Federal Trade Commission

"RECOGNIZING THE PROCOMPETITIVE POTENTIAL
OF ROYALTY DISCUSSIONS IN STANDARD SETTING"

REMARKS

of

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prepared for

STANDARDIZATION AND THE LAW:
DEVELOPING THE GOLDEN MEAN FOR GLOBAL TRADE
SEPTEMBER 23, 2005
STANFORD UNIVERSITY
STANFORD, CALIFORNIA

I appreciate the opportunity to appear before you today and provide some perspectives on standard setting and competition. I regret that I cannot be with you in person, but obligations on the East Coast have dictated that I make a "virtual" appearance at this important conference.

The setting of standards has long been a staple of our market economy. The setting of a

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[1] The views stated here are my own and do not necessarily reflect the views of the Commission or any other Commissioner.

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[2] *See FTC/DOJ Hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy*, *available at* http://www.ftc.gov/opp/intellect/index.htm, Peterson (“Consideration” stmt) 1, *available at* http://www.ftc.gov/opp/intellect/021106peterson.pdf (noting that many innovative information technology products “might never have existed without standards”). Hereinafter, citations to statements and transcripts associated with these hearings state the speaker’s or contributor’s name; date of testimony, if applicable; and relevant page(s).

standardization can change that dynamic. After the standard is chosen, industry participants likely will start designing, testing, and producing goods that conform to the standard – that is, after all, the whole idea of engaging in standard setting. Early in the standardization process, industry members might easily be able to abandon one technology in favor of another. But once the level of resources committed to the standard rises and the costs of switching to a new technology mount, industry members may find themselves locked into using the chosen technology. In that case, competition for the standard ends (at least for a time, until, for example, the next generation of technology supplants it). In other words, before lock in – or *"ex ante"* – technologies compete to be the standard, and no patent-holder can demand more than a competitive royalty rate. After lock in – or *"ex post"* – the owner of the chosen technology may have the power to charge users supra-competitive royalty rates -- rates that may ultimately be passed on to consumers in the form of higher prices.

"Hold up" by no means is inevitable. For example, if the chosen standard has to compete with rival standards, the owner of the SSO's chosen technology may end up with little market power.[3] If users can respond to a supra-competitive royalty rate by defecting to a rival standard, the patent holder will find itself unable to obtain anything more than the competitive price. But if there are no rival standards, the owner of the technology chosen for the standard may have market power sufficient to command supra-competitive royalties.

Moreover, even if an intellectual property owner can obtain a royalty rate higher than those of other technology owners, members of the organization that chose the standard are not necessarily being held up. The higher royalty rate may be explained by the superiority of its

3 *See, e.g.*, Lemley 4/18 at 76.

[4] *United States v. Alcoa*, 148 F.2d 416, 430 (2d Cir. 1945) (Hand, J.).

[5] The Commission was concerned that if Chevron had unconditionally inherited these patents in the merger, it could have been positioned to gain sensitive information and to claim royalties from its rivals. This, the Commission believed, would likely lessen competition in the refining and marketing of CARB reformulated gasoline, because Chevron could use its patent position to coordinate with its downstream rivals, injuring consumers. *See* Statement of Federal Trade Commission, *In re Unocal and In re Chevron and Unocal*, *available at*

SSOs have employed a variety of tools to prevent their members from being held up by a rights owner. For example, some have enacted SSO IP policies that require their members to disclose patents (or other intellectual property) related to a standard under consideration. Such disclosure rules could make SSO standard selection more competitive – and thus help avoid hold up – by flushing out members' relevant intellectual property early. That can allow the SSO members to decide whether the patented technology is worth the royalty that its owner may later charge, or whether the group would be better off selecting another technology (if one is available). [Issues regarding such disclosure rules are presented in a case that now is before the Comicionf7.19 0 TD0.00050.c-0.0008 Tw(disclose patentIn di Rambu25.96 0 TD0 Tcm(c-0.0007 Tw[(m)8.7(e)

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[6] *See, e.g.*, Mark A. Lemley, *Intellectual Property Rights and Standard-Setting Organizations*, 90 CAL. L. REV. 1889, 1906 (2002) (discussing these policies).

[7] *See, e.g.*, Lemley, 90 CAL. L. REV. at 1964 ("without some idea of what [reasonable and nondiscriminatory] terms are, reasonable and nondiscriminatory licensing loses much of its meaning").

[8] *See, e.g.*, Peterson ("Consideration" stmt) 6.

[9] *See, e.g.*, Robert A. Skitol, *Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting*, 72 ANTITRUST L. J. 727 (2005); David Balto & Daniel Prywes (stmt) 2, *available at* http://www.ftc.gov/os/comments/intelpropertycomments/baltoprywes.htm (proposing permissive discussion and joint negotiation of licensing terms).

While the antitrust concerns are understandable, they may have unduly prevented announcements of pricing intentions or royalty discussions that may, in fact, provide procompetitive benefits. First, a patent holder's voluntary and unilateral disclosure of its maximum royalty rate, like most unilateral conduct, is highly unlikely to require antitrust scrutiny. Unilateral announcement of a price is, by definition, not a collective act subject to per se condemnation or even review under Section 1 of the Sherman Act, and it is hard to see how announcing one's price before sale (without more) could amount to exclusionary conduct under Section 2.[11]

Second, joint ex ante royalty discussions that are reasonably necessary to avoid hold up do not warrant per se condemnation. Rather, they merit the balancing undertaken in a rule of reason review. We would apply the rule of reason to joint ex ante royalty discussions because, quite simply, they can be a sensible way of preventing hold up, which can itself be anticompetitive. Put another way, transparency on price can increase competition among rival technologies striving for incorporation into the standard at issue. They may allow the "buyers" (the potential licensees in the standard-setting group) to get a competitive price from the "sellers" (the rival patentees vying to be incorporated into the standard that the group is adopting) before lock in ends the competition for the standard and potentially confers market

[11] *Cf.* Michael A. Carrier, *Why Antitrust Should Defer to the Intellectual Property Rules of Standard-Setting Organizations: A Commentary on Teece & Sherry*, 87 MINN. L. REV. 2019, 2036-37 (2003) ("a patentee['s] announcing to the members of the SSO the terms of RAND licensing before the adoption of the standard [is no antitrust violation] [e]ven if the patentee and its competitors are members of the SSO and collectively possess market power"). However, any collective response from the SSO members to the patent holder's statement of its royalty rate – or any collective demand from the SSO members that the patent holder disclose its royalty rate (or maximum royalty rate) for its technology to be considered for the standard – would be evaluated under the rule of reason as joint ex ante royalty discussions. *See infra* at 7-11.

[12] *See, e.g.*, Lemley, 90 CAL. L.See, e.g.,

[16] *See, e.g.,* Holleman (stmt) 5, *available at* http://www.ftc.gov/os/comments/intelpropertycomme

It may also be appropriate to consider whether joint ex ante royalty discussions are reasonably necessary to mitigate hold up.[19] In such an analysis, we likely would consider whether an uncoordinated series of bilateral negotiations between patentees and individual would-be licensees would be equally capable of mitigating hold up,[20] or whether bilateral negotiations actually frustrate the necessary collective evaluation of which technology alternative is preferable, taking into consideration both the merits of the technologies and their prices.

Joint ex ante royalty discussions, of course, can offer an opportunity for SSO members to reach side price-fixing agreements that are per se illegal. If in conducting joint ex ante royalty discussions, manufacturing rivals cross over the line from discussing the price of technology they will "buy," if they choose a particular standard and start discussing – and fixing – the price of the products they *sell*, summary condemnation is almost certainly warranted. In fact, joint ex ante royalty discussions might make such collusion cheaper: "the costs of gathering together and deciding on a common plan could be spread over plans associated with both buying and

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[19] *See, e.g.*, Federal Trade Commission & U.S. Department of Justice, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (April 2000) § 3.36(b) (noting that "[t]he Agencies consider only those efficiencies for which the relevant agreement is reasonably necessary"); U.S. Department of Justice & Federal Trade Commission, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (April 1995) § 4.2 ("If it is clear that the parties could have achieved similar efficiencies by means that are significantly less restrictive, then the Agencies will not give weight to the parties' efficiency claim").

[20] *See, e.g.*, Holleman (stmt) 4 (noting that "outside of the activities of the SDO, individual standards participants are able to approach the patent holder to inquire of available licensing terms"; if the patent holder declines to "engage in [such] discussions," individual standards participants can choose "to not support the patent holder's technology or to propose an alternative technology to the standards developing committee.").

[21] BLAIR

simply does not have enough of such people to attend "the 300 different standards consortia or standards bodies" in which his company participates.[24] Joint ex ante royalty discussions may prove costly in another way: some SSOs and their members want to concentrate on the difficult job of choosing the technically best standard, and deem cost considerations to be a distraction.[25]

Thus, by pointing out the potential for joint ex ante royalty discussions to mitigate or eliminate the hold-up problem, I do not mean to suggest that such discussions in SSOs are

[24] Thompson 11/6 at 33.

[25] *See, e.g.*, IEEE (stmt) 5, *available at* http://www.ftc.gov/os/comments/intelpropertycomments/ieee.pdf (standard setting should aim to "develop the best technical standard, as independent of marketing and intellectual property rights issues as possible"); Holleman (stmt) 4-5 (stating that licensing terms discussions are "a bad idea" because, among other things, SSO discussions "should be focused on technical issues – not licensing terms and conditions.").