

**Standard-Essential Patents and Licensing:
An Antitrust Enforcement Perspective
Address by FTC Chairwoman Edith Ramirez
8th Annual Global Antitrust Enforcement Symposium
Georgetown University Law Center
Washington, DC
September 10, 2014**

It is a pleasure to be here again at the Georgetown Law Global Antitrust Enforcement Symposium and I want to thank the organizers for inviting me to speak at this luncheon.

I would like to focus this afternoon on a topic that continues to raise novel and challenging questions for regulators around the world – enforcement activity at the intersection of antitrust and intellectual property rights. In particular, we have seen jurisdictions across the globe continue to grapple with unilateral conduct issues associated with the licensing of standard-essential patents or SEPs.

The global attention to this issue is not surprising. Standards that incorporate patented technologies are the backbone of rapidly expanding worldwide markets in the information and communications technology (ICT) sector, such as global smartphone markets that have nearly tripled in size since 2009.¹

These markets are built on global licensing agreements. Many of the licenses for FRAND-encumbered SEPs are negotiated on an international, portfolio-wide basis. And the strategies firms employ in these negotiations can affect competition and innovation across jurisdictions. The owner of FRAND-encumbered SEPs can change the dynamics of a global negotiation by seeking an injunction against an implementer in a single jurisdiction, with repercussions for incentives to implement standards across the map.

¹ MarketsandMarkets: Global Smartphone Market Worth US \$150.3 Billion by 2014, *available at* <http://www.marketsandmarkets.com/PressReleases/smartphones-market.asp>.

At the same time, enforcement activity that deprives patent owners of a reasonable reward in one country can depress incentives to create technology for next-generation standards that will benefit consumers around the world. The consequences for competition and innovation can therefore be equally harmful. In other words, because the incentives that drive these markets are established globally, regional distortions can have a global impact.

Antitrust enforcement can advance competition and consumer welfare in these critical ICT markets by protecting the incentives of the key players in the standard-setting process. That includes both those that contribute patented technology to standards and those that invest to bring standard-compliant products to market.

This afternoon, I would like to discuss how the Federal Trade Commission has approached antitrust enforcement in this area and how the enforcement principles we apply promote competition and innovation globally. I would also like to say a few words about the ongoing effort in the United States to clarify the methodology for determining a reasonable royalty for FRAND-encumbered patents, and the Commission's competition policy work in this area.

I. The Framework

At the Commission, our approach to enforcement at the intersection of antitrust and intellectual property is grounded in the core principles of the joint 1995 Federal Trade Commission and Department of Justice IP Licensing Guidelines and 2007 Antitrust and Intellectual Property Rights Report.² Importantly, we recognize that antitrust and IP are complementary bodies of law that promote innovation and consumer welfare. Antitrust

² U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, Antitrust Guidelines for the Licensing of Intellectual Property (1995) ("IP Guidelines"), available at <http://www.ftc.gov/bc/0558.pdf>; U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition (2007) ("Antitrust/IP Report"), available at <http://www.ftc.gov/reports/innovation/P040101PromotingInnovationandCompetitionrpt0704.pdf>.

promotes innovation by protecting the competitive process. Competition pushes firms to win in the marketplace by developing better products and more efficient methods of production. Strong IP rights bolster the competitive process by discouraging firms from misappropriating the value of patented technologies. Without strong IP protection, firms that invest to create new technologies could see their inventions quickly copied by rivals and other implementers without recourse, depressing the incentives to innovate that drive dynamically competitive markets.

We also recognize that imposing liability for merely refusing to share IP, or license at a particular rate, undercuts the procompetitive value that a strong system of IP rights provides. To promote efficient investment in the development of new technologies, firms should be free to determine for themselves the best way to maximize the value of their IP in light of the available alternatives.

In some cases, a firm may conclude that retaining exclusive use of its patented technology to reduce production costs and undercut rivals' prices is a winning strategy. Or it may decide that exclusive use will allow it to offer consumers a unique product improvement and attract business from competitors. A specialized R&D firm may determine that it can boost the value of its portfolio by licensing exclusively to a firm with expertise in downstream product development or commercialization. In other circumstances, a firm may decide that it can maximize the value of its IP by contributing its technology to a standard in return for a fair, reasonable and nondiscriminatory, or FRAND, return.

From an antitrust enforcement perspective, these can all be procompetitive strategies for monetizing IP, and they are choices that U.S. antitrust law leaves largely to IP owners, licensees, private negotiations, and market forces.

But the same antitrust principles apply to IP as to other forms of property, and IP licensing is not free from antitrust scrutiny. Where a licensing agreement harms competition by, for example, eliminating close competition between product or technology market rivals, or harming the incentives of licensees to develop complementary technologies without legitimate justification, the FTC will act.³ However, because licensing has the broad potential to enhance competition, most licensing arrangements are evaluated under a rule of reason framework, which focuses on whether the arrangement is likely to have anticompetitive effects.

II. Patents & Interoperability Standards

Strong IP rights are equally important when patents are incorporated into interoperability standards. As a result, the same key enforcement principles also guide our analysis when standard essential patents are involved.

Of course, the application of those principles requires attention to the facts, and the licensing of SEPs raises certain unique competitive issues. So let me take a moment to describe some of the relevant competitive dynamics of the standard-setting process.

Standards benefit consumers by making it possible for products and technologies to work together reliably within systems and networks. They permit markets to develop without the cost and delay that can be associated with a standards war. Predictability tends to increase the demand for standardized products and encourages entry and competition, leading to more choice and lower prices for consumers.

But consensus standards also limit competition. Standards are agreements on various dimensions of product design made by organizations typically comprised of product or technology market competitors. These firms have the technical expertise that makes standards

³ IP Guidelines, §§ 5.1, 5.6.

development possible, and often a financial stake in the outcome that is large enough to justify the cost of participation. Since both the private and public stakes can be high, and not necessarily aligned, the incentives for anticompetitive behavior are apparent.⁴ Nevertheless, where standards are set according to fair and open procedures that protect the interests of consumers, the benefits can be substantial.

Standards that incorporate patented technologies raise a particular competitive risk known as patent hold-up. The standards that support markets in the wireless sector provide a good illustration of the problem. Before a standard is adopted, many technologies may compete to perform a particular function in the standard. A complex technical standard may incorporate thousands of technologies and take many years to complete. Because the technologies are designed to work together, it can be very difficult and costly to change technologies piecemeal after the fact, particularly once the industry begins to make investments that are tied to the standard.

As a result, firms that own essential patents may gain the leverage to demand licensing terms that reflect the investments made to implement the standard rather than the competitive value of the technology at the time the standard was adopted. The risk of patent hold-up harms competition by discouraging investments to implement the standard, ultimately reducing competition in downstream markets for standard-compliant products.

To reduce the risk of patent hold-up, many standard setting organizations require members to disclose patents that may read on a proposed standard, and to state whether they are willing to license those patents on FRAND terms.⁵ If the patentee refuses, the SSO can select an

⁴ *Allied Tube & Conduit v. Indian Head*, 486 U.S. 492, 500 (1988) (“an agreement on a product standard is implicitly, after all, an agreement not to manufacture, distribute, or purchase certain types of products”).

⁵ My remarks apply equally to commitments to license essential patents on reasonable and nondiscriminatory, or RAND, terms.

alternate technology or change the direction for the standard before extensive switching costs accrue. But, when a patentee voluntarily agrees to license its technology on FRAND terms as a condition of winning a place in the standard, antitrust enforcers are legitimately concerned with a breach that reintroduces the risk of patent hold-up. In particular, a breach may raise antitrust concerns if it threatens to deprive consumers of the procompetitive benefits that legitimize the standard-setting enterprise under the antitrust laws.

III. Antitrust Enforcement in the Area of SEP Licensing

The FTC addressed this issue most recently in our 2013 enforcement action in the *Google/MMI* matter. The Commission alleged that before its acquisition by Google, Motorola Mobility (MMI) breached commitments to license patents essential to implementing various cellular, video, and WiFi standards on FRAND terms by seeking injunctions and exclusion orders against implementers that were willing to abide by a FRAND license.⁶ The Commission alleged that Google continued the same conduct after acquiring MMI in June 2012.

To remedy the alleged Section 5 violation, the Commission entered into a consent order that, broadly speaking, requires Google to resolve disputes over FRAND licensing terms before a neutral third party before it may seek an injunction. More specifically, the order prohibits Google from renegeing on its FRAND commitment by seeking injunctions, and outlines specific negotiation procedures it must follow that are intended to protect the interest of both parties.

The order permits Google to seek an injunction in limited circumstances, such as where the potential licensee is not subject to jurisdiction in the United States, or where it refuses to agree to terms set by a neutral third party. While the order applies only to Google, the broad

⁶ *In re Motorola Mobility LLC*, No. C-4410 (F.T.C. July 23, 2013) (complaint), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/07/130724googlemotorolacmpt.pdf>.

principles embodied in the order provide a roadmap for parties that want to avoid FTC scrutiny to follow under similar circumstances.

The voluntary nature of MMI's licensing commitment was critical to our analysis of the competitive effects of the conduct in which MMI and later Google engaged. MMI made a voluntary commitment to license its essential patents on FRAND terms in order to see its technology included in the standard. By making that commitment, it demonstrated that it had determined for itself that it could maximize the value of its patents by sharing the technology broadly with implementers on terms it knew would be constrained by the FRAND agreement. MMI made that decision in light of the alternatives it faced at the time, and the FTC action merely required MMI and Google to keep that commitment.

In addition, the Commission looked carefully at whether the conduct was likely to harm competition. Antitrust has a role to play when licensing practices threaten competitive harm. In the standard-setting context, the risk of patent hold-up creates the type of competitive harm that falls properly within the scope of antitrust enforcement. An injunction can put a significant portion of the implementer's business at risk, giving the SEP owner the bargaining power to extract licensing terms that reflect the profits from potential lost sales, which can be extraordinarily high for an implementer if there is no feasible design-around alternative. Even the risk of hold-up can degrade the value of the standard-setting process for consumers by discouraging the investments required to implement the standard. But a dispute with a willing licensee over royalty terms that does not take place under the threat of an injunction is not likely to create the undue leverage that is the source of the competitive problem in the standard-setting context.

The recent actions taken by the European Commission reflect a similar approach. In April 2014, the EC issued two decisions, one involving Samsung and the other involving Motorola Mobility. Both cases involved a SEP owner that had willingly agreed to license its essential patents on FRAND terms and then pursued injunctions against implementers willing to license on FRAND terms. The EC accepted binding commitments from Samsung that it would not seek an injunction against potential licensees that agreed to a specific negotiation framework, providing for third-party determination of licensing terms in instances of a dispute.⁷ The EC also issued a decision in the Motorola Mobility matter that created a safe harbor from injunctions for implementers that agreed to be bound by a third-party determination of FRAND terms if private negotiations fail.⁸

Like the FTC's approach in *Google/MMI*, the EC's actions were based on breach of a voluntary licensing commitment by seeking injunctions against willing licensees. The actions were not predicated on demands for particular royalty terms. And like the FTC, the EC did not preclude injunctive relief for FRAND-encumbered SEPs where a licensee is unwilling or unable to abide by the terms of a FRAND license.

In contrast to the FTC's and EC's approach, media reports indicate that China's antitrust authorities may be willing to impose liability based solely on the royalty terms that a patent owner demands for a license to its FRAND-encumbered SEPs, as well as royalty demands for licenses for other patents that may not be subject to a voluntary FRAND commitment.

⁷ EC Press Release, "Antitrust: Commission accepts legally binding commitments by Samsung Electronics on standard essential patent injunctions" (Apr. 29, 2014), available at http://europa.eu/rapid/press-release_IP-14-490_en.htm.

⁸ Case AT.39985 – Motorola – Enforcement of GPRS Standard Essential Patents (April 29, 2014), available at http://ec.europa.eu/competition/antitrust/cases/dec_docs/39985/39985_928_16.pdf.

I am seriously concerned by these reports, which suggest an enforcement policy focused on reducing royalty payments for local implementers as a matter of industrial policy, rather than protecting competition and long-run consumer welfare.

As I have stated previously, here and elsewhere, I am of the firm belief that consumers are best served when competition enforcement is based solely on sound economic analysis of competitive effects. A contrary approach risks damaging the investment incentives that are critical to continued growth in many of today's global technology markets, in the ICT sector and beyond. We intend to continue to engage with our counterparts in China and around the world on these issues, in an effort to build consensus on policies that will benefit competition and consumers globally.

IV. Competition Policy & FRAND Royalties

I would like to conclude by spending a few minutes on the topic of royalty rates. While I believe that royalty rates should not be negotiated under the threat of antitrust liability, I think that additional clarity on a framework for determining FRAND royalties would benefit industry stakeholders and consumers alike.

In the United States, courts and juries routinely calculate reasonable royalty rates in infringement cases by relying on the so-called *Georgia-Pacific* factors.⁹ These factors include the rates paid by other licensees, the rates the implementer has paid to license comparable patents, and the commercial relationship between the licensor and implementer. The *Georgia-Pacific* decision also directs courts and juries to consider a hypothetical negotiation, and to determine the amount to which a licensor and willing licensee would have agreed in an arms-length negotiation.

⁹ *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970), *modified and aff'd*, 446 F.2d 295 (2d Cir. 1971).

In the FTC’s 2011 Report on the IP Marketplace, the Commission provided competition policy based guidance for courts to apply when calculating reasonable royalty damages in infringement cases.¹⁰ In particular, we recommended that courts use the concept of the hypothetical negotiation as the proper framework to determine reasonable royalties and suggested treating the other *Georgia-Pacific* factors as categories of information that might be relevant in predicting the outcome of the hypothetical negotiation.¹¹ The Commission also emphasized that the hypothetical negotiation should occur before the licensee has made significant investments to implement a technology. Otherwise, the outcome of a hypothetical negotiation will reflect the investments the licensee has made to implement the technology, rather than the competitive market value of the patent.

In a competitive marketplace, a licensee looking to, for example, implement a new technology to reduce costs or improve its product, will compare the benefits of the various available options. A firm will not be willing to pay more for a technology than the additional value it provides over available alternatives – in other words, the incremental value. If the patented technology allows the licensee to drastically reduce costs or increase sales over competing technologies, the licensee would be willing to pay more than if the patented technology faced many close substitutes that delivered similar value.

The Commission also recognized that an incremental value benchmark must often reflect both a royalty rate and royalty base and that the two are closely linked.¹² Consistent with our guidance on selecting a royalty rate, we recommended that courts identify the base that “the

¹⁰ FED. TRADE COMM’N, *The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition* (“2011 Report”) at 184-185, available at <http://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf>.

¹¹ *Id.* at 191.

¹² Alternatively, the evidence could suggest that the parties would have agreed to a lump-sum payment. *Id.* at 211.

parties would have chosen in a hypothetical negotiation as best suited to appropriately valuing the technology.”¹³ While the 2011 Report focused broadly on patent damages, we suggested that courts apply the same hypothetical negotiation framework to calculating royalties for FRAND-encumbered patents.

Since the Commission issued the 2011 Report, several federal district courts have weighed in on a framework for determining a reasonable royalty for FRAND-encumbered SEPs.¹⁴ These courts have employed various methodologies, including using a modified version of the *Georgia-Pacific* factors that accounts for the value the SEPs contribute to the standard, the importance of that standard to the infringing products, and the aggregate royalty demands facing firms implementing a complex standard with many essential patented technologies, typically known as the “royalty-stack.”

Greater clarity on the terms of a FRAND license is likely to facilitate private negotiations and limit the need to seek a third-party determination of a FRAND rate. But it is important to recognize that a contractual dispute over royalty terms, whether the rate or the base used, does not in itself raise antitrust concerns. Absent the threat of an injunction, a dispute between a SEP owner and a putative licensee over royalty rates will merely drive the parties to court to seek a neutral third-party determination of a FRAND rate, precisely what the Commission required in its *Google/MMI* order in the event that private negotiations fail.

* * *

Let me conclude by emphasizing the point with which I began – in the area of standard essential patent licensing, the decisions antitrust regulators make in particular jurisdictions can

¹³ *Id.* at 212.

¹⁴ See, e.g., *In re Innovatio IP Ventures, LLC Patent Litig.*, 2013 WL 5593609 at *5-6 (N.D. Ill. Oct. 03, 2013); *Microsoft Corp. v. Motorola, Inc.*, 2013 WL 2111217 at *3, *12 (W.D.Wash. Apr. 25, 2013).

have global impact. While I recognize that each jurisdiction must determine its own competition policy, in today's global ICT markets, protecting consumers at home requires that regulators consider the worldwide incentives that drive these markets. We must all understand that domestic decisions today are likely to affect the choices that consumers worldwide will have tomorrow. I look forward to continuing to engage with our international counterparts to advance an enforcement philosophy that safeguards those choices.

Thank you.