?

This is not really necessary, Gary! (I)

Claim No. 5: "*The patents in your pool are not essential!*"

- What patent can be included in the pool?
  - **"Essential" and "complementary" patents**
    - TT Guidelines, paras 216-218
    - Essentiality well established principle (*MPEG-LA* and *DVD* pools)
      - Technology necessary for complying with the standard
      - No substitute technologies exist (technically/practically)
    - If all are essential, generally the pool falls outside of 81(1) EC
    - If there are non-essential, but complementary patents, this brings about risk of third party foreclosure – effects analysis
    - Judgment in *Princo* 21 Sept. 2005 – Foreclosure effect must be proved; not enough that there was a theoretical alternative

This is not really necessary, Gary! (II)

- Essentiality review
  - When did the patent have to be essential? (at outset of licensing??)
  - Patent applications
  - Delay licensing until all are shown essential? = Higher royalty

- Who bears the burden of proof?
  - What if the independent expert came to conclusion that patent essential?

- What if there are non-essential patents in the pool?
  - What would the remedies be?
    - Removing from the pool, but offering for free has same “foreclosure effect” ? (*Philips v. Princo*)
    - Fine by Competition Authorities? But is the offence clear enough?
    - Denial of royalties as remedy in the EU?
      - Not justified -- each remaining patent holder can raise the price (back) to the perceived profit maximizing level
    - Patent abuse doctrine in the US.. (*Philips v. Princo*; *Wuxi v. 3C*)

This is not really necessary, Gary! (III)

- "Commission safe harbors" where there are non-essential technologies in the pool (TT Guidelines, para 222) :

  a) **Pro-competitive reasons for including those technologies**
  b) **Possibility of separate packages for distinct applications (if different applications for technology)**
  c) **Possibility of having license for part of package "with corresponding reduction in royalties"**
  d) **Ability to terminate license with reduction in royalties**

- Do these safe harbors make sense?
  - **Must pool licensors create different pools according to licensee demand?**
  - **And must the royalty rate be different if <u>*less*</u> patents (see *Princo)***
  - **If *à la carte* were required, may the licensors allocate to each pool for which there demand the full cost of running that pool?**

This is not really necessary, Gary! (V)

- Foreclosure of subsequent (new) technologies – non-essential patents continue to be used "for free" as part of pool licenses
  - **Is there a valid foreclosure argument by others "deprived" of a market?**
- Foreclosure issues for simultaneously existing technologies
  - **The *3G* solution:**
    - **Five separate 3G patent licensing arrangements for each of the five 3G technologies**
    - **Conditions:**
      - Each licensing agreement limited to essential patents only
      - Licensing under non-discriminatory terms
      - Competitively sensitive information is not exchanged.
      - No foreclosure of competition in related or downstream markets
      - Downstream manufacturer not forced to pay for patents rights other than those that they really need.
      - No discouragement of further R&D and innovation (several major 3G essential patent holders not party of pools)

This is outside of your domain, Wayne!

Claim No. 6: "*Licensors should only offer pool license for territories where all pool members have rights!*"

- Leveraging patents outside the territory of protection - Geographic "partial pools"?
- Is "geographic essentiality" a valid concept?
  - Technically or practically essential to the implementation in particular geographic area where licensees may demand it
  - This approach on its face inconsistent with Commission's own concept of essentiality (TT-Guidelines 216): "Essential as long as there is at least one valid IPR"
  - Also inconsistent with bundling analysis: Each individual patent would have to be defined as separate market

What you're doing is really bad, Brad!

Claim No. 7: "*Your pool is nothing but a cartel in disguise!*"

- Excessive format setting ("gold plating")
  - *Philips VCR, ETSI/DVSI* (over-standarisation and reduction of product differentiation)
- Setting a standard outside of formal standard-setting bodies – special safeguards on pricing and on content of standard?
  - Does "ex ante pricing" satisfy this concern or will the commercial incentive of a successful standard achieve the objective of a reasonable royalty and a competitive downstream market?
- Safeguards against "seepage" of confidential information
  - TT Guidelines, para 234: separate pool administrator and/or safeguards for sensitive information

Gimme something back, Jack!

Claim No. 8: *"The grant-back diminishes my incentive to innovate!"*

- TT Guidelines, para 228:
  - Pools must be allowed to feed on and benefit from improvement of pooled technology
  - Legitimate of licensors to ensure that pooled technology cannot be held up licensees that hold essential patents
  - But grant-backs should be:
    - Non-exclusive
    - Limited patents essential or important for the use of pooled technology

I can never challenge you, Lou!

Claim No. 9: *"Your non-challenge clause does not allow you to terminate the licensing agreement if I challenge the validity of your patents!"*

- No-challenge rules:
  - Pools should not shield invalid patents
    - Unjustified cost factor in pool licensing
    - Foreclosure of additional innovation
  - Termination allowed only as regards patents owned by licensor who is addressee of challenge (TT Guidelines, para 229)

This is a false truce, Bruce!

Claim No. 10: "*This settlement "stinks"!*"

- Licensors settle patent dispute by concluding cross-license agreement
  - Certainly legitimate to solve blocking positions (each party holds patent essential for pooled technology)
  - If no blocking position existed, settlement possibly restricts competition that previously existed; problematic issues:
    - Restrictions to use parties' technologies (including restrictions on licensing to third parties);
    - Parties have market power and restrictions go beyond what is required to unblock or share markets or fix reciprocal running royalties that have a significant impact on prices; or
    - Parties have market power and agreement prevent parties from gaining a competitive edge
- Settlements between pool members and competitors outside of the pool
  - "Paying off" a competing technology by including it in the pool..

Standards, pools and IP licensing: How to avoid being held to "ransom"

1. Don't require licensing of IP held by SSO member (*ETSI 1995*)
- Don't require IP to be made available on a royalty-free basis (*W3C*)
- Consider disclosure requirements for SDO
- Consider implementing *ex ante* price-setting to avoid ambushes
- Minimize risk of discrimination claims
- Ensure timely essentiality review by independent expert
- Encourage registration of patents in many countries
- Avoid standards which you think are a cover for market sharing
- Avoid excessive grant-back clauses
- Ensure that pool is administered in neutral manner