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**DEAL OR NO DEAL? LICENSING NEGOTIATIONS IN
STANDARD-SETTING ORGANIZATIONS**

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Technical standards benefit consumers and producers by facilitating product adoption, promoting compatible solutions, and helping to create an ecosystem of products and services in which competition can thrive.¹ However, standards also may create opportunities for the exercise of market power. Owners of patents with claims that are essential to a standard may “hold up” firms or consumers that are “locked-in” to a standard by charging high royalties for the use of products that comply with the standard.² This licensor (or seller) market power³ arises “ex post,” i.e., after firms and consumers have made investments that are specific to the standard.⁴

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¹ I focus on technology standards necessary for interoperability. Technical standards may be determined in a formal process, such as the standard development organizations accredited by the American National Standards Institute (ANSI), or in a less formal committee structure. A “standard-setting organization” may refer to any organization that promotes a standard, regardless of accreditation. *See, e.g.,* Jonathan L. Rubin, *Patents, Antitrust, and Rivalry in Standard-Setting*, 38 RUTGERS L.J. 509, 513–14 (2007).

² *See, e.g.,* U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, ANTITRUST ENFORCEMENT AND INTELLECTUAL PROPERTY RIGHTS: PROMOTING INNOVATION AND COMPETITION 38 (2007) (“A holder of IP incorporated into a standard can exploit its position if it is costly for users of the standard to switch to a different technology after the standard is set.”) [hereinafter IP REPORT], available at <http://www.justice.gov/atr/public/hearings/ip/222655.pdf>; Joseph Farrell et al., *Standard Setting, Patents, and Hold-Up*, 74 ANTITRUST L.J. 603 (2007).

³ Seller market power is sometimes called monopoly power, although monopoly power is the ability “to control prices or exclude competition.” *United States v. E. I. du Pont de Nemours & Co.*, 351 U.S. 377, 391 (1956). Concerns about holdup can arise if a rights holder possesses seller market power that falls short of monopoly power.

⁴ Opportunistic conduct may occur when the parties to an economic transaction make investments that are specific to the relationship and contracts do not completely specify the terms of

Some standard-setting organizations (SSOs) have addressed the potential for the exercise of ex post market power by seeking to obtain commitments from participating patent owners to license their essential patents at terms that are fair, reasonable, and non-discriminatory (FRAND).⁵ More recently, SSOs have considered “ex ante” joint negotiations by their members (potential licensees) with patent owners to more clearly establish parameters of the licensing terms for essential patents before the standard issues and firms and consumers make investments that are specific to the standard.⁶

Joint negotiation raises concerns that members of an SSO may engage in a different type of holdup. In particular, joint negotiation may create opportunities for potential licensees to exercise buyer market power,⁷ and suppress royalty terms ex ante, but after rights holders have made irreversible research and development investments necessary to create and patent technologies that are essential to a standard.⁸

trade. Specific investments create quasi-rents equal to the difference between the value of investments in the relationship and in their next most valuable use. If a contingency occurs that is not covered by the contract, parties can act strategically to obtain a share of these quasi-rents. For a sampling of the literature on specific investments and quasi-rents, see OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985); R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); Paul L. Joskow, *Vertical Integration and Long-term Contracts: The Case of Coal-Burning Electric Generating Plants*, 1 *J.L. ECON. & ORG.* 33 (1985); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 *J.L. & ECON.* 297 (1978); Oliver D. Hart, *Incomplete Contracts*, in 2 *THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS* 752 (John Eatwell, Murray Milgate & Peter Newman eds., 1987). The ability to act opportunistically does not imply that rights holders necessarily exercise this ability.

⁵ See, e.g., ANSI, *GUIDELINES FOR IMPLEMENTATION OF THE ANSI PATENT POLICY* (Feb. 2011) (“ANSI-accredited standards developer . . . [shall receive] an assurance that a license to such essential patent claim(s) will be made available to applicants desiring to utilize the license for the purpose of implementing the standard . . . under reasonable terms and conditions that are demonstrably free of any unfair discrimination.”). ANSI, the American National Standards Institute, establishes the consensus procedures that are the basis for about 9500 voluntary standards. See *Frequently Asked Questions*, ANSI, http://www.ansi.org/about_ansi/faqs/faqs.aspx?menuid=1. I make no distinction between FRAND commitments and commitments to license under RAND (reasonable and non-discriminatory) terms.

⁶ In the analysis that follows, I focus on royalty terms in licensing agreements, while acknowledging that licensing terms other than royalties (such as field-of-use restrictions, ability to sublicense, defensive suspension, etc.) are often very important to both licensors and licensees. Focusing on royalty terms simplifies the analysis, while providing useful insights into complex actual negotiations that involve additional terms and considerations.

⁷ Buyer market power is sometimes called monopsony power, although the latter is the counterpart to monopoly power on the buyer side of the market. See Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 *CORNELL L. REV.* 297, 306 (1991) (“[M]onopsony power is to the demand side of a market what monopoly power is to the supply side.”). In what follows I use the terms “buyer market power by an SSO” and “SSO monopsony power” to refer to the collective exercise of buyer market power and monopsony power by members of the SSO. Concerns about licensee holdup can arise if the SSO has buyer market power that falls short of monopsony power.

⁸ The exercise of buyer market power by members of an SSO is a concern if, as is often the case, most members of an SSO are users rather than suppliers of technologies that are considered

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