

## IPR and competition law – excessive patent royalty claims by non-practising entities

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Over the last five years, we have seen the development of a new business model in the ICT sector: businesses are being set up to acquire patents, including those essential to a standard (e.g., the second and third generation mobile standards, GSM and UMTS), with a view to obtaining substantial royalties. This article briefly examines ways in which European competition law can help to address these new challenges and constrain excessive claims by non-practising entities (NPEs) in relation to essential patents.

### THE RISE OF THE NPE

Historically, most patents essential to ICT standards were owned by companies that were active in both R&D and the supply of products or services. Few patent owners charged royalties for the use of their patents essential to the GSM standard, for example.

This century has seen a paradigm shift in patent strategies, with an increasing number of companies actively seeking royalty payments for the use of their patents relating to standards such as GSM and UMTS.

Moreover, a new business model has emerged – that of the NPE. NPEs are companies that do not supply goods or services, but acquire patent portfolios (including essential patents) with the sole objective of generating royalty revenues. NPEs typically do not contribute to the market with innovation or product development but wait until the industry is locked into a standard (through investment in standard specific infrastructure) to tax the industry with substantial royalty demands. Although not all NPEs necessarily engage in this behaviour, there is a significant number of them that do. An example is IPCOM's current

multimillion euro claim against Nokia for infringement of a number of alleged essential GSM and UMTS patents. NPEs are therefore posing new challenges for the industry as substantial royalty demands threaten to impose higher costs on consumers.

### CHALLENGES SET BY NPES

Some NPEs seek to impose undue royalties on suppliers of products or services by charging more in licensing fees than their patented technology justifies on a "fair and reasonable" basis. Their ability to do so is largely due to the following reasons:

- (i) NPEs are typically not members of standard setting organisations (SSOs) and have therefore not given commitments to license on fair, reasonable and non-discriminatory (FRAND) terms. The industry has largely relied on these commitments to ensure that IPR owners moderate their royalty claims and do not seek injunctions against those prepared to pay FRAND royalties. NPEs often acquire their essential patent portfolios after adoption of the standard to which the patents relate.

- (ii) NPEs have an enhanced ability to charge excessive royalties because they do not supply products and services and thus do not require cross-licences that might otherwise constrain a licensor's behaviour. NPEs are able to pursue injunctive relief against licensees in litigation proceedings in the knowledge that they are not exposed to the risk of similar actions being brought against them. Litigation or the threat of it is used as a tool to pressurise licensees into negotiating settlements.
- (iii) Unlike 'traditional' essential patent owners that are typically involved in the development of future standards, NPEs are often not engaged in standards-related R&D. They can therefore pursue excessive royalty practices without facing the threat that SSOs may be reluctant to accept their technology for incorporation into future standards.

#### HOW TO MEET THESE NEW CHALLENGES?

Articles 101 and 102 of the Treaty on the functioning of the European Union (TFEU) (ex Articles 81 and 82 of the EC Treaty) require essential patents to be licensed on FRAND terms.

The European Commission has made it clear that where standardisation results in a restriction of competition within the meaning of Article 101(1) TFEU (ex Article 81(1)) (for example, by eliminating inter-technology competition), the validity of the standardisation arrangements depends on the fulfilment of the conditions for exemption set out in Article 101(3) TFEU (ex Article 81(3)). The Commission has stated that these conditions will not be satisfied unless access to the standard is possible for third parties on FRAND terms.

The FRAND commitment is a promise not to exploit the market power that may arise from the inclusion of a patent holder's technology in a standard. The FRAND commitment reflects the requirements of Article 102 TFEU (ex Article 82), which expressly includes the following examples of abuse: "directly or indirectly imposing unfair purchase or selling prices or unfair trading conditions" ("fair and reasonable" components of FRAND) and "applying dissimilar conditions to

equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage" (non-discriminatory component of FRAND). Essential patent owners are generally dominant in the sense that standardised products cannot be manufactured without a licence.

There are a number of ways in which Articles 101 and 102 TFEU (ex Articles 81 and 82) can be deployed to constrain patent holders where standardised patents are in play. For the purposes of this article, however, we focus on two ways which we believe warrant further investigation, namely: (i) SSOs defining FRAND more clearly prior to a standard being adopted (on an ex ante basis); and (ii) limiting royalty rates by reference to a previous owner's licensing practices.

#### THE ROLE OF SSOs IN DEFINING FRAND PRIOR TO FORMAL ADOPTION OF A STANDARD

SSOs can provide clear guiding principles with which FRAND can be defined for a particular standard prior to its formal adoption. These principles may then be applied ex post in order to determine the appropriate rate that should be charged by a (subsequent) owner of an essential patent and competition law can be invoked to underpin the FRAND commitment.

As ETSI demonstrated in the context of the UMTS standard, an SSO can establish a consensus as to how FRAND should be defined in relation to a particular standard. As part of the provisional decision to select WCDMA technology for inclusion in the UMTS standard, ETSI members established the UMTS IPR Working Group to provide agreed guidelines for the FRAND licensing of UMTS essential patents. Following industry consultation, the Working Group published recommendations which defined FRAND to require a reasonable (single digit) aggregate royalty rate to be divided among the holders of essential patents based on the equality of those essential patents. As recognised by the UMTS IPR Working Group, "there is only one criterion for the weighting of essential patents and that is their essentiality, and it is this principle which justifies each patent attracting the same standard royalty rate." Absent objective justification, no owner of essential UMTS

patents should extract a disproportionate share of the cumulative royalty rate in the expectation that other licensors will accept a reduced share in order to keep the aggregate licensing burden low enough to facilitate adoption and implementation of the standard. Together these principles can be applied in national courts to ensure that licensees are charged royalty rates that are reasonable in aggregate when combined with the royalties paid to other essential patent owners.

### THE N-DATA APPROACH: LIMITING ROYALTY RATES BY REFERENCE TO PREVIOUS OWNER'S LICENSING PRACTICES

As stated above, European competition rules require that where, as is generally the case, industry standard agreements eliminate intertechnology competition, all patents essential to a standard are available to all interested parties on FRAND terms. To achieve this objective, the obligation to license on FRAND terms should follow the patent. If an NPE buys a patent that is essential to a standard and knows of the FRAND commitment given by the previous owner, it should be bound by that knowledge. Any attempt to exploit ex post market power by charging royalty rates higher than those that were imposed by the previous owner of the patent should in general be regarded as not being fair and in breach of Article 102 (ex Article 82). The royalty rate applied by the previous owner in compliance with its FRAND obligation should be, in most cases, the key benchmark as to what is fair and reasonable. In the recent N-Data case, N-Data (an NPE) obtained certain patents essential to a

standard adopted by the IEEE2, after the industry had become committed to this standard, and after the original patent-holder had committed to licensing the technology for a one-off fee of US\$1,000. N-Data refused to comply with the original patentholder's commitment and demanded royalties far in excess of US\$1,000. Following an FTC investigation, N-Data agreed to a consent order which required it to change its licensing terms to bring them in line with the original patent-holder's commitment.

### CONCLUSION

The application of competition rules to the royalty claims of NPEs is likely to be a developing area of law. The rules that will be applied are not as yet clear cut, but the issues at stake are of considerable importance to both the ICT industry and consumers.

#### Note:

- 1 UMTS IPR Working Group Report 'Third Generation Mobile Communications - The Way Forward for IPR', January 1999, at page 20.
- 2 The Institute of Electrical and Electronics Engineers (IEEE) is an international professional association for the advancement of technology. The IEEE Standards Association is a leading developer of industry standards in a broad range of industries.

*This article was originally published within the Euromoney Competition & Antitrust Review. Please visit [www.euromoney-yearbooks.com](http://www.euromoney-yearbooks.com) for more information.*