

# EU Competition Briefing

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## The European Commission's New Horizontal Co-operation Guidelines

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### Good Faith Disclosure and FRAND Commitment in the Context of Standardisation Agreements

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#### Abstract

*The European Commission recently revisited its Guidelines on Horizontal Co-operation Agreements and has significantly changed the chapter on standardisation agreements. The changes include specific provisions on standardisation agreements that involve the use of intellectual property rights. In order for such agreements to fall within a safe-harbour, where there is a presumption that competition is not restricted, several conditions must be fulfilled. These conditions include granting effective access to the standard on the basis of (i) good faith disclosure and (ii) FRAND commitment obligations. This briefing examines these two core obligations in order to understand how they should be applied in practice.*

#### I. Introduction

In December 2010, the European Commission (the EC) published revised guidelines on the assessment of horizontal co-operation agreements. The new Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union (TFEU) to horizontal co-operation agreements<sup>1</sup> (the new Guidelines) bring about a number of noteworthy modifications, including a significant revision of the chapter on standardisation agreements.

The core change in the chapter is the elaboration of more detailed guidance with regard to the conditions that a standardisation agreement should fulfil in order to avoid the application of Article 101 (1) and (3) TFEU. While the Guidelines previously in force required unrestricted participation and non-discriminatory, open and transparent procedures in the setting of a standard, the new Guidelines shed more light on the concepts of: “unrestricted participation”, “transparent procedure” and “access to the standard on fair, reasonable and non-discriminatory terms”.

According to the new Guidelines, standardisation agreements will normally not fall within the scope of Article 101 (1) TFEU if:

<sup>1</sup> OJ C 11/1, 14.1.2011, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:011:0001:0072:EN:PDF>

- They do not risk creating market power through a dominant standard;<sup>2</sup> or
- Despite risking the creation of market power, they cumulatively satisfy the following conditions:
  - all of the competitors in the market(s) affected by the standard enjoy unrestricted participation in the setting of the standard;
  - a transparent procedure is followed for the standard’s adoption, so that stakeholders are effectively informed at every stage of the standard’s development;
  - there is no obligation to comply with the standard; and
  - access to the standard is provided on fair, reasonable and non-discriminatory terms.<sup>3</sup>

In addition, the new Guidelines address a matter that was not covered in the old Guidelines; that is, standardisation agreements involving intellectual property rights (IPR). The new Guidelines state that, in cases of standards involving IPR, “a clear and balanced IPR policy, adapted to the particular industry and the needs of the standard-setting organization in question, increases the likelihood that the implementers of the standard will be granted effective access to the standards elaborated by that standard-setting organization”.<sup>4</sup> Such IPR policy imposes on participants two obligations: (i) a “good faith disclosure”; and (ii) a “fair, reasonable and non-discriminatory commitment” (FRAND commitment).

Both obligations are further discussed below in order to understand how they should be applied in practice and avoid falling foul of the prohibition in Article 101 (1) TFEU.

## II. The Good Faith Disclosure Obligation

According to the new Guidelines, the adoption by a standard-setting organization (SSO) of a clear and balanced IPR policy is a guarantee of effective access to the resulting standard. One necessary component of such IPR policy is the obligation imposed on participants to disclose *ex ante* and in good faith any IPR that might be essential for the implementation of the standard under development.<sup>5</sup>

This *ex ante* obligation is, according to the EC, intended to prevent patent

<sup>2</sup> *Ibid.*, paragraph 277. As commented in the concluding part of this article, the way in which the EC has structured the new Guidelines appears to assume that standardisation efforts will lead to the creation of dominant standards. While this, in our view erroneous, approach is not the subject-matter of this article, it is necessary to highlight it, as it contributes to the legal uncertainty surrounding any future standardisation efforts.

<sup>3</sup> *Ibid.*, paragraphs 278 and 280.

<sup>4</sup> *Ibid.*, paragraph 284.

<sup>5</sup> *Ibid.*, paragraph 286.

“ambush” strategies and, hence, justified in order to allow participants to identify in advance technologies which are covered by IPR.<sup>6</sup> This in turn enables them to make an informed judgment when adopting the standard—both in terms of the IPR holder’s willingness to actually license its IPR and the fees that it intends to charge.

Interestingly, the new Guidelines do not simply refer to a “disclosure” obligation, but rather qualify it with a “good faith” endeavour to disclose IPR. However, the use of the good faith concept, largely inspired from continental civil law, is rather vague, as the new Guidelines do not elaborate further on it. This creates queries such as how far would someone have to go for the obligation to be deemed fulfilled. It appears that the good faith qualification has been used in recognition of the fact that a full disclosure requirement is quite burdensome and impractical in itself, in view of the fact that technological innovation is an endless and always perfectible exercise in many industries. Accordingly, the new Guidelines state that “[s]uch a disclosure obligation could be based on ongoing disclosure as the standard develops and on reasonable endeavours to identify IPR reading on the potential standard”.<sup>7</sup> Still without further explanation, the use of the good faith concept—which has traditionally been used in the context of matters pertaining to civil law—in the field of EU competition law may be a source of uncertainty.<sup>8</sup> Such uncertainty is aggravated by the absence of any criteria according to which the EC will assess whether a participant has acted in good faith.

Having said that, the good faith disclosure requirement raises a number of issues:

- From a practical standpoint, it will inevitably result in increased administrative costs for both the participants to the SSO and the SSO itself. First, each time, the participants will need to identify and assess the importance of the IPR in question and whether such IPR are relevant to the specific standardisation programme. Second, the SSO will need to establish and enforce procedures to regulate matters such as, for example, the precise scope of the disclosure obligation, in order to avoid instances of under- or over-disclosure. This obligation could become burdensome and the SSO will inevitably need guidance, which the new Guidelines regrettably do not offer.
- It may discourage R&D efforts. By disclosing the IPR, even only partly, the IPR holder may see the right’s economic value decreased. This effect might induce major IPR holders to remain outside standardisation efforts. The new Guidelines seem to acknowledge this possibility and, in an effort to avoid it, recognize that it is sufficient for participants in standardisation undertakings to indicate the likely existence of IPR

<sup>6</sup> *Ibid.*, paragraph 268.

<sup>7</sup> *Ibid.*, paragraph 286.

<sup>8</sup> Paul Hughes, “Directors’ Personal Liability for Cartel Activity under UK and EC Law—A Tangled Web” (2008) E.C.L.R. 11 p. 632.

claims over a technology, without identifying them with any degree of precision.<sup>9</sup> This arrangement, however, raises the question whether the participants are at all in a position to make any meaningful and informed judgment on the indispensability and value of the IPR in question.

- Finally, another intriguing point is the way in which such obligation will in practice co-exist with the obligations imposed on competitors under the chapter of the new Guidelines on information exchange. A combined reading of the sections on information exchange and standardisation agreements suggests that, in a number of respects, the two chapters contain provisions that may conflict with, rather than complement, each other.

Specifically, the new Guidelines list technologies and R&D programmes and their results as strategic information, of which exchange between competitors is likely to be caught by Article 101 TFEU. They expressly state that “if companies compete with regard to R&D it is the technology data that may be the most strategic for competition”.<sup>10</sup> From this perspective, the disclosure of an IPR within an SSO could be considered as reducing both the strategic uncertainty and incentives to compete in the relevant market. It remains to be seen how this issue will be treated in practice, especially in instances of unnecessary over-disclosure of IPR.

In recognition of the admittedly rare and over-emphasized “ambush” problem identified and examined in the *Rambus* case<sup>11</sup>, the EC should, in our view, adopt an approach on the good faith disclosure that would be respectful not only of the need to protect valuable IPR efforts, but also of the potentially negative effects that open-ended information sharing may have on competition.

Where a SSO chooses to apply a different disclosure model from the one described in the new Guidelines (e.g., a model that allows for disclosure, without however requiring it), a case-by-case assessment is called for. While the scope of this assessment is not clear, it appears that it will boil down to whether the disclosure model opted for actually allows the participants in the SSO to make a fully informed choice as to the standard finally adopted.<sup>12</sup>

### III. The FRAND Commitment Obligation

Besides a good faith disclosure obligation, a clear and balanced IPR policy is also expected to include an *ex ante*, irrevocable FRAND commitment obligation, so as to ensure effective access to the standard.<sup>13</sup>

<sup>9</sup> *Supra*, note 5.

<sup>10</sup> *Ibid.*, paragraph 86.

<sup>11</sup> See Notice published pursuant to Article 27(4) of Council Regulation (EC) No 1/2003 in Case COMP/C-3/38636–Rambus, OJ C 133/16, 12 June 2009.

<sup>12</sup> *Supra*, note 1, paragraph 298.

<sup>13</sup> *Ibid.*, paragraph 285.

Under a FRAND commitment, participants undertake that their IPR, if incorporated into the standard, will be accessible on fair, reasonable and non-discriminatory terms and conditions. In essence, the FRAND commitment constitutes a restriction on the IPR holder's ability to freely set royalties for the use of its IPR by third parties.

The economic justification for the use of a FRAND commitment lies in the need to ensure that the IPR holder does not abuse the market power that it might gain as a result of its IPR's inclusion in the standard adopted. In the absence of such commitment, patent "hold-up" problems might arise and limit the dissemination of the standard.

While the logic underlying the use of a FRAND commitment appears quite clear, its precise content remains obscure, as the new Guidelines do not sufficiently specify what would be considered as fair, reasonable and non-discriminatory terms. It is merely implied that "fair" refers to the precise licensing terms imposed; "reasonable" concerns the fees charged for the IPR's use; and "non-discriminatory" relates to the treatment of the licensees.

The new Guidelines furthermore state that the SSO is not obliged to determine whether the terms provided by the IPR holder are indeed fair, reasonable and non-discriminatory.<sup>14</sup> This determination is to be made by the IPR holder itself and, in case of a dispute, examined on the basis of whether the fees bear a reasonable relationship to the economic value of the IPR. The new Guidelines do not stipulate a particular method, but only suggest a number of (rather impracticable) ways for carrying out such assessment (e.g., comparing the licensing fees charged by the company concerned before and after the inclusion of its IPR in the standard).<sup>15</sup> In doing so, they give the impression that the exercise is objective, while in reality the terms of access are decided on a case-by-case basis and are usually driven by purely commercial considerations.

The absence of an explicit definition of FRAND terms may not be harmful, since parties should be free to negotiate license conditions. Nevertheless, it does raise a number of questions:

- A first troubling issue is how exactly the IPR holder can ensure that the protected IPR is accessible to all third parties in a non-discriminatory way. Discrimination not only arises from treating similar situations in a different manner, but also from treating different situations in a similar manner. Does it follow from this that, in formulating the licensing terms and fees, the IPR holder will have to take into account the individual circumstances of the various parties across the negotiating table (e.g., market share or other meaningful parameters)? Moreover, on a more general note, the imposition of an obligation of non-discriminatory treatment without any further qualifications appears to disregard the

<sup>14</sup> *Ibid.*, paragraph 288.

<sup>15</sup> *Ibid.*, paragraph 289-290.

fact that foreclosure is not illegitimate *per se*; rather, anti-competitive foreclosure of a competitor should be in the EC's spotlight.

- Another question relates to who is to decide on the fairness, reasonableness and non-discriminatory nature of the terms provided by the IPR holder. While the new Guidelines explicitly state that the SSO has no obligation to do so, they do not stipulate who does. Because the fees paid by each licensee to the IPR holder could be characterised as strategic information under the section of the new Guidelines on information exchange, it does not appear feasible that the other licensees could collectively assess the terms. On the other hand, if the SSO did choose to assume that task, it could end up endangering its neutrality and objectivity—both important elements for the completion of any standardisation effort undertaken by it. One scenario would be for arbitrators to assess the terms, but both the IPR holder and the licensee would have to agree to this solution.
- Furthermore, similar to the good faith disclosure obligation, a FRAND commitment might have a negative impact on the industry's R&D efforts. Fearing a potential breach of the FRAND requirement, IPR holders might end up charging inadequate fees for use of their right by third parties. Low fees, while re-assuring the IPR holder that it is not in violation of its obligations, might act as a disincentive for industry participants to change the IPR incorporated into the standard, thereby slowing down further technological development.

It should be noted that the employment of the FRAND commitment obligation in the field of standardisation agreements is somewhat awkward, as it appears to transpose principles applied in the context of Article 102 TFEU to Article 101 TFEU. The new Guidelines seem to reduce the risk of abuses of dominance by urging SSOs to adopt proper rules<sup>16</sup> and introducing some sort of blanket mandatory licensing through the back door. It is questionable whether guidelines on co-operation among competitors (rather than on unilateral conduct) are an appropriate basis for this sort of approach to licensing.

#### IV. Conclusion

Undeniably, under the new Guidelines, the EC has opted for a stricter stance *vis-à-vis* standardisation agreements involving the use of IPR.

The introduction of the good faith disclosure and FRAND commitment obligations could well result in a significant number of instances where SSO processes and agreements may not benefit from the safe-harbour from the application of EU competition rules that the new Guidelines seek to set in place. This is because both obligations are not clearly delineated in the new Guidelines. Crucial issues such as what is good faith disclosure, as opposed to

<sup>16</sup> Damien Geradin 'Observations on Draft Horizontal Cooperation Guidelines and 'Patent Hold-Up'', speech in the context of the ABA Lunch 'The Draft EU Guidelines on Standard-Setting', 13 October 2010.

disclosure, what are considered to be fair, reasonable and non-discriminatory terms and how disclosure of IPR will interact in practice with the rules contained in the section of the new Guidelines on information exchanges between competitors are either overlooked or insufficiently explained.

Another issue relates to the EC's contention that standardisation agreements will normally fall within the safe-harbour if they do not risk creating market power through a dominant standard. In such instances, the new Guidelines seem to indicate that there is not even a need for adherence to the good faith disclosure and FRAND commitment obligations.<sup>17</sup> However, it could well be that a standard gains sufficient market power in order to become dominant *ex post*. Would the standardisation agreement or process risk then being found to be anti-competitive?

It appears therefore that it will be quite difficult for industry to exploit the safe-harbour offered by the new Guidelines; not only due to its narrow scope, but also because of the unclear conditions for its application.

Even though the new Guidelines explicitly recognize that a standardisation agreement that does not fall within the safe-harbour may avoid the prohibition under Article 101 (1) TFEU, standardisation undertakings may nonetheless suffer from legal uncertainty. Rather than helping, the section on Article 101 (3) TFEU in the new Guidelines is so vague that it only adds to the ambiguity. Both SSOs and their participants appear to be forced into conducting *ex ante* compliance reviews.

The EC itself may provide answers to the above questions as it applies the new Guidelines in practice. The policy choice made in the new Guidelines has proved to be quite controversial in that the EC appears to have used an extreme measure to pre-empt patent ambush and hold-up problems. In any case, what is crucial at this point is that participants in standardisation undertakings take the antitrust dimension into account when devising rules on membership and adoption of processes.

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<sup>17</sup> *Supra*, note 1, paragraphs 277-278.

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