

Analyzing Patent Pools: Will They Pass Muster Abroad?

Law360, New York (August 16, 2010) -- Patent pools are joint licensing arrangements in which a group of patent holders agree to license their respective patents to each other and often to third parties.

In business review letters and other guidance, the U.S. Department of Justice and the Federal Trade Commission have developed a framework for the antitrust analysis of patent pools that recognizes the benefits of patent pools and provides a blueprint for avoiding conflict with U.S. antitrust law.

However, many patent pools grant licenses on an international, if not worldwide basis. Is a pool safe from competition scrutiny outside the United States if it complies with guidance issued here?

As with so often in international competition law, the answer is “it depends.” Recent amendments to intellectual property licensing guidelines in foreign jurisdictions — especially in Asia, where much of the world’s high-tech manufacturing takes place — indicate considerable analytical convergence but also reveal differences in tone that could reflect a more aggressive enforcement approach to specific aspects of patent pools.

Patent Pools: Structure and Benefits

Patent pools can be structured in different ways and may involve three sets of agreements: first, an agreement among patentees to make their technologies available for joint licensing in return for a portion of the royalties collected by the pool.

Second, an agreement between the licensors and a licensing agent authorizing the agent to enter into licensing agreements with manufacturers of products that implement the licensors’ patented technology. The licensing agent may be one of the licensors on behalf of the others — such as Toshiba for the “DVD6C” Licensing Group, a consortium of patent owners that offers package licenses for certain essential DVD patents.

Or it can be a separate entity, such as MPEG-LA or Via Licensing — two service providers that specialize in the administration of patent pools. The final sets of contractual arrangements are the license agreements between the licensing agent and manufacturers of products that implement the patented technology.

The benefits of patent pools are well established. Patent pools reduce transaction costs because manufacturers of, say, DVD players or mobile phones can negotiate with one entity instead of several.

Patent pools also tend to reduce overall royalty rates by mitigating the risk of royalty stacking and “hold up” by patent owners that negotiate strategically to extract higher royalties (e.g., by asserting patents only against those manufacturers that have already designed products that implement the patented technology). Further, patent

pools are attractive to licensors because they tend to promote adoption of the patented technology and therefore overall royalty income.

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If the benefits of patent pools are well recognized, so are the competitive risks. To simplify, cooperation by patentees establishing patent pools potentially affects competition on three levels: technology (i.e., licensing), innovation (i.e., R&D) and downstream product markets.

Technology Markets. The U.S. agencies typically begin by evaluating how the patent pool will affect competition in technology markets. Most business review letters restate briefly that patent pools must not be premised on invalid or expired patents before turning to the agencies' main concern: whether substitutable technologies are included in the same pool.

As the DOJ has made clear, "we would expect the owners of [substitutable] intellectual property rights ... to compete, including through price, to persuade operators to adopt their technology."^[1] A pool that combines and establishes a uniform price for substitutable technology may not accomplish this goal; to the contrary, it may "risk turning the pool into a price-fixing mechanism."^[2] Pools of complementary patents generally do not present this risk.

Drawing a line between complements and substitutes often raises thorny practical issues, and the agencies are skeptical about the ability of pool members to distinguish fairly between the two. Accordingly, U.S. guidance strongly recommends that licensors involve independent patent experts to review potential pool patents and ensure that substitutable patents be excluded from the pool.

Outside the United States there is widespread agreement with the basic principle that patent pools generally should combine complementary, not substitutable, patents and that licensors should outsource the review of pool patents to independent patent experts.

Even Taiwan, which in the past has taken a particularly aggressive stance toward patent pools, seemed to recognize in submissions to the OECD that pools of complementary patents can be beneficial.^[3] There are, however, nuances in published guidance that indicate at least some divergence on specific questions.

For example, different jurisdictions may vary in their treatment of patent pools containing some substitutable patents. In the United States, the agencies will not apply bright-line rules but evaluate the inclusion of substitutes under the rule of reason on a case-by-case basis.^[4]

Other jurisdictions appear to be more skeptical that the inclusion of substitutable patents could ever be justified. The recently amended Korean Guidelines on the Unfair Exercise of Intellectual Property Rights, for example, state simply that it is "highly likely" that a pool with substitutable patents would violate competition law.^[5]

The Japan Fair Trade Commission takes a more nuanced approach: it emphasizes that including some substitutes generally "represent[s] a legal problem" but leaves the door open for a "comprehensive evaluation" of the pool as a whole.^[6]

The European Commission similarly seems open to considering the circumstances of each case, so long as the pool is not "substantially composed" of substitute technologies.^[7]

Another example of potential divergence is whether patent pools should retain independent third parties to administer their patent licensing in an effort to avoid undue influence of licensors over the licensing process. The

DOJ and the FTC do not appear to be overly concerned about patent pools with licensing agents owned or operated by the licensors, provided those pools otherwise are structured to prevent competitive harm.

One DOJ business review letter noted approvingly that the pool under review intended to engage an independent licensing administrator,[8] but at least two self-administered pools also passed DOJ business review.[9]

By contrast, the Korean Guidelines on the Unfair Exercise of Intellectual Property Rights express a clear preference for independently administered pools.[10] Similarly, the 2005 Guidelines on Standardization and Patent Pool Arrangements in Japan state that it is “advisable” to outsource the administration of the pool to a third party.[11]

Neither of these jurisdictions suggests that a licensor-operated pool would infringe local competition law per se, but the difference in tone is palpable.

Innovation. Concerns that patent pools can harm innovation most often focus on grant-back clauses—provisions that require licensees to give the pool the right to license the licensee’s own essential patents.

Grant-back rules can deter innovation by reducing the return on follow-on inventions. Business review letters and other U.S. guidance address this issue by requiring that grant-back clauses be narrowly tailored and limited to essential patents.

Other jurisdictions appear to agree. The recently amended Taiwanese Guidelines on Technology Licensing Arrangements, for example, note that nonexclusive grant-backs generally do not raise concern.[12]

Downstream Product Markets. Members of patent pools often are vertically integrated: they conduct research and own patents, but also compete on downstream products markets.

Cooperation among licensors can raise a variety of risks for competition downstream. For example, the pool might deny outsiders access to essential technology, charge discriminatory rates, provide a platform for overt downstream collusion, or give access to competitively sensitive information that facilitates tacit collusion downstream.

Unsurprisingly, agency guidance both in the United States and elsewhere favors open pools that commit to license on a nondiscriminatory basis and encourages licensors to implement safeguards both against licensor collusion and against access to licensees’ sensitive business information.

The main area of divergence — which reflects a broader difference between U.S. and certain other competition laws — is whether the members of an otherwise properly structured pool are free to charge whatever royalty the market will bear.

In short, the U.S. agencies “generally do not assess the reasonableness of royalties set by patent pools,”[13] but non-U.S. regulators might. Under EC law, for example, patent pools are normally free to set royalties except where the pool has a dominant position in the relevant technology markets, in which case royalties should be fair and nondiscriminatory (“FRAND”).[14]

Korea appears to go even further, noting that “remarkably unreasonable level of royalt[ies] in light of customary commercial practice” can be an element in determining the infringement of competition law.[15]

Conclusion

In light of the many benefits of patent pools, it is a welcome development that jurisdictions around the world increasingly provide guidance about structuring pro-competitive pools. The existing guidance reveals considerable convergence, but also areas where enforcement policy may differ.

Parties considering the establishment of patent pools with implications on multiple jurisdictions should bear in mind this divergence and carefully assess whether their pool is likely to meet resistance from regulators, especially in Asia.

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The opinions expressed are those of the author and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360.

[1] Letter from Charles A. James, Assistant Att’y Gen., Antitrust Division, U.S. Dep’t of Justice, to Ky P. Ewing (Nov. 12, 2002), at 10 (“3G Platform Business Review Letter”).

[2] Letter from Joel I. Klein, Assistant Att’y Gen., Antitrust Division, U.S. Dep’t of Justice, to Carey R. Ramos (June 10, 1999), at 12 (“DVD6C Business Review Letter”).

[3] See OECD Policy Roundtable — Intellectual Property Rights, National Contributions: Chinese Taipei, DAF/COMP(2004)24, at 119 (available at www.oecd.org/dataoecd/61/48/34306055.pdf).

[4] See 2007 DOJ/FTC Report on Antitrust Enforcement and Intellectual Property (“2007 Antitrust and IP Report”), at 78.

[5] Part III, Section 2.A (unofficial translation).

[6] Part 2, Section 2(1)(b) (available at www.jftc.go.jp/e-page/legislation/ama/Patent_Pool.pdf).

[7] Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (2004), at para. 219 (available at ec.europa.eu/competition/antitrust/legislation/transfer.html) (“TT Guidelines”).

[8] Letter from Thomas O. Barnett, Assistant Att’y Gen., Antitrust Division, U.S. Dep’t of Justice, to William F. Dolan and Geoffrey Oliver (Oct. 21, 2008), at 10.

[9] See 2007 Antitrust and IP Report, at 82.

[10] Part III, Section 2.A (unofficial translation).

[11] Part 2, Section 2(1)(a).

[12] See Section 5.E (available at www.ftc.gov.tw/internet/english/doc/docDetail.aspx?uid=746&docid=10254).

[13] 2007 Antitrust and IP Report, at 82.

[14] TT Guidelines, at para. 225-26.

[15] Part III, Section 1(A)(2) (unofficial translation).