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FTC Hosts Workshop on Preventing Patent "Hold-Ups" in Standard-Setting

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The FTC recently hosted a workshop on preventing patent "hold-ups" in standard-setting. Panelists addressed and evaluated the three main tools currently used by SSOs to prevent patent hold-ups: patent disclosure rules, *ex ante* disclosure of licensing terms by patent holders, and RAND commitments. The FTC has yet to formally comment on the workshop, but may prepare a report discussing the issues raised in this project.

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On June 21, 2011, the **Federal Trade Commission (FTC)** hosted a workshop on preventing **patent "hold-ups" in standard-setting.** A patent "hold-up" occurs when an industry-wide standard incorporates patented technology, allowing the patent owner to then leverage for higher or more costly royalties or licensing terms than could have been obtained before the standard was chosen. Most patent hold-up situations in which the FTC is involved result from the FTC determining that the patent owner did not disclose the patents prior to the incorporation of the standard. The FTC has brought enforcement proceedings against patent holders who have allegedly engaged in this conduct, most notably with ***Rambus*, *Dell*, and *Unocal*.**

The workshop panels were moderated by FTC staff and consisted of **intellectual property (IP) and antitrust counsel, standard-setting organization (SSO) leaders,** academics, consultants and business leaders. The panelists addressed the three main tools currently used by SSOs to prevent patent hold-ups: **patent disclosure rules, *ex ante* disclosure of licensing terms by patent holders, and "RAND" commitments** – promises by patent holders to license users of the standard on "reasonable and non-discriminatory" terms.

The majority of the panelists seemed to agree that the current rules relating to SSOs are working fairly well, and there was not a groundswell of support for additional FTC involvement in the process. However, there is potential for additional FTC guidance or regulation on standard-setting.

SSOs typically implement patent disclosure rules in order to make SSO members aware of relevant patents when adopting a standard. According to applicable case law, SSO members must comply with disclosure requirements to avoid antitrust risk. The first workshop panel addressed four policy difficulties of SSO disclosure rules: (1) the members' search for affected patents; (2) the requisite nexus between the patent and the standard that activates a disclosure requirement; (3) the evolving nature of standards and patent claims over time; and (4) the issue of patents held by non-members. In discussing the practical problems related to these issues, the panelists noted the variability and ambiguity in SSO rules, but nevertheless posited that ambiguity and variety is expected, as each SSO (and industry) is different.

A very small number of SSOs require or allow ***ex ante* disclosure or negotiation of licensing terms by a patent holder.** Under the *ex ante* SSO model, the standard is adopted after SSO members negotiate license royalties or terms, allowing SSO members to know the "price" of the patent before locking themselves into its use. The Department of Justice (DOJ) and FTC have tried to encourage SSOs to adopt *ex ante* licensing by stating that they will apply the more favorable "rule of reason" standard under the antitrust laws when evaluating joint activities that allow potential licensees to negotiate the licensing terms with patent holders before the standard is adopted. Nevertheless, SSOs have not adopted *ex ante* licensing terms as broadly as requiring participants to disclose their applicable IP before the selection of the standard. The workshop panelists explored the possible reasons for its limited use and concluded that mandatory *ex ante* disclosure requirements would be burdensome without providing much benefit. In support, the panelists noted that there is no guarantee that the rates a company would quote *ex ante* are RAND. Others addressed the reality of licensing negotiations, in which companies rarely license a single patent, but instead license a patent portfolio. Still others argued that *ex ante* negotiation is not well-suited to certain fields, particularly new technologies, as the potential value of those patents are often the most difficult to determine.

The most common tool that SSOs employ to prevent patent hold-up is to obtain commitments from SSO members that require patent holders to promise to license intellectual property that reads on the standard on RAND terms. The final workshop panel discussed these RAND commitments and their implications in licensing negotiations. After concluding that RAND commitments are generally enforceable, the discussion turned to the usefulness of these commitments, leading to a split in the panel. The panelists representing smaller companies viewed RAND commitments as essential, but often side-stepped, in licensing negotiations. Specifically, when these companies try to license only essential patents, patent holders often demand the licensing of a portfolio of related patents, some of which might not be subject to RAND commitments. On the other hand, panelists from the larger companies noted that bilateral negotiations for patent portfolios is the norm. In these negotiations, the specific terms of an essential patent are lost in the broader negotiation for the portfolio and the RAND commitment is less meaningful. The divergent views of the panel continued with respect to the meaning of RAND. Some of the panelists argued that RAND should be determined when the standard is set in order to take into account the added value of the license. Others argued that RAND should be determined *ex ante* and tied to the economic value of the invention itself. Although the panelists generally believed that disagreements over RAND should be resolved by a neutral third party, some panelists noted that litigation of this issue is so costly that it can push licensees to accept non-RAND terms to avoid litigation costs.

At the conclusion of the panel discussions, Joseph Farrell, the Director of the FTC Bureau of Economics, addressed the views of the panelists with his wrap-up discussion. Farrell summarized the positions of the panelists—namely, (1) the current SSO tools and rules to prevent hold-ups, although imperfect, are doing a "good enough" job; and (2) the FTC should refrain from getting too involved. Farrell reacted by focusing on the absence of the final consumer in the broad discussion of standard-setting. Although standard implementers might be viewed as reasonable stand-ins for consumers, Farrell argued that implementers' incentives to promote better and cheaper technologies in industry standards are weakened if non-discriminatory royalties are enforced. Consequently, Farrell believes the FTC's role is to champion the end consumers' perspective in this broader discussion of standard-setting.

As the consumers' advocate, Farrell acknowledged that the FTC needs to be mindful of the value of innovation as well as the value of low prices, particularly with respect to incentives to innovate and the **"reverse hold-up" problem.** That is, if a **company expects royalties to be depressed below the level of contribution to the innovation, then there are inadequate incentives to innovate.** Second, depending on the bargaining institutions, it could happen that the SSO or its members squeeze the patent holder down to a low price for the intellectual property rights.

In his conclusion, Farrell implied that he disagreed with the panelists' opinions regarding *ex ante* negotiation of licensing terms. His reaction suggests that, in his view, it is in consumers' best interests to know the terms and price of the license *ex ante*.

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