EU competition: industry standards and antitrust compliance

On 14 December 2010, the European Commission (the "**Commission**") adopted a new suite of rules governing co-operation between actual or potential competitors, consisting of (i) guidelines on the applicability of EU competition law to horizontal co-operation agreements (the "**Guidelines**") and (ii) two new block exemption regulations covering: (1) R&D agreements; and (2) specialisation and joint production agreements.

The Guidelines and block exemption regulations replaced existing rules which had been in place for a decade and cover a large variety of different types of horizontal co-operation agreements. In an effort to break down the myriad new rules to manageable proportions and in a user-friendly style, GTM has prepared a series of alerts which, in turn, examine the implications for the various categories of agreement. This alert focuses on **standardisation agreements**.[1]

Background

The standardisation chapter of the Guidelines applies to agreements which define technical or quality requirements with which products, production processes or services may or shall comply. Standards frequently incorporate intellectual property ("**IP**") rights of parties to standardisation agreements and many allegations of anti-competitive conduct focus on the lack of transparency in the standard-setting process and abuses of IP rights incorporated into standards.

The Commission has taken the opportunity to substantially rewrite the standardisation chapter in an effort to provide clearer guidance aimed at ensuring: (i) a competitive process of selecting standards; and (ii) following adoption of standards, access to the standard and any essential IP rights on "fair, reasonable and non-discriminatory" ("**FRAND**") terms for all parties.

The standardisation chapter adopts the orthodox structure for Commission guidance of this type. Firstly, it sets out certain types of standardisation agreements which will always be considered intentional – in competition-speak "by object" - infringements of EU competition law. It then sets out the parameters of a "safe harbour" - agreements falling within it are deemed to comply with EU competition law without the need, on the part of the parties to the arrangement, to carry out an in-depth assessment of its legality. Lastly, the chapter provides extensive guidance on the remaining large "grey area" – consisting of agreements which do not comply with all requirements of the safe harbour and which are not infringements by object.

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[1] We have recently issued alerts on the implications of the Guidelines for: (i) specialisation and joint production agreements; and (ii) information exchanges. These alerts are available at http://www.gtmlaw.com. A future alert will examine what is new for R&D agreements.

Restrictions of competition by object

The Guidelines make it clear that certain types of standardisation agreements will invariably constitute breaches of EU competition law "by object". Once the Commission has determined that an agreement constitutes an infringement by object, it is not required to analyse its actual effects on the market. Unsurprisingly, such "by object" offences include agreements which use: (i) a standard as part of a broader restrictive agreement aimed at excluding actual or potential competitors; and (ii) disclosure of "most restrictive" IP licensing terms as a cover for an attempt to jointly fix prices.

The safe harbour

Agreements falling within the safe harbour are automatically deemed to be competition law compliant. While the Guidelines go out of their way to stress that there is no presumption of illegality for agreements which fall outside of the safe harbour, many companies and standard-setting organisations will consider a measure of regulatory certainty important as non-compliant agreements may attract allegations of cartelist behaviour.

In defining the safe harbour, the Guidelines state that "[w]*here participation in standard-setting is* ***unrestricted*** *and the procedure for adopting the standard in question is* ***transparent****, standardisation agreements which contain* ***no obligation to comply*** *with the standard and provide* ***access to the standard on fair, reasonable and non-discriminatory terms*** *will normally not restrict competition* [...]". These requirements are examined below:

Unrestricted participation:	all competitors affected by the standard must be able to participate in the standard-setting process. Standard-setting organisations need to have objective criteria for selecting technologies to be incorporated into standards.
Transparency:	procedures must permit affected parties to inform themselves effectively of upcoming, ongoing and finalised standardisation processes.
Non-binding nature:	members of standard-setting organisations should remain free to develop alternative standards or products that do not comply with an agreed standard.
Access to standard:	access to standards must be given on FRAND terms. A party wishing to have its IP rights included in a standard must, prior to its adoption, be required to provide so-called "FRAND commitments" - irrevocable commitments to license IP rights to third parties on FRAND terms. In addition, parties possessing IP rights which may be essential for the implementation of a standard must be required to make a good faith disclosure of such rights.

Purpose and meaning of FRAND commitments

The purpose of FRAND commitments is to ensure that essential IP rights incorporated into standards are accessible to all users on FRAND terms, thereby preventing IP holders from refusing to license IP rights, or requesting excessive and/or discriminatory royalties after an industry has been "locked-in" to a standard. Similarly, good faith disclosure of relevant IP rights prior to adoption of the standard is designed to deny parties the possibility of "ambushing" industries once a standard has been agreed. Disclosure also enables parties to a standardisation agreement to better assess the likely costs inherent in a proposed standard. The Guidelines make it clear that standard-setting organisations are not required to verify whether any licensing terms are compliant with FRAND commitments. This will need to be assessed by the parties to the standardisation agreement themselves.

In order for access to essential IP rights to be considered FRAND, royalties charged must "*bear a reasonable relationship to the economic value*" of the IP right. In this context, the Commission does not consider cost-based methods to be appropriate (because of the difficulty in assessing costs attributable to the development

of a particular patent). While the Guidelines do not prescribe a particular method for assessing whether licensing fees charged are "fair and reasonable", the Commission does suggest the following, non-exhaustive examples:

- comparison of: (i) the fees charged for an IP right before the adoption of the standard incorporating it; with (ii) the fees charged after adoption of the relevant standard;
- comparison of the fees charged for the same IP right in other, comparable standards; and/or
- assessment by independent experts.

Restrictions of competition by effect

Agreements which do not comply with all the requirements of the safe harbour must firstly be individually assessed to determine whether they have any anti-competitive effects. If so, it must be determined whether such effects are outweighed by any pro-competitive effects. Such assessments nowadays are undertaken by the parties themselves (i.e. there is no notification or pre-clearance process).

Relevant markets

The Guidelines specify four types of markets which may be affected by a standardisation agreement:

- the product or service market to which the relevant standard relates;
- if any relevant IP rights are marketed separately, the relevant technology market;
- the market for standard-setting itself (if different standard-setting bodies exist); and
- where relevant, any distinct market for testing and certification.

Characteristics of the standardisation agreement

The Guidelines set out a number of criteria which need to be assessed when determining whether a standardisation agreement has anti-competitive effects:

<u>Mandatory vs. voluntary standards</u>: non-binding standards which allow parties to a standardisation agreement to develop alternative standards and/or products which do not comply with an agreed standard are much less likely to have restrictive effects than standards which prevent parties from producing products which do not comply with an agreed standard.

<u>Access to standard</u>: a standard, including any essential IP rights, which is not accessible to third parties, or only accessible on discriminatory terms, is much more likely to have restrictive effects than a freely-accessible standard. Standardisation agreements which discriminate against certain parties are also likely to have restrictive effects. However, if there are several competing standards, or if non-standardised solutions compete with standardised solutions, a limitation of access may not have restrictive effects.

<u>Participation in standard-setting process</u>: if all interested parties affected by a standard are able to participate in the standard-setting process, this will lower the risk of restrictive effects. The greater the market impact of the standard, the more important it is to allow for equal participation. However, if there are several competing standards or if it can be demonstrated that it would not have been possible to adopt a standard without limiting participation, there may be no restrictive effects.

<u>Market shares</u>: the market shares of the products based on the standard will be taken into account when analysing the effects of a standardisation agreement. Often, the market shares of the companies participating in the development of the standard are used as a proxy. It should,

however, be noted that high market shares do not necessarily indicate that restrictive effects are likely. The Commission recognises that the effectiveness of standards is often proportional to the share of the industry involved in setting/applying the standard.

IP rights: it is necessary to examine any IP disclosure models which do not comply with the terms of the safe harbour on a case-by-case basis. As a general rule, any disclosure model must ensure effective access to the standard. In this context, it should be noted that unilateral disclosure by the IP rights holder of its "most restrictive licensing terms" prior to the adoption of the standard will not, in principle, have restrictive effects. Accordingly, if a standard-setting organisation's disclosure policy provides that holders of IP rights shall unilaterally disclose their most restrictive licensing terms, including maximum royalty rates, prior to the adoption of a standard, this will not normally be deemed to have restrictive effects. *Ex ante* unilateral disclosure of this type must be distinguished from the "by object" offence referred to above: bilateral disclosure of most restrictive IP licensing terms prior to the adoption of a standard may be regarded as a cover for price-fixing.

Balancing exercise

Once it has been established that a standardisation agreement is potentially problematic because it has restrictive effects on a relevant market, it is necessary to determine whether it has any pro-competitive benefits which outweigh those effects. To do so, the parties will need to be able to demonstrate that the following *cumulative* conditions are met:

Efficiency gains

The Commission recognises that standardisation frequently gives rise to significant efficiency gains, including:

- EU-wide standards may facilitate market integration by permitting companies to market their products in all EU Member States leading to increased product choice and lower prices;
- standards establishing technical interoperability/compatibility may encourage competition on the merits between technologies from different companies;
- standards may reduce transaction costs for sellers and buyers; and
- standards may also facilitate consumer choice, lead to increased product quality, reduce the time it takes to bring a new technology to market and boost innovation.

Indispensability

Any restrictive effects of an agreement must be indispensable to the attainment of the identified efficiency gains. Accordingly, standardisation agreements should cover no more than what is necessary to achieve their aims. The Commission gives the following guidance in relation to this point:

- if only one technological solution has the identified efficiency gain then the standard should be set on a non-discriminatory basis;
- technology-neutral standards may lead to larger efficiency gains;
- the inclusion of substitute IP rights as essential parts of a standard and (i) forcing users to pay for more IP rights than technically necessary; or (ii) limiting the use of that technology to the particular standard will not be considered indispensible;
- restrictions making standards binding and obligatory for an industry are in principle not indispensable; and

- standardisation agreements which give organisations an exclusive right to certify compliance with a standard are generally not considered indispensible. Such exclusivity can, however, be justified for a short period of time by the need to recoup start-up costs. If this is the case, the agreement should include provisions aimed at limiting its anti-competitive effects, including provisions ensuring that any certification fee is reasonable and proportionate to the cost of compliance testing.

Pass-on of benefits to consumers

The parties to a standardisation agreement must allow consumers a fair share of the benefit resulting from the identified, indispensable efficiency gains. There exists a presumption of consumer benefit if a standard enables technical interoperability or competition between new and existing products.

No elimination of competition

Lastly, any standardisation agreement which permits the parties to eliminate competition in respect of a substantial part of the products in question will breach EU competition law.

Conclusion

The chapter on standardisation agreements, and in particular the guidance relating to IP rights, proved to be the most controversial section of the Guidelines, pitting proponents of solutions based on IP rights against "competition purists" - at one point even exposing deep, and unusually public, divisions within the Commission itself.

As a result, the chapter on standardisation agreements constitutes, and in places reads like, a compromise - but not necessarily a bad one. The competition faction has criticised the Commission's decision not to go further (e.g. by making the disclosure of maximum royalty rates mandatory) whereas sections of the "IP camp" vocally opposed the inclusion of a standardisation section in the Guidelines in the first place, fearing that the safe harbour would prove to be a "straight jacket" for innovation in Europe.

On balance, it appears that the competition faction has managed to hold the upper hand. In an apparent effort to appease critics, the chapter is now littered with statements clarifying that agreements falling outside of the safe harbour are not presumed to be illegal. Some may consider such statements reassuring. However, in reality, they do not add very much as they simply reflect standard assessment policy.

More usefully, the concerns raised have resulted in a significantly expanded guidance section for standardisation agreements (when compared with the consultation draft published in 2010) which do not fall within the safe harbour. This is a welcome development and should provide useful insight to businesses, and their advisers, attempting to assess the compliance status of a standardisation agreement and its potential impact on the relevant markets.

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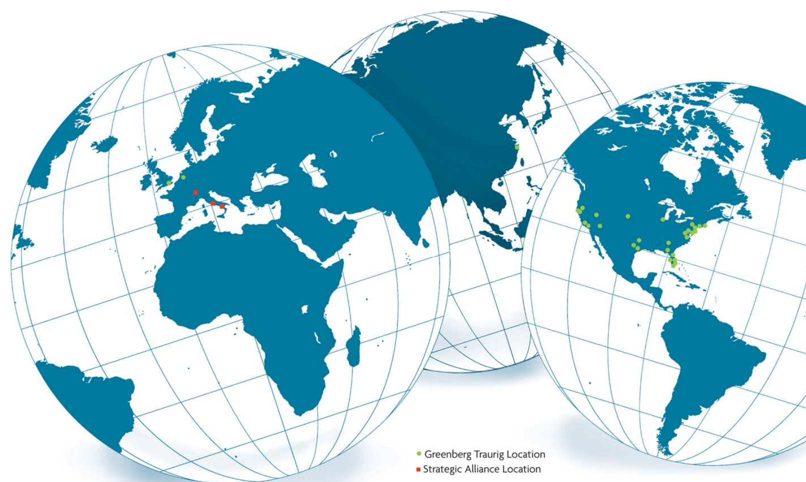

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