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REPs Not SEPs: A Reasonable and Non-Discriminatory Approach to Licensing Commitments

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I. INTRODUCTION

A lot of ink has been spilled on the subject of RAND commitments in recent years. Lawyers and judges have offered opinions on the proper methodology for calculating RAND royalties, regulators have sought to clarify the circumstances under which pursuing injunctive relief comports with a RAND commitment and competition law, and academics have suggested frameworks for arbitrating RAND license disputes. Seemingly everyone has extolled the virtuous role that RAND commitments play in fostering industry standards and interoperability and condemned the opportunistic breach of such commitments.

Much of that analysis and discussion, however, has been unduly narrow, with commentators focusing on RAND commitments made to formal, collaborative standard-setting organizations ("SSOs") and which encumber so-called standard-essential patents ("SEPs"). Indeed, much of the discussion has focused on the even narrower subset of SEPs related to smartphones and other wireless technology. Yet SEPs are merely a subset of the larger category of patents that are encumbered by RAND commitments, and patentees make such commitments in a variety of settings—not just in the context of formal SSO standard-setting efforts.

In whatever setting they are made, RAND commitments serve the same purpose: to encourage firms to adopt the underlying patented technology—either on a standalone basis or as incorporated into a standard—by assuring them that they will not be subject to unreasonable licensing demands or other types of "hold-up." The reasons for condemning the breach of such commitments, in turn, also depend on the effect on injured implementers, not on the institutional context in which the promises were originally made.

For some, the failure to consider non-SSO RAND commitments in their analysis of the issue is likely unintentional. Many of the recent RAND disputes that have prompted commentary, lawsuits, and enforcement actions have involved formal SSOs and SEPs, so it is perfectly understandable that some discussions would restrict themselves to that arena. Other commentators, however, have suggested that concerns over RAND commitments are fundamentally unique to SSOs because of the collective nature of institutionalized standard-setting. That conclusion, however, misunderstands the underlying antitrust principles at stake.

Simply put, there is no legal or economic reason to discriminate between a RAND commitment made to an SSO and a RAND commitment made to an industry at large. In either

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case, what matters is the effect that commitment has on encouraging industry adoption of the underlying patented technology. And if we are concerned about the wrongful acquisition of market power, it is important to recognize that both RAND commitments made unilaterally and RAND commitments made as part of collective SSO activities can induce industry adoption and confer market power on the underlying technology. On the other hand, there may also be SSO-developed standards that themselves face competition, such that even the right to entirely exclude others from practicing the standard would not confer a substantial degree of market power. Assessing whether a breach of a RAND commitment is anticompetitive, therefore, requires a case-by-case inquiry and the mere presence or absence of an SSO on its own does not reveal very much.

A broader understanding of the contractual and competitive importance of both SSO and non-SSO RAND commitments will not just promote doctrinal coherence, it will have salutary practical effects as well. By establishing general rules that at least presumptively govern all RAND commitments, it will make clear to stakeholders that RAND commitments carry with them a predictable set of norms and obligations. That, in turn, will help RAND commitments achieve their principal purpose: encouraging the development and adoption of new technologies by assuring both innovators and implementers that neither will exploit the other.

II. DE-CONFLATING RAND COMMITMENTS AND SEPS

It has long been recognized that there are at least two main types of industry standards. On the one hand there are standards established by "formal" SSOs such as ETSI, ITU, and IEEE, which we can call *de jure* standards (even though most are not actually established by law). On the other hand there are *de facto* standards, the product of unfettered "winner-take-all" competition among rival standard-bearers in the marketplace. Examples of the latter include Matsushita's VHS standard for VCRs (which famously defeated Sony's Betamax format in their bilateral standards war), 8-bit computer architecture (developed and supported by IBM in the 1960s), the CD-R "Orange Book" standard (developed by Philips and Sony in the 1980s), and Blu-Ray high definition DVDs (developed by Sony in the 2000s).

Yet despite recognition that both types of standards exist, and that both have led to substantial improvements in consumer welfare, many discussions of RAND commitments appear to assume that RAND commitments only exist within the domain of *de jure* standards (where they encumber formal SEPs), or at least that violations of RAND commitments raise competition law concerns solely due to the collective nature of such institutionalized standard-setting efforts. Remarks by former Deputy Assistant Attorney General for Economic Analysis Fiona Scott Morton from 2012 are illustrative of this view, and worth excerpting at length:

> One question that I have been asked is, "What's so special about standard essential patents versus other patents?" Standard essential patents achieve their status through the collective action at the SSOs. Harm can occur when companies come together and bestow market power on each other by agreeing on a common technology. F/RAND commitments are designed to reduce occurrences of opportunistic or exploitative conduct in the implementation of standards. It is these commitments, along with other things, that make competition authorities more comfortable with these collective decisions. In reviewing these collaborations we ask whether the net effect of the joint activity is good for consumers. If the F/RAND commitments are so vague and ill-defined as to have

> little meaning, then consumers may not realize all the benefits of the standard, which may be efficient and create new products and services due to the patent holders' exercise of market power, which may result in higher prices, less product choice and less investment in the overall network.
>
> All truly essential patents for a successful standard inherently have market power. We believe declared SEPs can be a powerful weapon, perhaps enhanced by over declaration, and can be used to harm competition through holdup.
>
> Note that non-SEPs can also be used to hold up licensees. If the licensee has already invested in a product and faces costs to designing around the patent, the licensor can extract some of the licensee's investment, not just the value of his IP. But this is an issue that arises out of the power that a patent gets when it is issued, which may or may not be market power in a competition law sense. However, notice that the holdup power of the non-SEP owner does not stem from a collective decision by competitors. Rather, it springs only from a single innovation deployed unilaterally by its owner. This is the difference that causes F/RAND encumbered SEPs to be of concern to competition authorities including the Department of Justice.[2]

Similarly, blogger and Microsoft consultant Florian Mueller has written:

> There's one thing Microsoft stresses . . . and it's an extremely important point to keep in mind: the very process of standardization raises competition issues unless FRAND promises are made and kept so as to ensure that the procompetitive aspects of standard-setting outweigh the negative ones. Standard-setting means that companies use their collective market power to define, for example, which encryption or compression methods must be implemented in order for devices to be compatible with the standard, excluding the numerous and sometimes literally countless technical alternatives that exist.[3]

These excerpts are indicative of the tendency to conflate RAND commitments and SEPs and to focus on the collective characteristics of institutionalized standard-setting when discussing the dangers of RAND violations. The assumption that RAND commitments solely encumber *de jure* SEPs, however, is simply incorrect and RAND violations can cause consumer harm even when the commitment was made unilaterally outside the SSO context.

One possible explanation for that analytic error is an assumption that RAND commitments are merely (or primarily) prophylactic devices designed to reduce the antitrust risk inherent in having a group of competitors reach agreement on an industry standard. While RAND commitments may indeed serve that purpose, it doesn't entirely explain their existence. Indeed, the very fact that some patentees unilaterally make such commitments *outside* the collective context demonstrates that they have an independent purpose apart from antitrust law: as a tool that patent holders deploy to encourage others to adopt their underlying technologies. An SSO may provide an efficient forum for encouraging collective buy-in from other industry participants, at least if it has sufficient mechanisms (such as disclosure requirements and an

[2] Fiona M. Scott-Morton, "The Role of Standards in the Current Patent Wars" (Dec. 5, 2012), *available at* http://www.justice.gov/atr/public/speeches/289708.pdf.

[3] Florian Mueller, "Microsoft brief stresses that standard-setting would be a 'blatant antitrust violation' without FRAND," FOSS Patents (June 10, 2013), http://www.fosspatents.com/2013/06/microsoft-brief-stresses-that-standard.html.

effective IPR policy) to protect implementers from hold-up. But patent holders can also encourage such collective buy-in by making RAND commitments to other industry participants outside the confines of an SSO.

III. BACK TO FIRST PRINCIPLES: LICENSING COMMITMENTS AND COMPETITION LAW

A. Why Firms Make RAND Commitments

A patent holder legally has the right to exclude others from practicing its patents, or to condition a license to its patents on whatever terms it likes. That right is, of course, known to would-be implementers, who must factor the patent holder's willingness to license into their decision whether or not to invest in the patented technology. When a patent holder wants to encourage the widespread adoption or standardization of its technology, it may therefore voluntarily relinquish or limit its statutory right to exclude. Sometimes that takes place within formal SSOs and sometimes it takes place outside of them.

When a patent holder voluntarily makes such a licensing commitment, it offers an enforceable promise to would-be licensees that it will make its patents available for license on RAND terms—or on a royalty-free basis, or subject to a maximum royalty-cap, or whatever else the commitment actually specifies in that instance.[4] The intended and foreseeable result is to induce implementers to adopt and make complementary investments in the underlying technology. Without such assurances, it would be irrational for implementing firms to invest in the technology. Because the patent holder could exercise its right to exclude or impose onerous licensing burdens on firms practicing its patents at any point, implementers' ability to recoup any return on products incorporating the underlying technology would be wholly at the mercy of the patent holder.

That said, the patent holder may be willing to trade its right to exclude for widespread adoption of its technology for any number of reasons: it may want to capitalize on implementing the technology itself and benefit from any associated network effects, it may want to develop complementary products, or it may want to provide support for others' implementations.[5]

If a sufficient number of firms buy into the patent holder's assurances and make these investments, the underlying technology may emerge as an industry standard. Again, sometimes this happens under the aegis of a formal SSO, and sometimes it happens on a *de facto* or *ad hoc* basis. Whatever the context, it is the patent holder's act of making a RAND commitment and the implementing firms' responses to that commitment that are significant, not the institutional context.

B. The Harm from Breach

Once an industry has become "locked-in" to a standard, the patent holder may be tempted to renege on its RAND commitment and exploit the leverage it possesses by virtue of the

[4] For purposes of this discussion, the focus will be on RAND commitments. But the analysis holds true for royalty-free and royalty-cap commitments as well.

[5] *See* Robert P. Merges & Jeffrey M. Kuhn, *An Estoppel Doctrine for Patented Standards*, 97 CA. L. REV. 1, 22-23 (2009).

industry's adoption of its patented technology. Even if there were originally alternative approaches that were not covered by the patent, the network effect dynamics and competitive significance of the standard may mean that it is not viable for implementing firms to simply stop producing conforming products or to develop an alternative to the patented technology. Further, the patent holder's RAND commitment may have displaced or stunted the development of competing technologies, as firms decided to adopt the patent holder's RAND-pledged technology and forego investments in potential alternatives. Thus there may be no adequate substitutes available.

When a patent holder reneges on a RAND commitment in order to exploit this leverage, implementers and consumers can suffer in any number of ways. Consumers may be forced to pay higher prices if the patent holder seeks supra-RAND royalties from implementers. They may also be harmed if the patent holder's RAND violation enables the patent holder to acquire or maintain market power in an adjacent product market. More generally, violating RAND commitments may undermine the credibility of the institution of RAND licensing, and thereby reduce the benefits of standardization and interoperability. In the words of the FTC, violating RAND commitments threatens to bring about a state of a affairs where "consumers will no longer enjoy the benefits of interoperability that arise from standard setting, manufacturers have less incentive to innovate and differentiate product offerings, and new manufacturers will be deterred from entering the market."[6]

IV. RAND VIOLATIONS AND SECTION 2 OF THE SHERMAN ACT

These harms are more than enough to justify enforcing RAND promises as a matter of contract and patent law. Antitrust law, however, presents additional issues.

It is well-known that only concerted activity can violate Section 1 of the Sherman Act. That has led some to suggest that the fact that a RAND commitment was given to an SSO in connection with a collective standard-setting effort implicates Section 1 and thus justifies additional regulatory scrutiny of alleged breaches. Yet the *breach* of the RAND commitment—the allegedly exclusionary conduct—is entirely unilateral, regardless of how many other companies may have participated in the standard setting or given their own RAND promises. Unilateral conduct is the province of Section 2 of the Sherman Act, and violates the antitrust laws only if it leads to, or threatens to lead to, the willful acquisition or maintenance of monopoly power.

Unsurprisingly, therefore, Section 2 has been at the heart of antitrust enforcement in this area: if a patent holder makes a RAND commitment in bad faith or deceives implementers as to its possession of intellectual property rights, and thereby induces standardization on its patented technology, enforcement precedent clearly demonstrates that the patent holder may be guilty of unlawfully acquiring monopoly power in violation of Section 2 of the Sherman Act.[7]

Further, the FTC's *Unocal* decision clearly demonstrates that the presence of a multilateral SSO is irrelevant to the substantive antitrust analysis. In *Unocal*, the defendant

[6] Analysis of Proposed Consent Order to Aid Public Comment, *In re Motorola Mobility* (Jan. 3, 2013), *available at* http://ftc.gov/os/caselist/1210120/130103googlemotorolaanalysis.pdf.

[7] *See*, e.g., *Rambus, Inc. v. F.T.C.*, 522 F.3d 456 (D.C. Cir. 2008); *In re Dell Computer Corp.*, 121 FTC 616 (1996).

represented to the California Air Resources Board ("CARB"), a state agency, that it did not own any patents essential to certain standards that CARB proposed to adopt. After CARB adopted the proposed standard (in reliance on Unocal's representation) and the industry "spent billions of dollars" and became locked into the standards, Unocal disclosed that it did in fact own patents essential to the standards and began enforcing those patents against implementers.[8] Notwithstanding the absence of a formal SSO or collaborative standard setting process, the FTC concluded that Unocal's conduct violated Section 2 of the Sherman Act.

Even a RAND commitment that was initially made in good faith can lead to Section 2 liability. As the D.C. Circuit has observed, "the means of illicit exclusion, like the means of legitimate competition, are myriad."[9] There is no specific list of anticompetitive acts that can support a claim of unlawful monopolization. Rather, the question in each case is whether the practice "harm[s] the competitive process, and thereby harm[s] consumers"[10] and whether, if the monopolist offers a pro-competitive justification for a practice, its anticompetitive effects outweigh its pro-competitive effects. That can include violating a RAND commitment, regardless of the circumstances in which it was made, if the violation leads to the willful acquisition or maintenance of monopoly power in a properly defined relevant market.

That is not to say that context is irrelevant. Looking at the institutional context in which a RAND commitment was made can undoubtedly provide guidance as to whether the elements of a Section 2 violation are present. It may expedite the analysis as to whether a binding commitment was made, an industry became locked-in, and a subsequent breach occurred. It may also be helpful for purposes of assessing market definition and market power.

But the institutional context surrounding the RAND commitment is not itself a determinative factor in the analysis. That RAND commitments made in the SSO context often involve collaborative efforts among competitors, while RAND commitments made outside the SSO context are the product of unilateral efforts, is a red herring in any Section 2 analysis. While RAND commitments may increase regulators' confidence that SSO activities are not anticompetitively collusive, that should not immunize violations of non-SSO RAND commitments from scrutiny under Section 2.

Of course, just as owning an SEP may not be sufficient to confer market power on the patent holder, owning RAND-encumbered patents pledged outside the SSO context may not be sufficient to confer market power on the patent holder either. But a holder of RAND-encumbered patents may possess market power in related or adjacent product markets. If the patent holder's RAND violation prevents a rival from challenging that power, that could constitute a Section 2 violation.

V. CASE STUDY: MICROSOFT AND EXCHANGE ACTIVESYNC

As noted earlier, many competitively significant standards have been established outside the confines of SSOs. One recent example, which demonstrates the important role played by

[8] Complaint, *In re Union Oil Company of California* at 1-2 (Mar. 4, 2003) *available at* http://www.ftc.gov/os/adjpro/d9305/030304unocaladmincmplt.pdf.

[9] *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001).

[10] *Id.*

unilateral RAND commitments, is Microsoft's Exchange ActiveSync mobile messaging synchronization protocol. Unlike many other *de facto* standards, which emerged solely from technical superiority or unfettered marketplace competition, Microsoft encouraged the industry to standardize on ActiveSync by promising to license its ActiveSync-essential patents on RAND terms, at "low royalty rates."[11] In doing so, Microsoft hoped both to encourage widespread implementation and, as a corollary, to discourage the development of alternative technologies.

As anyone with a smartphone and a corporate email account can attest, Microsoft's RAND commitment achieved its intended effect: Exchange ActiveSync is now, in Microsoft's words, "the industry standard for mobile messaging synchronization."[12] As one Microsoft Senior Vice President wrote recently, "if you use an iPhone, a Google Android phone, or a RIM BlackBerry to access work email there is a good chance you are using…Exchange ActiveSync, every day."[13]

ActiveSync's emergence as an industry standard, the direct result of Microsoft's RAND commitment, has given Microsoft significant leverage over implementers and created the very same risk of hold-up that the antitrust agencies have said justifies their concern over the breach of SSO commitments. That risk is exacerbated when, as with the case of ActiveSync, many of those who relied on Microsoft's RAND commitment are also rivals or potential rivals of Microsoft in other markets such as PC operating systems. Taken together, there is certainly no reason to believe that Microsoft's breaching its RAND commitment covering ActiveSync would be any less harmful, or less worthy of scrutiny, than a similar unilateral breach by, say, an IEEE member of a RAND commitment it had given to that SSO.

It is worth emphasizing that this is not merely (to quote Professor Scott Morton again), "an issue that arises out of the power that a patent gets when it is issued" and which "springs only from a single innovation deployed unilaterally by its owner." Not all patents inherently confer market power, and patent holders that make RAND commitments to the industry at large can acquire significant competitive power as a direct result of those RAND commitments and the resulting adoption of their technology over alternative solutions. If a company in that position breaches its commitment in an effort to acquire or maintain monopoly power in a properly-defined market, then it should face no less antitrust scrutiny than one that achieves the same effect by breaching a promise to an SSO.

VI. CONCLUSION

A promise is a promise, and licensing commitments made outside of SSOs matter. Failing to recognize that reality can lead regulators and industry participants to ignore or downplay patent abuse that occurs outside the confines of an SSO, to the detriment of consumers. It can

[11] Microsoft, Microsoft Interoperability Principles, ¶ I(4) http://www.microsoft.com/openspecifications/en/us/programs/other/interoperability-principles/default.aspx.

[12] Julia White (Senior Director, Exchange Product Management), "Exchange ActiveSync: The Industry Standard for Mobile Messaging," (Nov. 16, 2010), http://blogs.technet.com/b/uc/archive/2010/11/16/exchange-activesync-the-industry-standard-for-mobile-messaging.aspx.

[13] David A. Heiner (Vice President & Deputy General Counsel), *Microsoft: A Remedial Success*?, 78 ANTITRUST L.J. 329, 344 (2012).

also sow confusion over the meaning of RAND promises in general and undermine confidence that they will be respected and that violations will be redressed. This threatens to bring about the same dire consequences that are often invoked in discussions of hold-up: undermining the integrity and efficiency of standard-setting (both SSO-based and non-SSO-based), decreasing incentives to adopt technologies covered by such licensing commitments, and ultimately depriving consumers of the benefits of interoperability.

Just as commitments to reasonable and non-discriminatory patent licensing are important to avoiding those outcomes, so too is a non-discriminatory approach to enforcing those RAND commitments. Whenever the three elements of (1) a RAND commitment, (2) industry lock-in, and (3) a subsequent breach are present, there is a risk of consumer harm. By taking a non-discriminatory approach that considers all RAND-encumbered patents ("REPs"), not just an artificially limited subset of SEPs, courts and regulators can help ensure that consumers are truly protected against patent abuse.